

China / Hong Kong Company Update

HK Exchanges & Clearing

Bloomberg: 388 HK EQUITY | Reuters: 0388.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

25 Feb 2022

HOLD

Last Traded Price (24 Feb 2022): HK\$394.60 (HSI : 22,902)
 Price Target 12-mth: HK\$422 (7% upside) (Prev HK\$501)

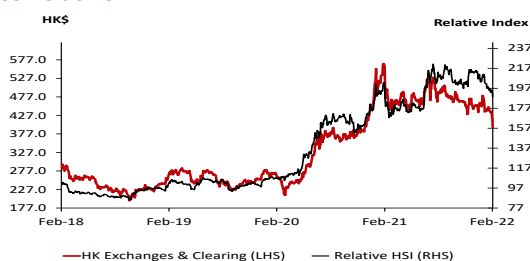
Analyst

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What's New

- FY2021 results in line with market expectations
- Geopolitical tensions weigh on HK trading volume in near term; better 2H2022 ADT is widely anticipated and has been reflected in the current share price
- Revised down FY22/FY23F earnings by 16%/18% to reflect the lowered ADT of HK\$176bn/HK\$184bn, respectively
- Maintain HOLD with lower TP at HK\$422

Price Relative



Forecasts and Valuation

FY Dec (HK\$m)	2020A	2021A	2022F	2023F
Turnover	19,190	20,950	22,171	23,502
EBITDA	14,238	16,041	16,945	17,926
Pre-tax Profit	13,222	14,841	15,745	16,726
Net Profit	11,395	12,535	13,297	14,123
Net Profit Gth (Pre-ex) (%)	21.3	10.0	6.1	6.2
EPS (HK\$)	9.04	9.94	10.54	11.20
EPS Gth (%)	21.3	10.0	6.1	6.2
Diluted EPS (HK\$)	9.04	9.94	10.54	11.20
DPS (HK\$)	6.63	6.63	7.03	7.47
BV Per Share (HK\$)	38.79	39.35	38.91	39.13
PE (X)	43.7	39.7	37.4	35.2
P/Cash Flow (X)	33.7	37.9	35.9	33.7
P/Free CF (X)	37.1	41.8	39.5	36.9
EV/EBITDA (X)	34.3	29.2	27.2	25.1
Net Div Yield (%)	1.7	1.7	1.8	1.9
P/Book Value (X)	10.2	10.0	10.1	10.1
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	24.5	25.4	26.9	28.7
Earnings Rev (%)			16	18
Consensus EPS (HK\$)			11.54	13.54
Other Broker Recs:		B:27	S:1	H:7

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

Weak market sentiment to persist

Investment Thesis

Weak market sentiment is likely to persist in 2Q due to the geopolitical conflict in Ukraine, on-and-off regulatory developments in the technology and new economy sectors, and the ongoing COVID-19 pandemic. The year-to-date ADT stays at the HK\$130bn level, in contrast to HK\$230bn during the same period last year. We reckon the current risk appetite remains low in the HK equity market, given that there is no near-term catalyst.

A better 2H2022 ADT is widely anticipated and has been reflected in the current share price. We believe there is a likely return of southbound net buys for the attractively valued and unique secular growth companies offered in HK. This is also given the significant increase in southbound eligible mutual funds.

ADT structural changes to persist in FY22-23F. ADT structural changes such as secondary listings, MSCI derivatives, attractive valuation of the HK market vs. that of A-share and the US, and higher Southbound participation should support a further increase in trading activities when market uncertainties ease.

Valuation:

We maintain our HOLD recommendation with a lowered target price (TP), at HK\$422. The TP is based on an unchanged valuation benchmark to FY22F, with our TP premised on a 40x PE, pegged to a +1.5SD of its 10-year mean.

Where we differ:

We are less optimistic on the FY23F average daily turnover compared to the consensus. After the three to four interest rate hikes this year, we believe the further interest rate hikes in FY23F could lead to a lower risk appetite for the equity market.

Key Risks to Our View:

Trading volume coming in higher than expected.

At A Glance

Issued Capital (m shrs)	1,268
Mkt Cap (HK\$m/US\$m)	500,353 / 64,083
Major Shareholders (%)	
The Hong Kong SAR Government	5.9
Free Float (%)	94.1
3m Avg. Daily Val. (US\$m)	210.38
GICS Industry: Financials / Diversified Financials	



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HK Exchanges & Clearing

WHAT'S NEW

Geopolitical conflicts weigh on HK's trading volume in near term

FY21 earning in line with market expectations. Net profit gained 9% to HK\$20.9bn. Revenue rose 9% to HK\$20.9bn in FY21, thanks to the higher trading and clearing fees driven by a record average daily turnover. Stock connect revenue increased 41% against 2020, accounting for 13% of HKEx's overall revenue. ADT reached a record high HK\$166.7bn in FY21, a growth of 29% from FY20, thanks to the ultra-high southbound turnover in Jan-Feb 2022. EBITDA margin is at 78%, 1% higher than 2020. The board announced a final dividend per share of HK\$8.87 (second interim: HK\$4.18) with the same payout ratio of 90%.

