

Analyst: Paul Sham
HONG KONG EXCHANGES AND CLEARING LIMITED (香港交易所)

Sector	: Financial Services	Chairman	: Mr. Ronald Joseph Arculli
HKSE Code	: 0388	Chief Executive	: Mr. Paul Chow Man Yiu
Market Price	: HK\$141.00 (05/03/2007)		
Shares Issued	: 1,070.2m		
Mkt. Cap.	: HK\$150,898.2m		
52 weeks Hi/ Lo	: HK\$268.60 / HK\$68.85		
HSI	: 23,114.34 (05/03/2007)		
Main Business	: Stock & futures exchange operations		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2007
Final Results Highlights

	FY2007	FY2006	Change
	HK\$ million	HK\$ million	
• Turnover	8,390.2	4,146.9	+102.3%
• Operating expenses	(1,411.6)	(1,210.6)	+16.6%
• Operating profit	6,978.7	2,936.3	+137.7%
• Gain on disposal of an associate	206.3	0.0	NA
• Share of results of associates	5.6	27.1	-79.4%
• Profit attributable to shareholders	6,169.3	2,518.6	+145.0%
• Basic EPS	5.78	2.37	+143.9%
• Interim DPS	1.79	0.94	+90.4%
• Final DPS	3.4	1.19	+185.7%
• Total DPS	5.19	2.13	+143.7%

Key Market Statistics

• Average daily turnover value on the Stock Exchange (HK\$ billion)	HK\$88.1bn	HK\$33.9bn	+159.9%
• Average daily number of derivatives contracts traded on the Futures Exchange	171,440	100,318	+70.9%
• Average daily number of stock options contracts traded on the Stock Exchange	187,686	73,390	+155.7%

- Hong Kong Exchanges and Clearing ("HKEx") reported a 145% surge in net profit to HK\$6,169m for FY2007, near the top end of market forecasts, which were in the range of HK\$5,345m to HK\$6,430m. Excluding the HK\$206m gain on disposal of its Computershare stake, the pre-tax profit grew 135% y-o-y.
- Turnover (HK\$8,390.2m, up 102% y-o-y) was up strongly on the back of record-high equity market volumes in FY2007, a higher number of listed companies on the main board, along with the substantial increase in the number of newly listed derivative warrants, and also a larger-than-expected investment income.
- Basic EPS for FY2007 was HK\$5.78. HKEx declared a final DPS of HK\$5.19. In line with HKEx's policy, the full-year dividend payout ratio for FY2007 was maintained at 90%.

This report has been prepared solely for information purposes and we are not soliciting any action based upon it. Neither this document nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information which we consider reliable, but accuracy or completeness is not guaranteed. Opinions expressed herein are subject to change without notice. At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein, while its group companies may from time to time have interests in securities of the company or companies mentioned herein.

Business Review

- Turnover breakdown:

	FY2007		FY2006		Change
Trading fees/trading tariff	3,086.0	36.8%	1,340.4	32.3%	+130.2%
Stock Exchange listing fees	688.5	8.2%	465.4	11.2%	+47.9%
Clearing/settlement fees	1,577.4	18.8%	674.4	16.3%	+133.9%
Depository/custody/nominee services fees	627.1	7.5%	376.1	9.1%	+66.7%
Income from sale of information	678.9	8.1%	391.2	9.4%	+73.5%
Investment income	1,238.2	14.8%	601.1	14.5%	+106.0%
Other income	494.0	5.9%	298.3	7.2%	+65.6%
Total turnover	8,390.2	100.0%	4,146.9	100.0%	+102.3%

