

COMPANY UPDATE

Hong Kong Exchanges and Clearing (388 HK)

4Q23 Results Preview: Limited Earnings Growth Ahead; Downgrade To HOLD

We expect HKEX to report a marginal net profit dip in 4Q23 due to sluggish core revenue, compensated by robust NII. However, a disappointing ADT recovery and peaking NII have cast uncertainties on the bourse's 2024 earnings, prompting us to downgrade HKEX to HOLD with a target price of HK\$300.00. We think HKEX's current valuation of -1.0SD is relatively fair given the market's current cautious sentiment due to China's slowing economy and looming political uncertainties.

WHAT'S NEW

• **Low expectations on 4Q23 earnings due to persistently lacklustre core revenue growth.** We expect Hong Kong Exchanges and Clearing (HKEX) to report a revenue and net profit of HK\$5.14b and HK\$2.93b (-1.0% yoy/-1.5% yoy) in 4Q23 respectively, mainly dragged by dampened cash market turnover and a decline in listing fees amidst weakening investor sentiment and sluggish fundraising activities. However, these headwinds were partly mitigated by the robust net investment income (NII) which was bolstered by rising interest rate and strong external-managed portfolio performance.

4Q23 & 2023 RESULTS ESTIMATES

(HK\$m)	4Q23F	qoq %	yoy %	2023F	yoy %
Total Revenue	5,147	1.2	-1.0	20,587	12.7
Core Revenue	3,803	-1.1	-9.8	15,058	-8.6
NII and other income	1,314	8.5	40.8	5,213	284.4
EBITDA	3,703	-0.1	-2.7	15,268	15.8
Net Profit	2,933	-0.7	-1.5	12,198	21.0
Trading Turnover Metrics					
	4Q23F	qoq %	yoy %	2023F	yoy %
Cash ADT (HK\$b)	91.0	-7.6	-28.5	105.0	-15.9
Derivative ADV ('000 contracts)	758.9	2.4	-9.2	739.4	4.6
Stock Options ADV ('000 contracts)	613.0	2.5	-5.4	622.2	4.5
LME Total ADV ('000 lots)	623.6	13.8	23.0	562.4	5.3

Source: HKEX, UOB Kay Hian

• **HKEX's strategy and ongoing reform unaffected by leadership change.** HKEX has appointed the current co-Chief Operating Officer, Bonnie Chan as its new CEO after the departure of Nicolas Aguzin. Chan was involved in several of the exchange's reforms over the past few years, such as: a) launching the new digital IPO settlement platform, b) allowing secondary listings of Great China company with Without Weighted Voting Rights (WVR) structure, and c) adding a new Listing Chapter 18C for Specialist Technology Companies. Hence, we do not expect any significant changes to HKEX's strategies: a) to connect China and overseas capital markets, and b) its ongoing reforms to attract new listings.

KEY FINANCIALS

Year to 31 Dec (HK\$m)	2021	2022	2023F	2024F	2025F
Net turnover	20,800	18,280	20,587	20,627	22,052
EBITDA	16,271	13,185	15,268	15,058	16,135
Operating profit	14,916	11,726	13,780	13,496	14,495
Net profit (rep./act.)	12,497	10,078	12,198	11,829	12,523
Net profit (adj.)	12,497	10,078	12,198	11,829	12,523
EPS (HK\$ cent)	988.7	799.1	962.1	935.8	986.1
PE (x)	26.1	32.3	26.8	27.5	26.1
P/B (x)	6.6	6.5	6.4	6.2	6.1
EV/EBITDA (x)	19.3	23.8	20.6	20.8	19.4
Dividend yield (%)	3.4	2.8	3.4	3.3	3.4
Net margin (%)	60.1	55.1	59.3	57.3	56.8
Net debt/(cash) to equity (%)	(18.6)	(21.5)	(23.6)	(25.8)	(28.2)
ROE (%)	25.4	20.3	24.2	22.9	23.7
Consensus net profit	-	-	11,895	12,763	13,607
UOBKH/Consensus (x)	-	-	1.03	0.93	0.92

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

HOLD

(Downgraded)

Share Price	HK\$255.80
Target Price	HK\$300.00
Upside	+17.3%
(Previous TP)	HK\$370.00)

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):	324,312.7
Market cap (US\$m):	41,516.8
3-mth avg daily t'over (US\$m):	150.1

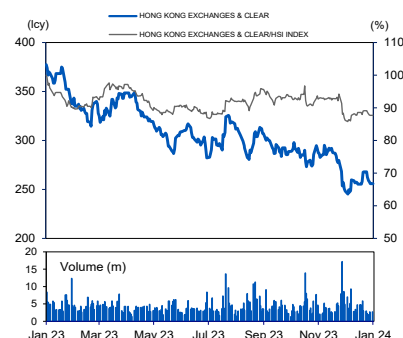
Price Performance (%)

