

COMPANY UPDATE

Hong Kong Exchanges and Clearing (388 HK)

A Head Of Steam Or A Flash In The Pan?

June headline ADT declined 12% mom as the market turned cautious ahead of the third plenum meeting. Hence, we revised down our 2Q24 net profit growth forecast to 11% yoy. While the upcoming minimum spread review is expected to boost the headline ADT in the long term, the outcome of the third plenum meeting and the upcoming Fed rate cut cycle are likely to be the key near-term drivers of market sentiment and trading turnover. Maintain BUY. Target price: HK\$310.00.

WHAT'S NEW

2Q24 & 1H24 ESTIMATES

Year to 31 Dec (HK\$m)	2Q24F	qoq %	yoy %	1H24F	yoy %
Total Revenue	5,487	5.5	9.4	10,688	1.1
Core Revenue	4,280	11.3	11.4	8,127	3.4
NII and other income	1,207	(10.9)	2.8	2,561	(5.7)
EBITDA	4,003	8.1	9.7	7,708	(1.9)
Net Profit	3,210	8.1	10.5	6,180	(2.1)
Trading Turnover Metrics	2Q24F	qoq %	yoy %	1H24F	yoy %
Cash ADT (HK\$b)	121.6	22.4	18.2	110.4	(4.5)
Derivative ADV ('000 contracts)	1,565	4.3	18.9	1,533	12.0
LME Total ADV ('000 lots)	746	11.1	29.8	708	31.5

Source: HKEX, UOB Kay Hian

- We revised down our 2Q24 net profit growth forecast to 11% yoy (previously: 16%) due to lower-than-expected turnover in June. Hong Kong Exchanges and Clearing's (HKEX) cash market average daily turnover (ADT) reduced by 12% mom to HK\$111.2b in June due to disappointing China macro data and market sentiment turned cautious ahead of a third plenum meeting. Additionally, the average daily volume (ADV) of both the derivative and commodities markets fell 21%/13% mom to 1.347m contracts and 639,000 lots respectively in June, the lowest level in 2024. Nonetheless, the cash, derivative and commodities market trading volume still surged 18%/19%/30% yoy respectively in 2Q24, leading to a recovery in core revenue growth to 11% yoy (vs 1Q24: -4%).
- NII to drop 11% qoq to HK\$1.2b. The overnight/one-month/six-month HIBOR declined by 24/25/28bp qoq respectively in 2Q24 due to the Fed signalling a more dovish stance as US inflation is broadly cooling. Hence, we estimate the rate-driven net investment income (NII) to drop about 10% qoq to HK\$1.05b. However, fair value gains from the external portfolio are expected to remain relatively flat qoq, supported by the strong performance of Asia ex-Japan equities and bond markets, despite a larger decline in the MSCI World Index return.

KEY FINANCIALS

Year to 31 Dec (HK\$m)	2022	2023	2024F	2025F	2026F
Net turnover	18,280	20,269	21,868	22,886	23,759
EBITDA	13,185	14,828	15,985	16,531	16,896
Operating profit	11,726	13,385	14,605	15,109	15,432
Net profit (rep./act.)	10,078	11,862	12,780	13,124	13,432
Net profit (adj.)	10,078	11,862	12,780	13,124	13,432
EPS (HK\$ cent)	799.1	935.6	1,008.1	1,035.2	1,059.6
PE (x)	30.3	25.8	24.0	23.4	22.8
P/B (x)	6.1	6.0	5.8	5.7	5.6
EV/EBITDA (x)	22.6	20.1	18.6	18.0	17.6
Dividend yield (%)	3.0	3.5	3.8	3.9	3.9
Net margin (%)	55.1	58.5	58.4	57.3	56.5
Net debt/(cash) to equity (%)	(21.5)	(15.9)	(17.5)	(19.2)	(21.0)
ROE (%)	20.3	23.5	24.6	24.7	24.6
Consensus net profit	-	-	12,276	12,833	13,692
UOBKH/Consensus (x)	-	-	1.04	1.02	0.98

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

BUY

(Maintained)

Share Price	HK\$241.40
Target Price	HK\$310.00
Upside	+28.4%
(Previous TP)	HK\$317.00

COMPANY DESCRIPTION

Hong Kong Exchanges and Clearing Limited (HKEX) 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):	306,055.8
Market cap (US\$m):	39,195.7
3-mth avg daily t'over (US\$m):	211.5

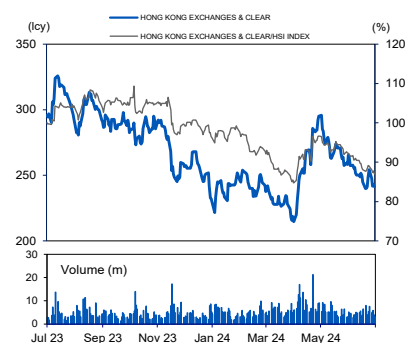
Price Performance (%)

