



March 5, 2015

Stock Rating
Overweight

Industry View
Attractive

HK Exchanges & Clearing

A Miss, but 2015 Is the Key

Quick Comment – HKEX reported 4Q14 EPS at HK\$1.30 compared to our estimate of HK\$1.38 and consensus forecast of ~HK\$1.23 – Revenue was a tad light and costs were marginally higher compared to our estimates. We have reduced our earnings estimates for the next two years by 1-3%, but remain materially above consensus.

YTD turnover in HK and MMA in line with our estimates: We are assuming average daily turnover at HKEX of HK\$80bn in 2015. This, coupled with HK\$4bn in attributable turnover from MMA, will help total turnover at HKEX reach HK\$84 a day. Thus far in 2015, HK turnover has averaged ~HK\$79.5bn and attributable MMA volumes have averaged HK\$3.5bn. Hence, we remain comfortable with our volume assumptions. LME volumes have done fairly well YTD despite seasonality.

MMA was the key focus from the perspective of presentation on strategy: Management was bullish on the prospects of a stock connect with Shenzhen likely to be launched in 2015. Moreover, with stock connect mechanism in place, it expects new products to be launched over the next two to three years in MMA over and above plain vanilla equity. It is looking at launching equity derivatives (likely this year), commodities, international equities, fixed income and currencies. News flow around MMA should help re-rate the stock. On LME, it expects earnings contribution to be >20% of group profit in 2015.

Strong earnings and reasonable multiples should help the stock do well: We expect strong performance in 2015 given turnover pickup. This, coupled with higher earnings from LME (trading fees and LME Clear), will likely help significant EPS growth in 2015. Multiples remain below long-run average at 27x 2015E EPS. This should help the stock outperform, in our view. For absolute performance, we believe stronger market performance will be needed. .

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Key Ratios and Statistics

Reuters: 0388.HK Bloomberg: 388 HK

Hong Kong Financials

Shr price, close (Mar 5, 2015)	HK\$175.80
52-Week Range	HK\$189.00-112.80
Sh out, dil, curr (mn)	1,153
Mkt cap, curr (mn)	HK\$202,624
Avg daily trading value (mn)	HK\$1,035

Fiscal Year ending	12/13	12/14e	12/15e	12/16e
ModelWare EPS (HK\$)	3.94	4.43	6.54	7.24
Prior ModelWare EPS (HK\$)	3.95	4.53	6.74	7.35
Consensus EPS (HK\$)§	4.07	4.37	5.81	6.61
EBITDA (HK\$ mn)	5,946	6,891	9,820	10,784
ModelWare net inc (HK\$ mn)	4,552	5,165	7,639	8,463
P/E	32.8	38.7	26.9	24.3
P/BV	7.3	9.4	9.3	9.0
ROE (%)	25.6	25.2	35.8	38.3
Div yld (%)	2.7	2.3	3.4	3.7

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

§ = Consensus data is provided by Thomson Reuters Estimates.

