

Company report

Hong Kong Exchanges & Clearing Limited

Research Team
Hong Kong | Financials

Rating BUY (as at 12 December 2022)
 Last Close HKD 339.2
 Fair Value HKD 385.0

A leverage play to market rebound

- **Pick up in average daily turnover**
- **Long-term growth drivers**
- **Lifting fair value estimate**

Investment thesis

The Hong Kong Exchanges and Clearing (HKEX) should be structurally well-positioned to take advantage of China's capital account liberalisation and its turnover is well supported by favourable structural and cyclical trends. Its capability is also further bolstered by the inclusion of A-shares into MSCI indices as well as listing reforms that open up possibilities of new economy initial public offerings (IPOs) and secondary listings.

Investment summary

- **Pick up in average daily turnover** – Recent average daily turnover (ADT) has picked-up substantially with ADT rising to HKD140b in November and HKD185b month-to-date in December, vs around HKD98b in 3Q22 and HKD123b in the first nine months this year. This has bucked the trend as cash trading volume is usually seasonality weaker in 4Q
- **Long-term growth drivers** – A pick up in ADT and an improving market sentiment set the stage for catalysts to play out. A consultation paper on Specialist Technology Companies was released mid-October with a 2-month consultation period. New rules would apply to companies in one of the five Specialist Technology Industries ((i.e. next-generation IT, advanced hardware, advanced materials, new energy & environmental protection, new food & agriculture technologies). Shifting to a more diversified exchange with a larger new economy companies mix and a higher velocity should help invigorate the IPO market and subsequent trading volume, in our view.
- **Lifting fair value estimate** – Share price has risen 53% since November, outperforming Hang Seng Index by about 19ppt, on the back of improving market

Security information

Ticker	388 HK
Market Cap (HKD b)	438.4
Daily turnover (HKD m)	1,672.3
Free Float	100%
Shares Outstanding (m)	1,268
Top Shareholder	Hong Kong Special Ad 5.9%

Price performance chart



Financial summary

HKD b	2021	2022E	2023E
Revenue	20.8	17.5	21.4
EBIT	14.9	10.9	14.3
Net profit	12.5	9.3	5.0
EPS (HKD)	9.9	7.3	9.7
DPS (HKD)	8.9	6.6	8.8

Key ratios

%	2021	2022E	2023E
ROAA	3.1%	2.2%	2.7%
ROAE	25.4%	18.8%	24.3%
Cost to total income	28.3%	38.1%	33.4%
Operating margin	71.7%	61.9%	66.6%
Investment yield	0.6%	0.5%	1.6%

Source: Bloomberg, Company, Internal estimates

sentiment owing to relaxation of Covid-19 measures and treatments, and further supporting policies in China real estate (for details, please refer to our report "China Strategy – A turning point" on 14 November 2022). The Politburo meeting that was held last week highlighted pro-growth messages. Look ahead, we will continue to watch out for: i) the upcoming FOMC so as to gauge the rate hike trajectory in the next 6 months and ii) the Central Economic Work Conference to get a first glimpse of economic priorities and issues under the new leadership team. A pick-up in ADT and the rolling out of long-term growth drivers should support re-rating. HKEX is uniquely positioned to be a key offshore listing venue for mainland Chinese companies and benefit from a revival of investment activity. Key swing factor would be whether the current consensus ADT forecast of HKD140b in 2023 would be achievable. We lift our fair value estimate to HKD385 with a higher valuation multiple of 35x forward price-to-earnings (P/E) and an unchanged ADT assumption of HKD140b in 2023, which is in-line with market expectations.

ESG updates

- **Continued leading governance practices** – HKEX continued to demonstrate strong efforts in contributing to the ESG transformation of capital markets. It maintained strong overall ESG practices relative to industry peers in 2021, especially in corporate governance. Research noted HKEX's strong initiatives for workforce diversity as its commodity arm London Metal Exchange (LME) announced a target to raise senior female leadership roles to 40% by 2025.
- HKEX leads global peers in business ethics framework. However, it is noted that UK regulators announced a review into LME in April 2022, following its temporary suspension of nickel trading amid disorderly price volatility in March 2022. LME was also involved in a related lawsuit filed by a US hedge fund in June 2022.
- HKEX seems to lag peers in talent management practices (i.e., tackling results of engagement surveys, and detailed grievance process). Its three-year average attrition rose slightly to 12.7% in 2021 vs 12% in 2020.

