

COMPANY UPDATE

Hong Kong Exchanges and Clearing (388 HK)

Further Valuation Re-rating Requires More Sustainable ADT Uptick Cycle

The increased turnover resulting from policy easing in China and the US rate cuts will improve HKEX's earnings. However, we remain cautious on the extremely high turnovers and the rich valuation (+1.2SD) might have priced in the sharp increase in ADT. We estimate that a 10% ADT increase could lead to a 4.8% EPS growth, but the NII decline will exert downward pressure on earnings. Thus, we see limited room for further valuation re-rating and downgrade HKEX to HOLD. Target price: HK\$355.00.

WHAT'S NEW

- China's latest stimulus measures propelled unprecedented turnover.** Hong Kong Exchanges and Clearing (HKEX) witnessed a sharp increase in average daily turnover (ADT) and the stock exchange ending 3Q24 with a historical high turnover of HK\$505.9b on 30 Sep 24 following the announcement of monetary policy easing by PBOC on 24 Sep 24. Although the stock rally lost momentum yesterday, the Hong Kong stock exchange achieved another milestone with a turnover of HK\$620.4b after the reopening of the A-share market. This led to a share increase in the 20-day moving average (DMA) ADT to HK\$238.2b, vs ytd ADT of HK\$120.4b. The stock connect programme continues to thrive in Sep 24, with 29% and 113% yoy jumps in Northbound and Southbound ADT.
- 3Q24 revenue and net profit growth aided by record-high turnovers in last trading week.** HKEX will report its 3Q24 results on 23 Oct 24 and we expect the exchange operator to register 9.3% core revenue growth in 3Q24, driven by record ADT of HK\$350.3b in the last five trading days of 3Q24, which boosted the ADT for the quarter by 20.7% yoy to HK\$118.8b. However, the revenue and net profit grew at lower rates of 6.8% and 6.0% respectively, mainly dragged by lower net investment income (NII) on falling deposit yield and higher effective tax rate. The derivative and commodities markets' average daily volume (ADV) also grew 10.5% and 17.3% yoy to 1.48m and 0.64m lots.
- Lower Fed rate environment benefits stock market and IPO activity.** Historical data indicates that the turnover and market velocity in the Hong Kong stock market during the previous interest rate cut cycle were higher compared to the interest rate hike cycle. While CME Futures are pricing in 50bp cuts by end-24, we expect the attractiveness of equities will continue to rise and further enhance the overall stock trading volume in Hong Kong. In addition, HKEX witnessed 45 IPO listings ytd, with the IPO fundraising amount of HK\$55.6b surpassing the entire amount in 2023, thanks to the mega-sized listing of Midea, the Chinese home appliance maker which has raised HK\$35.7b in Hong Kong. We believe the IPO recovery momentum will carry on into next year with healthy IPO pipelines (>100 applicants) and the low-rate environment.

KEY FINANCIALS

Year to 31 Dec (HK\$m)	2022	2023	2024F	2025F	2026F
Net turnover	18,280	20,269	21,824	23,513	24,294
EBITDA	13,185	14,828	16,025	17,247	17,585
Operating profit	11,726	13,385	14,632	15,812	16,107
Net profit (rep./act.)	10,078	11,862	12,801	13,610	13,807
Net profit (adj.)	10,078	11,862	12,801	13,610	13,807
EPS (HK\$ cent)	799.1	935.6	1,009.7	1,073.5	1,089.1
PE (x)	42.6	36.4	33.8	31.7	31.3
P/B (x)	8.6	8.4	8.2	8.0	7.8
EV/EBITDA (x)	48.2	43.0	39.7	36.8	36.1
Dividend yield (%)	3.1	3.7	4.0	4.2	4.3
Net margin (%)	55.1	58.5	58.7	57.9	56.8
Net debt/(cash) to equity (%)	(21.5)	(15.9)	(17.5)	(19.2)	(20.9)
ROE (%)	20.3	23.5	24.6	25.6	25.6
Consensus net profit	-	-	12,213	12,970	13,945
UOBKH/Consensus (x)	-	-	1.05	1.05	0.99

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

HOLD

(Downgraded)

Share Price	HK\$340.80
Target Price	HK\$355.00
Upside	+4.2%
(Previous TP)	HK\$300.00

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):	432,078.8
Market cap (US\$m):	55,593.6
3-mth avg daily t'over (US\$m):	350.0

