

## Hong Kong Exchange & Clearing (388 HK)

### Stamp duty hike impact not significant; current valuation largely reflects strong ADT trend

HKEX reported in-line FY20 net profit of HK\$ 11.5bn, up 23% YoY. But the record high results was overshadowed by HK government's decision to raise stamp duty for stock transaction from 0.1% to 0.13%. We think the stamp duty hike will hit market sentiment in near-term and slow some inflows from cost-sensitive investors in the mid-term, which could reduce HKEX ADT by ~10%, while in the longer run, HKEX's advantages in attracting China-related new economy names and the Connect Scheme is not likely to be materially affected by costs. We revise up our earnings to reflect stronger ADT trend and raise TP to HK\$ 549.0. We **maintain HOLD** as we think current valuation (47x 1-year fwd P/E) is relatively rich.

■ **Our thoughts on stamp duty hike: 1) The stamp duty hike may potentially reduce HKEX ADT by 10% and earnings by 5%, which could happen in mid-term.** HKEX mgmt. estimated that stamp duty accounted for ~30% in total trading costs in HK, therefore a 3bps hike will increase total costs by ~8%. We estimate that ~84% of HKEX's cash equity ADT (mainly local equities trading and Southbound) is exposed to stamp duty (ETFs and DWs/CBBCs/IWs are exempt), and they contributed ~40% of HKEX's revenue. We believe that high-frequency investors are most price sensitive, whose participation accounted for ~10% of ADT according to mgmt. Assuming all these 10% ADT will be affected due to stamp duty increase, this will reduce HKEX's FY21E net profit by 5% based on our estimates, which we believe is not significant. **2) But we think HKEX's core competitiveness of attracting trading on China-related new economy listings and through Connect Scheme is not likely to be materially dampened by trading costs**, as these are HKEX's advantages that are difficult to be copied elsewhere. Even without this stamp duty hike, HK already has one of the highest trading costs among major markets, esp. higher than its major competitors US exchanges and mainland China exchanges. But trading of new economy companies remained active and shares of secondary listing companies kept migrating from the US to HK. The new economy names and the Connect Scheme will continue to effectively bridge the liquidity from mainland to HKEX, in our view. **3) Potential downside risks here include: further stamp duty hike and longer existing period of higher stamp duty.** Historically, the trend of stamp duty in other markets was being cut and finally scraped. If stamp duty remains at a high level in the long run, it will definitely hurt HKEX's market velocity and hurt its attractiveness to global issuers and investors.

#### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Total revenue (HK\$ mn)	16,311	19,190	23,076	26,063	28,841
YoY growth (%)	3	18	20	13	11
Net profit (HK\$ mn)	9,391	11,505	13,761	15,637	17,372
EPS (HK\$)	7.49	9.11	10.85	12.33	13.70
YoY growth (%)	(0)	22	19	14	11
Consensus EPS (HK\$)	N/A	N/A	11.35	12.80	14.4
P/E (x)	68.0	55.9	46.9	41.3	37.1
P/B (x)	14.4	13.1	12.3	11.5	11.3
Yield (%)	1.3	1.6	1.9	2.2	2.4
ROE (%)	22.1	24.7	27.2	29.0	30.8
EBITDA margin (%)	75.2	76.3	75.3	75.3	75.2

Source: Company data, Bloomberg, CMBIS estimates

**HOLD (Maintain)**

Target Price **HK\$ 549.0**  
 (Previous TP **HK\$ 254.0**)  
 Up/Downside **+7.2%**  
 Current Price **HK\$ 509.0**

#### Diversified Financials Sector

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#### Stock Data

Mkt Cap (HK\$ mn)	645,329
Avg 3 mths t/o (HK\$ mn)	2,881.29
52w High/Low (HK\$)	587.0/206.0
Total Issued Shares (mn)	1,268