52-week high/low	HK\$325.80/HK\$214.60				
1mth	3mth	6mth	1yr	YTD	
(6.5)	10.4	4.1	(18.2)	(8.0)	

Major Shareholders

The Government of Hong Kong SAR	5.8
-	-
FY24 NAV/Share (HK\$)	41.48
FY24 Net Cash/Share (HK\$)	7.26

PRICE CHART



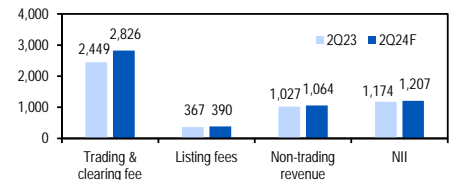
Source: Bloomberg

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• **Proposed to cut minimum spread by at least 50% for selected price bands.** In late-Jun 24, HKEX published a consultation paper on the reduction of minimum spread in the Hong Kong securities market to improve market liquidity. HKEX will adopt a two-phase approach for the implementation. More than 50% of the market in terms of ADT will be involved in the minimum spread adjustments.

REVENUE BREAKDOWN



Source: HKEX, UOB Kay Hian

2021-23 HONG KONG EQUITY MARKET LIQUIDITY PROFILE

Price Band	Number of stocks	Contribution to equity ADT (%)
From 0.01 to 0.25	544 / 20.77%	0.20%
Over 0.25 to 0.50	364 / 13.90%	0.26%
Over 0.50 to 1.00	1,345 / 51.36%	23.5%
0.50 to 1.00	385 / 14.70%	1.18%
1.00 to 2.00	332 / 12.68%	1.69%
2.00 to 5.00	398 / 15.20%	10.67%
5.00 to 10.00	230 / 8.78%	9.96%
Over 10.00 to 20.00	148 / 5.65%	13.98%
Over 20.00 to 100.00	181 / 6.91%	30.06%
20.00 to 50.00	135 / 5.15%	15.10%
50.00 to 100.00	46 / 1.76%	14.96%
Over 100.00 to 200.00	26 / 0.99%	16.42%
Over 200.00 to 500.00	11 / 0.42%	15.58%
Over 500.00 to 1,000.00	/	/
Over 1,000.00 to 2,000.00	/	/
Over 2,000.00 to 5,000.00	/	/
Over 5,000.00 to 9,995.00	/	/
Total	2,619	100%

Source: HKEX

a) **Phase 1** – The proposal recommends to reduce the minimum spreads of price bands between HK\$10 and HK\$20, and between HK\$20 and HK\$50 by 50% (from HK\$0.02 to HK\$0.01) and 60% (from HK\$0.05 to HK\$0.02) respectively. 283 securities with 29% of ADT will be affected in Phase 1.

b) **Phase 2** – The minimum spread of price bands between HK\$0.50 and HK\$10.00 will be reduced by 50% (from HK\$0.01 to HK\$0.005). The implementation of Phase 2 is subject to six months of observation on Phase 1's result. Some 1,345 securities with 24% of ADT will be affected in Phase 2.

SUMMARY OF PROPOSED CHANGES TO MINIMUM SPREAD

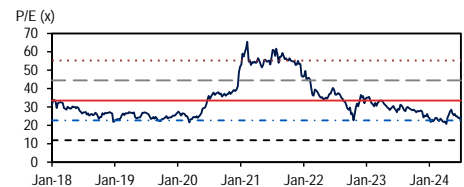
	Price Band (HK\$)	Original minimum spread (HK\$)	Proposed minimum spread (HK\$)	Reduction (%)	Original tick-to-price ratio (bp)	Proposed tick-to-price ratio (bp)
Phase 1	10.00-20.00	0.02	0.01	-60	10-20	5-10
	20.00-50.00	0.05	0.02	-60	10-25	4-10
Phase 2	0.50-10.00	0.01	0.005	-50	10-200	5-100

Source: HKEX, UOB Kay Hian

STOCK IMPACT

• **Transaction cost of around 85% of securities will reach optimal range.** As per HKEX disclosure, the spread cost in Hong Kong market is around 16.4bp, higher than its international peers, such as Mainland China (7.5bp), Japan (4.5bp), the UK (5.8bp) and the US (3.4bp). Upon the implementation, the tick-to-price ratios for the stocks above HK\$5.00 (contributing 85% of ADT) will now achieve the optimal range of 4-10bp, which will then effectively reduce the transaction cost and enhance cash market turnover.

FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

• **What can we learn from past minimum spread review in ETPs?** In Jun 20, HKEX cut the minimum spreads of Exchanged Traded Products (ETP) by 50% to 90%. Following this change, the bid-ask spreads of ETPs narrowed by at least 10%, with a more significant reduction up to 54% observed among actively traded products. Therefore, we believe actively traded stocks with higher tick-to-price ratios, such as China banking stocks priced between HK\$0.5 and HK\$10, are likely to be the key beneficiaries of this reform. Additionally, ETP's ADT has also improved substantially from HK\$7b in 2020 to HK\$14b in 2023. As such, we believe this review could help to boost the headline ADT in 2025, which is the main driver of HKEX's revenue growth, as Phase 1 is expected to kick off in 2025.