e = Morgan Stanley Research estimates

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Exhibit 1

F4Q14 Results Summary

Income Statements							
(HK\$mn)	4Q13	1Q14	2Q14	3Q14	4Q14	YoY	QoQ
Revenues:							
Trading fees & tariff	860	938	827	956	1039	20.8%	8.7%
Listing fees	279	299	242	279	282	1.1%	1.1%
Clearing & settlement fees	406	453	390	476	679	67.2%	42.6%
Depository fees	106	92	287	218	128	20.8%	-41.3%
Information fees	186	201	181	194	193	3.8%	-0.5%
LME Clear Fees					0	n.a.	n.a.
Net Investment income	145	163	186	176	182	25.6%	3.4%
Other revenues	167	189	173	172	254	52.1%	47.7%
Total revenues	2149	2335	2286	2471	2757	28.3%	11.6%
Expenses:							
Staff costs	376	411	411	444	450	19.7%	1.4%
IT	163	136	125	114	135	-17.2%	18.4%
Premises	78	72	73	75	74	-5.1%	-1.3%
Marketing	10	6	12	5	30	200.0%	500.0%
Legal	50	47	56	43	29	-42.0%	-32.6%
Depreciation	155	164	160	157	166	7.1%	5.7%
Other expenses	82	62	66	72	64	-22.0%	-11.1%
Costs related to LME deal	0	0	0			n.a.	n.a.
Reversal of provision for impairment losses arising from Participants' default on market contracts			-54				n.a.
Total expenses	914	898	849	910	948	3.7%	4.2%
Finance cost	46	51	47	55	43	-6.5%	-21.8%
FV Loss on derivative component							
Share of loss of a joint venture	3	3	2	2	3	0.0%	50.0%
Profit before tax	1186	1383	1388	1504	1763	48.7%	17.2%
Tax	168	212	205	223	260	54.8%	16.6%
Profit for the period	1018	1171	1183	1281	1503	47.7%	17.3%
Profit/(Loss) attributable to non-controlling interest	-6	-7	-6	-6	-8	33.3%	33.3%
Profits attributable to HKEx shareholders	1024	1178	1189	1287	1511	47.6%	17.4%
EPS (HK\$)	0.89	1.02	1.02	1.10	1.30	46.2%	17.4%
Daily Stock Turnover (HK\$bn)	58.5	68.3	57.5	70.9	80.7	37.9%	13.8%
ADT QoQ	6%	17%	-16%	23%	14%	7.8%	-9.5%
Trading fee QoQ	3.2%	9.1%	-8.5%	12.6%	7.5%	4.2%	-5.1%
Cost income ratio	43%	38%	37%	37%	34%	-8.1%	-2.4%
Core Cost Income Ratio	46%	41%	40%	40%	37%	-8.8%	-2.8%
Tax rate	14.2%	15.3%	14.8%	14.8%	14.7%	0.6%	-0.1%
YoY staff cost growth	28%	8%	10%	22%	20%	-8.2%	-2.3%

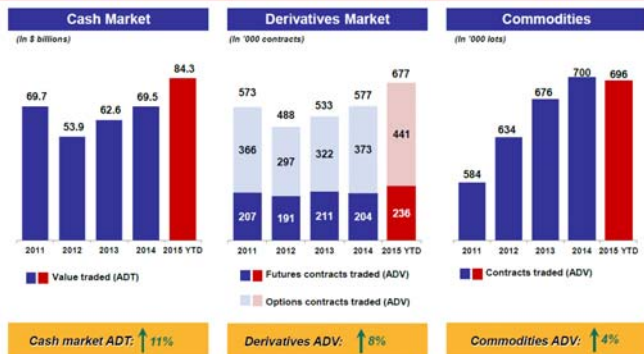
Source: Company Data, Morgan Stanley Research

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Exhibit 2

Strong Trading Momentum Has Carried into 2015 – Despite Seasonality

2014 Trading Trend
 Strong Momentum Continued into 2015

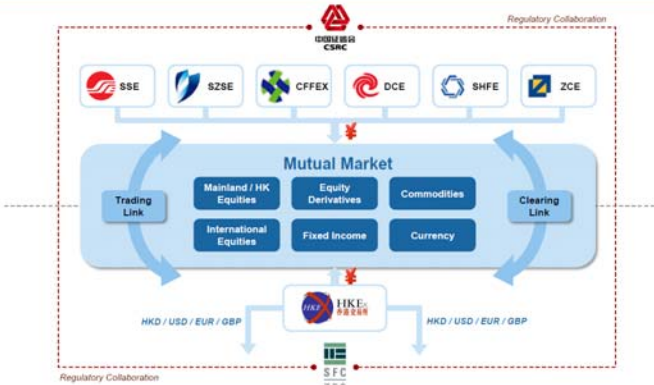


Source: Bloomberg, Morgan Stanley Research estimates

Exhibit 3

With Underlying Business Going Strong – Strategy Completely Focused on MMA

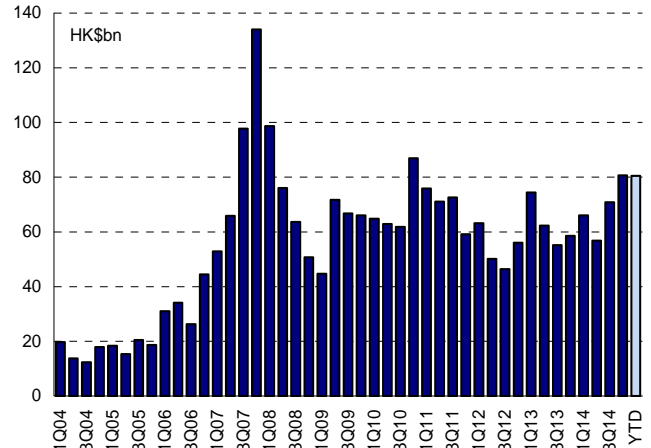
Moving Towards a Mutual Market Era
 Stock Connect's model is scalable and replicable across multiple asset classes



