

Last Closing: HK\$175.8

Upside: +11.09%

Target Price: HK\$195.3 →

Non-bank Financial Sector

## HKEx (388.HK)

### LME's contribution to increase substantially in 2015E

#### Financial Highlights

Y/E 31 Dec (HK\$m)	2013	2014	2015E	2016E	2017E
Total revenue	8,723	9,849	12,227	13,722	15,181
YoY growth (%)	21.0%	12.9%	24.1%	12.2%	10.6%
Operating income	5,439	6,244	8,224	9,323	10,408
YoY growth (%)	6.7%	14.8%	31.7%	13.4%	11.6%
Net Profit attr. to shareholders	4,552	5,165	6,839	7,783	8,791
YoY growth (%)	11.5%	13.5%	32.4%	13.8%	13.0%
EPS (HK\$)	3.92	4.45	5.89	6.70	7.57
P/E	44.8	39.5	29.8	26.2	23.2
P/B	9.9	9.6	8.7	8.1	7.6
Dividend yield (%)	2.00%	2.27%	3.02%	3.43%	3.88%

Source: Company, BOCOM Int'l estimates

- Earnings slightly beat market consensus.** Profit attributable to shareholders was HK\$5,165mn for full-year 2014, up by 13.5% YoY, slightly beating market consensus by 1.2% and our estimate by 3.3%, mainly driven by higher-than-expected clearing and settlement fees and other revenues from the launch of LME Clear. Net profit for 14Q4 was HK\$1,511mn, up by 47.6% YoY and 17.4% QoQ. As shown by the breakdown of earnings growth drivers, market-driven revenues (including trading fees, clearing and settlement fees, and depository, custody and nominee services fees) contributed a total of 8.2 ppts, with listing fees 1.0 ppt, net investment income 1.4 ppts, and operating expenses 1.9 ppts, while the growth was partly offset by the increased effective tax rate (-2.1%). Effective tax rate for 2014 was 14.9%, up by 1.6 ppts YoY. Taxation dropped in the same period of 2013 due to an one-off deferred tax credit arising from the reduction of the corporate tax rate in the UK. Operating expenses (excl. depreciation and amortization) grew by 6.5%. Cost-to-income ratio for 2014 was 36.6%, 1.0 ppt lower than that of 2013. EBITDA margin for 2014 was 70.0%, 1.2 ppts higher than that of 2013, as the growth rate of revenue outpaced that of the operating expenses.

- Market indicators performed strongly in 2014. Listing fees stayed stable despite the total funds raised hitting record high. Net investment return dropped YoY.** ADT on the stock exchange was HK\$69.5bn, up by 11.0% YoY. The average daily number of derivatives contracts traded on the Futures Exchange dropped by 3.1%, while the average daily number of stock options contracts traded increased by 21.1%. HKEx ranked second globally in IPOs with total equity funds raised of HK\$232.5 billion, up by 37.6% YoY. Total funds raised of HK\$942.7 billion represents a record for HKEx, which was up by 148.8%. Total funds raised included the amount of consideration shares (equivalent to HK\$223.5bn) issued by Citic Pacific (00267.HK) to acquire the parent company in August. Compared with the volatile change in equity financing amount, HKEx's listing fees were relatively stable. The quarterly listing fees have stayed within the range of HK\$200-300mn since 09Q2. Net investment return for



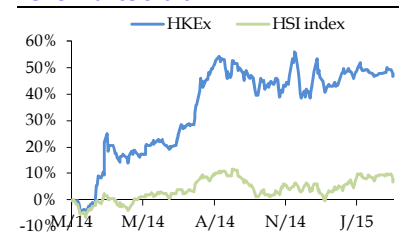
- Profit attributable to shareholders was HK\$5,165mn for full-year 2014, up by 13.5% YoY, slightly beating market consensus by 1.2% and our estimate by 3.3%, mainly driven by higher-than-expected clearing and settlement fees and other revenues from the launch of LME Clear.
- Based on our calculation, LME contributed 16.0% to total revenue in 2014, and we estimate the percentage to increase to 21.3% in 2015E, of which 7.0% will come from LME Clear.
- Of the HK\$68mn revenue generated from the Stock Connect in 2014, HK\$48mn was one-off revenue, and the rest was from revenue sharing with SH Stock Exchange based on trading turnover.
- Maintain LT-Buy rating and TP of HK\$195.3.