Potential catalysts

- Stronger-than-expected ADT
- Potential regulatory changes to enable stronger-than-expected capital inflows to Hong Kong's equities market
- Stronger-than-expected growth in international listings and new economy company listings, following the approval of proposed listing reforms

Investment risks

- Weaker-than-expected macroeconomic growth in China
- Sharper-than-expected US rate hikes
- Liquidity tightening in China
- A sharper-than-expected decline in stock turnover

Valuation analysis

	Price/Earnings		Price/Book		Dividend Yield (%)		ROE (%)	
	2022E	2023E	2022E	2023E	2022E	2023E	2022E	2023E
HONG KONG EXCHANGES & CLEAR (388 HK)	45.2	36.5	8.6	8.2	2.0	2.5	19.4	23.2
SINGAPORE EXCHANGE LTD (SGX SP)	20.8	19.4	6.0	5.6	3.6	3.8	30.0	29.8
LONDON STOCK EXCHANGE GROUP (LSEG LN)	23.4	20.7	1.6	1.5	1.4	1.5	7.0	7.7

Source: Bloomberg

Price/Earnings chart



Source: Bloomberg

Price/Book chart



Source: Bloomberg

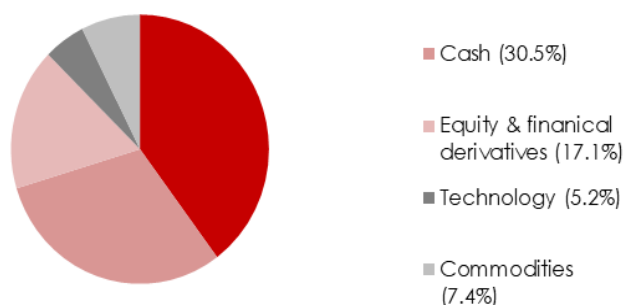
Company overview (as of 31 December 2021)

Company description

The Hong Kong Exchanges and Clearing (HKEX) Limited was listed in June 2000 after the integration of the securities and futures markets. It operates two cash markets - the Main Board and the Growth Enterprise Market, as well as a derivatives market in Hong Kong - along with their respective clearing houses. The company provides an integrated platform for cash trading, derivative trading, clearing, settlement, fixed income, currencies and commodities (FICC), and custody and information services in Hong Kong.

