

COMPANY UPDATE

Hong Kong Exchanges and Clearing (388 HK)

August Headline ADT Sluggish

The headline ADT in Aug 23 was on a downward trajectory with a 0.5% mom decline, due to the pessimistic sentiment on China's economic outlook. The potential stamp duty cut may boost market turnover in the short term but a significant improvement on China's economic fundamentals is necessary to encourage a more substantial ADT recovery. As such, we continue to expect HKEX's earnings to be supported by a robust NII. Maintain BUY. Target price: HK\$380.00.

AUG 23 MARKET STATISTICS

	Aug 23	Jul 23	Aug 22	mom	yoy
Headline ADT (HK\$b)	101.8	102.3	92.4	-0.5%	10.2%
Northbound Trading ADT (Rmbb)	108.5	108.6	99.8	-0.1%	8.7%
Southbound Trading ADT (HK\$b)	29.0	28.9	20.7	0.1%	40.1%
Derivatives contracts ADV ('000 contracts)	1,396.3	1,366.3	1,091.0	2.2%	29.7%
LME ADV ('000 lots)	600.6	528.1	491.6	13.7%	28.0%

Source: Hong Kong Exchanges and Clearing, UOB Kay Hian

WHAT'S NEW

- Hong Kong established a task force to enhance market turnover.** On 29 August, the Hong Kong SAR government set up a 13-member task force to reignite the capital market's activity. The task force will holistically review key internal and external factors affecting market liquidity like listing regime, market structure and trading mechanisms. Among that, the street's main attention is on the government's possibility of slashing stamp duty to rejuvenate market liquidity.
- ADT continues its downtrend after a mild rebound in July.** The headline average daily turnover (ADT) slipped 0.5% mom to HK\$101.8b in August after the total market capitalisation and benchmark HSI plunged 8.1% mom and 8.5% mom respectively as the weak batch of macro data in July eroded investor confidence on China's economic outlook. 8M23 ADT also declined by 12.7% yoy to HK\$111.9b (vs HK\$128.2b in 8M22). However, tax-exempt exchange-traded product (ETP) trading has sustained its robust momentum with an 18% yoy growth and constituted 14% of total ADT in August.
- Derivative and commodity market's solid performance offsets softness in cash market.** The derivatives contracts' average daily volume (ADV) jumped 2.2% mom to 1.4m contracts, primarily driven by the positive reception of new products launched such as HSTECH F&O and Options on Futures. Meanwhile, commodity trading volume in LME maintained its recovery momentum with a commendable 28.0% yoy growth in ADV.

KEY FINANCIALS

Year to 31 Dec (HK\$m)	2021	2022	2023F	2024F	2025F
Net turnover	20,800	18,280	20,844	22,909	24,630
EBITDA	16,271	13,185	15,496	17,303	18,679
Operating profit	14,916	11,726	13,998	15,730	17,027
Net profit (rep./act.)	12,497	10,078	12,326	13,825	14,927
Net profit (adj.)	12,497	10,078	12,326	13,825	14,927
EPS (HK\$ cent)	988.7	804.9	972.3	1,093.7	1,175.3
PE (x)	30.4	37.3	30.9	27.4	25.5
P/B (x)	7.6	7.6	7.5	7.3	7.1
EV/EBITDA (x)	22.7	28.0	23.8	21.3	19.8
Dividend yield (%)	3.0	2.4	2.9	3.3	3.5
Net margin (%)	60.1	55.1	59.1	60.3	60.6
Net debt/(cash) to equity (%)	(18.6)	(21.5)	(23.2)	(24.9)	(26.6)
ROE (%)	25.4	20.3	24.5	26.8	28.2
Consensus net profit	-	-	12,460	13,554	14,668
UOBKH/Consensus (x)	-	-	0.99	1.02	1.02

Source: Hong Kong Exchanges and Clearing Ltd., Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$301.20
Target Price	HK\$380.00
Upside	+26.2%

COMPANY DESCRIPTION

Hong Kong Exchanges and Clearing owns and operates the stock exchange, futures exchange and their related clearing houses in Hong Kong.