Source: Bloomberg

#### Shareholding Structure

JPMorgan Chase & Co	8.02%
The Government of HKSAR	5.93%

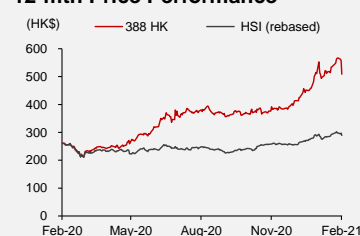
Source: Bloomberg

#### Share Performance

	Absolute	Relative
1-mth	9.3%	5.1%
3-mth	48.4%	28.0%
6-mth	48.2%	21.5%

Source: Bloomberg

#### 12-mth Price Performance

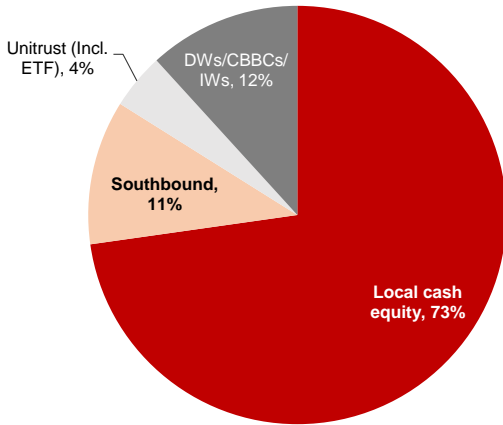


Source: Bloomberg

Auditor: PwC

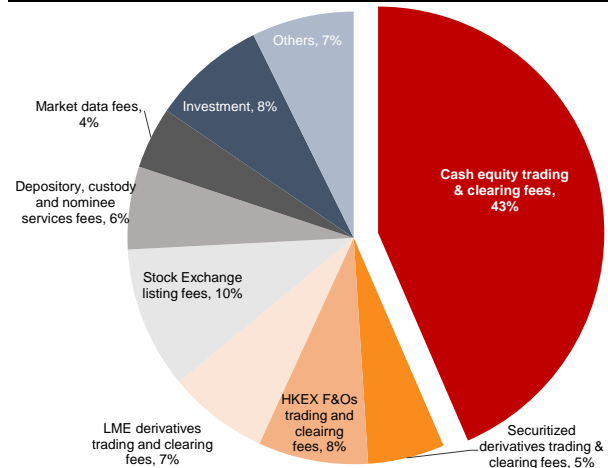
- **4Q20 results recap and implications:** 4Q20 revenue reached HK\$ 5.1bn, 4% lower QoQ due to seasonality. Core revenue (excl. net investment income and other incomes) was down 9% QoQ, as cash equity ADT was stronger (local excl. Southbound ADT +5% QoQ and Southbound ADT +3% QoQ), but was more than offset by weak derivatives. Investment income came in 16% higher QoQ, on higher gains from corp. fund investment and higher margin and CH fund size. On a YoY base, cost-to-income ratio was improved 5.3ppt, showing better operating efficiency.
- **Revise up FY21E-22E earnings and raise TP to HK\$ 549; Maintain HOLD.** We lift our FY21E/22E net profit by 25%/27%, mainly to reflect stronger cash equity ADT and Stock Connect ADT. Our new TP of HK\$ 549.0 is derived from 3-stage DDM, where we lower our COE from 8.3% to 8.0% and other assumptions not changed. HKEX's share price has gained 20% YTD, and traded at >50x recently, vs. post-Connect Era average +2SD of 45x. We think the valuation largely reflected recent strong Southbound and several news from new economy listings. We maintain HOLD on HKEX.

