

Hong Kong Exchange & Clearing (388 HK)

So far so good, but lacks luster

HKEx reported FY19 net profit of HK\$ 9.4bn, flat YoY, in-line with our estimates vs. shy 1% of consensus. Sequentially, 4Q19 recorded weaker investment income and higher costs which we see as an implication for similar trend ahead. YTD market data showed recovery and resilience, but the catalysts that the market has been longing for are yet to be materialized. Trading above its 5-yr avg. P/E at 33x, we think HKEx looks fair in valuation. **We raise TP to HK\$ 265** to reflect better-than-expected market activity, while **maintain HOLD** on the stock.

- **4Q19 results recap and implications:** Strong investment incomes (+129% YoY) helped offset soft market activity (other revenues -4% YoY). Northbound was a bright spot (ADT +78% YoY), and Stock Connect's trading and clearing fees contribution rose to 8.5%. But note that invt. income dropped 10% QoQ, and we expect its support to revenue may fade as market volatility could weigh on gains from Collective Invt. Scheme. Total cost (opex+D&A) also went up (+5% YoY) and mgmt. guided further tech expenses ahead.
- **Results briefing key takeaways:** 1) There was **no update on launch schedule of the MSCI A Index Future**, a major near-term catalyst still absent. 2) Mgmt. shared **several structural changes that could drive near-term growth**, incl. more engagement of quant funds to boost esp. derivatives vol., new economy mega IPOs that fuels up ADT, continuous active flows through Stock Connect Schemes, etc. 3) **HKEx aims to build its FIC competitiveness in the long run both organically**, i.e. through established Bond Connect and the deepening RMB internationalization, **and inorganically**. The Exchange is also developing this business in a different way by cooperating with Chinese tech giants and leveraging their state-of-the-art technologies.
- **YTD cash market data ahead of our est.; revise up FY20E/21E earnings by 2%/7%.** Both local cash market and Stock Connect ADT was stronger and more resilient than we expected YTD, yet derivatives trading fell slightly short. We therefore revise up our FY20E/21E net profit forecasts by 2%/7%. We also factor in a slower IPO pipeline in 1Q20E due to coronavirus; but we would expect the demand to resume soon post outbreak.
- **Raise TP to HK\$ 265; Maintain HOLD.** We raise TP by 7% to HK\$ 265 on new earnings forecast, implying 33.4x FY20E P/E. HKEx now trades at 32.7x FY20E P/E, above its 5-yr average of 30x. The market activity recovery is underway, but we believe it is in the price, and near-term catalyst is absent to underpin re-rating. Maintain HOLD.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Total revenue (HK\$ mn)	15,867	16,311	17,438	19,878	22,147
Net profit (HK\$ mn)	9,312	9,391	10,061	11,448	12,765
EPS (HK\$)	7.50	7.49	7.94	8.96	9.90
EPS YoY growth (%)	24	(0)	6	13	11
P/E (x)	34.7	34.7	32.7	29.0	26.3
P/B (x)	7.9	7.4	6.9	6.4	6.0
Yield (%)	2.6	2.6	2.7	3.1	3.4
ROE (%)	23.9	22.1	21.9	23.1	23.9
EBITDA margin (%)	74.1	75.2	75.0	74.7	74.5

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Maintain)

Target Price **HK\$ 265.0**
 (Previous TP **HK\$ 248.0**)
 Up/Downside **+2.0%**
 Current Price **HK\$ 259.8**

Diversified Financials Sector

Karen Sui
 (852) 3761 8775
 suixiaomeng@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn)	327,660
Avg 3 mths t/o (HK\$ mn)	1,084
52w High/Low (HK\$)	286.2/222
Total Issued Shares (mn)	1,261.2

Source: Bloomberg

Shareholding Structure

JPMorgan Chase & Co	7.85%
The Government of HKSAR	5.93%

Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-3.5%	0.3%
3-mth	4.9%	5.3%
6-mth	3.7%	1.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