52-week high/low	HK\$377.40/HK\$245.20				
1mth	3mth	6mth	1yr	YTD	
0.9	(10.4)	(14.0)	(29.3)	(4.6)	

Major Shareholders

	%
The Government of Hong Kong SAR	5.8
FY24 NAV/Share (HK\$)	41.51
FY24 Net Cash/Share (HK\$)	10.73

PRICE CHART



Source: Bloomberg

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- **Nickel chaos over with strong turnaround in commodity volume.** London Metal Exchange's (LME) average daily volume (ADV) continues to recover from a lower base, hitting 0.71m lots in Dec 23 (+54% yoy), the highest level since the suspension of nickel trading. As such, we forecast the commodities segment's trading fees to grow 10% yoy in 2023, accounting for 18% of HKEX's total trading fees. In addition, the recent favourable adjudication in the nickel litigation could allay concerns about the potential legal provisions.

STOCK IMPACT

- **Headline ADT rebounded in Nov and Dec 23, but still trending below HK\$100b.** The city's bourse recorded headline average daily turnover (ADT) of HK\$95.5b and HK\$98.4b over the past two months, bringing 4Q23 turnover to HK\$98.0b (-7.6% qoq/-28.5% yoy). Despite a slight uptick in November and December, the subdued market sentiment continued to weigh on trading activity due to a lack of fresh catalysts on China's macro front. For the Stock Connect performance in November, the ADT of Northbound trading increased by 8.6% yoy to Rmb107.8b but Southbound trading declined by 34.0% yoy to HK\$29.2b. All in all, HKEX's trading revenue is estimated to record a 9.7% yoy decline in 2023, mainly due to: a) subdued headline ADT, b) a change in fee structure for Cash Market, and c) a reduction in trading fees for Northbound Trading.

- **Last ride on high interest rate wave before Fed pivots.** We expect HKEX's NII to increase 40.8% yoy/8.5% qoq in 4Q23 to HK\$1.3b. Interest-related NII from margin funds and internal corporate funds is expected to increase by 42% yoy due to the high interest environment, but slightly decline by 4% qoq, mainly attributed to: a) narrowing of 1M-6M HIBOR spread (1M-HIBOR: +33bp qoq to 5.18%; rolling average 6M-HIBOR: +30qoq to 4.88%), and b) a significant reduction in margin requirements for futures product caused by the declining market indices. Meanwhile, the externally-managed corporate fund's strong performance in 4Q23, bolstered by the Fed's dovish pivot and the subsequent surge in overseas bond and equity markets, is estimated to contribute HK\$238m in investment income to the stock market operator.

- **A tougher year ahead with inactive capital market and potential NII decline.** The Hong Kong capital market finished the first trading week of 2024 with an ADT of HK\$76.7b, down 48.3% yoy as investors gauged concerns over the sluggishness in economic recovery. Thus, we expect HKEX's core revenue to be under pressure in 2024 and we assume a more conservative full-year headline ADT of HK\$108.9b in our earnings forecasts, given that spot market trading activity remains relatively weak. Besides, HKEX's interest income will face headwinds as the market is pricing in steeper rate cuts in 2024. Thus, we project a 25%/11% yoy decline in NII for 2024/25, assuming 150bp/50bp rate cuts in our base-case scenario.

EARNINGS REVISION/RISK

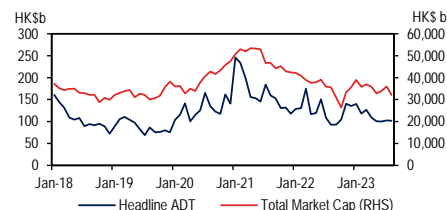
- **We cut our earnings projections for 2024/25 by 11%/13% respectively** on lower headline ADT assumptions and declining NII due to the upcoming Fed rate cuts.

VALUATION/RECOMMENDATION

- **Downgrade to HOLD with a target price of HK\$300.00 on low visibility for headline ADT recovery and earnings growth.** Our target price is derived from the Gordon Growth Model with the assumption of 6.6% cost of equity and 4.0% terminal growth, implying 2024F PE of 29.7X, 0.7SD below its historical mean.

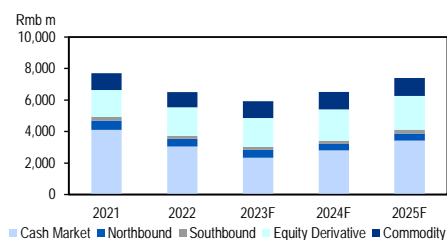
- Although the interest rate down-cycle is around the corner and is expected to attract foreign fund inflow, the lack of macroscopic catalysts from China given the recent disappointing macro data and looming political uncertainties such as the upcoming Taiwan and US presidential election could delay a sustained market recovery as investors are adopting a wait-and-see approach. Thus, in our opinion, HKEX's current valuation of 26.1X PE (-1.0 SD) appears fairly priced at this juncture, justifying our HOLD call.