FY21 net revenue breakdown

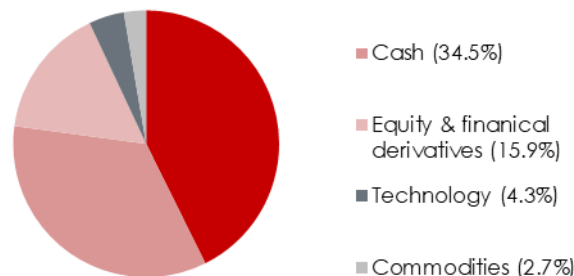
By segment



Source: Company data

FY21 pretax income breakdown

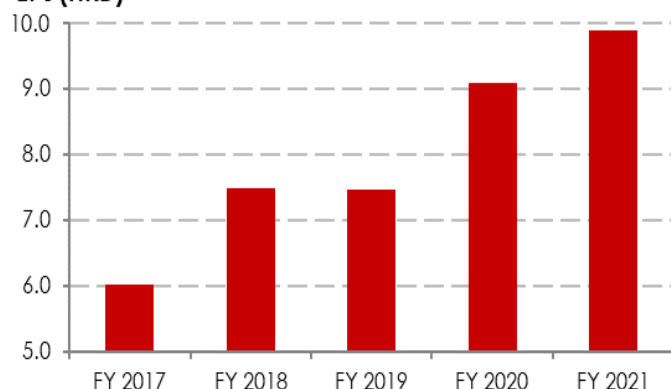
By segment



Source: Bloomberg

Earnings per share

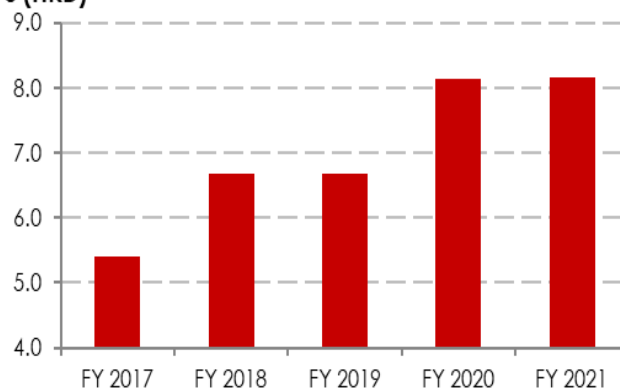
EPS (HKD)



Source: Bloomberg

Dividends per share

DPS (HKD)



Source: Bloomberg

Company financials

Income Statement

In Millions of HKD except Per Share	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
12 Months Ending	31/12/2017	31/12/2018	31/12/2019	31/12/2020	31/12/2021
Net Revenue	11,574	14,252	13,565	16,835	19,471
Other Operating Income	0	2,782	3,196	2,102	902
Operating Expenses	1,224	6,056	5,554	5,588	5,597
Operating Income or Losses	10,350	10,978	11,207	13,349	14,776
Non-Operating (Income) Loss	1,740	95	256	123	74
Pretax Income	8,610	10,883	10,951	13,332	14,841
- Income Tax Expense (Benefit)	1,255	1,592	1,561	1,845	2,343
Income Before XO Items	7,355	9,291	9,390	11,487	12,498
- Minority/Non Controlling Interests (Credits)	-49	-21	-1	-18	-37
Net Income/Net Profit (Losses)	7,404	9,312	9,391	11,505	12,535
Net Inc Avail to Common Shareholders	7,404	9,312	9,391	11,505	12,535
Abnormal Losses (Gains)	23	0	0	4	13
Tax Effect on Abnormal Items	-4	0	0	-1	-2
Normalized Income	7,423	9,312	9,391	11,508	12,546
Basic Earnings per Share	6	8	7	9	10
Basic Weighted Avg Shares	1,228	1,242	1,254	1,263	1,265
Diluted EPS Before Abnormal Items	6.0	7.5	7.5	9.1	9.9
Diluted EPS Before XO Items	6.0	7.5	7.5	9.1	9.9
Diluted EPS	6.0	7.5	7.5	9.1	9.9
Diluted Weighted Avg Shares	1,230.8	1,244.8	1,256.7	1,265.8	1,267.6

Profitability Ratios

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
12 Months Ending	31/12/2017	31/12/2018	31/12/2019	31/12/2020	31/12/2021
Returns					
Return on Common Equity	21.3	23.9	22.1	24.7	25.4
Return on Assets	2.6	3.2	3.5	3.4	3.1
Return on Capital	19.9	23.1	21.3	23.4	24.2
Return on Invested Capital	22.9	22.3	20.6	22.1	22.9
Margins					
Operating Margin	89.4	77.0	82.6	79.3	75.9
Incremental Operating Margin	293.6	23.5	—	65.5	54.1
Pretax Margin	74.4	76.4	80.7	79.2	76.2
Income before XO Margin	63.5	65.2	69.2	68.2	64.2
Net Income Margin	64.0	65.3	69.2	68.3	64.4
Net Income to Common Margin	64.0	65.3	69.2	68.3	64.4
Additional					
Effective Tax Rate	14.6	14.6	14.3	13.8	15.8
Dvd Payout Ratio	89.9	89.7	89.8	89.9	89.5
Sustainable Growth Rate	2.1	2.4	2.3	2.5	2.7

Credit Ratios

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
12 Months Ending	31/12/2017	31/12/2018	31/12/2019	31/12/2020	31/12/2021
Total Debt/EBIT	0.2	0.1	0.3	0.2	0.2
Net Debt/EBIT	(13.3)	(9.4)	(9.8)	(13.2)	(12.6)
EBIT to Interest Expense	77.2	96.3	63.3	73.8	95.9
Long-Term Debt/Total Assets	0.3	0.1	0.8	0.5	0.5
Net Debt/Equity	(367.8)	(252.4)	(246.6)	(357.8)	(374.5)

Source: Bloomberg

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