

Hong Kong Exchanges and Clearing----- Maintain UNDERPERFORM

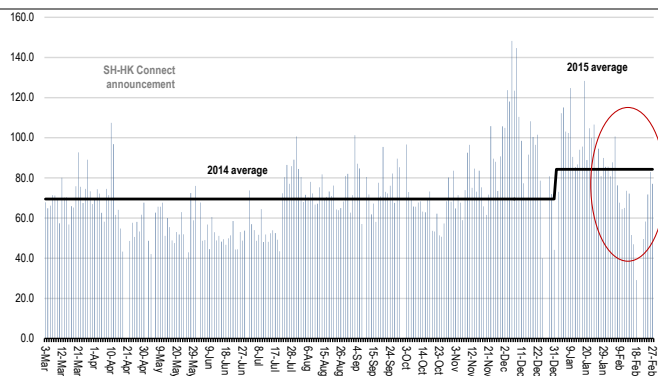
2014 result in line; but recent volumes weaker

EPS: ▼ TP: ◀▶

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- HKEx reported an FY14 NPAT of HK\$5,165 mn, up 13% YoY, around 1.5% above CS's estimate, with slight beat mainly from higher clearing and settlement fees in 4Q14. HKEx declared a final dividend of HK\$2.15 per share. However, we downgrade our earnings by 2-3%, given the recent weaker volume momentum.
- **Key highlights:** The better-than-expected 4Q14 result was due to higher clearing and settlement fees, due to: (1) Reduction in average transaction size, leading to more clearing transactions being subject to a minimum fee, (2) start of LME Clear, generating HK\$187 mn in clearing fees since September 2014
- **Key catalysts:** Recent activity has been weak, with ADT at HK\$68 bn this past week, relative to HK\$69 mn for February 2015, HK\$97 bn for January 15, and our 2015 forecast of HK\$80 bn. But note that weaker volumes may be more temporary due to the CNY effect.
- Our target price is unchanged at HK\$150. HKEx is trading at 30x 2015 earnings (relative to the 10-year average 25x), with lower volumes assumption (FY15 ADT HK\$80 bn).

Figure 1: Volumes weakened recently, but note CNY impact
HKEx daily turnover (HK\$ bn)



Source: Company data, Credit Suisse estimates

We assume an average daily turnover of HK\$80 bn for 2015E, and HK\$84 bn for 2016E. Sensitivity valuation to volumes and trading multiples highlighted below:

Bbg/RIC	388 HK / 0388.HK	Price (05 Mar 15, HK\$)	175.80		
Rating (prev. rating)	U (U)	TP (prev. TP HK\$)	150.00 (150.00)		
Shares outstanding (mn)	1,168.31	Est. pot. % chg. to TP	(15)		
Daily trad vol - 6m avg (mn)	6.7	52-wk range (HK\$)	187.1 - 113.2		
Daily trad val - 6m avg (US\$ mn)	150.5	Mkt cap (HK\$/US\$ bn)	205.4/ 26.5		
Free float (%)	94.2	Performance			
Major shareholders	HK SAR 5.8%	Absolute (%)	1M (1.6) 3M (1.2) 12M (46.9)		
		Relative (%)	(0.1) (2.0) 39.7		
Year	12/13A	12/14A	12/15E	12/16E	12/17E
Revenue (HK\$ bn)	8.7	9.7	12.1	13.7	15.2
EBITDA (HK\$ bn)	5.7	6.6	8.5	9.7	10.7
Net profit (HK\$ bn)	4.6	5.2	6.7	7.6	8.4
EPS (HK\$)	3.94	4.43	5.71	6.46	7.14
- Change from prev. EPS (%)	n.a.	n.a.	(2)	(3)	(3)
- Consensus EPS (HK\$)	n.a.	n.a.	5.8	6.6	13.1
EPS growth (%)	(0.8)	12.4	28.9	13.1	10.5
P/E (x)	44.6	39.7	30.8	27.2	24.6
Dividend yield (%)	2.0	2.3	2.9	3.3	3.7
EV/EBITDA (x)	36.2	29.3	22.4	19.6	17.6
P/B (x)	10.0	9.6	8.6	7.9	7.2
ROE (%)	23.9	24.8	29.7	30.3	30.6
Net debt(cash)/equity (%)	2.5	(64.1)	(58.5)	(57.7)	(56.6)

Note 1: ORD/ADR=1.00. Note 2: Hong Kong Exchanges and Clearing Limited (HKEx) owns and operates the stock exchange and futures exchange in Hong Kong and their related clearing houses. It also owns the London Metal Exchange, the main global exchange for industrial metals.

Volumes weak recently, but note CNY impact

While there is no doubt the long-term growth profile of HKEx is very strong, we highlight that the nearer term fortunes of the stock are more market volume related. Around 60% of HKEx's revenues are related to the value of trades in its equities and derivative markets and a further 10% come from listing fees (>50% from capital raisings).

We highlight that average daily turnover (ADT) remained weak recently at HK\$68 bn (see Fig 1), behind HK\$69 mn for February 2015, HK\$97 bn for January 2015, and our 2015 forecast of HK\$80 bn. But note that weaker volumes may be more temporary due to the CNY effect.

