

## 香港交易所 [388.HK]

连接中国与全球;长短期估值双重吸引;首次覆盖并予买入

我们首次覆盖香港交易所并予买入评级, 戈登增长模型目标价为 232.5 港元 (40.9 倍 12 个月动态市盈率, 29.2 倍 12 个月动态 EV / EBITDA; 的β值为 1.38, 股权成本为 8.4%, 短期股本回报率为 20.5%)。从长远来看, 若 A 股被纳入 MSCI 指数, 将会改变整个港交所的格局, 而市场正低估了这带来的利益。随着 MSCI A 股指数的自由流动市值比重逐渐增加, 沪股通及深港通的年度成交额或在 10 年内分别达到香港市场 2016 年成交额的 103%。从短期来看, 目前的 2017 年市场共识预测代表着 2017 年全年日均成交额仅约为 730 亿港元, 只与年初至今的水平相若。随着港股和 A 股强劲的表现将吸引更多的资金流入, 我们认为实际的成交额有望高于这水平, 我们相信, 基于港交所的新定位, 公司有望获得估值提升, 2017 年市盈率有望升至 40.9 倍 (+1 标准偏差; 对比六年平均水平为 33.4 倍)。

### 投资亮点

**新的定位, 连接中国与世界。**如果 A 股被正式纳入 MSCI 指数, 初始带来的利好可能有限, 因为只有 5% 的自由流通量会被纳入。不过如果假设在 10 年内, 全数的自由流通量都被纳入, 那么十年后的沪/深港通和港股通的总成交额可能分别相当于现在的香港市场的两倍。另外, 如果我们再考虑到以下因素: (1) 港股通带来的持续贡献;

(2) 盈利增长推动总体市值的增长; (3) 新增指数公司数量的增加, 那么根据我们相对保守的预测, 港交所的日均成交额可望在中期内达到超过 20% 的年增长。我们认为, 互联互通是新时代的关键起点, 我们对与中国未来的互联互通所产生的盈利持正面看法。总体而言, 我们认为香港市场现时极低的换手率 (约 0.5 倍) 应该已经见底, 并会在未来数年反弹。

**市场预测的短期假设仍为保守。**尽管沪港通及深港通 (及其他新计划如债券通) 可能需要一段时间才能发挥巨大的潜力, 但我们认为市场预测代表的短期假设仍较保守。根据市场共识预测, 2017 净利润预测仅代表日均成交额为 730 亿港元, 对比年初至今的 740 亿港元颇为保守。据我们预测, 今年港股市场的日均成交额为 780 亿港元, 基于港股市场和 A 股市场的强劲表现将继续吸引更多港股通和海外投资者。

**定位独特, 估值不贵。**公司的 12 个月动态市盈率为 33.8 倍, 对比 6 年平均水平为 33.4 倍。公司 25.1 倍的 EV/EBITDA 仍低于其 6 年平均水平 25.3 倍。如果 MSCI 在 6 月底的年度评审中正式纳入 A 股, 香港交易所将在中长期受益于更多来自海外投资者的在岸投资, 以及更多来自内地投资者的离岸投资。考虑到上述所讨论的增长潜力, 香港交易所具有吸引力, 目前来看, 其估值并不远高于历史平均水平。

截至 12 月 31 日止年度	2014	2015	2016	2017E	2018E
收入 (百万港元)	9,127	12,233	10,398	11,475	12,259
收入净额 (百万港元)	5,165	7,956	5,769	6,837	7,536
净利润率	57%	65%	55%	60%	61%
基本每股盈利 (港元)	4.44	6.70	4.76	5.58	6.07
同比变动	12%	51%	-29%	17%	9%
市盈率 (倍)	44.0	29.2	41.1	35.0	32.2
市盈率 (倍)	10.9	9.2	7.7	7.2	6.6
平均净资产收益率	25%	31.1%	18.6%	20.2%	20.4%
平均资产收益率	3%	3%	2%	3%	3%

来源: 公司, 中国银河国际证券研究部

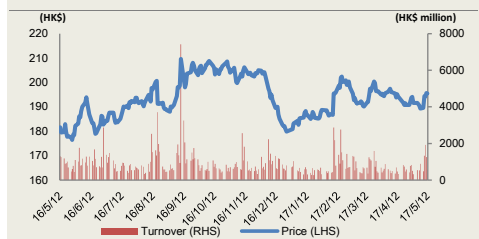
## 香港金融业

### 买入 (首次覆盖)

收盘价: 195.5 港元 (2017年5月12日)

目标价: 232.5 港元 (+18.9%)

### 股價表現



来源: 彭博

市值	307.11 亿美元
发行在外股数	12.25 亿股
核数师	PricewaterhouseCoopers
自由流通股	94.48%
52 周交易区间	175.00-213.20 港元
三个月日均成交量	1.02 亿美元
主要股东	HK SAR (5.45%)

来源: 公司, 彭博

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## Hong Kong Exchange [388.HK]

**Bridging China and the World; Undemanding Valuation from both Long-term and Short-term Perspectives. Initiate with BUY.**

We initiate coverage on Hong Kong Exchanges and Clearing Limited (HKEx) with a BUY rating and a Gordon Growth Model-based target price of HK\$232.5 (40.9x 12-month-forward PER and 29.2x 12-month-forward EV/EBITDA; beta at 1.38, cost of equity at 8.4%, and medium-term ROE at 20.5%). From a long-term perspective, the potential inclusion of A-shares in the MSCI indices is a game changer under-appreciated by the market. With a gradual increase in the free float adjusted factor of the MSCI A-share index, the annual volume of northbound trading may be equivalent to 103% of Hong Kong market trading volume in 2016 within 10 years. From a short-term perspective, the current 2017E consensus implies a 2017 ADT assumption of about HK\$73bn, just in line with the YTD level. We see upside potential as the strong performance of the Hong Kong market versus the A-share market is likely to attract more fund flow. We believe HKEx well deserves a re-rating for its new positioning from its 33.4x six-year-average historical PER to 40.9x 2017E PER (+1 STD).

### Investment Highlights

**New positioning to connect China and the World.** The initial benefits may be limited if A-shares are officially included in the MSCI indices because only 5% of the free float is counted. However, if we assume 100% of the free float will be counted in 10 years, northbound ADT in 2027E may be equivalent to 103% of Hong Kong market ADT in 2016. In addition, if we consider the contribution from southbound trading and the overall market cap expansion driven by earnings growth and the increasing number of new companies, HKEx could see over 20% annual ADT growth in the medium term, based on our relatively conservative simulation. We believe the Stock Connect is the critical starting point of a new era and hold a positive view on its future earnings generated through the new China connections. Overall, we believe the exceptionally low trading velocity (about 0.5x) of the Hong Kong market should have reached the bottom and is going to turn around in the coming years.

**Implied short-term assumptions of the market are not aggressive.** Although it may take some time for the Stock Connect (and other new programmes, such as the Bond Connect) to deliver its huge potential, we believe the short-term assumptions projected by the market are not aggressive. Consensus 2017E net profit implies an ADT assumption of HK\$73bn, which is quite conservative compared with YTD ADT of HK\$74bn. We are expecting ADT of HK\$78bn for this year, as the strong performance of the Hong Kong market versus the A-share market will continue to attract more investors from southbound trading and overseas.

**Undemanding valuation with a unique market position.** On a 12-month rolling forward basis, HKEx is trading at 33.8x PER, largely in line with the 6-year average of 33.4x. Its EV/EBITDA of 25.1x is still below its 6-year average of 25.3x. If MSCI officially includes A-shares in its index series during the annual review in late June, HKEx will enjoy the benefits of more onshore investments from overseas investors and growing offshore investments from Mainland investors at the same time in the medium to long term. With the growth potential we discussed above, HKEx is attractive, as the current valuation is not much higher than its historical average.

Year ended 31 December	2014	2015	2016	2017E	2018E
Revenue(HK\$ m)	9,127	12,233	10,398	11,475	12,259
Net income(HK\$ m)	5,165	7,956	5,769	6,837	7,536
Net Margin	57%	65%	55%	60%	61%
Basic EPS (HKD)	4.44	6.70	4.76	5.58	6.07
YOY Change	12%	51%	-29%	17%	9%
PE (x)	44.0	29.2	41.1	35.0	32.2
PB (x)	10.9	9.2	7.7	7.2	6.6
ROAE	25%	31.1%	18.6%	20.2%	20.4%
ROAA	3%	3%	2%	3%	3%

Sources: Company, CGIS Research Estimates

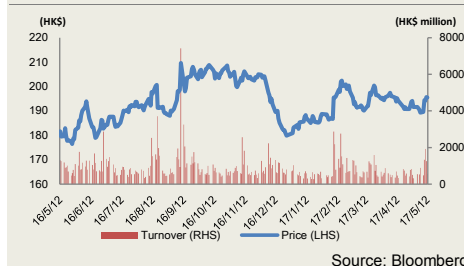
## Hong Kong Financials Sector

# BUY (Initiation)

Close: HK\$ 195.5 (May 12, 2017)

Target Price: HK\$ 232.5 (+18.9%)

### Price Performance



Market Cap	US\$30,711m
Shares Outstanding	1,225m
Auditor	PricewaterhouseCoopers
Free Float	94.48%
52W range	HK\$175.00-213.20
3M average daily T/O	US\$102m
Major Shareholder	HK SAR (5.45%)