Source: Bloomberg, Morgan Stanley Research estimates

Exhibit 4

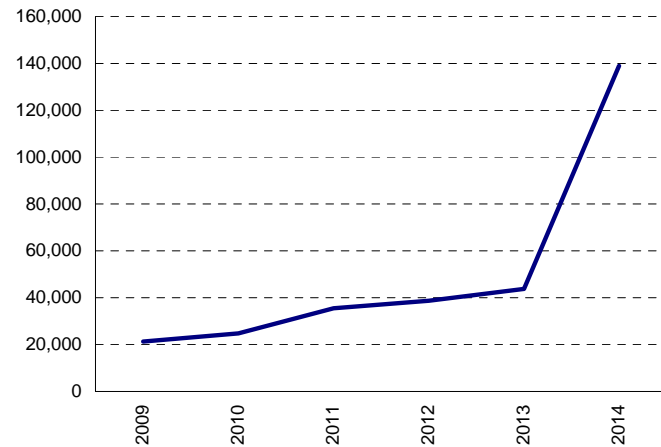
HKEx: Quarterly ADV Progression



Source: Company Data, Bloomberg, Morgan Stanley Research

Exhibit 5

Margin Funds Size due to Cash Collateral from LME

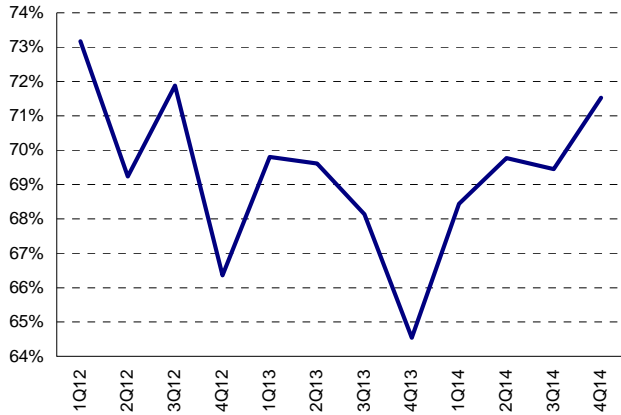


Source: Company Data, Morgan Stanley Research

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Exhibit 6

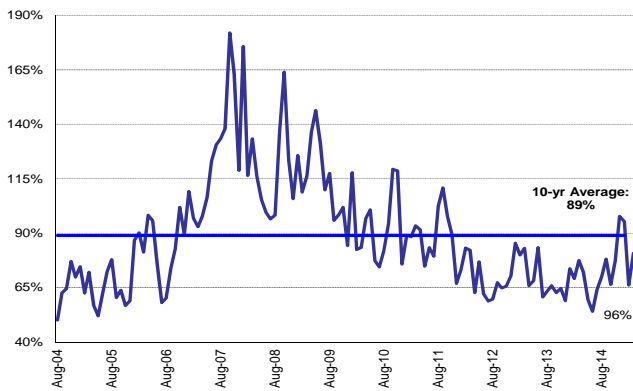
HKEX: EBITDA Margin Trend



Source: Company Data, Morgan Stanley Research

Exhibit 7

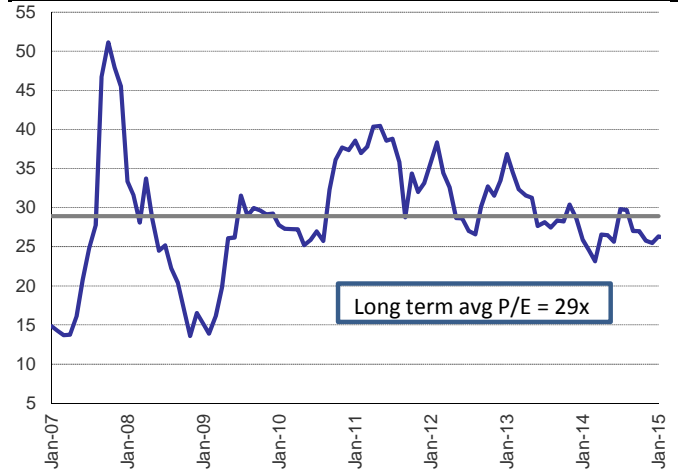
Trading Velocity at HKEx



Source: Bloomberg, Morgan Stanley Research estimates

Exhibit 8

HKEX: Prospective P/E



Source: RIMES, Company Data, Morgan Stanley Research estimates

Hong Kong Exchanges & Clearing: Financial Summary

Earnings Model						Balance Sheets					
HK\$ mn; Years Ending Dec 31	2012	2013	2014	2015E	2016E	HK\$ mn; Years Ending Dec 31	2012	2013	2014	2015E	2016E
Revenues:						ASSETS:					
Trading fees and trading tariff	2448	3509	3760	5005	5333	Cash	34077	41452	136778	138782	140874
Listing fees	916	1016	1102	1267	1394	Accounts receivable & prepayments	13696	10946	22523	22523	22523
Clearing & settlement fees	1406	1631	1998	2886	3120	Financial Assets	13065	12948	72942	72942	72942
Depository, custody & nominee fees	644	629	725	870	957	Fixed Assets	1675	1753	1603	1603	1603
Information fees	570	737	769	884	973	Goodwill and other intangible assets	18183	18680	17901	17006	16156
Net Investment income	766	581	707	1080	1310	Interest in a joint venture	97	87	77	85	85
Other revenues	461	620	788	1071	1165	Other Assets	44	77	36	50	51
Total Revenues	7211	8723	9849	13064	14253	Total Assets	80837	85943	251860	252991	254234
Expenses:						LIABILITIES					
Staff costs	1178	1495	1716	1888	2020	Margin Funds	36786	39793	129484	129484	129484
IT	299	549	510	551	589	Accounts payable & other liab	15838	12834	22849	22849	22849