**Figure 1: We expect ~84% of HKEX's FY21E cash equity ADT is subject to stamp duty hike**



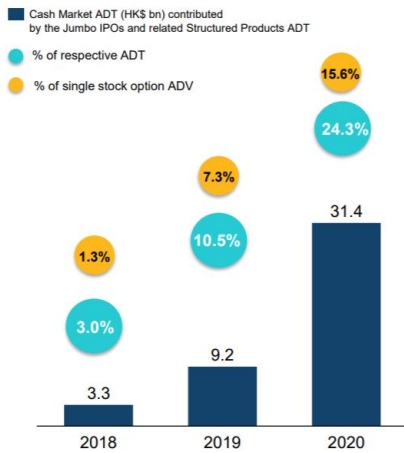
Source: CMBIS estimates

**Figure 2: Trading & clearing fees from equities trading accounted for 43% of HKEX's FY21E revenue**



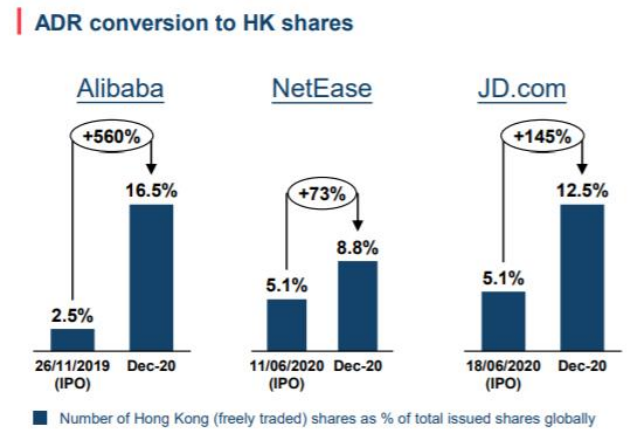
Source: CMBIS estimates

**Figure 3: ADT and ADV contribution of 28 jumbo IPOs (mostly new economy companies) since 2018**



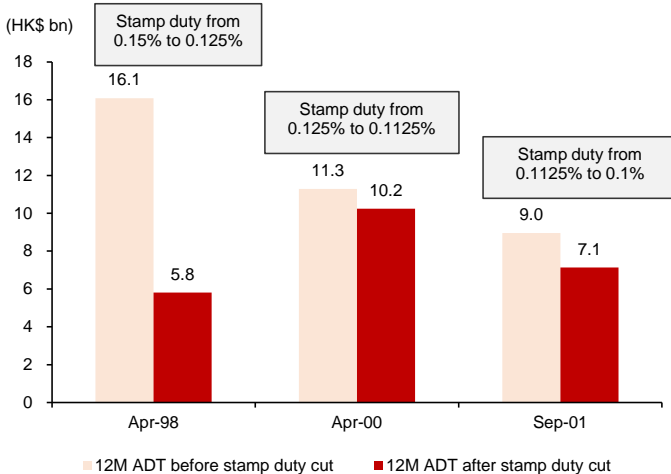
Source: Company data  
Note: Jumbo IPO refers to IPO whose fund raising size was >US\$ 1bn.

**Figure 4: Secondary listing companies saw continuous shares migration from US to HK**



Source: Company data

**Figure 5: Historically, stamp duty cut in HK didn't necessarily boost HKEX cash equity ADT...**



Source: Wind, CMBIS

**Figure 6: ...though situation may be different from 10+ years ago as Algo/Quant accounted for ~10% of ADT**

**Algo / Quant Participation in Cash Market**

**Relatively low**  
(circa. 10-20% of ADT)

Due to...

- Presence of stamp duty
- Minimal high frequency trading
- Single market structure

**Algo / Quant Participation in Derivatives Market**

**Relatively high**  
(circa. 40-60% of ADV)

Driven by...

