

COMPANY UPDATE

Hong Kong Exchanges and Clearing (388 HK)

2Q23 Results Preview: ADT Slumps; NII Continues To Support Top-line

HKEX will report its 2Q23 results next week. We expect the company to deliver a 21.9% and 39.8% yoy growth in revenue and net profit, underpinned by a whopping yoy growth in net investment income amid high interest rates. Core revenue growth hit a bottleneck as headline ADT plunged 20.7% in 2Q23, but IPO activity is coming back from its trough. We tweak our full-year ADT assumptions and earnings downwards to reflect sluggish ADT in 2Q23. Maintain BUY. Target price: HK\$380.00.

WHAT'S NEW

- **2Q23 results preview.** Hong Kong Exchanges and Clearing (HKEX) will release its 2Q23 earnings on 16 Aug 23. We estimate HKEX's 2Q23 revenue to hike 21.9% yoy to HK\$5.2b but drop 6.8% qoq, primarily due to the robust net investment income (NII) amid the high interest environment, partially offset by the subdued average daily turnover (ADT) as the result of weakening market sentiment. We estimate 2Q23 net profit at HK\$3.0b, indicating a 29.8% yoy growth.

2023 RESULTS ESTIMATES

(HK\$m)	2023F	1Q23	2Q22	qoq	yoy %
Total Revenue	5,178	5,558	4,247	(6.8)	21.9
Core Revenue	3,921	4,015	4,210	(2.4)	(6.9)
NII and other income	1,257	1,543	37	(18.5)	3,298.4
EBITDA	3,802	4,209	2,921	(9.7)	30.2
Net Profit	3,031	3,408	2,168	(11.1)	39.8
Trading Turnover Metrics	2Q23F	1Q23	2Q22	qoq	yoy %
Cash ADT (HK\$b)	102.8	127.8	129.7	(19.5)	(20.7)
Derivative ADV ('000 contracts)	710.4	745.6	696.4	(4.7)	2.0
Stock Options ADV ('000 contracts)	606.3	672.1	578.0	(9.8)	4.9
LME Total ADV ('000 lots)	606.4	531.2	515.0	14.2	17.8

Source: HKEX, UOB Kay Hian

- **Risk-off sentiment leads to sluggish headline ADT in cash market.** As of end-Jun 23, the total market capitalisation and benchmark HSI fell 8.2% qoq and 7.2% qoq respectively due to the slower-than-expected recovery in China's economy. As a result, 2Q23 headline ADV in the cash market shrank 20.7% yoy and 19.5% qoq to HK\$102.8b, of which Apr 23/May 23/ Jun 23 ADT was HK\$108.9b/HK\$101.0b/HK\$99.8b respectively, representing a mom decline of 14.0%, 7.2% and 1.3%. Among that, the ADT performance for Stock Connect showed divergence, with Southbound ADT declining by 3% yoy to HK\$30.1b and Northbound ADT increasing by 20% yoy to Rmb122.5b.

KEY FINANCIALS

Year to 31 Dec (HK\$m)	2021	2022	2023F	2024F	2025F
Net turnover	20,800	18,280	21,102	22,531	24,026
EBITDA	16,271	13,185	15,705	16,865	18,005
Operating profit	14,916	11,726	14,180	15,263	16,323
Net profit (rep./act.)	12,497	10,078	12,515	13,432	14,294
Net profit (adj.)	12,497	10,078	12,515	13,432	14,294
EPS (HK\$ cent)	988.7	804.9	987.1	1,062.6	1,125.5
PE (x)	32.1	39.4	32.1	29.9	28.2
P/B (x)	8.1	8.0	7.9	7.7	7.5
EV/EBITDA (x)	40.9	50.4	42.3	39.4	36.9
Dividend yield (%)	2.8	2.3	2.8	2.9	3.1
Net margin (%)	60.1	55.1	59.3	59.6	59.5
Net debt/(cash) to equity (%)	(18.6)	(21.5)	(23.2)	(24.8)	(26.6)
ROE (%)	25.4	20.3	24.9	26.1	27.1
Consensus net profit	-	-	13,190	14,199	15,401
UOBKH/Consensus (x)	-	-	0.95	0.95	0.93