STOCK DATA

GICS sector	Financials
Bloomberg ticker:	388 HK
Shares issued (m):	1,267.8
Market cap (HK\$m):	380,604.6
Market cap (US\$m):	48,589.9
3-mth avg daily t'over (US\$m):	166.6

Price Performance (%)

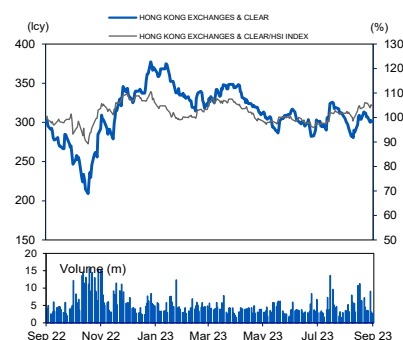
52-week high/low		HK\$377.40/HK\$209.00		
1mth	3mth	6mth	1yr	YTD
(3.2)	(2.8)	(5.7)	(3.5)	(11.0)

Major Shareholders

	%
The Government of Hong Kong SAR	5.8

FY23 NAV/Share (HK\$)	40.12
FY23 Net Cash/Share (HK\$)	9.30

PRICE CHART



Source: Bloomberg

ANALYST(S)

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• **No IPO in August, bumpy road ahead for IPO market recovery.** After Feb 23, Hong Kong Exchanges and Clearing (HKEX) witnessed another IPO drought in Aug 23. Although August is not a traditional peak season for IPOs in Hong Kong, there has not been a zero-listing occurrence in the past five years. A total of 35 companies went public through IPO in 8M23 (vs 42 in 8M22) and the total fund raised also dropped 64.3% yoy to HK\$20.8b (vs HK\$58.4b in 8M22) as there is no mega-sized IPOs raising over US\$1b (HK\$7.8b) so far in 2023. However, considering the IPO pipeline still remains robust and few new IPO initiatives are taking place such as New Specialist Technology Company listing regime and Fast Interface for New Issuance (FINI) IPO settlement platform, we believe that IPO market activities will pick up once market sentiment improves.

STOCK IMPACT

- **Net investment income expected to remain elevated in higher rate environment.** HKEX has enhanced transparency in estimating its interest-related investment income. Considering that the company has allocated 70% of its total margin funds into time deposits (linked to six months' rolling average of 6M HIBOR) with longer maturities and that the reference rate for interest rebate to exchange participants, 1M HIBOR has been trending lower since Aug 23, we anticipate limited downward pressure on HKEX's interest income in 2023. Furthermore, profit volatility from the external-managed portfolio has reduced alongside its smaller size of HK\$6.6b. All in all, we expect the company to achieve a net investment income (NII) of HK\$4.8b in 2023 to offset the impact of lacklustre growth in core trading revenue.
- **Stamp duty cut may boost liquidity in short term.** We expect ADT to rebound as a knee-jerk reaction if the government chooses to cut or abolish the stamp duty to improve liquidity. This could encourage more day traders, high-frequency traders, and quantitative traders to return to the market. However, we believe that the long-term impact of stamp duty adjustment is minimal, as demonstrated by the historical data. Based on our findings, despite the single-month ADT in Aug 21 recording a significant 14% mom decline following the Hong Kong government raising the stamp duty, the two-year average ADT after the implementation of the new stamp duty rate (Aug 21 to Aug 23) was only 2.2% lower than the period before the policy changes (Jan 19 to Aug 21).
- **Risk-off sentiment on Chinese stocks the root cause of lukewarm trading volume.** Since the Hong Kong stock market is closely tied to the performance of Chinese companies, international investors have become more cautious about investing in Mainland Chinese stocks due to concerns about the deteriorating economic outlook in China. Against this backdrop, the benchmark HSI is currently trading at an undemanding valuation of 9.2x one-year forward PE (-1.6SD), adversely impacting the ADT. If more significant stimulus is introduced in China, we expect market sentiment to improve on economic fundamentals and more substantial valuation recovery in the Hong Kong market, ultimately boosting ADT and also fundraising activities.

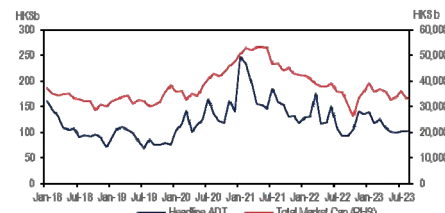
EARNINGS REVISION/RISK

- **We slightly trimmed our headline ADT assumption to HK\$107.8b** from HK\$108.9b after factoring in July and August data.
- **We raised our earnings projections for 2024/25 by 3%** to reflect the resilient interest-related investment income under the "higher-for-longer" rate environment. We believe that the better NII forecasts will overcome our more conservative ADT outlook.
- **Downside risks:** a) Rising China macro headwinds leading to lower turnover, b) sluggish fundraising activities, c) geopolitical tension, and d) one-off legal provision from LME nickel lawsuit.

VALUATION/RECOMMENDATION

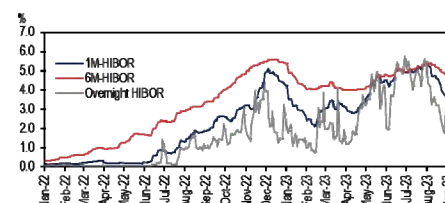
- **Maintain BUY with a target price of HK\$380.00.** Our target price is derived from the Gordon Growth Model with the assumption of 6.4% cost of equity and 4.0% terminal growth, pegging to 2024F PE of 37.6X, 0.2SD higher than its historical mean valuation. Valuation re-rating and ADT recovery in the Hong Kong market may fuel the share prices in the near term if there is a positive outcome from the policy front.