Sources: Company, Bloomberg

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## Key Financials

<b>P&amp;L summary (HK\$m)</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017E</b>	<b>2018E</b>
Trading fees and trading tariff	3,760	5,469	4,428	4,935	5,277
Stock exchange listing fees	1,102	1,114	1,092	1,165	1,232
Cearing and settlement fees	1,998	3,118	2,358	2,725	2,992
Depository related fees	725	867	857	930	980
Market data fees	769	803	816	840	872
Other revenue	773	862	847	880	905
<b>Revenue</b>	<b>9,127</b>	<b>12,233</b>	<b>10,398</b>	<b>11,475</b>	<b>12,259</b>
<i>YoY</i>	<i>12%</i>	<i>34%</i>	<i>-15%</i>	<i>10%</i>	<i>7%</i>
Net investment income	707	1,123	696	1,032	1,286
Other income	15	19	22	22	22
<b>Revenue and other income</b>	<b>9,849</b>	<b>13,375</b>	<b>11,116</b>	<b>12,529</b>	<b>13,566</b>
Staff costs	(1,716)	(2,020)	(2,035)	(2,125)	(2,260)
IT expenses	(510)	(517)	(500)	(510)	(520)
Premises expenses	(294)	(294)	(333)	(340)	(345)
Marketing expenses	(53)	(41)	(54)	(58)	(62)
Legal and professional fees	(175)	(99)	(106)	(120)	(125)
Other operating expenses	(287)	(396)	(427)	(450)	(480)
<b>EBITDA</b>	<b>6,891</b>	<b>10,085</b>	<b>7,661</b>	<b>8,926</b>	<b>9,774</b>
Depreciation & amortisation	(647)	(684)	(771)	(757)	(767)
<b>Operating profit</b>	<b>6,244</b>	<b>9,401</b>	<b>6,890</b>	<b>8,168</b>	<b>9,007</b>
Finance costs	(196)	(114)	(82)	(83)	(83)
Share of loss of JV	(10)	(9)	(9)	(9)	(9)
<b>Profit before tax</b>	<b>6,038</b>	<b>9,278</b>	<b>6,799</b>	<b>8,076</b>	<b>8,915</b>
Tax	(900)	(1,347)	(1,058)	(1,268)	(1,409)
Minorities	(27)	(25)	(28)	(29)	(30)
<b>Net Profit</b>	<b>5,165</b>	<b>7,956</b>	<b>5,769</b>	<b>6,837</b>	<b>7,536</b>
<i>YoY</i>	<i>13.5%</i>	<i>54.0%</i>	<i>-27.5%</i>	<i>18.5%</i>	<i>10.2%</i>
<b>Balance Sheet summary (HK\$m)</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017E</b>	<b>2018E</b>
Cash	136,778	110,890	115,723	123,798	133,318
Financial assets	72,885	92,144	99,159	103,125	112,620
Accounts receivable	22,517	15,535	12,928	14,475	16,355
<b>Current assets</b>	<b>232,188</b>	<b>218,571</b>	<b>227,810</b>	<b>241,398</b>	<b>262,293</b>
Financial assets	57	57	74	75	80
Goodwill	17,901	17,872	17,812	17,850	17,820
Fixed assets	1,603	1,560	1,499	1,450	1,430
<b>Non-current assets</b>	<b>19,672</b>	<b>19,622</b>	<b>19,508</b>	<b>19,502</b>	<b>19,457</b>
Financial liabilities	59,680	64,486	61,627	62,009	65,009
Margin deposits	129,484	115,213	126,846	135,000	148,000
Accounts payable	22,835	15,270	12,246	13,455	14,719
Clearing House Fund of Participants	9,426	7,474	8,656	8,982	9,070
<b>Current liabilities</b>	<b>222,564</b>	<b>203,976</b>	<b>210,688</b>	<b>220,933</b>	<b>238,420</b>
Borrowings	7,026	3,409	3,422	3,430	3,436
Deferred tax liabilities	839	761	713	888	986
<b>Non-current liabilities</b>	<b>7,937</b>	<b>4,255</b>	<b>4,246</b>	<b>4,441</b>	<b>4,555</b>
<b>Shareholders' Equity</b>	<b>21,273</b>	<b>29,816</b>	<b>32,266</b>	<b>35,380</b>	<b>38,598</b>
Minorities	86	146	118	147	177

Source: CGIS Research estimates

## Key Financials

Cash Flow summary (HK\$m)	2014	2015	2016	2017E	2018E
<b>Profit before tax</b>	<b>6,038</b>	<b>9,278</b>	<b>6,799</b>	<b>8,076</b>	<b>8,915</b>
Depreciation& amortisation	647	684	771	757	767
Net working capital adjustment	(1,323)	(293)	(321)	(487)	(626)
<b>Net cash from operations</b>	<b>4,673</b>	<b>8,321</b>	<b>6,164</b>	<b>7,519</b>	<b>8,125</b>
Capex	(665)	(710)	(620)	(746)	(717)
Others	1,447	290	(2,715)	(2,198)	(3,980)
<b>Net cash from investing</b>	<b>782</b>	<b>(420)</b>	<b>(3,335)</b>	<b>(2,944)</b>	<b>(4,697)</b>
Dividends paid	(3,234)	(3,017)	(3,329)	(3,077)	(3,391)
<b>Net cash from financing</b>	<b>(3,718)</b>	<b>(3,224)</b>	<b>(3,586)</b>	<b>(3,368)</b>	<b>(3,708)</b>
Free cash flow	4,008	7,611	5,544	6,773	7,408
Net cash/(debt)	1,041	9,335	5,864	7,063	6,777
Net Gearing	n.a.	n.a.	n.a.	n.a.	n.a.
Gross gearing	33%	11%	11%	10%	9%

Ratios	2014	2015	2016	2017E	2018E
EBITDA margin	76%	82%	74%	78%	80%
Net margin	57%	65%	55%	60%	61%
ROAE	25%	31%	19%	20%	20%
ROAA	3%	3%	2%	3%	3%
PE (x)	44.0	29.2	41.1	35.0	32.2
PB (x)	10.9	9.2	7.7	7.2	6.6
EV/EBITDA	34.5	22.7	30.4	26.0	23.7

Basic EPS (HKD)	4.44	6.70	4.76	5.58	6.07
Diluted EPS (HKD)	4.43	6.67	4.75	5.56	6.06
DPS (HKD)	3.99	5.94	4.25	4.97	5.40
Dividend yield	2%	3%	2%	3%	3%
BVPS (HKD)	90%	90%	90%	90%	90%
	17.9	21.2	25.4	27.3	29.4

### Segment Income Contribution

Cash	30%	28%	26%	26%	26%
Equity and financial derivatives	18%	18%	20%	20%	19%
Commodities	14%	14%	15%	15%	15%
Clearing	33%	36%	35%	35%	35%
Platform and infrastructure	5%	4%	5%	5%	5%

Key assumptions	2014	2015	2016	2017E	2018E
ADT of equity products (HK\$bn)	56.2	79.9	50.2	59.0	65.0
ADT of DWs, CBBCs & warrants (HK\$bn)	13.3	25.7	16.7	19.0	20.0
Total Cash Segment ADT (HK\$bn)	69.5	105.6	66.9	78.0	85.0
ADT of northbound(¥ bn)	5.6	6.4	4.7	6.5	9.5
ADT of southbound(HK\$bn)	0.9	3.4	3.6	8.0	11.0
Southbound Contribution	1.3%	3.2%	5.4%	10.3%	12.9%
Number of newly listed (main board)	103	104	81	85	90
Number of newly listed (GEM)	19	34	45	39	42
ADT of DWs, CBBCs & warrants (HK\$bn)	13.3	25.7	16.7	19.0	20.0
ADnumber of derivative contracts	274,844	393,948	463,722	500,000	530,000
ADnumber of stock options contracts	301,797	374,346	297,903	340,000	360,000
ADvolume of metals contracts (LME)	700,204	670,189	618,627	680,000	720,000

Source: CGIS Research estimates

## Valuation and Recommendation

### Initiate coverage with a BUY rating

We initiate our coverage of HKEx (388.HK) with a BUY rating and a HK\$232.5 target price (TP), based on 40.9x 12-month-forward PER (equivalent to 29.2x 12-month-forward EV/EBITDA). If we include a future cash dividend, its investment return upside would be 21% in the next 12 months.

Though there have been ups and down, we have seen an impressive growth in the stock exchange and securities clearing house of Hong Kong, with a 42% CAGR in total turnover on the exchange during the last 45 years. Going forward, after the 2012 acquisition of the LME (London Metal Exchange, founded in 1877), HKEx officially stepped up from a regional stock exchange to a global multi-financial-product platform. We hold a positive long term view on HKEx's new position as an investment bridge between China's tremendous, but still relatively conservative, financial markets and the outside world.

### How we differentiate: We see higher growth potential

We use the 12-month DDM Model to highlight mid-term catalysts and a stable dividend pay-out. Considering its stable dividend pay-out ratio of around 90% in recent years, we adopt the formula  $PER = (1-g/ROE)/(k-g)$  of Next-year Dividend Discount Model (also called the "Gordon Growth Model", assuming a stable growth rate) as our principal valuation method to reflect the near- to mid-term business development and market catalysts, including the rising ADT of the Hong Kong equity market, increasing southbound flows in Stock Connect and potential A-share inclusion in the MSCI index.