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

BUY

(Maintained)

Share Price	HK\$312.20
Target Price	HK\$380.00
Upside	+21.7%
(Previous TP	HK\$409.65)

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):	402,157.9
Market cap (US\$m):	51,510.5
3-mth avg daily t'over (US\$m):	153.4

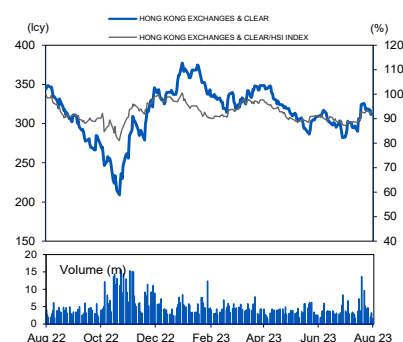
Price Performance (%)

52-week high/low	HK\$377.40/HK\$209.00				
1mth	3mth	6mth	1yr	YTD	
12.4	(0.8)	(6.5)	(11.4)	(5.9)	

Major Shareholders

The Government of Hong Kong SAR	5.8
FY23 NAV/Share (HK\$)	40.16
FY23 Net Debt/Share (HK\$)	206.79

PRICE CHART



Source: Bloomberg

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- Derivative and commodity trading volumes remain solid.** In 2Q23, the average daily volume (ADV) of derivatives contracts traded on the Futures Exchanges and stock option contracts traded on the Stock Exchange rose 2.0% yoy and 4.9% yoy to 710.4k and 606.3k contracts respectively. The trading volume for relatively new products such as Hang Seng Tech Futures and Hang Seng China Enterprises Index Futures Options also recorded significant growth due to the higher turnover velocity of Chinese tech stocks in 2Q23. Suprisingly, the ADV on the LME has regained some ground in 2Q23 a year on from the nickel crisis, acheiving a 17.8% yoy growth to 606.4k contracts.

- LME nickel litigation update.** The first Judicial Review trial on the nickel market incident last year concluded in Jun 23 and LME awaits the UK High Court's final verdict on a potential \$456m (HK\$3.56b) compensation to Elliot, a US hedge fund. Another case was filed against LME in Mar 23 seeking £10m (HK\$99.6m) in similar damages. The total claims against LME come up to around HK\$3.66b, which is equivalent to 36% of HKEX's 2022 earnings. No provision has been made against the claims but legal costs will continue to stay high in 2H23.

STOCK IMPACT

- Inspiring NII drives revenue growth as core revenue depresses.** Similar to the previous quarter, the strong NII will play a significant role in boosting HKEX's top-line, given the lacklustre growth in core revenue. The NII of internal corporate funds and participants' funds are anticipated to benefit from a higher 182-day rolling average 6M HIBOR (2Q23: 4.5% vs 2Q22: 1.5%). Meanwhile, the external portfolio is expected to record a capital gain of HK\$80m based on our calculations, attributed to the solid performance of public equities in the portfolio (MSCI World Index: +6.3%, MSCI AC Asia ex Japan Index: -2.2%). As such, we estimate the NII of HKEX in 2Q23 to increase 3300% yoy to HK\$1,257m, but drop 19.5% qoq due to the surge of 1M HIBOR, resulting in higher rebates to exchange participants.

- HK's IPO market showed signs of recovery.** 15 companies made their debuts on HKEX in 2Q23 (vs 10 in 2Q22), with a total of HK\$11.1b in funds raised, a 128% increase from the all-time low recorded during the corresponding period in 2022. As the IPO pipeline remains robust with 105 active applicants (vs 90 in Mar 23) and the launch of FINI, HKEX's new digital IPO settlement platform in 4Q23, we expect IPO activity to pick up in 2H23.

EARNINGS REVISION/RISK

- Reviewed our earnings forecast to factor in the latest ADT assumptions.** We trimmed our full-year headline ADT assumptions by 15% to HK\$108.9b for 2023 from our previous assumption of HK\$128.6b to reflect significant slowdown of ADT in 2Q23. Our new 2023 EPS forecast is HK\$9.90 (vs HK\$12.08 previously).