Premises	254	302	294	306	327	Participants contributions	1924	3884	9426	9897	10392
Marketing	19	29	53	63	67	Deferred tax liabilities	1056	900	839	755	680
Legal & LME	192	146	175	207	221	Total Debt	6615	6921	7026	7026	7026
Other expenses (ex-Lehman)	153	256	287	316	338	Other Liab	854	1093	60877	60877	60877
Total expenses	2095	2777	2958	3244	3469	Total Liabilities	63073	65425	230501	230888	231308
EBITDA						EQUITIES					
EBITDA	5116	5946	6891	9820	10784	Share capital	1150	1161	12225	12225	12225
Depreciation and Amortization	158	507	647	679	679	Share premium	8731	10167	0	0	0
Interest Expense	55	183	196	196	196	Retained earnings	6881	7800	8800	9543	10367
Operating profits	4903	5256	6048	8945	9909	Other Equities	1002	1390	334	334	334
Total Exceptional	-58	-10	-10	-10	-10	Total Equities	17764	20518	21359	22102	22926
Profit before tax	4845	5246	6038	8935	9899	Total Liabs & Equities	80837	85943	251860	252991	254234
Tax	761	700	900	1296	1435						
Effective Tax Rate	15.7%	13.3%	14.9%	14.5%	14.5%						
Profit for the year	4084	4546	5138	7639	8463						
Profit/(Loss) attributable to non-controlling interest	0	0	-27	0	0						
Modelware Profits	4084	4552	5165	7639	8463						
Key Data						Valuations					
Years Ending Dec 31	2012	2013	2014	2015E	2016E	Years Ending Dec 31	2012	2013	2014	2015E	2016E
Per Share (HK\$)						P/E (X)					
Modelware EPS	3.74	3.94	4.43	6.54	7.24	P/E (X)	47.0	44.6	39.7	26.9	24.3
Book Value Per Share	15.45	17.77	18.33	18.92	19.63	P/Book (X)	11.4	9.9	9.6	9.3	9.0
Dividend Per Share	3.36	3.54	3.98	5.90	6.54	Dividend Yield	1.9%	2.0%	2.3%	3.4%	3.7%
Profitability						E = Morgan Stanley Research Estimates					
ROE	30.3%	23.7%	24.2%	35.2%	37.6%	Source: Company data, Morgan Stanley Research					
ROA	6.1%	5.5%	3.1%	3.0%	3.3%						
Gross Margins	68.0%	60.3%	61.4%	68.5%	69.5%						
Net Profit Margins	56.6%	52.1%	52.2%	58.5%	59.4%						
Efficiency											
Core Cost/Income	31.2%	37.6%	36.6%	30.0%	29.1%						
Daily Turnover (HK\$bn)	53.9	62.6	69.5	84.0	90.0						