Weak market sentiment is likely to persist in 2Q due to the geopolitical conflict in Ukraine, on-and-off regulatory developments in the technology and new economy sectors, and the ongoing COVID-19 pandemic. The year-to-date ADT stays at the HK\$130bn level, in contrast to HK\$230bn in the same period last year. We reckon the current risk appetite remains low in the HK equity market, given there is no near-term catalyst.

Cautiously optimistic for 2H2022 ADT, where market uncertainties should show signs of easing, in our view. Given that these overhangs are largely priced in the current market valuation for the HK market, we could likely see the return of southbound net buys for the attractively valued and unique secular growth companies offered in HK. Additionally, given the significant increase in southbound eligible mutual funds in the previous years, this should provide a relatively strong basis for a bounce back. We expect the overall HK turnover to gradually improve to HK\$180bn moving into 2H.

HKEx was the 4th largest IPO market in term of IPO fund raised. It raised 331.4bn in FY21 with 88% from new economy and Biotech companies. 5 secondary listings and 3 dual-primary listings. HKEx continues to enhance its listing framework, including introducing and enhancing HK SPAC and overseas issuers listing regime. HK government

proposed more listing reforms to help pre-profit or pre-revenue start-ups raise funds during Budget 2022-2023. However, the strength of IPO pipeline subjects to the market sentiment in stock market. With the current sentiment amid various uncertainties, we think applicants would prefer to wait until HK market to have a better risk appetite in 2H.

Revised down FY22/FY23F earnings by 16%18% to reflect weak market sentiment in HK. We have revised down our average daily turnover estimates from HK\$196bn/ HK\$204bn to HK\$176bn/ HK\$184bn for FY22/FY23F, respectively. We have factored the low trading velocity in the first two months of 2022 into our estimates but expect a HK\$180bn ADT for the rest of the year. We have also lowered our net investment income as persistent inflationary pressures, global tightening of the monetary policy, and upcoming interest rate hikes could cause volatility and impact returns on the external investment portfolio.

Maintain our HOLD recommendation with a lowered target price (TP), at HK\$422. The TP is based on an unchanged valuation benchmark to FY22F, with our TP premised on a 40x PE, pegged to a +1.5SD of its 10-year mean. The secondary listings and dual-primary listings conversion, especially for those tech and new economy giants, will be a positive catalyst for the company to re-rate.

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 trading platforms for a range of cash and derivatives products and the facilities for processing trades.

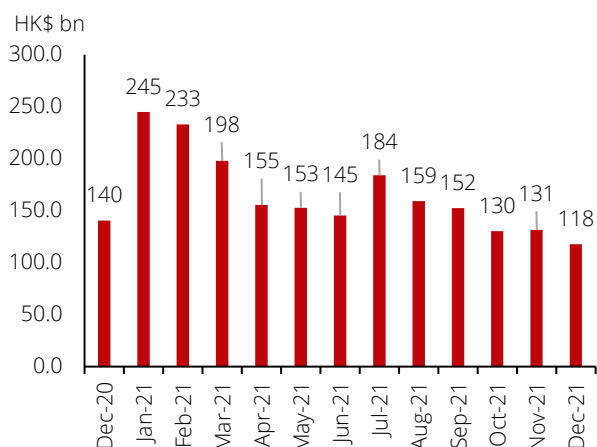
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Income Statement (HK\$ m)

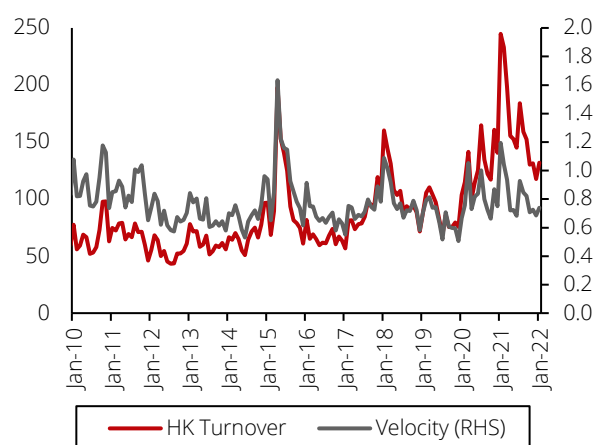
FY Dec	2020A	2021A	% chg v-o-y
Revenue	19,190	20,950	9.2
Gross Profit	19,190	20,950	9.2
Other Opng (Exp)/Inc	(5,746)	(6,035)	5.0
Operating Profit	13,444	14,915	10.9
Other Non Opng (Exp)/Inc	(110)	0	nm
Associates & JV Inc	69	80	15.9
Net Interest (Exp)/Inc	(181)	(154)	14.9
Exceptional Gain/(Loss)	0	0	nm
Pre-tax Profit	13,222	14,841	12.2
Tax	(1,845)	(2,343)	27.0
Minority Interest	18	37	105.6
Net Profit	11,395	12,535	10.0
Net Profit before Except.	11,395	12,535	10.0
EBITDA	14,238	16,041	12.7
Margins & Ratio			
Gross Margins (%)	100.0	100.0	
Opg Profit Margin (%)	70.1	71.2	
Net Profit Margin (%)	59.4	59.8	