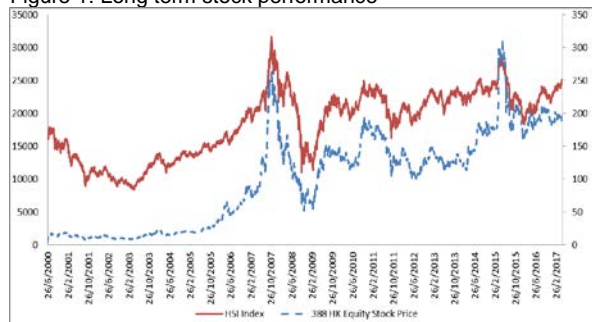
The Gordon Growth Model is commonly used for valuing financial stocks, but our main difference from some bearish views in the market is that we set HKEx's perpetual growth rate at 6.8% (more supporting arguments to follow later), while some bearish views set the growth rate at 4.5% or less.

Our TP of HK\$232.5 is based on 40.9x 12-month-forward PER. This is equivalent to 29.2x 12-month-forward EV/EBITDA, which is around +1 STD above the six-year average. Our 40.9x PER is derived from Gordon Growth Model using the following parameters:

- (a) a risk-free rate of 2.5% (7-year average of US 10-year treasuries);
- (b) 6.8% expected market return;
- (c) beta of 1.38 (10-year override raw beta);
- (d) cost of equity at 8.4% (the end result of the parameters above);
- (e) 6.8% growth rate; and
- (f) medium-term ROE of 20.5%.

The first two parameters are in accordance with those of our coverage stocks Haitong International (665.HK) and GTJA International (1788.HK). Its mid-term profitability is referred to our 2017E ROE and 2018E ROE.

Figure 1: Long term stock performance



Source: CGIS Research, Bloomberg

Figure 2: Target price (red spot)



Source: CGIS Research, Bloomberg

## Stock Connect Effect Calculation

Although we believe the Stock Connect contribution may look relatively limited in 2017E and 2018E, we see a huge potential over a longer period of time. We project northbound and southbound ADT of RMB6.5bn and HK\$ 8.0bn in 2017E. It implies Stock Connect ADT will be equivalent to 13% of Hong Kong market ADT in 2018E, up from 5% in 2015. However, the mid-term ADT growth could reach more than 20% (21%/2 southbound + 21%/2 northbound); details on this will be illustrated later.

Figure 3: Stock Connect effect

<b>Stock Connect Effect</b>	<b>2015</b>	<b>2016</b>	<b>2017E</b>	<b>2018E</b>
ADT of northbound( ¥ bn)	6.4	4.7	6.5	9.5
ADT of northbound (HK\$bn)	8.0	5.9	7.2	10.6
ADT of southbound(HK\$ bn)	3.4	3.6	8.0	11.0
(Northbound ADT+Southbound ADT)/2** (HK\$ bn)	5.7	4.7	7.6	10.8
Hong Kong market ADT(HK\$ bn)	105.6	66.9	78.0	85.0
Stock Connect's contribution to HK ADT	5%	7%	10%	13%

\*\*We divided stock connect ADT by 2, based on the fee-sharing mechanism between exchanges in HK and Mainland.

Source: CGIS Research estimates

## Sensitivity analysis

Based on our financial model, we ran a couple of sensitivity tests on different market ADT assumptions. Under the bull case scenario, our 12-month forward target PER could reach around 46.5x and a TP of HK\$275/share, accordingly. In contrast, if we assume ADT to be lower than YTD market performance for the whole year, our TP will drop to HK\$186/share for the next 12 months.

Figure 4: ADT sensitivity analysis

<b>Bull Case</b>				
	<b>ADT (HK\$bn)</b>	<b>Net Profit (HK\$m)</b>	<b>Indicated ROE</b>	<b>EPS (HK\$)</b>
2017E	83	7,038	20.8%	5.74
2018E	92	7,850	21.3%	6.41
	<b>Growth Rate</b>	<b>Target PER (x)</b>	<b>12M forward EPS</b>	<b>Target Price(HKD)</b>
	7.0%	46.5	5.90	275
<b>Base Case</b>				
	<b>ADT (HK\$bn)</b>	<b>Net Profit (HK\$m)</b>	<b>Indicated ROE</b>	<b>EPS (HK\$)</b>
2017E	78	6,856	20.3%	5.58
2018E	85	7,536	20.4%	6.07
	<b>Growth Rate</b>	<b>Target PER (x)</b>	<b>12M forward EPS</b>	<b>Target Price(HKD)</b>
	6.8%	40.9	5.69	233
<b>Bear Case</b>				
	<b>ADT (HK\$bn)</b>	<b>Net Profit (HK\$m)</b>	<b>Indicated ROE</b>	<b>EPS (HK\$)</b>
2017E	73	6,664	19.7%	5.44
2018E	78	7,482	20.1%	5.96
	<b>Growth Rate</b>	<b>Target PER (x)</b>	<b>12M forward EPS</b>	<b>Target Price(HKD)</b>
	6.4%	33.4	5.56	186

Source: CGIS Research estimates

## Peer comparison

With 20.2% 2017E ROE and 2.5% 2017E dividend yield, HKEx did not surprise us with much-higher-than-average performance among the world's major exchanges. However, we think the stock is still a growth play, which should enjoy a decent higher-than-average PER with more visible earnings upside, thanks to its unique positioning as an investment bridge between the fast-growing, developing Chinese market and relatively developed financial markets. Historically, the PER of the Company has also traded at a 60% premium to its peers.

Figure 5: Peer comparison

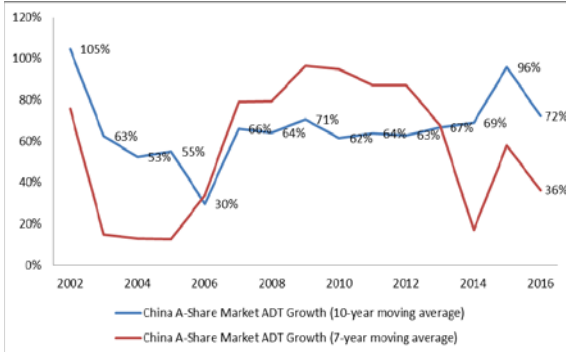
Company	Ticker	Price (local Currency)	Market cap (US\$m)	PBR (x)			PBR (x)			ROA(%)			ROE(%)			Dividend yield (%)	
				2016	2017E	2018E	2016	2017E	2018E	2016	2017E	2018E	2016	2017E	2018E	2016	2017E
<b>World Exchanges</b>																	
<b>HONG KONG EXCHANGES &amp; CLEAR</b>	<b>388 HK Equity</b>	<b>195.50</b>	<b>30,886</b>	<b>41.1</b>	<b>35.0</b>	<b>32.2</b>	<b>7.7</b>	<b>7.2</b>	<b>6.6</b>	<b>2.4</b>	<b>2.7</b>	<b>2.8</b>	<b>18.6</b>	<b>20.2</b>	<b>20.4</b>	<b>2.2</b>	<b>2.5</b>
CME GROUP INC	CME US Equity	116.64	40,031	28.1	23.9	21.8	1.9	1.9	1.9	2.2	-	-	7.6	8.1	7.8	2.3	5.0
INTERCONTINENTAL EXCHANGE IN	ICE US Equity	58.99	35,750	24.2	19.7	17.3	2.2	2.2	2.1	2.0	-	-	10.1	11.1	10.9	1.4	1.4
NASDAQ INC	NDQA US Equity	67.59	11,486	19.0	16.4	15.1	2.1	2.1	2.1	1.0	-	-	2.6	12.3	13.4	2.2	2.1
CBOE HOLDINGS INC	CBOE US Equity	84.15	8,995	34.6	26.3	23.1	3.4	3.3	3.3	5.3	-	-	10.1	11.6	11.1	1.2	1.2
JAPAN EXCHANGE GROUP INC	8697 JP Equity	1,640.00	7,671	21.3	21.0	20.9	3.4	-	-	0.1	-	-	16.4	-	-	2.9	2.9
ASX LTD	ASX AU Equity	51.70	7,136	23.1	22.8	21.9	2.6	-	-	4.6	-	-	11.3	-	-	5.6	3.9
SINGAPORE EXCHANGE LTD	SGX SP Equity	7.35	5,839	23.7	22.5	20.8	8.3	8.0	8.4	16.4	-	-	35.6	38.4	43.8	3.8	3.9
EURONEXT NV	ENX FP Equity	47.62	3,154	16.8	17.0	16.0	6.1	5.6	6.2	26.1	-	-	39.6	33.4	41.2	3.0	2.9
<b>Simple average</b>				<b>25.8</b>	<b>22.7</b>	<b>21.0</b>	<b>4.2</b>	<b>4.3</b>	<b>4.4</b>	<b>6.7</b>	<b>2.7</b>	<b>2.8</b>	<b>16.9</b>	<b>19.3</b>	<b>21.2</b>	<b>2.7</b>	<b>2.9</b>
<b>HK Financials</b>																	
KINGSTON FINANCIAL GROUP LTD	1031 HK Equity	2.72	4,539	34.3	-	-	2.0	-	-	4.3	-	-	8.2	-	-	0.7	-
<b>HANTONG INTERNATIONAL SECURI</b>	<b>665 HK Equity</b>	<b>4.23</b>	<b>3,187</b>	<b>13.3</b>	<b>9.1</b>	<b>7.7</b>	<b>1.0</b>	<b>0.9</b>	<b>0.8</b>	<b>1.5</b>	<b>1.8</b>	<b>1.9</b>	<b>7.8</b>	<b>10.3</b>	<b>11.1</b>	<b>4.9</b>	<b>5.4</b>
<b>GUOTAI JUNAN INTERNATIONAL</b>	<b>1788 HK Equity</b>	<b>2.45</b>	<b>2,245</b>	<b>16.5</b>	<b>12.2</b>	<b>11.0</b>	<b>2.1</b>	<b>1.9</b>	<b>1.7</b>	<b>2.5</b>	<b>2.6</b>	<b>2.5</b>	<b>13.0</b>	<b>15.7</b>	<b>16.3</b>	<b>4.2</b>	<b>4.7</b>
VALUE PARTNERS GROUP LTD	806 HK Equity	7.20	1,807	96.5	22.3	18.4	3.6	-	-	3.3	-	-	3.7	14.2	-	0.7	2.5
HUARONG INTERNATIONAL FINANC	993 HK Equity	2.47	1,261	122.6	-	-	8.5	-	-	4.1	-	-	18.9	-	-	-	-
EMPEROR CAPITAL GROUP LTD	717 HK Equity	0.64	581	7.1	6.4	4.9	0.9	-	-	7.1	-	-	13.3	14.7	-	3.9	4.7
BRIGHT SMART SECURITIES AND	1428 HK Equity	2.38	555	16.4	-	-	1.9	-	-	4.3	-	-	12.4	-	-	2.4	-
SHENWAN HONGYUAN HK LTD	218 HK Equity	2.93	342	28.3	-	-	1.1	-	-	1.3	-	-	5.3	-	-	1.4	-
QUAMU LTD	952 HK Equity	1.19	236	-	-	-	3.0	-	-	(0.5)	-	-	(2.7)	-	-	0.4	-
FIRST SHANGHAI INVESTMENTS	227 HK Equity	1.04	206	-	-	-	0.5	-	-	(0.7)	-	-	(1.7)	-	-	-	-
SOUTHWEST SECURITIES INTERNA	812 HK Equity	0.26	107	-	-	-	1.8	-	-	(5.2)	-	-	(26.7)	-	-	-	-
SUNVAH KINGSWAY CAPITAL HOLD	188 HK Equity	0.12	92	-	-	-	0.7	-	-	(3.7)	-	-	(5.7)	-	-	3.7	-
CNIDA INTERNATIONAL HOLDINGS	111 HK Equity	0.96	80	15.0	-	-	0.9	-	-	4.3	-	-	8.5	-	-	-	-
<b>Simple average</b>				<b>38.9</b>	<b>12.5</b>	<b>10.5</b>	<b>2.2</b>	<b>1.4</b>	<b>1.3</b>	<b>1.7</b>	<b>2.2</b>	<b>2.2</b>	<b>4.2</b>	<b>13.7</b>	<b>13.7</b>	<b>2.5</b>	<b>4.4</b>