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(as of February 28, 2015)

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Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)		
	Count	% of Total	Count	Total IBC	% of Rating Category
Overweight/Buy	1161	35%	321	41%	28%
Equal-weight/Hold	1459	44%	370	47%	25%
Not-Rated/Hold	101	3%	10	1%	10%
Underweight/Sell	609	18%	88	11%	14%
Total	3,330		789		

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months.

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Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

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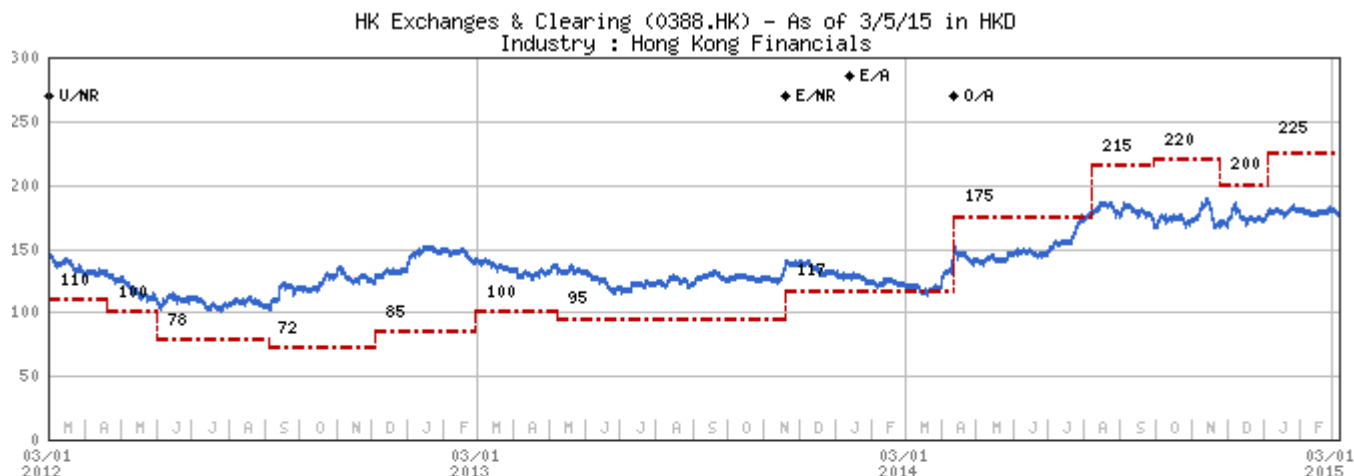
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

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Stock Price, Price Target and Rating History (See Rating Definitions)

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Stock Rating History: 3/1/12 : U/NR; 11/19/13 : E/NR; 1/13/14 : E/A; 4/11/14 : O/A

Price Target History: 8/10/11 : 110; 4/19/12 : 100; 6/1/12 : 78; 9/4/12 : 72; 12/5/12 : 85; 2/28/13 : 100; 5/9/13 : 95; 11/19/13 : 117; 4/11/14 : 175; 8/7/14 : 215; 9/29/14 : 220; 11/24/14 : 200; 1/5/15 : 225

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target -- No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Industry Coverage: Hong Kong Financials

Company (Ticker)	Rating (as of)	Price* (03/05/2015)
Anil Agarwal		
BOC Hong Kong (2388.HK)	O (03/11/2013)	HK\$26.85
Bank of East Asia (0023.HK)	E (12/01/2014)	HK\$30
Dah Sing Financial (0440.HK)	O (05/22/2009)	HK\$43.65
HK Exchanges & Clearing (0388.HK)	O (04/11/2014)	HK\$175.8
HSBC Holdings (0005.HK)	U (04/25/2014)	HK\$67.9
Hang Seng Bank (0011.HK)	E (08/06/2013)	HK\$142.5
Standard Chartered (2888.HK)	U (01/13/2014)	HK\$121
Silvia Fun, CFA		
Value Partners Group Limited (0806.HK)	E (08/14/2014)	HK\$6.58

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