

Hong Kong Exchange & Clearing (388 HK)

Potential acquisition of LSEG: Uncertainty prevails

On 11 Sep, HKEx announced a surprising potential acquisition of LSEG (LSE LN, NR) with a consideration of GBP 29.7bn (or HK\$ 287.8bn), but the deal will move forward only if LSEG's takeover of Refinitiv does not happen. We see the potential deal to extensively expand HKEx's global presence, diversify its revenue streams, and connect China with the rest of the world on a broader scope, while uncertainties remain high and deal valuation seems not attractive.

- **Deal valuation and structure:** The consideration implies 42.5x FY19E P/E of LSEG, much higher than its current 36.5x and HKEx's current 29.7x. HKEx will fund the deal by cash (both its own funds and new debt) and new share issuance to current LSEG shareholders (Figure 1), who will hold ~41% in HKEx's enlarged share capital. The newly issued shares of HKEx will seek to float on LSE for secondary listing.
- **Strategic synergies>financial benefits in short-run.** If succeeded, the deal aims to form a world leading market infrastructure operator connecting the East (esp. China) and the West with diversified asset classes. HKEx's revenue structure will be enhanced by LSEG's information services (esp. FTSE Russell Indices) and FICC business, where HKEx currently lacks competitiveness (Figure 2). In addition, the Connect Scheme may further penetrate into the European market. Though the strategic prospects are promising, short-term financial synergies may be limited as 1) earnings will be diluted due to new share issuance, 2) LSEG has relatively lower operating efficiency than HKEx (Figure 4), and 3) HKEx will bear heavier debt burden whilst targeting to maintain a ~90% payout ratio after combination.
- **Challenges ahead. 1) Uncertainties regarding the Refinitiv deal.** It would not be easy to get LSEG to back down this transaction. LSEG stated it would remain "committed to and continue to make good progress" on takeover of Refinitiv. Its stock has also surged 27% since the Refinitiv deal was announced, showing investor's welcome to the transaction. **2) Geopolitical and regulatory uncertainties.** Whether the UK regulators will allow HKEx to acquire its key capital market operator considering national interest would be a big concern, especially amid rising geopolitical upheavals.
- **Valuation.** HKEx currently trades at 29.7x FY19E P/E, equivalent to its 5-yr avg. The market may not react so excitedly as long-term positives may be overshadowed by uncertainty regarding the completion of the transaction.

Earnings Summary

(YE 31 Dec)	FY16A	FY17A	FY18A
Revenue (HK\$ mn)	11,116	13,180	15,867
Net income (HK\$ mn)	5,769	7,404	9,312
EPS (HK\$)	4.76	6.03	7.50
YoY growth (%)	(29)	27	24
P/E (x)	51.7	40.8	32.8
P/B (x)	9.3	8.2	7.5
Yield (%)	1.7	2.2	2.7
ROE (%)	18.6	21.3	23.9
EBITDA margin (%)	68.9	72.9	74.1

Source: Company data, Bloomberg, CMBIS

NOT RATED

Current Price

HK\$246.0

Diversified Financials Sector

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Stock Data

Mkt Cap (HK\$ mn)	309,495
Avg 3 mths t/o (HK\$ mn)	1,225.5
52w High/Low (HK\$)	286.2/195.6
Total Issued Shares (mn)	1,258

Source: Bloomberg

Shareholding Structure

The Government of the Hong Kong Special Administrative Region	5.38%
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Source: HKEx

Share Performance

	Absolute	Relative
1-mth	1.2%	-1.6%
3-mth	-5.0%	-1.8%
6-mth	-8.0%	-2.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

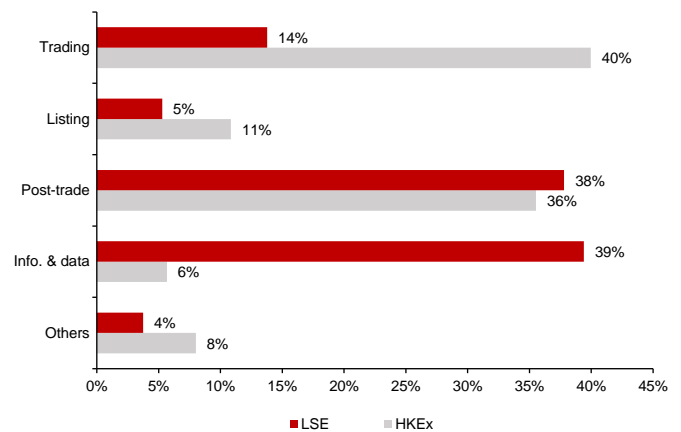
1. "Looking beyond interconnections" – 1 Mar 2019
2. "Nexus between opening-up China capital market and the world" – 20 Jul 2018

Figure 1: Deal structure and valuation

Deal structure	
Each LSEG share to receive:	Cash GBP 2,045 +
	2.495 HKEx new shares
Implied price per share (GBP)*	8,376
No. of LSEG shares issued (mn)	354.5
Total consideration (GBP bn)	29.7
EV	31.7
Valuation	
Implied FY18 P/E	49.0x
Implied FY19E P/E	42.5x
Implied FY18 EV/EBITDA	30.1x
Implied FY19E EV/EBITDA	26.0x