Source: Bloomberg data, CGIS Research (Note: Estimations and data of our coverage stocks are displayed in red lines.)

## Growth rate assumption

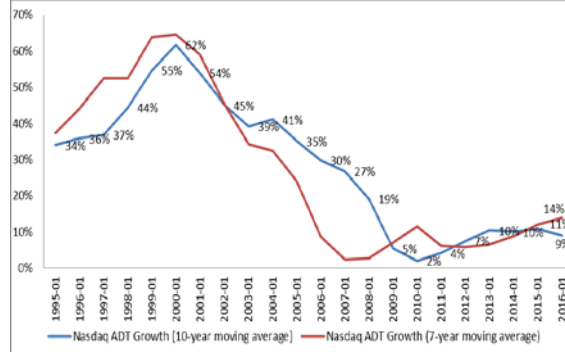
As HKEx's earnings are still correlated to market turnover to some extent, our growth rate assumptions are based on the historical average daily turnover (ADT) performance of the major global exchanges. Thanks to the strong momentum in China A-share ADT growth, we believe HKEx will benefit from increasing inflow from mainland China in the long term. After the development of the Hong Kong financial market spanning two decades, we don't think its growth rate will be as high as that of the emerging Chinese market (15-year average at 60%). However, we think that the growth rate of HKEx will at least return from low single-digits in recent years to somewhat higher than that of the Japanese market, which is suffering from a severe economic recession, as well as lower than that of the Nasdaq market, which covers the high-tech sector.