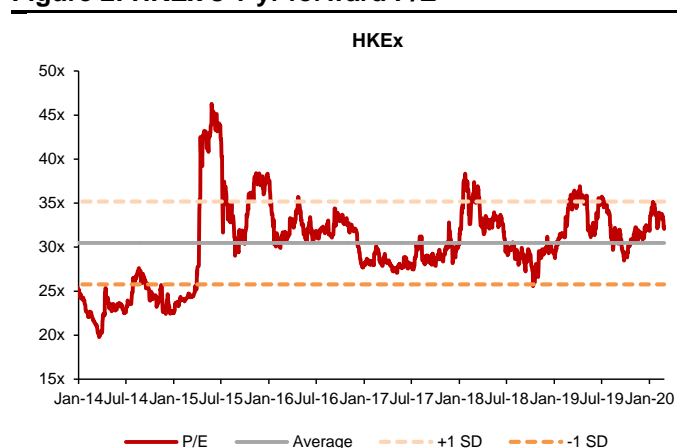
Related Reports

1. "Near-term catalysts take time to materialize" (Initiation) – 30 Dec 2019
2. "Potential acquisition of LSEG: Uncertainty prevails" – 12 Sep 2019
3. "1H19 results in-line; more challenges in 2H19E" – 15 Aug 2019
4. "Looking beyond interconnections" – 1 Mar 2019

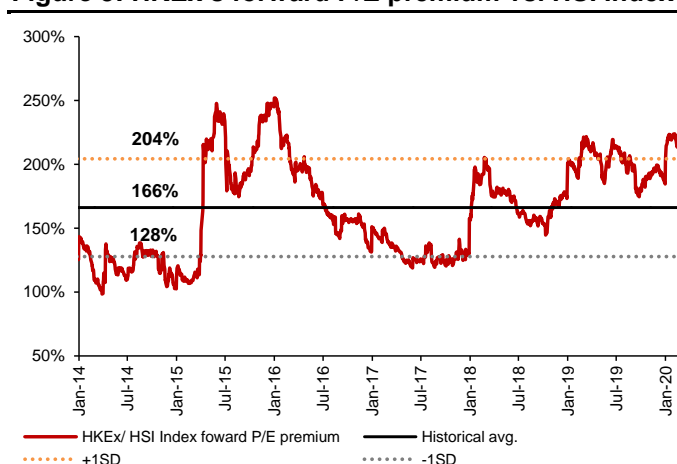
Figure 1: HKEx's quarterly results summary

(HK\$ mn)	4Q18	1Q19	2Q19	3Q19	4Q19	QoQ	YoY	FY18	FY19	YoY
I/S										
Trading fees & tariffs	1,490	1,491	1,449	1,369	1,283	-6%	-14%	6,339	5,592	-12%
Listing fees	410	453	394	394	392	-1%	-4%	1,721	1,633	-5%
Clearing and settlement fees	750	834	821	777	728	-6%	-3%	3,281	3,160	-4%
Depository, custody & nominee services fees	166	140	435	276	201	-27%	21%	979	1,052	7%
Market data fees	224	229	232	231	227	-2%	1%	899	919	2%
Net investment income	250	882	637	637	573	-10%	129%	1,584	2,729	72%
Other revenue and incomes	281	259	322	303	342	13%	22%	1,064	1,226	15%
Total revenue	3,571	4,288	4,290	3,987	3,746	-6%	5%	15,867	16,311	3%
Opex	(1,167)	(970)	(983)	(949)	(1,146)	21%	-2%	(4,110)	(4,048)	-2%
EBITDA	2,404	3,318	3,307	3,038	2,600	-14%	8%	11,757	12,263	4%
D&A	(186)	(248)	(247)	(271)	(278)	3%	49%	(762)	(1,044)	37%
Pre-tax profit	2,189	3,029	3,021	2,605	2,296	-12%	5%	10,883	10,951	1%
Taxation	(361)	(422)	(425)	(400)	(314)	-22%	-13%	(1,592)	(1,561)	-2%
Minority interests	0	1	1	2	(3)	-250%	N/A	21	1	-95%
Net profit	1,828	2,608	2,597	2,207	1,979	-10%	8%	9,312	9,391	1%
Key ratios										
Cost-to-income ratio	37.9%	28.4%	28.7%	30.6%	38.0%	7.4ppt	0.1ppt	30.7%	31.2%	0.5ppt
EBITDA margin	67.3%	77.4%	77.1%	76.2%	69.4%	-6.8ppt	2.1ppt	74.1%	75.2%	1.1ppt
ROE	18.2%	26.0%	24.8%	20.4%	18.3%	-2.1ppt	0.0ppt	23.9%	22.1%	-1.8ppt
Key drivers										
Cash equity ADT (HK\$ bn)	86	101	95	77	77	0%	-10%	107	87	-19%
Cash equity ADT excl. Southbound (HK\$ bn)	82	96	90	73	72	-1%	-12%	102	82	-19%
Southbound ADT (HK\$ bn)	8.2	11.9	10.5	9.7	11.2	16%	36%	12.7	10.8	-15%
Northbound ADT (RMB bn)	23.0	38.5	49.7	38.5	40.9	6%	78%	20.4	41.7	104%
HKEx F&Os ADV ('000 contracts)	1,223	1,187	1,173	990	937	-5%	-23%	1,204	1,070	-11%
LME commodities ADV ('000 contracts)	571	611	628	617	614	0%	8%	630	618	-2%