Figure 2: Valuation sensitivity to ADT and PE multiple

HKEx valuation sensitivity to average daily volumes (HK\$ bn) and PE multiple (x)

PE (x)	65	70	75	80	85	90	95
19x	-44%	-42%	-40%	-39%	-35%	-33%	-31%
21x	-38%	-36%	-33%	-32%	-28%	-26%	-24%
23x	-32%	-29%	-27%	-26%	-21%	-19%	-16%
25x	-26%	-23%	-20%	-19%	-15%	-12%	-9%
27x	-20%	-17%	-14%	-13%	-8%	-5%	-2%
29x	-14%	-11%	-8%	-7%	-1%	2%	5%
31x	-8%	-5%	-1%	0%	6%	9%	13%
33x	-2%	1%	5%	6%	13%	16%	20%
35x	4%	7%	11%	13%	20%	23%	27%
37x	9%	14%	18%	19%	26%	30%	34%

Source: Company data, Credit Suisse estimates

P/E multiple likely to come under pressure

HKEx is now trading at a 20% premium to its longer-term average P/E multiple of 25x. It is currently trading at a 172% premium to the HSI, relative to its longer-term average of 114%.

It is also trading at a significant premium to global exchanges.

Figure 3: HKEx premium to Asian/Global exchanges

	SGX	Bursa	ASX	JPX	NZX	LSE	NASDAQ	CME
	SGXL.SI	BMYS.KL	ASX.AX	8697.T	NZX.NZ	LSE.L	NDAQ	CME
PE (x)	23.4x	19.9x	19.9x	23.2x	17.4x	17.1x	15.3x	25.5x
HKEx premium	33%	56%	56%	34%	78%	81%	103%	22%

Source: Company data, Credit Suisse estimates

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ASX (ASX.AX, A\$41.8)
Bursa Malaysia (BMYS.KL, RM8.31)
CME Group Inc. (CME.OQ, \$96.49)
Hong Kong Exchanges and Clearing (0388.HK, HK\$175.8, UNDERPERFORM, TP HK\$150.0)
Japan Exchange Group (8697.T, ¥3,335)
London Stock Exchange (LSE.L, 2400.0p)
NASDAQ OMX Group Inc. (NDAQ.OQ, \$51.02)
NZX (NZX.NZ, NZ\$1.14)
Singapore Exchange (SGXL.SI, S\$8.01)

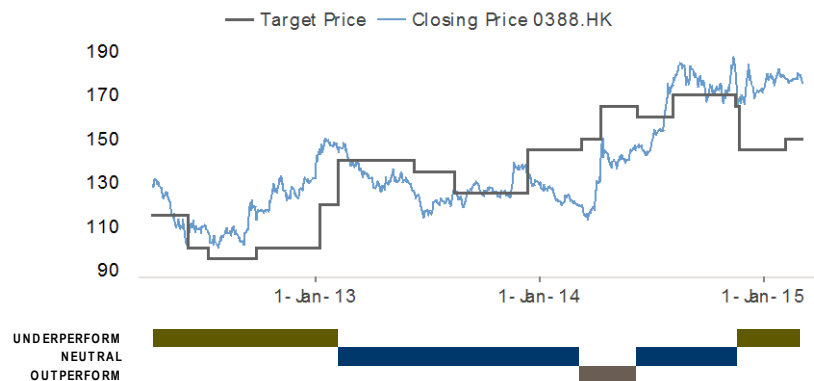
Disclosure Appendix

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3-Year Price and Rating History for Hong Kong Exchanges and Clearing (0388.HK)

0388.HK Date	Closing Price (HK\$)	Target Price (HK\$)	Rating
10-Apr-12	128.50	115.00	U
07-Jun-12	108.40	100.00	
09-Jul-12	107.70	95.00	
26-Sep-12	113.10	100.00	
08-Jan-13	143.10	120.00	
07-Feb-13	144.00	140.00	N
10-Jun-13	126.20	135.00	
15-Aug-13	126.50	125.00	
12-Dec-13	133.00	145.00	
10-Mar-14	119.00	150.00	O
10-Apr-14	130.90	165.00	
10-Jun-14	146.90	160.00	N
06-Aug-14	174.50	170.00	
17-Nov-14	178.10	165.00	
23-Nov-14	167.10	145.00	U
06-Feb-15	177.70	150.00	



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Method: Our 12-month target price of HK\$150 for Hong Kong Exchanges and Clearing is derived a sum-of-the parts valuation methodology, which averages out to an average 12-month P/E (price-to-earnings) of 33x (above its 25x long term historical average), given potential upside from HK-SH connect.

Risk: The primary risk to our 12-month target price of HK\$150 for Hong Kong Exchanges and Clearing is a downturn in securities and derivatives market volumes and duration of the decline, due to a general economic downturn in Asia or China, which might negatively affect equities' market sentiment. HKEx also faces competition from its peers, in terms of attracting new companies to list in respective Exchanges and products offered, which would directly affect its revenue.

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