HEADLINE ADT AND TOTAL MARKET CAP



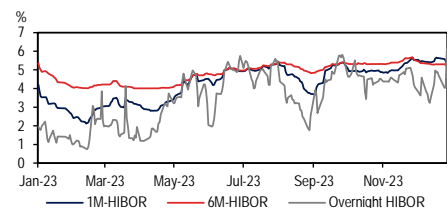
Source: HKEX, UOB Kay Hian

HKEX TRADING FEE BREAKDOWN



Source: HKEX, UOB Kay Hian

HIBOR TREND



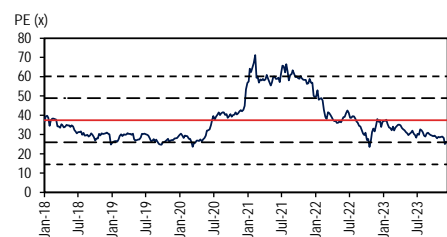
Source: Bloomberg, UOB Kay Hian

HKEX TRADING REVENUE KEY ASSUMPTIONS

(%)	2023F	2024F	2025F
Cash ADT (HK\$b)	105.0	108.9	129.1
Futures ADV ('000)	739.4	777.3	816.7
Stock Option ADV ('000)	622.2	662.1	693.9
LME ADV ('000)	562.4	587.5	612.2

Source: UOB Kay Hian

HKEX FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (HK\$m)	2022	2023F	2024F	2025F
Net turnover	18,280	20,587	20,627	22,052
EBITDA	13,185	15,268	15,058	16,135
Deprec. & amort.	1,459	1,487	1,562	1,640
EBIT	11,726	13,780	13,496	14,495
Associate contributions	(67)	(59)	(80)	(80)
Pre-tax profit	11,659	13,721	13,416	14,415
Tax	(1,564)	(1,431)	(1,541)	(1,825)
Minorities	(17)	(92)	(46)	(67)
Net profit	10,078	12,198	11,829	12,523
Net profit (adj.)	10,078	12,198	11,829	12,523

CASH FLOW

Year to 31 Dec (HK\$m)	2022	2023F	2024F	2025F
Operating	14,956	16,060	17,246	18,522
Pre-tax profit	13,062	13,976	14,955	16,002
Other operating cashflows	1,894	2,083	2,292	2,521
Investing	(1,700)	(453)	(464)	(492)
Proceeds from sale of assets	0	0	0	0
Others	(1,700)	(453)	(464)	(492)
Financing	(10,373)	(11,060)	(11,465)	(11,145)
Dividend payments	(9,665)	(10,632)	(11,002)	(10,646)
Proceeds from borrowings	0	0	0	0
Others/interest paid	(708)	(429)	(463)	(499)
Net cash inflow (outflow)	2,883	4,546	5,318	6,885
Beginning cash & cash equivalent	12,398	15,258	19,804	25,122
Changes due to forex impact	(23)	0	0	0
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	22,064	23,236	24,476
Cash/ST investment	13,011	14,312	15,743	17,318
Other current assets	369,467	375,713	395,103	402,182
Total assets	406,051	413,893	436,067	446,158
ST debt	809	794	801	808
Other current liabilities	352,139	358,582	379,563	388,390
LT debt	1,509	1,424	1,424	1,424
Other LT liabilities	1,495	1,493	1,503	1,514
Shareholders' equity	49,728	51,173	52,307	53,506
Minority interest	371	427	469	516
Total liabilities & equity	406,051	413,893	436,067	446,158

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	72.1	74.2	73.0	73.2
Pre-tax margin	63.8	66.7	65.0	65.4
Net margin	55.1	59.3	57.3	56.8
ROA	2.5	3.0	2.8	2.8
ROE	20.3	24.2	22.9	23.7
Growth				
Turnover	(12.1)	12.6	0.2	6.9
EBITDA	(19.0)	15.8	(1.4)	7.2
Pre-tax profit	(21.2)	17.7	(2.2)	7.5
Net profit	(19.4)	21.0	(3.0)	5.9
Net profit (adj.)	(19.4)	21.0	(3.0)	5.9
EPS	(19.2)	20.4	(2.7)	5.4
Leverage				
Debt to total capital	4.4	4.1	4.0	4.0
Debt to equity	4.7	4.3	4.3	4.2
Net debt/(cash) to equity	(21.5)	(23.6)	(25.8)	(28.2)

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