Source: Company, DBS HK

HK ADT



HK ADT vs. trading velocity



Historical PE and PB band

Forward PE band (x)



PB band (x)



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
ADT on the Stock Exchange (\$bn)	87.2	129.5	166.0	176.3	185.9
ADT of DWs, CBBCs and warrants traded on the Stock Exchange (\$bn)	18.0	18.6	20.1	26.4	27.9
ADT of Northbound Trading	41.7	91.3	120.1	142.8	165.7
ADT of Southbound Trading (HK\$bn)	10.8	24.4	24.4	42.3	46.5
Number of newly listed companies on Main Board	168.0	146.0	97.0	97.0	97.0

Source: Company, DBS HK

Segmental Breakdown (HK\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (HK\$m)					
Cash instruments	3,646	4,991	6,131	5,734	6,079
Equity and Financial Derivatives	2,988	3,241	3,436	4,128	4,309
Commodities	1,399	1,454	1,478	1,426	1,494
Clearing	6,226	7,637	7,995	8,882	9,383
Platform and Infrastructure	796	910	1,050	1,212	1,398
Corporate Items	1,256	957	860	790	838
Total	16,311	19,190	20,950	22,171	23,502
Gross margin (HK\$ m)					
Cash instruments	3,043	4,396	5,517	4,810	5,097
Equity and Financial Derivatives	2,437	2,549	2,645	3,383	3,531
Commodities	731	762	783	749	784
Clearing	5,402	6,752	7,125	7,746	8,179
Platform and Infrastructure	551	606	731	843	972
Corporate Items	99	(424)	(546)	(357)	(408)
Total	12,263	14,641	16,269	17,173	18,154
Gross margin Margins (%)					
Cash instruments	83.5	88.1	90.0	83.9	83.8
Equity and Financial Derivatives	81.6	78.6	77.0	82.0	81.9
Commodities	52.3	52.4	53.0	52.5	52.5
Clearing	86.8	88.4	89.1	87.2	87.2
Platform and Infrastructure	69.2	66.6	69.6	69.6	69.5
Corporate Items	N/A	N/A	N/A	N/A	N/A
Total	75.2	76.3	77.7	77.5	77.2

Source: Company, DBS HK

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Income Statement (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	16,311	19,190	20,950	22,171	23,502
Cost of Goods Sold	0	0	0	0	0
Gross Profit	16,311	19,190	20,950	22,171	23,502
Other Opg (Exp)/Inc	(5,092)	(5,746)	(6,035)	(6,351)	(6,701)
Operating Profit	11,219	13,444	14,915	15,819	16,800
Other Non Opg (Exp)/Inc	0	(110)	0	0	0
Associates & JV Inc	32	69	80	80	80
Net Interest (Exp)/Inc	(300)	(181)	(154)	(154)	(154)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	10,951	13,222	14,841	15,745	16,726
Tax	(1,561)	(1,845)	(2,343)	(2,486)	(2,641)
Minority Interest	1	18	37	37	37
Preference Dividend	0	0	0	0	0
Net Profit	9,391	11,395	12,535	13,297	14,123
Net Profit before Except.	9,391	11,395	12,535	13,297	14,123
EBITDA	11,695	14,238	16,041	16,945	17,926
Growth					
Revenue Gth (%)	2.8	17.7	9.2	5.8	6.0
EBITDA Gth (%)	1.4	21.7	12.7	5.6	5.8
Opg Profit Gth (%)	2.0	19.8	10.9	6.1	6.2
Net Profit Gth (%)	0.8	21.3	10.0	6.1	6.2
Margins & Ratio					
Gross Margins (%)	100.0	100.0	100.0	100.0	100.0
Opg Profit Margin (%)	68.8	70.1	71.2	71.4	71.5
Net Profit Margin (%)	57.6	59.4	59.8	60.0	60.1
ROAE (%)	22.1	24.5	25.4	26.9	28.7
ROA (%)	3.5	3.4	3.1	3.3	3.5
ROCE (%)	21.0	22.8	23.5	25.0	26.6
Div Payout Ratio (%)	89.0	73.3	66.7	66.7	66.7
Net Interest Cover (x)	37.4	74.3	96.9	102.7	109.1