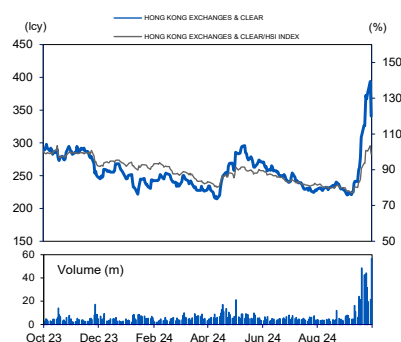
Price Performance (%)

52-week high/low	HK\$397.80/HK\$207.84			
1mth	3mth	6mth	1yr	YTD
48.2	42.1	50.5	18.1	27.2

Major Shareholders

The Government of Hong Kong SAR	5.8
-	-
FY24 NAV/Share (HK\$)	41.48
FY24 Net Cash/Share (HK\$)	7.26

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- Multiple tailwinds do not guarantee sustainability of stock market frenzy.** While the 5DMA ADT reached HK\$376.2b and the total market cap in Hong Kong rocketed 10% w/w to HK\$40.3t as of 7 Oct 24, we believe that such a sharp increase in ADT is unlikely to be sustained in the long run. The turnover velocity reached about 400% on 8 Oct 24, which is significantly higher than the long-term average of 80.7%, surpassing even the levels when China began to lift all pandemic restrictions in 2022. Thus, we expect a normalisation of ADT from the current elevated level to around HK\$150b in 4Q24, mainly due to potential rising geopolitical risks from the upcoming US election.
- Strong share price performance might largely price in skyrocketing turnover.** HKEX's share price has surged 35% in the last two weeks since the PBOC policy easing announcement. Despite the share price plunging 13% yesterday, its valuation has still recovered from the ytd low of 21x 2025F PE to 32x, 1.2SD above its long-term mean of 27.0x. To recap, HKEX traded at 34.0x forward PE on average in 2021 when its annual ADT reached HK\$166b during the period of massive quantitative easing by the Fed. Therefore, we think the current valuation is relatively rich, considering that the ytd ADT was HK\$120b, and we expect the 2024/25 ADT to only reach HK\$124b/HK\$145b. Furthermore, the valuation premium of HKEX against HSI has also risen sharply to 2.3x, surpassing its historical average of 2.0x.
- Can the potential earnings revision justify the rally?** The Bloomberg 2024/25 earnings consensus for HKEX has been revised upwards by 1.0% and 2.2% respectively compared to the previous week and further positive earnings revisions are expected after the 3Q24 results announcement. Our sensitivity analysis shows that a 10% boost in headline ADT could lead to a 4.8% upside in EPS. However, even with this potential increase, the current share price still implies a relatively high valuation of +1.0SD under this scenario. Additionally, the NII decline will become the key earnings headwind in the next two years, as we estimate NII to fall 11%/8% yoy in 2024/25, mainly dragged by the deposit yield decrease.

SENSITIVITY ANALYSIS OF TARGET PRICE TO CHANGES IN ADT

HKEX target price sensitivity	Forward PE				
	-2 SD	-1 SD	Avg	+1 SD	+2 SD
-20%	175	216	257	298	340
-10%	184	228	271	315	358
ADT changes					
Base (HK\$145b)	194	239	285	331	376
10%	203	251	299	347	395
20%	213	263	313	363	413

Source: UOB Kay Hian

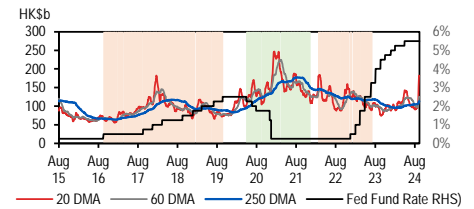
EARNINGS REVISION/RISK

- We raise our 2024-26 earnings forecasts by 6.4%/8.6%/6.0% respectively** after we upgrade our headline ADT estimates for 2024-26 by 10.7%/11.0%/12.5% to HK\$124b/HK\$145b/HK\$155b to reflect a more optimistic ADT outlook amid the Fed easing cycle and the rollout of the stimulus package in China.

VALUATION/RECOMMENDATION

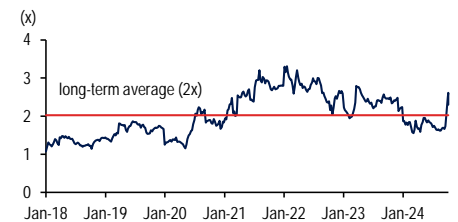
- Downgrade to HOLD but raise our target price to HK\$355.00** to reflect positive earnings adjustment and improved market sentiment. Our target price is derived from the dividend discount model, assuming lower cost of equity of 9.0% (previously: 9.5%) as we lower the risk-free rate to 3.5% (previously: 4.0%). Our target price implies 33.0x 2025F PE, 1.5SD above its long-term average. However, we think further price appreciation from here will require a more sustainable ADT uptick cycle to support the underlying EPS. Hence, we downgrade HKEX to HOLD as we see limited upside at this juncture.