- Downside risks:** a) Fragile market sentiment leads to lower turnover, b) unfavorable outcome from LME nickel litigation, and c) intensifying competition with China's onshore capital markets due to less advantageous fee structure.

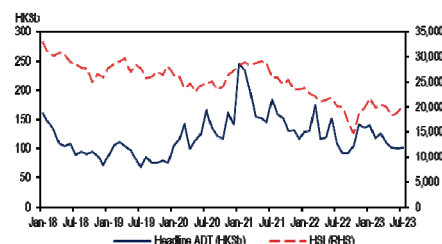
VALUATION/RECOMMENDATION

- Maintain BUY with a lower target price of HK\$380.00** from HK\$409.65 to reflect the ADT assumption adjustment. Our target price is derived from the Gordon Growth model with the assumption of 6.4% cost of equity and 4.0% sustainable growth, implying 38.4x 2023F PE, 0.2SD higher than its historical mean valuation.

SHARE PRICE CATALYST

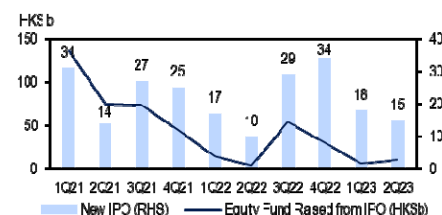
- China's politburo vowed to enliven China's capital market and increase support for the economy recovery in the latest meeting.
- Tail-end of interest rate hike cycle in the US.
- Expansion of HKD-RMB dual-counter model to include Stock Connect eligible stocks starting 4Q23.
- New listing regime to boost fundraising for Specialist Technology Company.

HKEX ADT TREND VS HSI PERFORMANCE



Source: HKEX, Bloomberg, UOB Kay Hian

NEWLY LISTED COMPANIES AND FUND RAISED



Source: HKEX, UOB Kay Hian

HKEX TRADING REVENUE KEY ASSUMPTIONS

(%)	2023F	2024F	2025F
Cash ADT (HK\$b)	108.9	122.3	136.5
Futures ADV ('000)	753.3	810.8	861.9
Stock Option ADV ('000)	629.5	669.6	709.9
LME ADV ('000)	585.4	608.4	634.1

Source: UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (HK\$m)	2022	2023F	2024F	2025F
Net turnover	18,280	21,102	22,531	24,026
EBITDA	13,185	15,705	16,865	18,005
Deprec. & amort.	1,459	1,525	1,602	1,682
EBIT	11,726	14,180	15,263	16,323
Associate contributions	(67)	(75)	(80)	(80)
Pre-tax profit	11,659	14,105	15,183	16,243
Tax	(1,564)	(1,570)	(1,762)	(1,959)
Minorities	(17)	(20)	10	10
Net profit	10,078	12,515	13,432	14,294
Net profit (adj.)	10,078	12,515	13,432	14,294

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	402,622	439,056	479,084
Total assets	406,051	442,865	483,322	527,778
ST debt	809	867	953	1049
Other current liabilities	352,139	387,376	426,114	468,715
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	50,910	52,172	53,512
Minority interest	371	408	449	494
Total liabilities & equity	406,051	442,865	483,322	527,778

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	72.1	74.4	74.9	74.9
Pre-tax margin	63.8	66.8	67.4	67.6
Net margin	55.1	59.3	59.6	59.5
ROA	2.5	2.9	2.9	2.8
ROE	20.3	24.9	26.1	27.1
Growth				
Turnover	(12.1)	15.4	6.8	6.6
EBITDA	(19.0)	19.1	7.4	6.8
Pre-tax profit	(21.2)	21.0	7.6	7.0
Net profit	(19.4)	24.2	7.3	6.4
Net profit (adj.)	(19.4)	24.2	7.3	6.4
EPS	(18.6)	22.6	7.7	5.9
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)	(24.8)	(26.6)

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