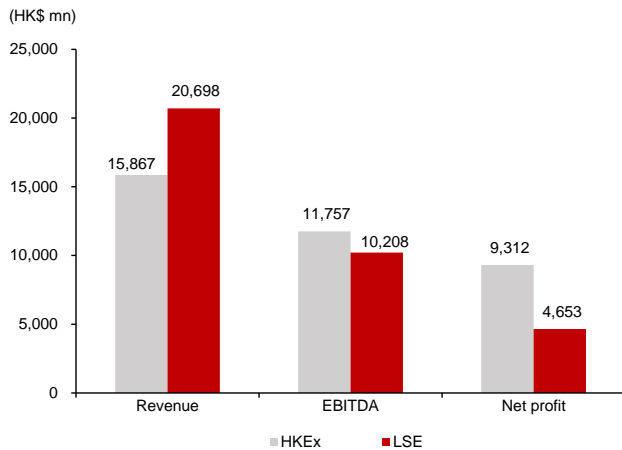
Source: Company data, Bloomberg, CMBIS

* Using HKEx's close price of HK\$ 246.0 on 11 Sep.

Figure 2: FY18 Revenue mix of HKEx and LSEG

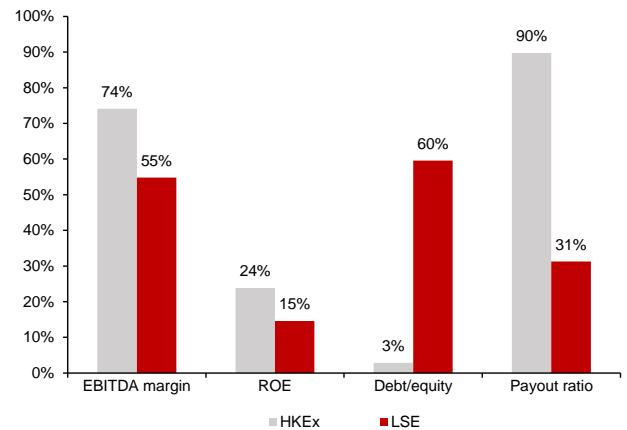
Source: Company data, CMBIS

Note: including reclassification by CMBIS

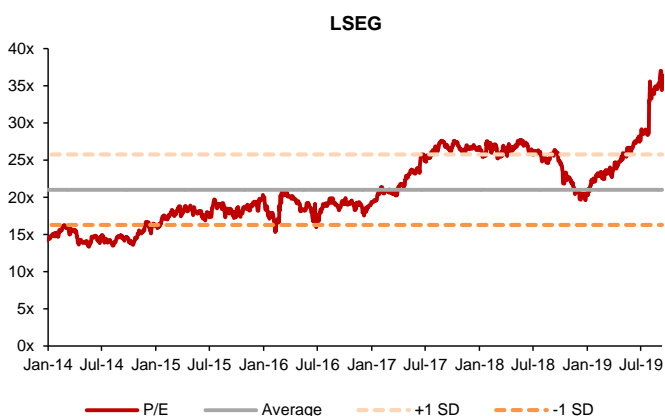
Figure 3: Comparison of certain FY18 financial data of HKEx and LSEG

Source: Company data, CMBIS

Note: Assuming a GBPHKD exchange rate of 9.695.

Figure 4: Comparison of certain FY18 operating indicators of HKEx and LSEG

Source: Company data, CMBIS

Figure 5: 5-yr forward rolling P/E of LSEG

Source: Bloomberg, CMBIS

Figure 6: 5-yr forward rolling P/E of HKEx

Source: Bloomberg, CMBIS

About LSEG

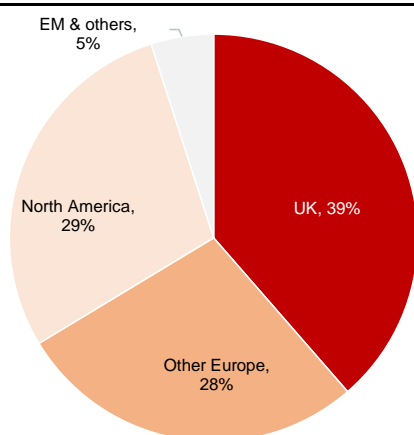
Headquartered in London, LSEG is a leading financial market operator and has a long history that could be traced back to 1698. The Group operates several equities, fixed income and derivatives markets, including LSE, Borsa Italiana, MTS and Truquise. LSEG ranked seventh place in the world in terms of market cap by the end of 2018. Through FTSE Russell, the Group provides financial indexing, benchmarking and analytic services to and has ~US\$ 15tn AUM benchmarked to its indices. The Group also provides post trade services via LCH, CC&G and Monte Titoli, with over 90% market share globally in interest rate swap clearing. The Group has expanded its global footprint throughout North America, Italy, France and Sri Lanka except for its headquarter, with a total of ~4,500 employees.

Figure 7: Business lines of LSEG

Item	Information Services	Post Trade	Capital Market	Technology Services
Business lines	- FTSE Russel: multi-asset index provider - Real time data: on UK and Italian markets - Other information	- Clearing services LCH: OTC Clearing/non-OTC Clearing CC&G and Monte Titoli: Clearing/ Settlement and custody business	-Primary market -Secondary market (equities, fixed income, derivatives, etc.) LSE, Borsa Italiana, MTS and Turquoise	-Software sales, -Network connections, etc.
% in FY18 revenue	39%	38%	19%	4%

Source: Company data, CMBIS

Figure 8: Geographical revenue breakdown of LSEG



Source: Company data, CMBIS

Note: Data as of FY2018.

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