Source: Company data, CMBIS

Figure 2: HKEx's 1-yr forward P/E

Source: Bloomberg, CMBIS estimates

Figure 3: HKEx's forward P/E premium vs. HSI Index

Source: Bloomberg, CMBIS estimates

Figure 4: Earnings revision

(HK\$ mn)	New			Change vs. Old	
I/S	FY20E	FY21E	FY22E	FY20E	FY21E
Trading fees and tariffs	6,229	7,364	8,386	2%	7%
Listing fees	1,787	1,987	2,147	6%	13%
Clearing and settlement fees	3,846	4,621	5,304	5%	14%
Depository, custody and nominee services fees	1,126	1,204	1,289	0%	0%
Market data fees	954	1,008	1,067	0%	1%
Net investment income	2,148	2,209	2,324	67%	56%
Other revenue and incomes	1,349	1,483	1,632	-41%	-35%
Total revenue	17,438	19,878	22,147	2%	7%
Opex	(4,360)	(5,029)	(5,648)	2%	7%
EBITDA	13,079	14,849	16,500	2%	7%
D&A	(1,169)	(1,310)	(1,414)	4%	11%
Operating profit	11,910	13,539	15,086	2%	7%
Pre-tax profit	11,757	13,379	14,918	2%	7%
Taxation	(1,698)	(1,932)	(2,154)	0%	5%
Net profit	10,061	11,448	12,765	2%	7%
Key drivers	FY20E	FY21E	FY22E	FY20E	FY21E
Cash equity ADT (HK\$ bn)	106	128	146	9%	16%
Southbound ADT (HK\$ bn)	16.1	18.9	21.2	22%	25%
Northbound ADT (HK\$ bn)	63.9	73.0	83.9	16%	17%
HKEx F&Os ADV ('000 contracts)	1,135	1,373	1,598	-4%	2%
LME commodities ADV ('000 contracts)	655	703	761	-1%	-1%

Source: CMBIS estimates

Figure 5: TP sensitivity to cash equity ADT with different P/Es

		P/E scenarios						
		30x	31x	32x	33.4x	34x	35x	36x
Cash Equity ADT (HK\$ bn)	70	198	204	211	220	224	231	237
	80	209	216	223	233	237	244	251
	90	220	227	235	245	249	257	264
	Base=106	238	246	254	265	270	278	286
	110	243	251	259	270	275	283	291
	120	254	262	271	283	288	296	305
	130	265	274	283	295	300	309	318

Source: CMBIS estimates

Figure 6: TP sensitivity to HKEx derivatives ADV with different P/Es

		P/E scenarios						
		30x	31x	32x	33.4x	34x	35x	36x
HKEx Derivatives ADV ('000 contracts)	1,000	171	177	183	191	194	200	205
	1,050	196	203	209	218	222	229	235
	1,100	221	228	236	246	251	258	265
	Base=1,135	238	246	254	265	270	278	286
	1,200	271	280	289	302	307	316	325
	1,250	296	306	315	329	335	345	355
	1,300	321	331	342	357	363	374	385