Figure 6: China A-Share market ADT growth



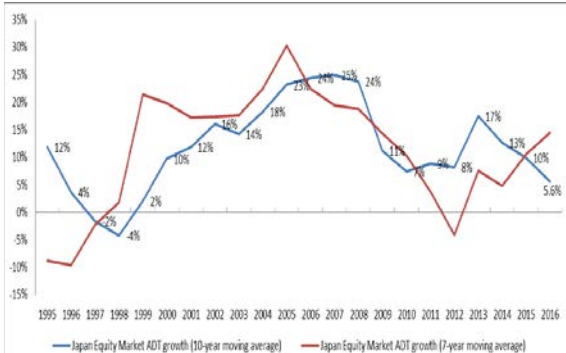
Source: CGIS Research, WIND

Figure 7: Nasdaq ADT growth



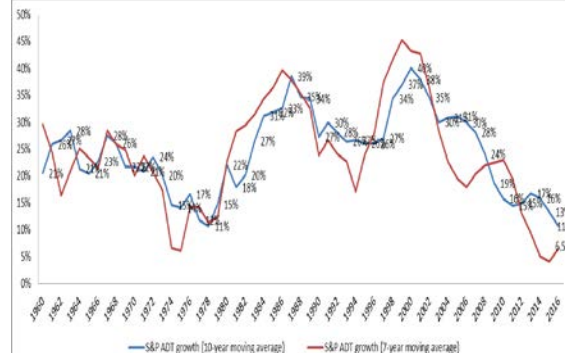
Source: CGIS Research, WIND

Figure 8: Japan equity market ADT growth



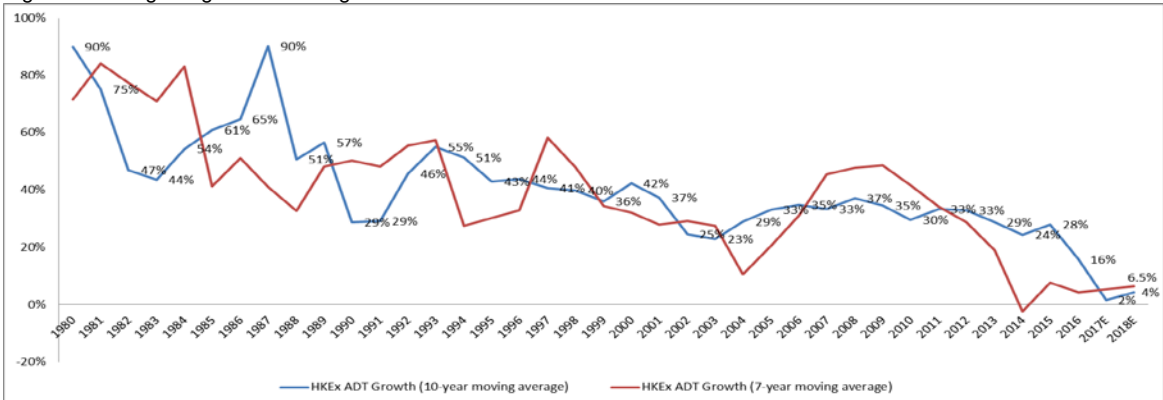
Source: CGIS Research, WIND

Figure 9: S&P ADT growth



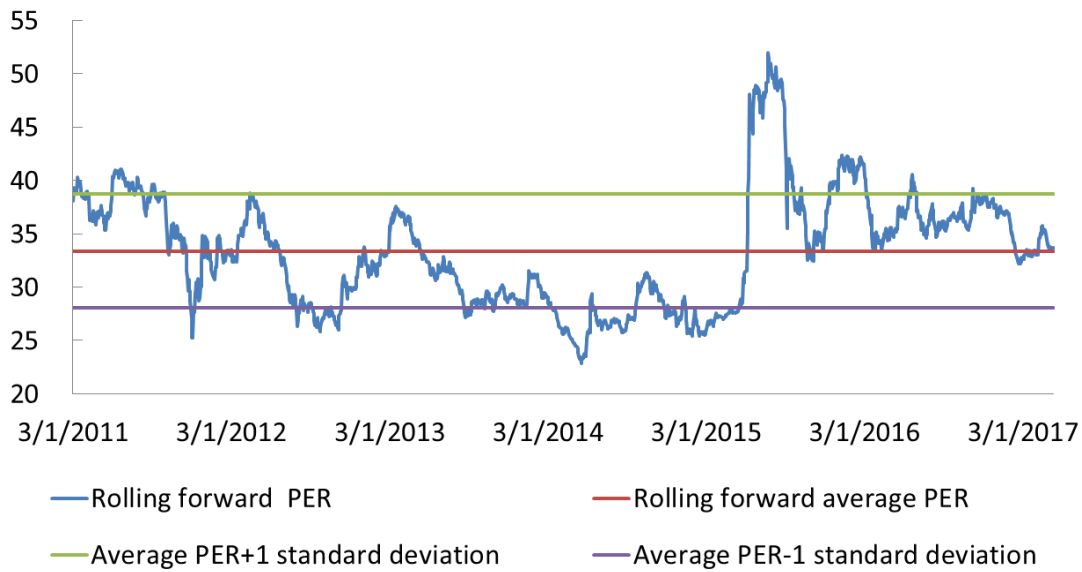
Source: CGIS Research, WIND

Figure 10: Hong Kong market ADT growth



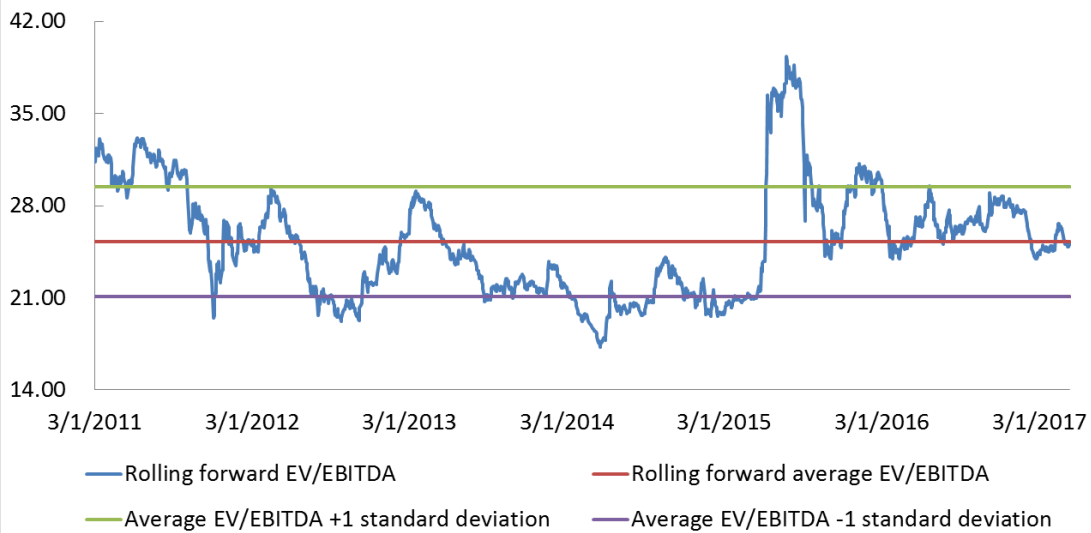
Source: CGIS Research, WIND

Figure 11: PER Band



Source: CGIS Research estimates, Bloomberg

Figure 12: EV/EBITDA Band



Source: CGIS Research estimates, Bloomberg

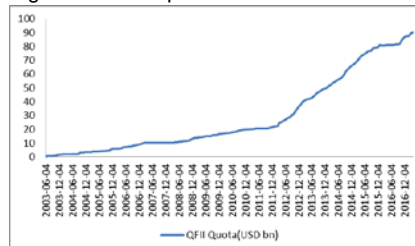
## Investment Thesis – Linking China to the world

### Increasing interest on China

Although China has already bid farewell to the era of double-digit GDP growth, it is still the largest growth driver globally with >6% GDP growth, much faster than overall global economic growth of 2.2% in 2016, according to United Nations data.

We can see from the few existing open investment channels that interest in the China market has been rising faster in recent years through increasing quotas for the Qualified Foreign Institutional Investor (QFII) Scheme and the RMB Qualified Foreign Institutional Investor (RQFII) Scheme. In particular, of the total assets in QFII investment, securities (including bonds and equities) make up almost 90% of the total.

Figure 13: QFII quota



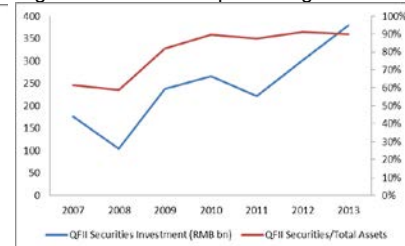
Source: CGIS Research, WIND

Figure 14: RQFII quota



Source: CGIS Research, WIND

Figure 15: Securities percentage in QFII



Source: CGIS Research, WIND

### Potential MSCI Inclusion: Small impact initially, large impact in the medium term

After rejecting A-shares three times since 2014 for inclusion in the Emerging Market Index (EMI), MSCI refined its consultation for the potential inclusion of China A-shares in March this year and proposed reducing the number of stocks from 448 to 169. We can see the Chinese financial market's gradual improvement in opening up through the ground-breaking cross-border trading schemes and an increasing probability of China A-shares' inclusion in the MSCI EMI.

As of June 2016, based on data from eVestment, Morningstar and Bloomberg, MSCI has over US\$1.6 trillion in assets benchmarked to the MSCI EMI family. Although the weight of China A-shares in the MSCI EMI would be reduced from 5% in the previous plan to 0.5% in the latest consultation document, the potential inclusion would still probably bring US\$ 80bn in fresh funds to China's equity market.

Figure 16: Potential plan of A-share inclusion in the MSCI EMI

	Current Standard		Original Proposal (IF = 5%)			New Proposal (IF = 5%)			# Securities	
	Weight	# Sec	Weight	# Sec	1 way Turnover	Weight	# Sec	1 way Turnover	Add	Del
<b>MSCI China</b>										
A Shares	0.0%	0	3.7%	448	3.66%	1.8%	169	1.77%	169	0
B Shares	0.2%	2	0.4%	4	0.15%	0.4%	4	0.15%	2	0
H Shares	38.6%	70	36.9%	86	1.28%	37.6%	86	1.30%	16	0
Red Chip	16.9%	30	16.3%	38	0.70%	16.6%	38	0.72%	8	0
P Chip	21.5%	34	21.4%	50	1.55%	21.8%	50	1.58%	16	0
Overseas	22.8%	14	21.4%	18	0.31%	21.8%	18	0.32%	4	0
<b>Total</b>	<b>100.0%</b>	<b>150</b>	<b>100.0%</b>	<b>644</b>	<b>7.65%</b>	<b>100.0%</b>	<b>365</b>	<b>5.84%</b>	<b>215</b>	<b>0</b>
<b>MSCI EM</b>										
A Shares	0.0%	0	1.0%	448	1.04%	0.5%	169	0.50%	169	0

Source: MSCI

It may look small at first, but it will become much more significant if the weighting increases to >5% in a few years' time (MSCI does not offer a clear timetable for adjusting the free float factor at present) and the fund flow involved will be US\$800bn.

Figure 17: Difference between Stock Connect, QFII and RQFII

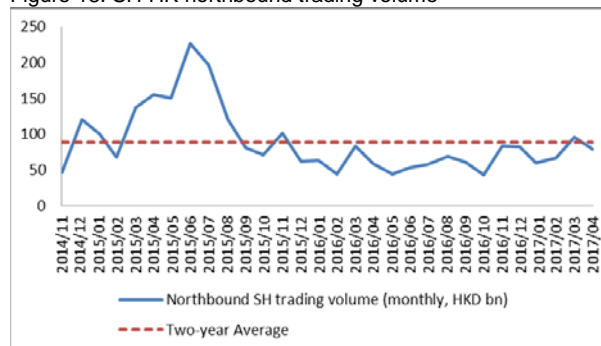
	Stock Connect	RQFII	QFII
<b>Quota Size</b>	• No quota limit	• US\$218bn	• US\$150bn
<b>Eligible Investor</b>	• All Investors	• Only licensed investors based in selected eligible locations where the RQFII scheme is available	• Only licensed investors that meet certain operation and AUM requirements
<b>Quota requirement</b>	• No requirement	• Quota linked to asset size or investment requirements. To be approved by SAFE • Unused quota within a year will be cancelled	• Quota linked to asset size or investment requirements. To be approved by SAFE • Unused quota within a year will be cancelled
<b>Capital Mobility</b>	• No restriction • Daily investment quota of RMB 13bn (USD 1.9bn) for Northbound channels and RMB 10.5bn (USD 1.5bn) for Southbound channels	<b>Open-Ended Funds:</b> -Repatriation: Daily -Lock-up: None -Remit Period: None -Others: Quota required to be used within 1 year upon approval	<b>Open-Ended Funds:</b> -Repatriation: Daily -Lock-up: 3 months -Remit Period: N.A. -Others: Monthly repatriation cannot exceed 20% of NAV of previous year
<b>Eligible Investment</b>	• 1480+ stocks listed on Shanghai and Shenzhen Stock Exchanges	• All securities listed on Shanghai and Shenzhen Stock Exchanges	
<b>Currency</b>	• Off-shore RMB (CNH)	• Off-shore RMB (CNH)	• On-shore RMB (CNY)

Source: MSCI

### Direct beneficiary of Northbound Stock Connect

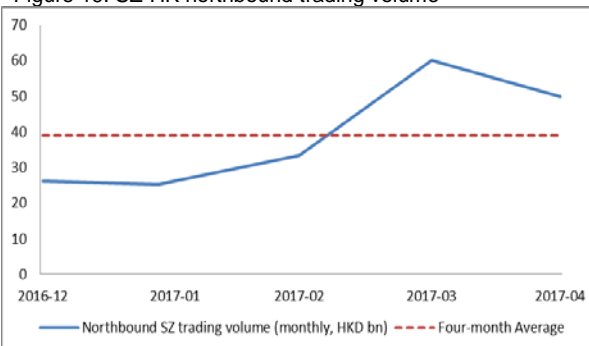
Thanks to Shanghai-Hong Kong Stock Connect, launched in 2014, and Shenzhen-Hong Kong Stock Connect, launched in 2016, overseas investors now have new channels to invest in China A-shares, other than the RQFII and QFII schemes. Unlike the latter two schemes, for which investors must get a license following a specific application procedure, the Stock Connect arrangements offer a more flexible platform, and we believe HKEx will directly benefit from the increasing trading volume through the northbound Connect.

