

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

Sector	: Financial Services	Chairman	: Mr. Ronald Joseph Arculli
HKSE Code	: 00388	Chief Executive	: Mr. Charles Li Xiaojia
Market Price	: HK\$129.7 (05/03/2010)		
Shares Issued	: 1,076.6m		
Mkt. Cap.	: HK\$139,635.0m		
52 weeks Hi/ Lo	: HK\$154.00 / HK\$54.60		
HSI	: 20,787.97 (05/03/2010)		
Main Business	: Stock & futures exchange operations		

SUMMARY OF THE FINAL RESULTS FOR THE YEAR ENDED 31ST DECEMBER 2009
Final Results Highlights

	FY2009	FY2008	Change
	HK\$ million	HK\$ million	
◆ Turnover	7,035.0	7,549.1	-6.8%
◆ Operating expenses	(1,492.9)	(1,620.6)	-7.9%
◆ Operating profit	5,542.1	5,928.5	-6.5%
◆ Taxation	(838.0)	(799.5)	+4.8%
◆ Profit attributable to shareholders	4,704.0	5,129.0	-8.3%
◆ Basic EPS	4.38	4.78	-8.4%
◆ Interim DPS	1.84	2.49	-26.1%
◆ Final DPS	2.09	1.80	+16.1%
◆ Total DPS	3.93	4.29	-8.4%

Key Market Statistics

• Average daily turnover on the Stock Exchange (HK\$ billion)	HK\$62.3	HK\$72.1	-13.6%
• Average daily number of derivatives contracts traded on the Futures Exchange	206,458	207,052	-0.3%
• Average daily number of stock options contracts traded on the Stock Exchange	191,676	225,074	-14.8%

- **FY09 results missed consensus** Hong Kong Exchanges and Clearing (HKEx) reported FY09 net profit of HK\$4,704m, down 8.4% y-o-y, which was slightly below Bloomberg consensus of HK\$4,821m. As investors' trading interests did not fully recover in 2009 following the financial crisis, the average daily turnover (ADT) on the Main Board recorded a fall of 13.6%, which resulted in a drop of 6.8% in total market turnover. Lower-than-expected investment income is another key reason to drag the overall performance.
- **No change in dividend policy** Annual dividends of HK\$3.93 (including interim dividends of HK\$1.84) imply a consistent payout ratio of 90%. In spite of expected higher capital expenditures for the new data centre (around HK\$700m), the company stated that external funding is unnecessary and HKEx has no intention to change the dividend policy.

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Business Review

- Turnover breakdown:

	FY2009		FY2008		Change
	HK\$ million		HK\$ million		
Trading fees/trading tariff	2,586.3	36.8%	2,803.1	37.1%	-7.7%
Stock Exchange listing fees	728.5	10.4%	712.0	9.4%	+2.3%
Clearing/settlement fees	1,424.7	20.3%	1,405.2	18.6%	+1.4%
Depository/custody/nominee services fees	562.6	8.0%	496.7	6.6%	+13.3%
Income from sale of information	694.6	9.9%	673.4	8.9%	+3.1%
Investment income	621.0	8.8%	999.2	13.2%	-37.9%
Other income	417.4	5.9%	459.5	6.1%	-9.2%
Total turnover	7,035.0	100.0%	7,549.1	100.0%	-6.8%

- **Trading fees and trading tariff** fell 7.7% in FY09 mainly due to lower income from the Cash Market on lower average market turnover in 2009. On the other hand, trading fees and trading tariff from the Derivatives Market recorded negative growth (down 3% y-o-y), driven by the decrease in the number of contracts traded. Despite the drop in the turnover of Cash Market, **Clearing and settlement fees** still rose slightly by 1.4%, which resulted from a lower proportion of transactions subject to the maximum settlement fee and a higher proportion of trades subject to the minimum fee. The **depository, custody and nominee fees** delivered the best result among other operations and grew by 13.3% y-o-y, mainly due to the increase in corporate action fees, scrip fees and eIPO handling fees.
- HKEx's income from **Stock Exchange listing fees** rose at a meagre 2.3% in FY09. The increase in listing fees is attributable to higher number of listed securities on the Main Board, which increased from 47 in FY08 to 68 in FY09. The number of newly listed Callable Bull/Bear Contracts (CBBCs) also surged to 8,072 in 2009 from 4,231 in 2008. Nevertheless, the higher revenue generated from newly listed securities and CBBCs were partially offset by the decline in the number of new Derivative Warrants (down 12% y-o-y, from 4,822 to 4,230).
- **Investment income** was down significantly by 37.9% y-o-y, attributable to a drop in the average amount of margin funds (down from HK\$62.3 billion to HK\$40.1 billion), which was mainly caused by the decrease in open interest in futures contracts and the lower margin rate applicable per futures contract. Besides, the net investment income was also brought down by the decrease in interest rates, with net return falling from 1.76% in 2008 to 1.12% in 2009
- **Operating expense** fell 8% y-o-y. The absence of the one-off provision relating to Lehman Brothers Group of HK\$157m and the on-off donation of HK\$10m for the Sichuan earthquake made in 2008 helped offset the higher premises expense in 2009 due to increase in rentals upon renewal of certain leases. The decrease in operating expense drove the cost-to-income ratio down slightly to 21.2% in FY09, compared to 21.5% in FY08.



Outlook & Prospect

- **Market activities as the ultimate earnings driver** Despite stock market stabilization has been largely confirmed, we do not see much improvement in the recent market activities. We believe that current market velocity of HK\$60 billion to HK\$70 billion ADT is quite sustainable, as Hong Kong market is still the only real “point of entry” for overseas investors to participate in China’s economic growth. Nevertheless, the current ADT is still far away from the 2008 peak of above HK\$100 billion. Some other concrete catalysts are required to boost the ADT to a higher level.
- **Ambitious 3-year plan** The new CEO Charles Li announced HKEx’s 3-year plan which include: 1) broaden IPOs to include other emerging market companies (particularly those in metals, mining and alternative energy); 2) tap the gradual internationalization of the RMB by introducing RMB fixed income, ETFs and derivative products; 3) prepare for liberalization of fund flows from China into Hong Kong which Mr. Li believes will ultimately materialize. With such ambitious CEO, we expect HKEx will offer more innovative products and services in the future.
- **The near-term catalyst – HK ETFs in Mainland** After securing its No. 1 position in CBBC and derivative warrant turnover globally, HKEx is likely to proceed towards the cross listing of ETFs in Mainland exchanges. Although initial fund flow may be modest at this moment, this move would allow more Mainland liquidity to buy Hong Kong-listed stocks.
- **Levy reduction** Local press reported that the Securities and Futures Commission is also considering a proposal of a reduction on transaction levy by 25% from the current 0.004% to 0.003%, which might come into effect in October. The lower trading costs may boost trading activities and HKEx would benefit from this potential change in the long run.
- **Valuation remains expensive** HKEx’s share price will remain to be driven by ADT in the near term. While it does not appear that ADT in Hong Kong is going to have a breakthrough soon, the current valuation of 24.1x FY10E P/E is on the high side. As such, we recommend “Underperform” rating on the counter.

Recommendation: *Underperform*



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