HONG KONG HEADLINE ADT AND MARKET CAP TREND



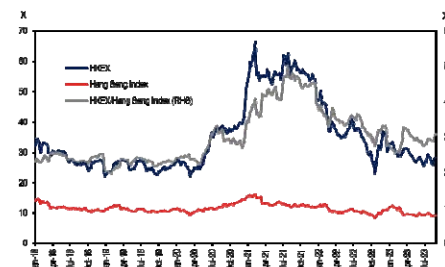
Source: HKEX, UOB Kay Hian

HIBOR TREND



Source: Bloomberg, UOB Kay Hian

HKEX AND HANG SENG INDEX PE COMPARISON



Source: UOB Kay Hian

HKEX TRADING REVENUE KEY ASSUMPTIONS

(%)	2023F	2024F	2025F
Cash ADT (HK\$b)	107.8	121.0	135.6
Futures ADV ('000)	782.9	823.2	854.9
Stock Option ADV ('000)	638.1	670.5	716.6
LME ADV ('000)	585.5	609.4	635.1

Source: UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (HK\$m)	2022	2023F	2024F	2025F
Net turnover	18,280	20,844	22,909	24,630
EBITDA	13,185	15,496	17,303	18,679
Deprec. & amort.	1,459	1,498	1,573	1,652
EBIT	11,726	13,998	15,730	17,027
Associate contributions	(67)	(71)	(80)	(80)
Pre-tax profit	11,659	13,927	15,650	16,947
Tax	(1,564)	(1,539)	(1,794)	(1,974)
Minorities	(17)	(62)	(32)	(46)
Net profit	10,078	12,326	13,825	14,927
Net profit (adj.)	10,078	12,326	13,825	14,927

CASH FLOW

Year to 31 Dec (HK\$m)	2022	2023F	2024F	2025F
Operating	17,092	18,391	19,790	21,299
Pre-tax profit	13,688	14,647	15,672	16,769
Other operating cashflows	3,404	3,744	4,119	4,530
Investing	(5,950)	(5,612)	(5,503)	(5,608)
Proceeds from sale of assets	68	75	82	90
Others	(6,018)	(5,686)	(5,585)	(5,698)
Financing	(9,023)	(10,748)	(675)	(1,608)
Dividend payments	(8,449)	(9,294)	0	0
Proceeds from borrowings	(45)	(54)	(64)	(77)
Others/interest paid	(529)	(1,400)	(611)	(1,530)
Net cash inflow (outflow)	2,119	2,031	13,613	14,084
Beginning cash & cash equivalent	11,690	12,274	12,888	13,532
Changes due to forex impact	26	26	26	27
Ending cash & cash equivalent	13,011	14,312	15,743	17,318

BALANCE SHEET

Year to 31 Dec (HK\$m)	2022	2023F	2024F	2025F
Fixed assets	1,640	1,804	1,984	2,183
Other LT assets	21,933	24,126	26,539	29,193
Cash/ST investment	13,011	14,312	15,743	17,318
Other current assets	369,467	402,575	439,048	479,140
Total assets	406,051	442,818	483,315	527,834
ST debt	809	867	953	1,049
Other current liabilities	352,139	387,376	426,114	468,725
LT debt	1,509	1,660	1,826	2,008
Other LT liabilities	1,495	1,645	1,809	1,990
Shareholders' equity	49,728	50,863	52,164	53,568
Minority interest	371	408	449	494
Total liabilities & equity	406,051	442,818	483,315	527,834

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	72.1	74.3	75.5	75.8
Pre-tax margin	63.8	66.8	68.3	68.8
Net margin	55.1	59.1	60.3	60.6
ROA	2.5	2.9	3.0	3.0
ROE	20.3	24.5	26.8	28.2
Growth				
Turnover	(12.1)	14.0	9.9	7.5
EBITDA	(19.0)	17.5	11.7	7.9
Pre-tax profit	(21.2)	19.4	12.4	8.3
Net profit	(19.4)	22.3	12.2	8.0
Net profit (adj.)	(19.4)	22.3	12.2	8.0
EPS	(18.6)	20.8	12.5	7.5
Leverage				
Debt to total capital	4.4	4.7	5.0	5.4
Debt to equity	4.7	5.0	5.3	5.7
Net debt/(cash) to equity	(21.5)	(23.2)	(24.9)	(26.6)

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