HKEX TRADING REVENUE KEY ASSUMPTIONS

(%)	2024F	2025F	2026F
Cash ADT (HK\$b)	119	132	136
Futures ADV ('000)	790	751	780
Stock Option ADV ('000)	658	677	710
LME ADV ('000)	693	709	743

Source: UOB Kay Hian

EARNINGS REVISION/RISK

• **We cut our 2024-26 earnings by 1.7%/2.3%/2.5% respectively** to reflect Jun 24 and mtd Jul 24 turnover data and NII performance.

VALUATION/RECOMMENDATION

• **Maintain BUY and trim our target price to HK\$310.00.** Our target price implies 30.7x 2024F PE, 0.3SD below its historical mean. The share price experienced 20% correction from its highest level in May 24 as the 20-day moving-average of headline ADT has dropped to HK\$101b due to weakening market sentiment. The outcome of the third plenum meeting and the upcoming Fed rate cut cycle could be the key catalysts for a sequential market valuation re-rating and improvement in trading volume. We see further upside in HKEX due to its attractive risk-reward ratio as HKEX is trading at undemanding valuation (-0.9SD) while its EPS appears to be bottoming out following increased market activity.

PROFIT & LOSS

Year to 31 Dec (HK\$m)	2023	2024F	2025F	2026F
Net turnover	20,269	21,868	22,886	23,759
EBITDA	14,828	15,985	16,531	16,896
Deprec. & amort.	1,443	1,380	1,421	1,464
EBIT	13,385	14,605	15,109	15,432
Associate contributions	(53)	(44)	(47)	(48)
Pre-tax profit	13,332	14,561	15,062	15,385
Tax	(1,351)	(1,696)	(1,841)	(1,859)
Minorities	(119)	(85)	(97)	(94)
Net profit	11,862	12,780	13,124	13,432
Net profit (adj.)	11,862	12,780	13,124	13,432

CASH FLOW

Year to 31 Dec (HK\$m)	2023	2024F	2025F	2026F
Operating	11,500	12,311	13,180	14,110
Pre-tax profit	11,294	12,085	12,931	13,836
Other operating cashflows	206	227	249	274
Investing	(6,290)	(8,124)	(7,190)	1,963
Proceeds from sale of assets	(1,460)	0	0	0
Others	(4,830)	(8,124)	(7,190)	1,963
Financing	(11,250)	(11,089)	(12,896)	(12,306)
Dividend payments	(10,316)	(10,662)	(11,502)	(11,812)
Proceeds from borrowings	0	0	(934)	0
Others/interest paid	(934)	(427)	(459)	(495)
Net cash inflow (outflow)	(6,040)	(6,901)	(6,906)	3,767
Beginning cash & cash equivalent	15,258	9,212	2,311	(4,595)
Changes due to forex impact	(6)	0	0	0
Ending cash & cash equivalent	10,286	11,315	12,446	13,691

BALANCE SHEET

Year to 31 Dec (HK\$m)	2023	2024F	2025F	2026F
Fixed assets	1,553	1,708	1,879	2,067
Other LT assets	23,424	22,226	23,402	24,645
Cash/ST investment	10,286	11,315	12,446	13,691
Other current assets	305,916	365,024	378,287	364,416
Total assets	341,179	400,273	416,014	404,819
ST debt	719	714	720	727
Other current liabilities	285,792	343,589	357,985	345,411
LT debt	1,399	1,399	1,399	1,399
Other LT liabilities	1,473	1,484	1,497	1,510
Shareholders' equity	51,344	52,590	53,866	55,170
Minority interest	452	497	547	602
Total liabilities & equity	341,179	400,273	416,014	404,819

KEY METRICS

Year to 31 Dec (%)	2023	2024F	2025F	2026F
Profitability				
EBITDA margin	73.2	73.1	72.2	71.1
Pre-tax margin	65.8	66.6	65.8	64.8
Net margin	58.5	58.4	57.3	56.5
ROA	3.2	3.4	3.2	3.3
ROE	23.5	24.6	24.7	24.6
Growth				
Turnover	10.9	7.9	4.7	3.8
EBITDA	12.5	7.8	3.4	2.2
Pre-tax profit	14.3	9.2	3.4	2.1
Net profit	17.7	7.7	2.7	2.3
Net profit (adj.)	17.7	7.7	2.7	2.3
EPS	17.1	7.7	2.7	2.4
Leverage				
Debt to total capital	3.9	3.8	3.7	3.7
Debt to equity	4.1	4.0	3.9	3.9
Net debt/(cash) to equity	(15.9)	(17.5)	(19.2)	(21.0)

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