- No stamp duty
- Market maker participation
- Capital efficiency

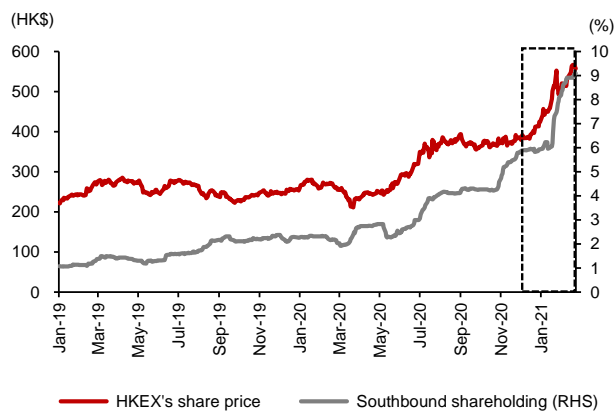
Source: Company data

**Figure 7: HKEX's 1-year forward P/E close to high end in Connect Era**



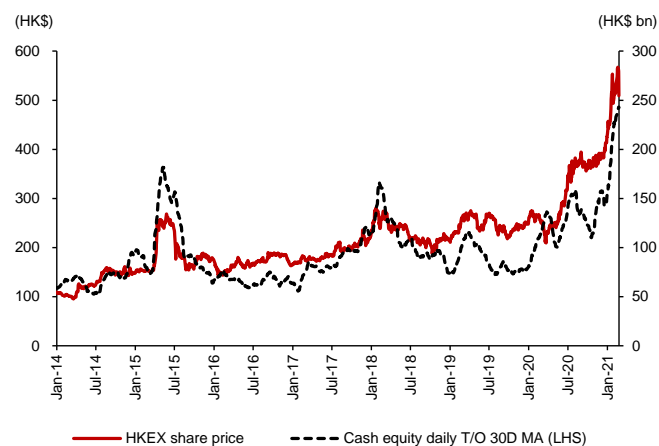
Source: Company data, CMBIS

**Figure 8: The recent rally was greatly fueled by strong Southbound**



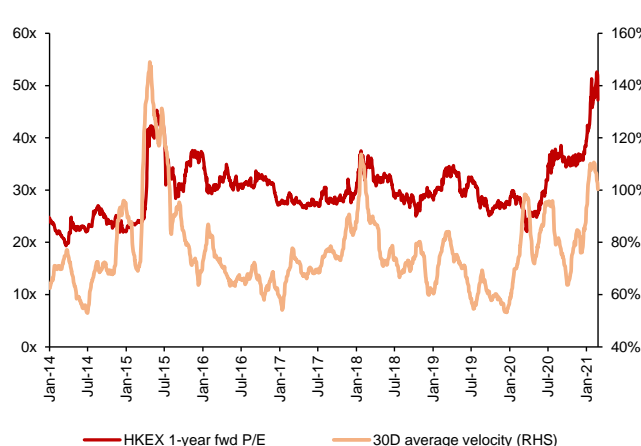
Source: Wind, CMBIS

**Figure 9: HKEX's share price vs. cash equity daily T/O 30D MA**



Source: Bloomberg, Wind, CMBIS

**Figure 10: HKEX's 1-year forward P/E vs. cash equity 30D average velocity**



Source: Wind, CMBIS estimates

Figure 11: HKEX's quarterly results summary

(HK\$ mn)	4Q19	1Q20	2Q20	3Q20	4Q20	QoQ	YoY	FY19	FY20	YoY
<b>I/S</b>										
Trading fees and tariffs	1,283	1,794	1,536	1,915	1,714	-10%	34%	5,592	6,959	24%
Listing fees	392	492	436	499	472	-5%	20%	1,633	1,899	16%
Clearing and settlement fees	728	1,052	938	1,245	1,120	-10%	54%	3,160	4,355	38%
Depository, custody and nominee services fees	201	160	391	378	335	-11%	67%	1,052	1,264	20%
Market data fees	227	237	235	239	242	1%	7%	919	953	4%
Net investment income	573	(47)	885	645	745	16%	30%	2,729	2,228	-18%
Other revenue and incomes	342	321	352	388	471	21%	38%	1,226	1,532	25%
<b>Total revenue</b>	<b>3,746</b>	<b>4,009</b>	<b>4,773</b>	<b>5,309</b>	<b>5,099</b>	<b>-4%</b>	<b>36%</b>	<b>16,311</b>	<b>19,190</b>	<b>18%</b>
Incl. Trading & Clearing fees from Stock Connect	170	319	259	512	395	-23%	132%	699	1,485	112%
% in total Trading & Clearing fees	8%	11%	10%	16%	14%	-2ppt	5ppt	8%	13%	5ppt
Opex	(1,095)	(1,025)	(1,051)	(1,132)	(1,231)	9%	12%	(4,048)	(4,659)	15%
<b>EBITDA</b>	<b>2,651</b>	<b>2,984</b>	<b>3,722</b>	<b>4,177</b>	<b>3,868</b>	<b>-7%</b>	<b>46%</b>	<b>12,263</b>	<b>14,531</b>	<b>18%</b>
D&A	(278)	(274)	(271)	(282)	(370)	31%	33%	(1,044)	(1,197)	15%
<b>Operating profit</b>	<b>2,373</b>	<b>2,710</b>	<b>3,451</b>	<b>3,895</b>	<b>3,498</b>	<b>-10%</b>	<b>47%</b>	<b>11,219</b>	<b>13,334</b>	<b>19%</b>
Finance costs	(48)	(49)	(47)	(43)	(42)	-2%	-13%	(177)	(181)	2%
