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As SGX Outlook Remains Cloudy, Hong Kong Exchange Gains Favor

Shares of Singapore Exchange which operates the country's stock market, have lost almost half their value in the past six months, far more than the broader Singapore market. Yet many analysts aren't convinced the days of going downward are over. They are advising investors to trim their holdings, contending that the global economic slowdown is likely to further erode trading volume on the Singapore market and slow the flow of foreign listings that are needed to broaden the exchange's appeal.

Last year, at its peak, the Singapore exchange averaged more than S\$4 billion (US\$2.9 billion) a day in trades. Now, the value of daily trading typically ranges between S\$1.4 billion and S\$1.9 billion. The stock price of SGX -- as the company is known -- gained 15% during April, capped by a rise of 1.5% on Wednesday to S\$8.59. Still, the stock has fallen 36% this year and is 50% below its 52-week high of S\$17.20, reached interday on Oct. 8. So far in 2008, the Straits Times Index has fallen 9.2%.

"Deciding on the level at which to buy SGX feels much like an attempt to catch the proverbial [falling] knife," Andrew Maule of Merrill Lynch wrote in mid-April. He has a "sell" on the stock and a 12-month target price of S\$5, or 42% below Wednesday's close.

Ng Wee Siang of BNP Paribas Securities also has a sell rating, with a 12-month target of S\$5.70. Some analysts say that at least in the short term, shares of Hong Kong Exchanges & Clearing, the SGX's bigger rival among regional stock markets, might offer better value for those wanting exposure to an Asian stock exchange.

Among listed stock-exchange managers, HKEx is Asia's largest by market capitalization, SGX is next, while ASX, which runs the Australian stock exchange, is third. According to Thomson One Analytics, HKEx's market capitalization is estimated at US\$22.3 billion, while SGX is at US\$6.7 billion and ASX at US\$5.7 billion.

Although HKEx shares have also slipped this year -- the stock is down 28% so far -- BNP Paribas forecasts that its return on equity, a profitability measure relative to the company's capital base, will top that of the Singapore company this year. The French firm forecasts that SGX's ROE will be 51%, while HKEx's will reach 83%. According to Thomson One Analytics, shares of SGX are trading at a projected price/earnings ratio of 20.14 times for 2008, lower than HKEx's P/E of 26.18, and in line with the average of its other global peers including NYSE Euronext and Nasdaq OMX Group.

About 50% of SGX's revenue comes from fees for share-trading and listing fees from Singapore-based companies. An additional 25% is from the listing fees paid by foreign companies, cross-border real-estate investment trusts, or REITs, and exchange-traded funds. The remaining one-quarter comes from fees on the trading of derivatives, such as options and contracts.

Analysts say the growth in the derivatives segment is helping to offset some of the weakness in the securities market. SGX has tried to win Chinese listings but hasn't had great success. It has attracted dozens of such listings but not the type of huge issues that have boosted Hong Kong's market.

In 2006, 24 of Singapore's 63 new listings were by Chinese companies. Last year, they accounted for 31 of 66 new listings. In the first quarter of 2008, the Singapore Exchange attracted 11 listings, of which four were by mainland Chinese companies.

SGX's chief executive, Hsieh Fu Wah, says he expects listings from China to slow in 2008. Analysts say that current market conditions -- slowing share offerings world-wide -- make it unlikely that SGX will be able to match the 2007 listing numbers.

"They might be able to get 40 new listings this year, of which 35%-40% might be Chinese," says Anand Pathmakanthan, based in Malaysia for Nomura Securities. He has a sell rating on SGX shares with a 12-month target price of S\$7.

Paul Lee of Tai Fook Research in Hong Kong says the Singapore Exchange hasn't been able to attract the big Chinese oil and bank companies that will draw investors, especially from the cash-rich Middle East, who can help maintain volumes when Asian or Western economies slow. Middle East investors "will invest only in well-known Chinese companies and they are listed only in Hong Kong," he says.

For its third quarter ended March 31, SGX reported a net profit of S\$101.5 million, its smallest profit in four quarters. Net profit was down 17% from the second quarter. Year-to-year, earnings rose 14%, thanks to an increase in revenue from derivatives transactions that offset a slight drop in securities market revenue.

Revenue in the quarter rose 10% to S\$173.3 million from S\$157.3 million the year earlier. Citigroup expects SGX's net profit to rise 43% to S\$445 million in the fiscal year that will end June 30 but expects earnings to drop 24% in the next financial year to S\$337 million.

Still, a few analysts are upbeat about SGX's long-term prospects; they point to the company's efforts to cut costs, introduce new derivative instruments and enter into alliances with other stock markets. That will "lower revenue volatility, while broadening its product and geographical focus," suggests Harsh Wardhan Modi, an analyst at J.P. Morgan who has a "buy" rating on the stock with a 12-month target price of S\$10, or 16% above Wednesday's close.

SGX recently acquired the Singapore Commodities Exchange to further develop its commodities trading platform. The company also has cooperation pacts with exchanges such as the Taiwan Futures Exchange, the Ho Chi Minh City Securities Trading Center and the Abu Dhabi Securities Market, which analysts say will help SGX broaden its revenue base in the long term.

- P R Venkat, Wall Street Journal