Figure 18: SH-HK northbound trading volume



Source: CGIS Research, WIND

Figure 19: SZ-HK northbound trading volume



Source: CGIS Research, WIND

After excluding the bull market effect in 2015, we find that northbound trading volume has recovered from the trough in 2016 through Stock Connect, despite depreciation pressure on the renminbi (RMB) as a result of the strengthening USD. Although we project our estimation for the northbound effect with

cautious optimism in the next two years, the simulation in Figure 20 basically shows a mid-term outlook from a more quantitative angle.

Our simulation represents a static analysis and conservatively assumes: (1) that it will take 10 years for the MSCI EMI to increase the free float adjusted factor from 5% to 100%; (2) we have not considered any potential market cap expansion driven by earnings growth and listings of new companies; and (3) that foreign investment holdings will remain capped at 30%, offering an estimated range of trading velocity from 0.5x to 3x, which is basically the velocity difference between the Hong Kong and mainland markets, respectively. Using 1.5x trading velocity as a base case, northbound ADT may reach HK\$69bn in 2027 on a static basis, equivalent to 103% of Hong Kong market ADT in 2016. Corresponding ADT annual growth could reach >21%(7%+7%+>7%) if we assume the number of stocks in the list and their stock prices go up 7% annually.

Figure 20: Northbound mid-term effect simulation

Current Northbound Free Float (RMB trn)	2017E Northbound ADT Assumption (RMB bn)	Indicated 2017E Velocity*	
10.2	6.5	0.15x	
2027E Velocity for Northbound Stocks	Indicated ADT (HK\$ bn) *	Indicated ADT Annual Growth	
0.5x	23	3%	
1x	46	5%	
1.5x	69	7%	
2x	93	8%	
3x	139	11%	

\*Static analysis (We conservatively assume northbound free float to remain the same.)

Source: CGIS Research estimates

### Long-term drivers: New China Connections

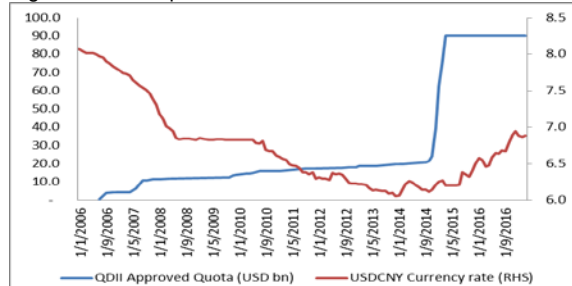
Besides the Stock Connect mechanism, we note HKEx's potential connections with China in the areas of bonds, ETFs, commodities, index futures, primary markets, etc. Based on its strategic 2016-2018 plan released in January 2016, and the latest published 2017 work plan, the Company is strengthening its unique position as a mutual market platform step by step. As the timeline of the above connections is still undefined, we did not include the potential effect in our current valuation.

## Investment Thesis - Connecting the world with Chinese investors

### Increasing overseas investment amid RMB depreciation

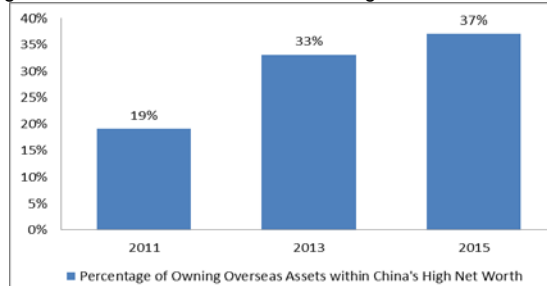
We have seen a sudden strong pick-up in QDII approved quota since 2014, following the depreciation cycle of the RMB. However, as capital outflow pressure accumulated, the State Administration of Foreign Exchange (SAFE) has not granted any new QDII quota for around two years. As for the private investment sector, we have also noted a gradual increase in China's high net worth individuals who have overseas assets. The percentage rose from 19% in 2011 to 37% in 2015, according to the 2015 China Private Wealth Report.

Figure 21: QDII quota



Source: CGIS Research, WIND

Figure 22: Overseas assets of China's high net worth individuals



Source: 2015 China Private Wealth Report, CGIS Research

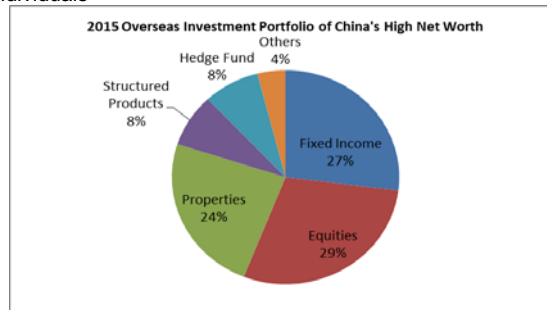
### Momentum should continue

Equities are gradually becoming more popular with China's high net worth individuals, with a gradual pick-up from 26% to 29% in the equities percentage of their overseas investment blanket. With multi-advantages in the tax rate, location, language and culture, Hong Kong is considered as the most preferred region for overseas investment for rich mainland Chinese, based on statistics from the 2015 China Private Wealth Report.

Figure 23 and 24: Overseas assets of China's high net worth individuals

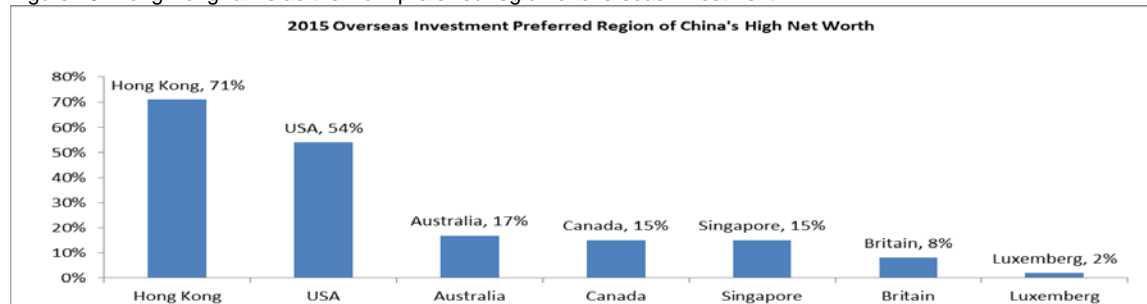


Source: 2015 China Private Wealth Report, CGIS Research



Source: 2015 China Private Wealth Report, CGIS Research

Figure 25: Hong Kong ranks as the No.1 preferred region of overseas investment

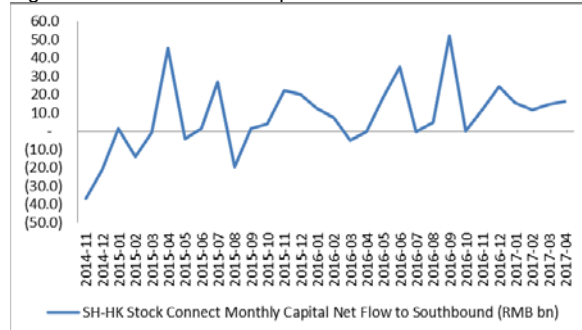


Source: 2015 China Private Wealth Report, CGIS Research

## Increasing overseas investment through Stock Connect

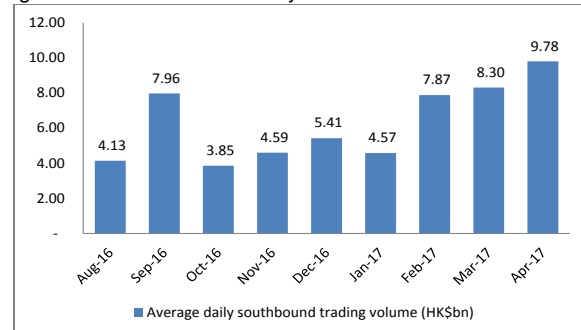
Although the Stock Connects are a mutual channel for Hong Kong and Chinese investors, we can see that the overall capital flow has favoured southbound stocks since the commencement SH-HK Stock Connect. Excluding the bull-market effect in May 2015, southbound trading volume has continued an upward trend since 2014, and monthly ADT reached a much higher level this year of HK\$ 8-9bn, around 10% of the Hong Kong market's ADT. Hence, we estimate that southbound ADT will increase to HK\$8bn in 2017E and HK\$11bn in 2018E, accounting for 10% and 13% of the total market, respectively.