Shares in associate/JVs	15	19	20	15	15	0%	0%	32	69	116%
<b>Pre-tax profit</b>	<b>2,347</b>	<b>2,680</b>	<b>3,424</b>	<b>3,867</b>	<b>3,471</b>	<b>-10%</b>	<b>48%</b>	<b>10,951</b>	<b>13,332</b>	<b>22%</b>
Taxation	(314)	(422)	(448)	(528)	(447)	-15%	42%	(1,561)	(1,845)	18%
<b>Profit for the period</b>	<b>2,033</b>	<b>2,258</b>	<b>2,976</b>	<b>3,339</b>	<b>3,024</b>	<b>-9%</b>	<b>49%</b>	<b>9,390</b>	<b>11,487</b>	<b>22%</b>
Non-controlling interests	(3)	4	(5)	8	11	38%	-467%	1	18	1700%
<b>Net profit</b>	<b>2,030</b>	<b>2,262</b>	<b>2,971</b>	<b>3,347</b>	<b>3,035</b>	<b>-9%</b>	<b>50%</b>	<b>9,391</b>	<b>11,505</b>	<b>23%</b>
<b>Key ratios</b>										
Cost-to-income ratio	36.7%	32.4%	27.7%	26.6%	31.4%	4.8ppt	-5.3ppt	31.2%	29.9%	-1.3ppt
EBITDA margin	70.8%	74.4%	78.0%	78.7%	75.9%	-2.8ppt	5.1ppt	75.2%	76.3%	1.1ppt
ROE	18.7%	20.8%	26.5%	28.8%	25.6%	-3.2ppt	6.9ppt	22.1%	24.7%	2.6ppt
ROA	3.0%	2.9%	3.7%	4.3%	3.4%	-0.9ppt	0.4ppt	3.5%	3.4%	-0.1ppt
<b>Key drivers</b>										
Headline cash equity ADT (HK\$ bn)	77	121	114	141	141	0%	83%	87	129	49%
Equity excl. Southbound (HK\$ bn)	54	85	81	100	104	5%	93%	58	93	59%
DWs, CBBCs and IWs (HK\$ bn)	13	18	17	21	18	-18%	39%	18	19	3%
Southbound ADT (HK\$ bn)	11.2	21.6	19.5	27.4	28.1	3%	150%	10.8	24.4	126%
Northbound ADT (RMB bn)	40.9	78.0	70.1	117.0	95.3	-18%	133%	41.7	91.3	119%
HKEX F&Os ADV ('000 contracts)	937	1,298	1,048	1,152	1,032	-10%	10%	1,070	1,134	6%
LME commodities ADV ('000 contracts)	614	683	567	525	515	-2%	-16%	618	573	-7%
<b>Segment revenue</b>										
Cash	896	1,162	1,091	1,384	1,354	-2%	51%	3,646	4,991	37%
Equity and financial derivatives	640	898	740	873	730	-16%	14%	2,988	3,241	8%
Commodities	353	403	346	358	347	-3%	-2%	1,399	1,454	4%
Post-trade	1,380	1,752	1,877	2,142	1,866	-13%	35%	6,226	7,637	23%
Technology	220	212	231	219	248	13%	13%	796	910	14%
Corporate items	257	(418)	488	333	554	66%	116%	1,256	957	-24%
<b>Total revenue</b>	<b>3,746</b>	<b>4,009</b>	<b>4,773</b>	<b>5,309</b>	<b>5,099</b>	<b>-4%</b>	<b>36%</b>	<b>16,311</b>	<b>19,190</b>	<b>18%</b>