Source: CMBIS estimates

Financial summary

Income statement

YE 31 Dec (HK\$ mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Trading fees and tariff	6,339	5,592	6,229	7,364	8,386
Listing fees	1,721	1,633	1,787	1,987	2,147
Clearing & settlement fees	3,281	3,160	3,846	4,621	5,304
Depository & custody fees	979	1,052	1,126	1,204	1,289
Market data fees	899	919	954	1,008	1,067
Net investment income	1,584	2,729	2,148	2,209	2,324
Others	1,064	1,226	1,349	1,483	1,632
Total revenue	15,867	16,311	17,438	19,878	22,147
Staff costs	(2,540)	(2,703)	(2,925)	(3,374)	(3,781)
IT costs	(508)	(580)	(672)	(826)	(987)
Other opex	(1,062)	(765)	(762)	(829)	(880)
Total opex	(4,110)	(4,048)	(4,360)	(5,029)	(5,648)
EBITDA	11,757	12,263	13,079	14,849	16,500
D&A	(762)	(1,044)	(1,169)	(1,310)	(1,414)
Pre-tax profit	10,995	11,219	11,910	13,539	15,086
Taxation	(1,592)	(1,561)	(1,698)	(1,932)	(2,154)
Minority interests	21	1	1	1	1
Net profit	9,312	9,391	10,061	11,448	12,765

Balance sheet

YE 31 Dec (HK\$ mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Cash & Financial assets	217,840	230,794	229,776	242,393	254,966
Fixed assets	1,625	3,955	4,074	4,196	4,322
Goodwill & intangible assets	18,019	18,378	18,562	18,747	18,935
Interest in JV/ assoc.	63	95	105	115	126
Other assets	18,401	25,829	27,895	29,848	32,236
Total assets	255,948	279,051	280,411	295,299	310,585
Margin deposits	123,728	142,536	135,910	138,488	143,702
CP's Clearing Funds	14,787	14,394	14,826	15,715	16,501
Borrowings	1,166	418	418	418	418
Other liabilities	75,364	77,202	81,136	88,824	94,160
Total liabilities	215,045	234,550	232,289	243,445	254,782
Shareholders' fund	40,729	44,173	47,778	51,493	55,423
Minority interest	174	328	344	362	380

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Key market indicators					
Cash equity ADT (HK\$ bn)	107	87	106	128	146
Southbound ADT (HK\$ bn)	12.7	10.8	16.1	18.9	21.2
Northbound ADT (RMB bn)	20.4	41.7	57.3	65.5	75.3
HKEx F&Os ADV ('000)	1,204	1,070	1,135	1,373	1,598
LME commodities ADV ('000)	630	618	655	703	761
Biz segment revenue mix					
Cash	24%	22%	24%	25%	24%
Equity & financial derivatives	22%	18%	18%	19%	19%
Commodities	9%	9%	8%	8%	8%
Post-trade	39%	38%	40%	40%	40%
Others	6%	13%	9%	9%	9%
Total	100%	100%	100%	100%	100%
% of total revenue					
Trading fees and tariff	40%	34%	36%	37%	38%
Listing fees	11%	10%	10%	10%	10%
Clearing and settlement fees	21%	19%	22%	23%	24%
Staff costs	16%	17%	17%	17%	17%
IT costs	3%	4%	4%	4%	4%
Growth, YoY					
Total revenue	20.4%	2.8%	6.9%	14.0%	11.4%
EBITDA	22.3%	4.3%	6.7%	13.5%	11.1%
Net profit	25.8%	0.8%	7.1%	13.8%	11.5%
Efficiency					
Cost-to-income ratio	31%	31%	32%	32%	32%
EBITDA margin	74%	75%	75%	75%	75%
Profitability					
ROE	23.9%	22.1%	21.9%	23.1%	23.9%
ROA	3.2%	3.5%	3.6%	4.0%	4.2%
Per share					
EPS (HK\$)	7.50	7.49	7.94	8.96	9.90
DPS (HK\$)	6.68	6.68	7.12	8.02	8.87
BVPS (HK\$)	32.71	35.28	37.82	40.38	43.07

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIS Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIS

OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US, institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.