Figure 26: Stock Connect capital net southbound flows



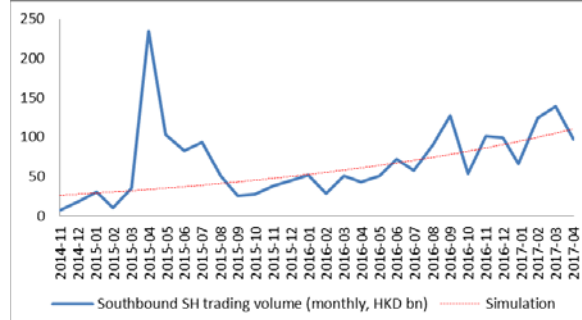
Source: CGIS Research, WIND

Figure 27: Southbound monthly ADT



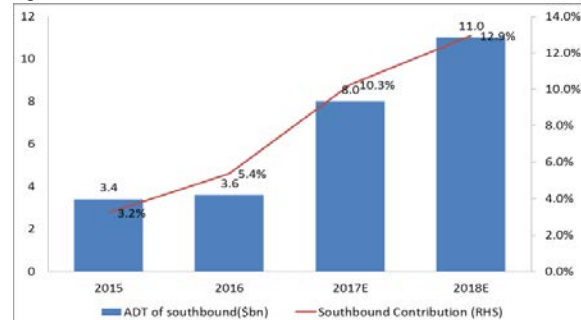
Source: CGIS Research, WIND

Figure 28: SH-HK southbound trading volume simulation



Source: CGIS Research, WIND

Figure 29: Southbound contribution forecast



Source: CGIS Research estimates

## Investor structure change and velocity improvement

If we list the world's major exchanges by market capitalization from high to low, HKEx ranks 6<sup>th</sup>, just after Shanghai and Shenzhen. However, the turnover velocity of the Hong Kong market ranks 18<sup>th</sup>, which is far below that of mainland China's stock exchanges. This usually contributes to the investor structure, with institutional investors making up more than half of Hong Kong market participants and retail investors still being the majority in the Chinese market.

Figure 30: Exchange ranking by market cap

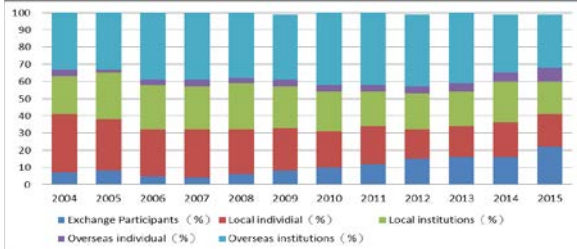
Rank	Exchange	Market Capitalisation (USD millions)	End 2016	Percentage
1	NYSE Group		19,573,074	29%
2	Nasdaq - US		7,779,127	12%
3	Japan Exchange Group		4,955,300	7%
4	Shanghai Stock Exchange		4,098,789	6%
5	Shenzhen Stock Exchange		3,212,671	5%
6	Hong Kong Exchanges and Clearing		3,193,236	5%
	WFE total		66,480,892	n.a.

Source: CGIS Research, WFE

Figure 31: Exchange ranking by turnover velocity

Rank	Exchange	Turnover Velocity	End 2016	End 2015
1	Shenzhen Stock Exchange		374.2%	518.6%
2	Shanghai Stock Exchange		192.4%	449.7%
3	Taipei Exchange		171.0%	196.0%
6	Japan Exchange Group		116.8%	113.8%
13	Taiwan Stock Exchange		59.0%	75.7%
14	Nasdaq Nordic Exchanges		54.9%	56.4%
18	Hong Kong Exchanges and Clearing		42.2%	65.0%

Source: CGIS Research, WFE

**Figure 32: Investor make-up of HK equity market**


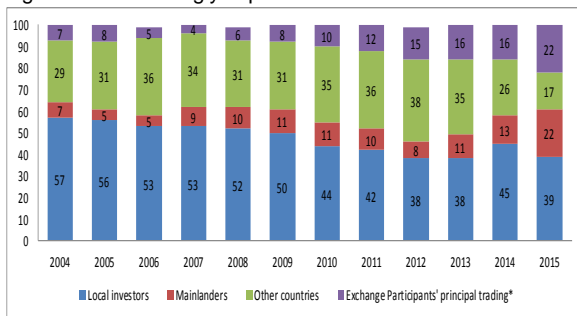
Source: CGIS Research, HKEx

**Figure 33: Investor make-up of mainland equity market**

	Number of accounts (<RMB 1m)	Number of accounts (RMB 1m-10m)	Number of accounts (RMB 10m-100m)	Number of accounts (>RMB -100m)
<b>Retail investors</b>	47,951,128	1,293,134	58,960	4,680
<b>Institutions</b>	29,857	18,617	13,499	10,009

Source: CGIS Research, CSDC

However, as mainlanders take a more important role in the Hong Kong market, we think the Hong Kong market will see an improvement in trading velocity in the long term. And we expect the Hang Seng China AH Premium Index to continue to narrow in the future.

**Figure 34: Increasingly important role of Mainland investors**


Source: CGIS Research, HKEx

**Figure 35: AH valuation to converge**


Source: CGIS Research, Bloomberg

As Figure 36 shows, we estimate that the velocity improvement effect from the southbound channel could reach 21% (7% static ADT growth with 1.5x mid-term velocity, and 14% free float growth, with 7% from price rises and 7% from volume), using a similar method as in Figure 20

**Figure 36: Southbound mid-term effect simulation**

Current Southbound Free Float (HK\$ trn)	2017E Southbound ADT Assumption (HK\$ bn)	Indicated 2017E Velocity*
11.4	8.0	0.17x
2027E Velocity for Southbound Stocks		Indicated ADT (HK\$ bn) *
0.5x	23	3%
1x	47	5%
1.5x	70	7%
2x	93	8%
3x	140	11%

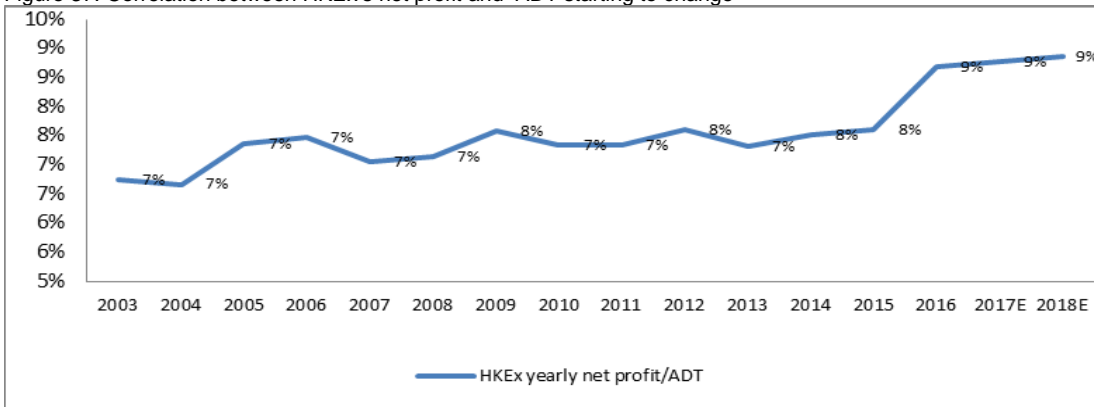
\*Static analysis (We conservatively assume southbound free float to remain the same.)

Source: CGIS Research estimates

## Investment Thesis –No longer a pure HK market proxy after LME acquisition

On 6 December 2012, the Group completed the acquisition of the entire issued ordinary share capital of LMEH for a total cash consideration of £1,388 million (HK\$17,298 million). The LME Group operates a leading exchange for the trading of base metals forward and options contracts in the UK.

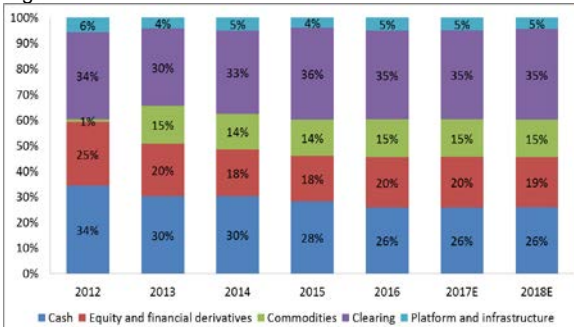
Figure 37: Correlation between HKEx's net profit and ADT starting to change



Source: CGIS Research estimates

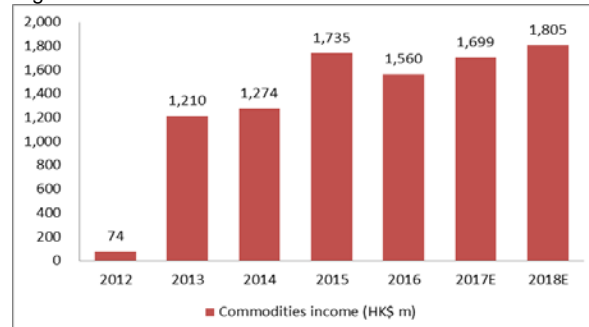
After the acquisition, the contribution from the Group's UK operations realized a considerable increase due to the commercialization of the LME's trading fees effective 1 January 2015. The commodities income of the Group has risen from ~HK\$ 1,200m in 2012 and 2013 to the recent level of ~HK\$ 1,700m. In particular, we can also see that the ratio of HKEx's earnings divided by the Hong Kong market's ADT has largely improved in the past several years.