Source: Company data, CMBIS

Figure 12: Earnings revision

(HK\$ mn)	New		New vs. Old	
	FY21E	FY22E	FY21E	FY22E
<b>I/S</b>				
Trading fees and tariffs	8,932	10,370	28%	31%
Listing fees	2,343	2,606	8%	8%
Clearing and settlement fees	5,847	6,716	36%	36%
Depository, custody & nominee services fees	1,365	1,447	13%	12%
Market data fees	1,017	1,101	-2%	0%
Net investment income	1,886	1,969	-8%	-5%
Other revenue and incomes	1,685	1,854	14%	14%
<b>Total revenue</b>	<b>23,076</b>	<b>26,063</b>	<b>20%</b>	<b>22%</b>
Opex	-5,695	-6,442	17%	18%
<b>EBITDA</b>	<b>17,381</b>	<b>19,621</b>	<b>21%</b>	<b>23%</b>
D&A	-1,332	-1,412	2%	0%
<b>Operating profit</b>	<b>16,049</b>	<b>18,209</b>	<b>23%</b>	<b>26%</b>
<b>Pre-tax profit</b>	<b>15,951</b>	<b>18,128</b>	<b>24%</b>	<b>26%</b>
Taxation	-2,207	-2,509	19%	21%
<b>Net profit</b>	<b>13,761</b>	<b>15,637</b>	<b>25%</b>	<b>27%</b>
<b>Key drivers</b>	<b>FY21E</b>	<b>FY22E</b>	<b>FY21E</b>	<b>FY22E</b>
Cash equity ADT (HK\$ bn)	192	216	57%	55%
Southbound ADT (HK\$ bn)	47	50	116%	115%
Northbound ADT (RMB bn)	115	143	61%	73%
HKEX F&Os ADV ('000 contracts)	1,382	1,728	9%	17%
LME commodities ADV ('000 contracts)	588	616	-13%	-14%

Source: CMBIS estimates

Figure 13: TP sensitivity vs. cash equity ADT

		P/E						
		48x	49x	50x	50.6x	52x	53x	54x
<b>Cash Equity ADT (HKD bn)</b>	160	442	452	461	466	479	488	498
	170	467	477	486	492	506	516	525
	180	492	502	512	518	533	543	553
	Base=192	521	532	543	549	564	575	586
	200	541	552	563	570	586	597	609
	210	566	577	589	596	613	624	636
	220	590	603	615	622	639	652	664

Source: CMBIS estimates

## Financial summary

### Income statement

YE 31 Dec (HK\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Trading fees and tariff	5,592	6,959	8,932	10,370	11,622
Listing fees	1,633	1,899	2,343	2,606	2,853
Clearing & settlement fees	3,160	4,355	5,847	6,716	7,552
Depository & custody fees	1,052	1,264	1,365	1,447	1,534
Market data fees	919	953	1,017	1,101	1,192
Net investment income	2,729	2,228	1,886	1,969	2,049
Others	1,226	1,532	1,685	1,854	2,039
<b>Total revenue</b>	<b>16,311</b>	<b>19,190</b>	<b>23,076</b>	<b>26,063</b>	<b>28,841</b>
Staff costs	(2,703)	(2,967)	(3,591)	(4,082)	(4,546)
IT costs	(580)	(635)	(764)	(862)	(954)
Other opex	(765)	(947)	(1,341)	(1,498)	(1,642)
<b>Total opex</b>	<b>(4,048)</b>	<b>(4,549)</b>	<b>(5,695)</b>	<b>(6,442)</b>	<b>(7,142)</b>
<b>EBITDA</b>	<b>12,263</b>	<b>14,641</b>	<b>17,381</b>	<b>19,621</b>	<b>21,699</b>
D&A	(1,044)	(1,197)	(1,332)	(1,412)	(1,497)
Pre-tax profit	11,219	13,444	16,049	18,209	20,203
Taxation	(1,561)	(1,845)	(2,207)	(2,509)	(2,787)
Minority interests	1	18	18	18	18
<b>Net profit</b>	<b>9,391</b>	<b>11,505</b>	<b>13,761</b>	<b>15,637</b>	<b>17,372</b>

