

JPM-pp1

Asia Pacific Equity Research

05 March 2015

Hong Kong Exchanges & Clearing (388 HK)

Neutral

Price: HK\$177.30

04 Mar 2015

Price Target: HK\$185.00

PT End Date: 31 Dec 2015

4Q in-line with the Street

HKEx (388 HK) announced 4Q net profit of HK\$1,511mn, up 17% q/q, 48% y/y and in-line with the Street. This brought full year net profit to HK\$5,165mn, up 13% y/y and in-line with the Street. Trading related revenue was up 9% q/q, driven by higher SDAV of HK\$80.7bn (+14% q/q) and DDAV of 696,281 contracts (+25% q/q). Securities ADT for FY14 came in at HK\$69.5bn, up 11% y/y. However, ADT has increased to HK\$84.3bn in first two months of this year (up 26% y/y), indicating steady pick-up in the Connect volumes. The exchange proposed a final dividend of HK\$2.15/share, bringing full year dividend to HK\$3.98/share and implying a payout ratio of 90%. We do not expect any meaningful share price reaction on the back of these results.

Table 1: HKEx: 4Q earnings snapshot

HK\$ in 'mn	4Q13	1Q14	2Q14	3Q14	4Q14E	4Q14A	% Q/Q	% Y/Y	% JPMe
Trading fees and trading tariff	860	938	827	956	1,150	1,039	9%	21%	-10%
Clearing and settlement fees	406	453	390	476	476	679	43%	67%	43%
Depository and custody fees	106	92	287	218	119	128	-41%	21%	7%
Stock Exchange listing fees	279	299	242	279	270	282	1%	1%	5%
Market Data fees	186	201	181	194	205	193	-1%	4%	-6%
Other Revenues	167	189	173	172	185	254	48%	52%	37%
Net investment income	145	163	186	176	173	182	3%	26%	5%
Operating revenues	2,149	2,335	2,286	2,471	2,578	2,757	12%	28%	7%
Staff costs	376	411	411	444	437	450	1%	20%	3%
IT and computer maintenance	163	136	125	114	136	135	18%	-17%	0%
Premises expenses	78	72	73	75	79	74	-1%	-5%	-6%
Product marketing & promotion	10	6	12	5	13	30	500%	200%	126%
Legal and professional fees	50	47	56	43	51	29	-33%	-42%	-43%
Depreciation	155	164	160	157	178	166	6%	7%	-7%
Other operating expenses	82	62	66	72	94	87	21%	6%	-8%
Interest costs	46	51	47	55	47	43	-22%	-7%	-9%
Operating expenses	960	949	950	965	1,035	1,014	5%	6%	-2%
Operating profits	1,189	1,386	1,336	1,506	1,542	1,743	16%	47%	13%
Associates / JV	3	3	2	2	3	3	50%	0%	0%
Tax	168	212	205	223	247	260	17%	55%	5%
Core profits Before MI	1,018	1,171	1,129	1,281	1,292	1,480	16%	45%	15%
Minority Interest	6	7	6	6	7	8	33%	33%	9%
One time revenues	-	-	54	-	-	23	NM	NM	NM
Reported Net Profit After Tax	1,024	1,178	1,189	1,287	1,299	1,511	17%	48%	16%
Operating Margin	55%	59%	58%	61%	60%	63%	2%	8%	3%
Basic EPS (HK\$)	0.89	1.02	1.02	1.10	1.12	1.30	18%	46%	16%
Key Parameters									
ADT - Securities (HK\$ mn)	59,049	68,318	57,457	70,871	73,163	80,728	14%	37%	10%
ADT - Derivatives	514,398	554,700	496,449	556,968	600,139	696,281	25%	35%	16%

Source: J.P. Morgan estimates, Company data.

Investment Thesis

The Connect is off the ground, with limited execution issues. This is more important for the expansion of the plan than initial low volumes. The current situation contrasts with the rush of southbound flows in the 2007 "through-train" that eventually led to a re-think. Hence, we see low initial volumes as a rather good outcome. From here, we expect a steady move up in volumes over the next few quarters, with southbound having higher potential as institutional money starts participating.

Valuation

Our Dec-15 PT of HK\$185 is based on a 34.5x mean dynamic P/E. At our PT, the stock would price in 12M fwd ADT of HK\$80.2bn, up 19% from HK\$67.6bn in FY14E.

Risks to Rating and Price Target

Higher-than-expected southbound flows during the course of next year and subsequent upward revision of the quota may pose upside risks to our estimates and vice versa.

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
13-Oct-06	OW	57.50	70.00
14-Nov-06	OW	65.75	75.50
08-Mar-07	OW	76.80	91.00
05-Jul-07	OW	127.60	145.00
14-Nov-07	OW	226.60	258.00
01-Mar-08	OW	145.70	200.00
13-Aug-08	N	103.50	120.00
09-Dec-08	N	70.50	55.00
13-May-09	N	109.80	101.00
09-Jun-09	OW	119.50	158.00
04-Oct-10	OW	152.80	168.00
29-Feb-12	OW	144.70	166.00
18-Apr-12	N	129.60	140.00
23-Aug-12	N	106.40	125.00
16-Sep-12	OW	120.90	125.00
05-Nov-12	OW	131.50	140.00
20-Jan-13	N	149.20	150.00
27-Feb-13	N	137.80	155.00
12-Aug-13	OW	119.40	135.00
19-Feb-14	OW	123.00	140.00
05-Apr-14	OW	126.80	145.00
11-Apr-14	OW	132.30	160.00
31-Jul-14	N	174.90	185.00

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