Figure 38: LME contribution



Source: CGIS Research estimates

Figure 39: LME income



Source: CGIS Research estimates

## Financial Analysis

We expect the Company's recurring net profit to climb up by 18.5% and 10.2% in 2017 and 2018, respectively, thanks to: 1) the recovering Hong Kong market ADT, supported by accumulated interest in southbound Stock Connect; 2) increasing trading fees from northbound tunnel services; 3) stabilizing investment income as the interest income contribution rises gradually; and 4) a stable contribution from the LME sector to support its top line.

Figure 40: Major assumptions and forecasts

P&Lsummary (HK\$m)	2014	2015	2016	2017E	2018E
Trading fees and trading tariff	3,760	5,469	4,428	4,935	5,277
Stock exchange listing fees	1,102	1,114	1,092	1,165	1,232
Cearing and settlement fees	1,998	3,118	2,358	2,725	2,992
Depository related fees	725	867	857	930	980
Market data fees	769	803	816	840	872
Other revenue	773	862	847	880	905
<b>Revenue</b>	<b>9,127</b>	<b>12,233</b>	<b>10,398</b>	<b>11,475</b>	<b>12,259</b>
YoY	12%	34%	-15%	10%	7%
Net investment income	707	1,123	696	1,032	1,286
Other income	15	19	22	22	22
<b>Revenue and other income</b>	<b>9,849</b>	<b>13,375</b>	<b>11,116</b>	<b>12,529</b>	<b>13,566</b>
Staff costs	(1,716)	(2,020)	(2,035)	(2,125)	(2,260)
IT expenses	(510)	(517)	(500)	(510)	(520)
Premises expenses	(294)	(294)	(333)	(340)	(345)
Marketing expenses	(53)	(41)	(54)	(58)	(62)
Legal and professional fees	(175)	(99)	(106)	(120)	(125)
Other operating expenses	(287)	(396)	(427)	(450)	(480)
<b>EBITDA</b>	<b>6,891</b>	<b>10,085</b>	<b>7,661</b>	<b>8,926</b>	<b>9,774</b>
Depreciation& amortisation	(647)	(684)	(771)	(757)	(767)
<b>Operating profit</b>	<b>6,244</b>	<b>9,401</b>	<b>6,890</b>	<b>8,168</b>	<b>9,007</b>
Finance costs	(196)	(114)	(82)	(83)	(83)
Share of loss of JV	(10)	(9)	(9)	(9)	(9)
<b>Profit before tax</b>	<b>6,038</b>	<b>9,278</b>	<b>6,799</b>	<b>8,076</b>	<b>8,915</b>
Tax	(900)	(1,347)	(1,058)	(1,268)	(1,409)
Minorities	(27)	(25)	(28)	(29)	(30)
<b>Net Profit</b>	<b>5,165</b>	<b>7,956</b>	<b>5,769</b>	<b>6,837</b>	<b>7,536</b>
YoY	13.5%	54.0%	-27.5%	18.5%	10.2%
Key assumptions	2014	2015	2016	2017E	2018E
ADT of equity products (HK\$bn)	56.2	79.9	50.2	59.0	65.0
ADT of DWs, CBBCs & warrants (HK\$bn)	13.3	25.7	16.7	19.0	20.0
Total Cash Segment ADT (HK\$bn)	69.5	105.6	66.9	78.0	85.0
ADT of northbound( ¥ bn)	5.6	6.4	4.7	6.5	9.5
ADT of southbound(HK\$bn)	0.9	3.4	3.6	8.0	11.0
Southbound Contribution	1.3%	3.2%	5.4%	10.3%	12.9%
Number of newly listed (main board)	103	104	81	85	90
Number of newly listed (GEM)	19	34	45	39	42
ADT of DWs, CBBCs & warrants (HK\$bn)	13.3	25.7	16.7	19.0	20.0
ADnumber of derivative contracts	274,844	393,948	463,722	500,000	530,000
ADnumber of stock options contracts	301,797	374,346	297,903	340,000	360,000
ADvolume of metals contracts (LME)	700,204	670,189	618,627	680,000	720,000

Source: CGIS Research estimates

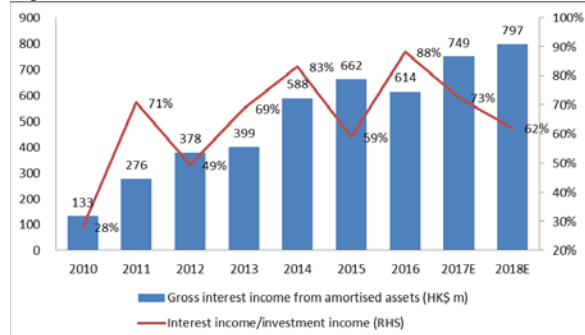
Our Hong Kong market ADT assumptions are unchanged since February 20, 2017, as shown in our reports of Haitong International (665.HK) and GTJA International (1788.HK), with estimations of HK\$78bn in 2017E and HK\$85bn in 2018E. The southbound contribution should become a more important factor and may rise from 5.4% in 2016 to 10.6% in 2018E, given the increasing overseas investment needs of mainland investors.

### Less sensitive earnings to the Hang Sang Index

The Company's net investment income contributed 6% of its total revenue in 2016, and its corporate fund size reached HK\$ 17.4bn as at end-2016. Its total investment fund size was HK\$145bn with margin funds and clearing house funds included. We have noticed fluctuating income performance of its fund investment in the past years, and believe that it will gradually stabilize in 2017E and 2018E, as the interest income/investment income ratio has risen sharply from 28% back in 2010 to the current level of ~60%.

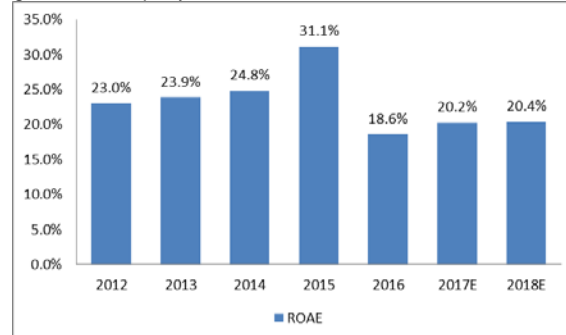
The ROE of the Company recorded a historical high of 31.1% in 2015, owing to the extraordinary performance of its trading and clearing fees, thanks to the bull market in 2015. According to our forecast, its ROE in 2017 and 2018 will return to a normalized level of ~20%, but still below the level of ~24% in 2012 and 2014, as the Company's equity was already boosted significantly by surging retained earnings in 2015.

Figure 41: Interest income contribution to investment income



Source: CGIS Research estimates

Figure 42: Company ROE



Source: CGIS Research estimates

## Appendix: HKEx Timeline

Reports of securities trading in Hong Kong date back to the mid-19th century. However, the first formal market, the Association of Stockbrokers in Hong Kong, was not established until 1891. The Association was re-named the Hong Kong Stock Exchange in 1914.

In 1999, Hong Kong's Financial Secretary announced comprehensive market reform of the stock and futures markets. Under the reform, The Stock Exchange of Hong Kong Limited (SEHK) and Hong Kong Futures Exchange Limited (HKFE) demutualised, and together with Hong Kong Securities Clearing Company Limited (HKSCC), merged under a single holding company, HKEX. The merger of the three institutions took operational effect on 6 March 2000, and HKEX was listed on the SEHK on 27 June 2000.

Every three years, HKEX Group unveils a Strategic Plan, setting the blueprint for the major initiatives and investments that it will pursue to deliver its strategy. In January 2016, it set out an ambitious plan to develop markets as unique platforms for cross-border access by international and Chinese investors, as well as attractive destination markets in their own right, offering a range of relevant products across three asset classes: equities, commodities, and fixed income & currency.

Figure 43: HKEx's history and future plan

Milestones and Future Development	
1914	Foundation of Hong Kong stock exchange
1986	Stock exchange begins trading
1992	Central clearing and settlement system introduced
1995	Stock options debut
2000	HKEx lists on the stock exchange
2006	CBBCs debut
2011	Trading hours extended
2012	Acquisition of LME (London Metal Exchange)
2014	Shanghai-Hong Kong Stock Connect launches
2016	Shenzhen-Hong Kong Stock Connect begins
TBD	Qianhai Commodities Trading Platform to open
TBD	New Board
TBD	A-shares futures
TBD	Bond Connect, Primary Connect, Commodities Connect

Source: CGIS Research, HKEx

## Appendix: Risks

- **The cycle of US dollar appreciation** may continue for some time. Usually, a strong USD is unfavourable for fund flows to emerging markets.
- We cannot rule out the possibility of a **stock market crash** if the Hong Kong market gets overheated or if another global financial crisis hits market sentiment and overall trading activity on the stock exchange.
- Slow progress or **suspension of the execution of the 2016-2018 strategy** may lead to lower growth in the Company's earnings.
- A much lower-than-expected economic downturn may lead to **stronger RMB depreciation**, which could possibly impede the internationalization process of China A-shares, and hence, northbound trading volume would remain low.
- More stringent **capital controls** may affect the confidence of both onshore and offshore investors, leading to lower trading volume.

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