Source: Company, DBS HK

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Balance Sheet (HK\$ m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	1,589	1,657	1,605	1,537	183
Invt in Associates & JVs	95	164	244	142	161
Other LT Assets	22,172	21,592	22,386	22,386	22,386
Cash & ST Invt	10,603	10,417	30,242	37,950	47,397
Inventory	0	0	0	0	0
Debtors	25,791	47,059	32,717	18,341	18,341
Other Current Assets	218,801	318,218	312,112	316,185	312,582
Total Assets	279,051	399,106	399,304	396,538	401,046
ST Debt	338	340	340	340	340
Creditors	22,447	42,974	28,335	26,167	27,791
Other Current Liab	208,152	303,020	317,289	317,289	319,930
LT Debt	80	83	86	85	85
Other LT Liabilities	3,533	3,453	3,344	3,344	3,344
Shareholder's Equity	44,173	48,918	49,626	49,067	49,346
Minority Interests	328	318	284	247	210
Total Cap. & Liab.	279,051	399,106	399,304	396,538	401,046
Non-Cash Wkg. Capital	13,993	19,283	(795)	(8,930)	(16,798)
Net Cash/(Debt)	10,185	9,994	29,816	37,526	46,972
Debtors Turn (avg days)	493.8	692.8	694.9	420.3	284.9
Creditors Turn (avg days)	(7,135.0)	(9,974.4)	(9,611.4)	(7,346.1)	(7,272.8)
Inventory Turn (avg days)	N/A	N/A	N/A	N/A	N/A
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)	0.2	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 (%)	261.0	319.4	286.6	302.9	294.8
Z-Score (X)	1.6	1.6	1.7	1.7	1.7

Source: Company, DBS HK

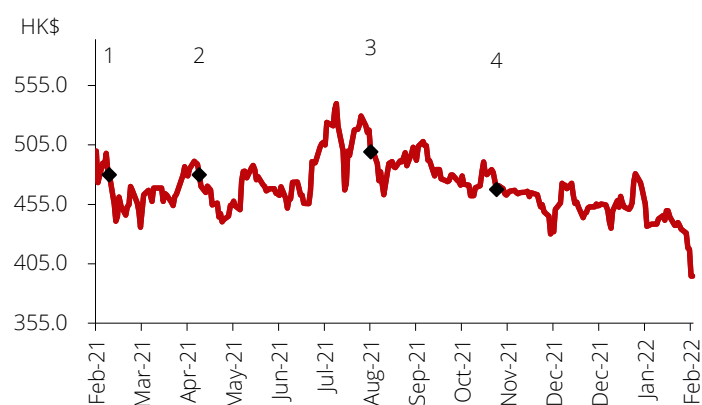
Cash Flow Statement (HK\$m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	10,951	13,222	14,841	15,745	16,726
Dep. & Amort.	1,044	1,198	1,356	1,357	1,358
Tax Paid	(431)	(1,845)	(2,343)	(2,486)	(2,641)
Assoc. & JV Inc/(loss)	(32)	(69)	(80)	(80)	(80)
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg. Cap.	65	(127)	(101)	(113)	(69)
Other Operating CF	(1,535)	2,391	(546)	(546)	(546)
Net Operating CF	10,062	14,770	13,127	13,878	14,749
Capital Exp. (net)	(1,091)	(1,351)	(1,221)	(1,286)	(1,254)
Other Invt. (net)	(2,435)	(6,131)	0	0	0
Invt in Assoc. & JV	0	0	(80)	103	(20)
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	41	0	0	0	0
Net Investing CF	(3,485)	(7,482)	(1,301)	(1,184)	(1,273)
Div Paid	(5,785)	(6,983)	(5,908)	(4,712)	(3,753)
Chg in Gross Debt	(1,121)	(118)	(119)	(118)	(119)
Capital Issues	0	0	0	0	0
Other Financing CF	(248)	(373)	14,027	(154)	(154)
Net Financing CF	(7,154)	(7,474)	8,000	(4,984)	(4,026)
Currency Adjustments	0	0	0	0	0
Chg in Cash	(577)	(186)	19,826	7,710	9,450
Opg CFPS (HK\$)	7.93	11.81	10.49	11.09	11.75
Free CFPS (HK\$)	7.11	10.64	9.44	9.99	10.70

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	5-Mar-21	HK\$483.00	HK\$574.00	Buy
2:	29-Apr-21	HK\$488.80	HK\$563.00	Buy
3:	12-Aug-21	HK\$517.50	HK\$501.00	Hold
4:	28-Oct-21	HK\$474.80	HK\$501.00	Hold

Source: DBS HK

Analyst: Dennis Lam
Byron Lam

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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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Sources for all charts and tables are DBS HK unless otherwise specified.

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