#### Stock data

52w High	189.00
52w Low	112.80
Market cap (HK\$bn)	205.4
Issued shares (m)	1,168
Avg daily vol (m)	5
1-mth change (%)	-1.24
YTD change (%)	2.39
50d MA	176.78
200d MA	168.74
14-day RSI	48.37

Source: Company data, Bloomberg

#### Performance chart



Source: Company data, Bloomberg

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2014 was 0.84%, 20bps lower compared with that of 2013, mainly due to the fact that LME Clear's Margin Funds are only allowed to be invested in overnight investments with very low investment yields.

- **LME is expected to contribute over 20% of total revenue and we estimate LME Clear to account for around 7% of total revenue for 2015E. Average daily volume of metals contracts traded on LME was 700,204 lots, up by 3.5% YoY.** The growth rate was 3.2 ppts lower than that of last year. LME Clear was launched on 22 September 2014, and it generated HK\$187mn clearing fees after its launch. As part of the LME commercialization plan, LME announced its new trading fees in September 2014, which took effect from 1 January 2015. According to the new fee schedule, the average LME transaction fee will increase by 34%. Based on our calculation, LME contributed 16.0% to total revenue in 2014, and we estimate the percentage to increase to 21.3% in 2015E, of which 7.0% will come from LME Clear. According to the results briefing, LME's EBITDA margin is expected to reach mid-60% (or the upper 60%) from currently 55% in the long term.
- **We estimate the increase in trading turnover through the SH-HK Stock Connect will likely be gradual and slow.** Shanghai-Hong Kong Stock Connect was launched on 17 November 2014. From the launch day to the end of December 2014, the average daily trading turnovers of Northbound Trading and Southbound Trading were RMB5,584mn and HK\$929mn, respectively. In January 2015, the percentage of quota used for Southbound trading increased to the range of 5-10%, compared with 0-5% in November and December 2014, but it returned to the range of 0-5% in February 2015. The percentage of quota used for Northbound trading also dropped in February 2015. Given the narrowing valuation gap and time needed for investors to become familiar with new markets, the increase in trading turnover through the SH-HK Stock Connect will likely be gradual and slow. The total revenue and other income generated by the Stock Connect during 2014 was approximately HK\$68mn. According to the results briefing, of the HK\$68mn, HK\$48mn was one-off revenue, and the rest was from revenue sharing with SH Stock Exchange based on trading turnover.
- **Maintain LT-Buy.** We mainly revise upward our estimates on LME Clear and raise our 15/16E earnings estimates by 14.6%/6.7%. Our new forecasts point to +32.4%/+13.8% earnings growth in 15E/16E. The counter is trading at 29.8x 15E P/E or 8.7x 15E P/B (convertible bonds converted into equity are not considered). We believe the substantial increase of LME's contribution in 2015E has been priced in. Maintain LT-Buy rating and TP of HK\$195.3.

Figure 1: Results review

(HK\$m)	2013	2014	YoY%	13Q4	14Q1	14Q2	14Q3	14Q4	YoY%	QoQ%
Revenue										
Trading fees and trading tariff	3,509	3,760	7.2%	860	938	827	956	1,039	20.8%	8.7%
Stock Exchange listing fees	1,016	1,102	8.5%	279	299	242	279	282	1.1%	1.1%
Clearing and settlement fees	1,631	1,998	22.5%	406	453	390	476	679	67.2%	42.6%
Depository, custody and nominee service fees	629	725	15.3%	106	92	287	218	128	20.8%	-41.3%
Market data fees	737	769	4.3%	186	201	181	194	193	3.8%	-0.5%
Other revenue	609	773	26.9%	161	189	164	172	248	54.0%	44.2%
Revenue and turnover	8,131	9,127	12.2%	1,998	2,172	2,091	2,295	2,569	28.6%	11.9%
Net investment income	581	707	21.7%	148	163	186	185	173	16.9%	-6.5%
Other income	11	15	36.4%	3	0	9	-9	15		
Total revenue	8,723	9,849	12.9%	2,149	2,335	2,286	2,471	2,757	28.3%	11.6%
Operating expenses	2,777	2,958	6.5%	759	734	689	753	782	3.0%	3.9%
Staff costs and related expenses	1,495	1,716	14.8%	376	411	411	444	450	19.7%	1.4%
Information technology and computer maintenance expenses	549	510	-7.1%	163	136	125	114	135	-17.2%	18.4%
Premises expenses	302	294	-2.6%	78	72	73	75	74	-5.1%	-1.3%
Product marketing and promotion expenses	29	53	82.8%	10	6	12	5	30	200.0%	500.0%
Legal and professional fees	146	175	19.9%	50	47	56	43	29	-42.0%	-32.6%
Depreciation	507	647	27.6%	155	164	160	157	166	7.1%	5.7%
Other operating expenses	256	210	-18.0%	82	62	12	72	64	-22.0%	-11.1%
Total operating expenses	3,284	3,605	9.8%	914	898	849	910	948	3.7%	4.2%
Profit before tax	5,246	6,038	15.1%	1,186	1,383	1,388	1,504	1,763	48.7%	17.2%
Taxation	-700	-900	28.6%	-168	-212	-205	-223	-260	54.8%	16.6%
Profit for the year	4,546	5,138	13.0%	1,018	1,171	1,183	1,281	1,503	47.6%	17.3%
Net Profit attributable to shareholders	4,552	5,165	13.5%	1,024	1,178	1,189	1,287	1,511	47.6%	17.4%