### Balance sheet

YE 31 Dec (HK\$ mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Cash & Financial assets	230,794	329,223	339,350	350,897	365,476
Fixed assets	3,955	3,850	3,810	3,770	3,730
Goodwill & intangible assets	18,378	18,737	18,924	19,114	19,305
Interest in JV/ assoc.	95	164	213	256	307
Other assets	25,829	47,132	51,842	57,023	47,336
<b>Total assets</b>	<b>279,051</b>	<b>399,106</b>	<b>414,140</b>	<b>431,060</b>	<b>436,154</b>
Margin deposits	142,536	187,008	185,054	187,865	193,673
CP's Clearing Funds	14,394	20,439	21,665	22,749	23,886
Borrowings	418	423	423	423	423
Other liabilities	77,202	142,000	154,547	163,822	161,077
<b>Total liabilities</b>	<b>234,550</b>	<b>349,870</b>	<b>361,689</b>	<b>374,858</b>	<b>379,060</b>
<b>Shareholders' fund</b>	<b>44,173</b>	<b>48,918</b>	<b>52,131</b>	<b>55,881</b>	<b>56,773</b>
Minority interest	328	318	320	321	323

### Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Key market indicators</b>					
Cash equity ADT (HK\$ bn)	87	129	192	216	241
Southbound ADT (HK\$ bn)	11	24	47	50	56
Northbound ADT (RMB bn)	42	91	115	143	172
HKEX F&Os ADV ('000)	1,070	1,134	1,382	1,728	1,988
LME commodities ADV ('000)	618	573	588	616	632
<b>Biz segment revenue mix</b>					
Cash	22%	26%	29%	28%	28%
Equity & financial derivatives	18%	17%	17%	19%	20%
Commodities	9%	8%	7%	6%	6%
Post-trade	38%	40%	39%	39%	39%
Others	13%	10%	8%	7%	7%
Total	100%	100%	100%	100%	100%
<b>% of total revenue</b>					
Trading fees and tariff	34%	36%	39%	40%	40%
Listing fees	10%	10%	10%	10%	10%
Clearing and settlement fees	19%	23%	25%	26%	26%
Staff costs	17%	15%	16%	16%	16%
IT costs	4%	3%	3%	3%	3%
<b>Growth, YoY</b>					
Total revenue	2.8%	17.7%	20.3%	12.9%	10.7%
EBITDA	4.3%	19.4%	18.7%	12.9%	10.6%
Net profit	0.8%	22.5%	19.6%	13.6%	11.1%
<b>Efficiency</b>					
Cost-to-income ratio	31.2%	29.9%	30.5%	30.1%	30.0%
EBITDA margin	75.2%	76.3%	75.3%	75.3%	75.2%
<b>Profitability</b>					
ROE	22.1%	24.7%	27.2%	29.0%	30.8%
ROA	3.5%	3.4%	3.4%	3.7%	4.0%
<b>Per share</b>					
EPS (HK\$)	7.49	9.11	10.85	12.33	13.70
DPS (HK\$)	6.68	8.15	9.77	11.10	12.33
BVPS (HK\$)	35.28	38.83	41.37	44.33	45.03

Source: Company data, CMBIS estimates



# Disclosures & Disclaimers

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## 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  
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