- **Trading fees and trading tariff** soared 130.2% in FY2007. The increase in trading fees and trading tariff from the Cash Market was mainly due to the significant increase in market turnover, with an average daily turnover (ADT) of HK\$88.1bn (up 160% y-o-y). On the other hand, the increase in trading fees and trading tariff from the Derivatives Market was driven by the increase in the number of contracts traded (up 70.9% y-o-y). In addition, **clearing and settlement fees** also surged 133.9%, mainly attributable to the strong Cash Market transactions. Regarding the **depository, custody and nominee fees**, the income jumped 66.7% in FY2007, thanks to higher scrip fees, eIPO handling fees and corporate action fees as a result of increased transactions of the Cash Market.
- HKEx's income from **Stock Exchange listing fees** rose 47.9% in FY2007, mainly driven by a 103% increase in initial and subsequent issue listing fees which accounted for 54.4% of total listing fees. Fund raised (including both IPOs and post-IPOs) via Main Board amounted to HK\$570.9bn in 2007, slightly up by 11% from HK\$516.0bn in 2006, due to the lack of mega IPOs such as ICBC and Bank of China that were listed in FY2006. On the other hand, fund raised via GEM amounted to only HK\$19.5bn (2006: HK\$85bn). The warrant market also flourished this year. There were totally 6,312 newly-listed warrants in 2007, up by 124% from 2,823 a year earlier.
- **Investment income** grew 106% y-o-y. There was a substantial increase in net interest income, as the funds size expanded by 130% y-o-y to HK\$69.1bn as of 31/12/2007, largely due to the sharp expansion in the derivative margin fund on the back of buoyant derivative turnover.
- Operating expenses rose 16.6% y-o-y in FY2007, mainly attributable to the 26.3% y-o-y rise of staff expenses. If performance-based payments were excluded, staff expenses rose only 5% y-o-y. Putting aside the staff expenses, cost growth was just 5.2% y-o-y. This suggests that HKEx should be able to control cost growth if revenue momentum is slow. As operating leverage remains high, the surge in operating income drove the cost-to-income ratio further down to 16.8% in FY2007, compared to 29.2% in FY2006 and 42.5% in FY2005.

Outlook & Prospect

- **Declining turnover** There has been a significant sell-off of HKEx's shares recently. We believe this could be regarded as natural profit-taking, given that HKEx's share price has rallied dramatically since 4Q07. Global economic fundamentals have also turned drastically more negative since the beginning of 2008, and the ADT in Hong Kong has shrunk to HK\$70bn-HK\$80bn recently from HK\$120bn in early Jan-08 and HK\$130bn in 4Q07.



- **“Through train” still at station** The Chinese government reiterated that the “through train scheme” is still pending for further studies and no timetable could be given so far. Even if launched, the impact on the Hong Kong stock market should not be as significant as if the program was launched last year, because mainland investors might no longer be interested in the Hong Kong market given the A-share market has become cheaper in valuation after correcting for almost 30% from the peak in October 2007.
- **Smaller board lot size** HKEx said it would reduce the size of its board lot to 100 shares from 500 shares, effective 7 April 2008, in an attempt to attract more retail investors. Even though it does not directly link to HKEx’s profitability, we believe the action does help provide more liquidity to the stock which is positive to the share price in short run.
- **Valuation remains expensive after heavy correction** Fundamentally, the HKEx share price correlates strongly with market turnover as 63.1% of total income is related to market activities. Trading at 24.4x FY2007 P/E, the rich valuation of HKEx is premised on the back of a sustained increase in ADT in 2008 and 2009, which might not be achievable under the current negative market sentiments and without the timeline of China’s “through train scheme”. We accordingly recommend a “Sell” rating for the counter.

Recommendation: Sell



Important Disclosure / Analyst Certification / Disclaimer

This document is published by East Asia Securities Company Limited, a wholly-owned subsidiary of The Bank of East Asia, Limited (BEA).

The research analyst primarily responsible for the content of this report, in part or in whole certifies that the views on the companies and their securities mentioned in this report accurately reflect his/her personal views. The analyst also certifies that no part of his/her compensation was, is, or will be, directly, or indirectly, related to specific recommendations or views expressed in this report.

This report has been prepared solely for information purposes and has no intention whatsoever to solicit any action based upon it. Neither this report nor its contents shall be construed as an offer, invitation, advertisement, inducement or representation of any kind or form whatsoever. The information is based upon information, which East Asia Securities Company Limited considers reliable, but accuracy or completeness is not guaranteed. Information and opinions expressed herein reflect a judgment as of the date of this document and are subject to change without notice. Any recommendation contained in this report does not have regard to the specific investment objectives, financial situation and the particular needs of any specific addressee. This report is not to be taken in substitution for the exercise of judgment by respective readers of this report, who should obtain separate legal or financial advice. East Asia Securities Company Limited and / or The BEA Group accepts no liability whatsoever for any direct or consequential loss arising from any use of this report or further communication given in relation to this report.

At time of this report, East Asia Securities Company Limited has no position in securities of the company or companies mentioned herein the report, while BEA along with its affiliates and/or persons associated with any of them may from time to time have interests in the securities mentioned in this report. BEA and its associates, its directors, and/or employees may have positions in, and may effect transactions in securities mentioned herein and may also perform or seek to perform broking, investment banking and other banking services for these companies.

BEA and/or any of its affiliates may beneficially own a total of 1% or more of any class of common equity securities of the subject company or companies mentioned in this report and may, within the past 12 months, have received compensation and/or within the next 3 months seek to obtain compensation for investment banking services from the subject company or companies mentioned in the report.

This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of, or located in, any locality, state, country or other jurisdiction, publication, availability or use would be contrary to law and regulation.