Source: BOCOM Int'l

Figure 2: Updated earnings forecasts

	2015E			2016E		
	Previous	Current	Chng%	Previous	Current	Chng%
Trading fees and trading tariff	4,036	4,582	13.5%	5,195	5,150	-0.9%
Stock Exchange listing fees	1,253	1,143	-8.8%	1,323	1,218	-8.0%
Clearing and settlement fees	2,678	3,116	16.4%	3,086	3,577	15.9%
Depository, custody and nominee services fees	855	841	-1.7%	1,009	992	-1.7%
Market data fees	820	807	-1.6%	886	856	-3.4%
Revenue and turnover	10,434	11,392	9.2%	12,386	12,820	3.5%
Net investment income	790	836	5.8%	825	902	9.3%
Total revenue	11,224	12,227	8.9%	13,211	13,722	3.9%
Staff costs and related expenses	1,962	2,062	5.1%	2,329	2,410	3.5%
Operating expenses	4,021	4,003	-0.4%	4,458	4,399	-1.3%
Operating income	7,202	8,224	14.2%	8,753	9,323	6.5%
PBT	7,002	8,038	14.8%	8,563	9,146	6.8%
Net profit attr to shareholders	5,966	6,839	14.6%	7,296	7,783	6.7%
EPS	5.14	5.89	14.6%	6.28	6.70	6.7%
	Previous	Current	Chng%	Previous	Current	Chng%
ADT (HK\$billion)	79.9	79.9	0.0%	94.3	94.3	0.0%
Avg. daily trading number of derivatives ('000 contracts)	609.2	609.2	0.0%	657.9	657.9	0.0%
# of New listings	134.0	124.0	-7.5%	145.0	135.0	-6.9%
Equity funds raised (HK\$billion)	655.0	659.9	0.7%	694.3	699.5	0.7%
			ppts			ppts
Cost-to-income ratio	35.8%	32.7%	-3.1%	33.7%	32.1%	-1.7%
Staff costs/Rev. and turnover	18.8%	18.1%	-0.7%	18.8%	18.8%	0.0%
Effective tax rate	14.8%	14.9%	0.1%	14.8%	14.9%	0.1%

Source: BOCOM Int'l; note: LME consolidated

## Company background

HKEx owns and operates the stock exchange, futures exchange, and their related clearing houses in Hong Kong. The Company provides the trading platforms for a range of cash and derivatives products and the facilities for processing trades.

### HKEx (388.HK) : Financial Statements

#### Balance sheet (HK\$m)

	2013	2014	2015E	2016E	2017E
<b>Assets</b>					
Fixed assets	1,776	1,626	1,635	1,622	1,564
Financial assets	54,400	209,720	219,579	227,450	235,611
Accounts receivable/prepayments/deposits	10,946	22,523	23,649	24,359	25,089
Goodwill and Other assets	18,821	17,991	18,357	18,724	19,097
<b>Total assets</b>	<b>85,943</b>	<b>251,860</b>	<b>263,220</b>	<b>272,155</b>	<b>281,361</b>
<b>Liabilities</b>					
Financial liabilities	43,683	198,590	207,649	215,053	222,903
Accounts payable/accruals/other liabilities	12,834	22,849	22,849	22,621	22,168
Deferred revenue	593	646	672	699	727
Taxation payable	379	348	401	486	460
Other liabilities	7,936	8,068	8,088	8,109	8,129
<b>Total liabilities</b>	<b>65,425</b>	<b>230,501</b>	<b>239,660</b>	<b>246,967</b>	<b>254,387</b>
<b>Equity</b>					
Share capital	1,161	1,161	1,161	1,161	1,161
Shareholders' funds	20,518	21,359	23,560	25,188	26,974