HONG KONG STOCK MARKET ADT TREND UNDER DIFFERENT FED RATE ENVIRONMENT



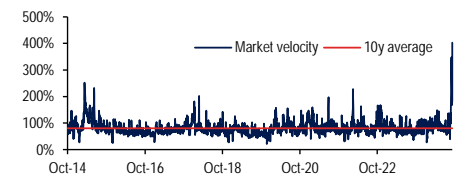
Source: Bloomberg, UOB Kay Hian

HKEX VS HSI VALUATION PREMIUM



Source: Bloomberg, UOB Kay Hian

STOCK MARKET TURNOVER VELOCITY



Source: Bloomberg, UOB Kay Hian

FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

HKEX TRADING REVENUE KEY ASSUMPTIONS

(%)	2024F	2025F	2026F
Cash ADT (HK\$b)	124	145	155
Futures ADV ('000)	809	857	901
Stock Option ADV ('000)	713	767	795
LME ADV ('000)	684	700	734

Source: UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (HK\$m)	2023	2024F	2025F	2026F
Net turnover	20,269	21,824	23,513	24,294
EBITDA	14,828	16,025	17,247	17,585
Deprec. & amort.	1,443	1,393	1,435	1,478
EBIT	13,385	14,632	15,812	16,107
Associate contributions	-53	-35	-42	-41
Pre-tax profit	13,332	14,597	15,771	16,066
Tax	-1,351	-1,693	-2,055	-2,154
Minorities	-119	-103	-106	-106
Net profit	11,862	12,801	13,610	13,807
Net profit (adj.)	11,862	12,801	13,610	13,807

CASH FLOW

Year to 31 Dec (HK\$m)	2023	2024F	2025F	2026F
Operating	11,500	12,311	13,180	14,110
Pre-tax profit	11,294	12,085	12,931	13,836
Other operating cashflows	206	227	249	274
Investing	-6,290	-4,082	-7,426	2,009
Proceeds from sale of assets	-1,460	0	0	0
Others	-4,830	-4,082	-7,426	2,009
Financing	-11,250	-11,089	-12,696	-12,503
Dividend payments	-10,316	-10,662	-11,302	-12,009
Proceeds from borrowings	0	0	-934	0
Others/interest paid	-934	-426.7	-459.47	-494.617
Net cash inflow (outflow)	-6,040	-2,859	-6,942	3,616
Beginning cash & cash equivalent	15,258	9,212	6,353	-590
Changes due to forex impact	-6	0	0	0
Ending cash & cash equivalent	10,286	11,315	12,446	13,691

BALANCE SHEET

Year to 31 Dec (HK\$m)	2023	2024F	2025F	2026F
Fixed assets	1,553	1,708	1,879	2,067
Other LT assets	23,424	22,226	23,402	24,645
Cash/ST investment	10,286	11,315	12,446	13,691
Other current assets	305,916	380,891	397,880	399,642
Total assets	341,179	416,140	435,607	440,045
ST debt	719	714	720	727
Other current liabilities	285,792	359,470	377,543	380,565
LT debt	1,399	1,399	1,399	1,399
Other LT liabilities	1,473	1,484	1,497	1,510
Shareholders' equity	51,344	52,576	53,901	55,242
Minority interest	452	497	547	602
Total liabilities & equity	341,179	416,140	435,607	440,045

KEY METRICS

Year to 31 Dec (%)	2023	2024F	2025F	2026F
Profitability				
EBITDA margin	73.2	73.4	73.4	72.4
Pre-tax margin	65.8	66.9	67.1	66.1
Net margin	58.5	58.7	57.9	56.8
ROA	3.2	3.4	3.2	3.2
ROE	23.5	24.6	25.6	25.6
Growth				
Turnover	10.9	7.7	7.7	3.3
EBITDA	12.5	8.1	7.6	2.0
Pre-tax profit	14.3	9.5	8.0	1.9
Net profit	17.7	7.9	6.3	1.4
Net profit (adj.)	17.7	7.9	6.3	1.4
EPS	17.1	7.9	6.3	1.5
Leverage				
Debt to total capital	4.1	4.0	3.9	3.8
Debt to equity	4.1	4.0	3.9	3.8
Net debt/(cash) to equity	-15.9	-17.5	-19.2	-21.0

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