#### Income statement (HK\$m)

	2013	2014	2015E	2016E	2017E
Trading fees and trading tariff	3,509	3,760	4,582	5,150	5,706
Stock Exchange listing fees	1,016	1,102	1,143	1,218	1,291
Clearing and settlement fees	1,631	1,998	3,116	3,577	4,038
Depository, custody and nominee service fees	629	725	841	992	1,141
Market data fees	737	769	807	856	899
Revenue and turnover	8,131	9,127	11,392	12,820	14,228
Net investment income	581	707	836	902	953
<b>Total revenue</b>	<b>8,723</b>	<b>9,849</b>	<b>12,227</b>	<b>13,722</b>	<b>15,181</b>
Staff costs and related expenses	1,495	1,716	2,062	2,410	2,703
Total operating expenses	3,284	3,605	4,003	4,399	4,773
Operating income	5,439	6,244	8,224	9,323	10,408
Profit before tax	5,246	6,038	8,038	9,146	10,331
Net Profit attri. to shareholders	4,552	5,165	6,839	7,783	8,791

Source: BOCOM Int'l

#### Growth rate

	2013	2014	2015E	2016E	2017E
Revenue and turnover	26.4%	12.2%	24.8%	12.5%	11.0%
Operating expenses	55.3%	9.8%	11.1%	9.9%	8.5%
PBT	8.3%	15.1%	33.1%	13.8%	13.0%
Net profit attr to shareholders	11.5%	13.5%	32.4%	13.8%	13.0%
<b>Earnings abilities</b>					
Cost-to-income ratio	37.6%	36.6%	32.7%	32.1%	31.4%
Staff costs/Rev. and turnover	18.4%	18.8%	18.1%	18.8%	19.0%
Gross profit margin	62.4%	63.4%	67.3%	67.9%	68.6%
Net profit margin	52.1%	52.2%	55.9%	56.7%	57.9%
Effective tax rate	13.3%	14.9%	14.9%	14.9%	14.9%
ROAA	5.46%	3.06%	2.66%	2.91%	3.18%
ROAE	23.8%	24.7%	30.5%	31.9%	33.7%

#### Earnings drivers (HK\$bn)

	2013	2014	2015E	2016E	2017E
ADT of cash market	62.6	69.5	79.9	94.3	108.4
YoY growth%	16.2%	11.0%	15.0%	18.0%	15.0%
ADT of financial derivatives ('000 contracts)	530	580	609	658	697
YoY growth%	8.5%	9.5%	5.0%	8.0%	6.0%
# of new listings	110	122	124	135	141
Total funds raised	379	943	660	699	734
YoY growth%	24.6%	148.8%	-30.0%	6.0%	5.0%

#### Other key ratios (HK\$)

	2012	2013	2014E	2015E	2016E
A/E (x)	4.19	11.79	11.17	10.81	10.43
Gearing ratio	76.1%	91.5%	91.0%	90.7%	90.4%
Dividend payout ratio	90%	90%	90%	90%	90%
EPS	3.92	4.45	5.89	6.70	7.57
BPS	17.67	18.40	20.29	21.69	23.23
DPS	3.52	3.99	5.30	6.03	6.81
P/E (x)	44.8	39.5	29.8	26.2	23.2
P/B (x)	9.9	9.6	8.7	8.1	7.6
Dividend yield	2.00%	2.27%	3.02%	3.43%	3.88%

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**Rating System**

**Company Rating**

Buy: Expect more than 20% upside in 12 months  
 LT Buy: Expect more than 20% upside but longer than 12 months  
 Neutral: Expect low volatility  
 Sell: Expect more than 20% downside in 12 months

**Sector Rating**

Outperform ("OP"): Expect more than 10% upside in 12 months  
 Market perform ("MP"): Expect low volatility  
 Underperform ("UP"): Expect more than 10% downside in 12 months

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