

# FINANCIAL REVIEW

HKEX Group – Overview of 2015 Results and Financial Position

## Key Business Drivers – Cash Segment

	2015
ADT of equity products on the Stock Exchange	\$79.9 bn*
Number of newly listed companies on Main Board	104
Number of newly listed companies on GEM	34
Number of Main Board companies at 31 Dec 2015	1,644
Number of GEM companies at 31 Dec 2015	222
Total equity funds raised on Main Board	\$1,094 bn*
Total equity funds raised on GEM	\$22 bn*
Total equity funds raised	\$1,116 bn*

\* New record high in 2015

## Reportable Segment Profit for the Year

	Cash \$m	Equity and Financial Derivatives \$m	Commodities \$m	Clearing \$m	Platform and Infrastructure \$m	Corporate Items \$m	Group \$m
Revenue and other income	3,435	2,179	1,735	5,002	499	525	13,375
Operating expenses	(531)	(446)	(546)	(692)	(148)	(927)	(3,290)
Reportable segment EBITDA	2,904	1,733	1,189	4,310	351	(402)	10,085
Depreciation and amortisation	(85)	(87)	(275)	(148)	(43)	(46)	(684)
Finance costs	-	-	-	-	-	(114)	(114)
Share of loss of a joint venture	-	(9)	-	-	-	-	(9)
Reportable segment profit before taxation	2,819	1,637	914	4,162	308	(562)	9,278
Taxation							(1,347)
Profit for the year							7,931
Loss attributable to non-controlling interests							25
Profit attributable to shareholders of HKEX							7,956

## Key Business Drivers – Equity and Financial Derivatives Segment

	2015
ADT of DWs, CBBCs and warrants on the Stock Exchange	\$25.7 bn*
Average daily number of derivatives contracts traded on the Futures Exchange <sup>1</sup>	393,948*
Average daily number of stock options contracts traded on the Stock Exchange	374,346*
Number of newly listed DWs	6,336
Number of newly listed CBBCs	11,213*

1 Excludes London Metal Mini Futures contracts which are included under the Commodities segment

\* New record high in 2015

## Key Business Drivers – Commodities Segment

	2015
Average daily volume of metals contracts traded on LME (lots)	670,189

## Key Business Drivers – Clearing Segment

	2015
ADT on the Stock Exchange	\$105.6 bn*
Average daily value of Settlement Instructions settled by CCASS	\$254.7 bn

\* New record high in 2015

## Consolidated Statement of Financial Position

At 31 Dec 2014

ASSETS	\$m
Cash and cash equivalents of Corporate Funds	8,067
Cash and cash equivalents of Funds and prepayments for A-shares	150,041
Financial assets – Others	13,263
Financial assets – Base metals futures and options contracts	59,679
Goodwill and other intangible assets	17,901
Fixed assets and lease premium for land	1,626
Other assets	22,613
Total assets	251,860
LIABILITIES AND EQUITY	
Liabilities	
Margin deposits, Mainland security and settlement deposits, and cash collateral from CPs and CPs' contributions to Clearing House Funds	138,910
Financial liabilities – base metals futures and options contracts cleared through LME Clear	59,679
Borrowings	7,026
Other liabilities	24,886
Total liabilities	230,501
Equity	
Share capital and reserves	12,955
Shares held for Share Award Scheme	(482)
Retained earnings	8,800
Equity attributable to shareholders of HKEX	21,273
Non-controlling interests	86
Total equity	21,359
Total liabilities and equity	251,860

## Cash Flows for the Year

	2015
	\$m
Operating activities	
Net cash inflow from operating activities	8,321
Investing activities	
Net proceeds from disposal of a leasehold property and other fixed assets	512
Payments for purchases of fixed assets and intangible assets	(710)
Net increase in financial assets of Corporate Funds	(239)
Interest received from financial assets	17
Financing activities	
Dividends paid	(3,017)
Payments of finance costs	(71)
Purchases of shares for Share Award Scheme	(227)
Other net inflows	91
Net increase in cash and cash equivalents	4,677
Cash and cash equivalents at 1 Jan 2015	8,067
Cash and cash equivalents of Corporate Funds at 31 Dec 2015	12,744

## Consolidated Statement of Financial Position

At 31 Dec 2015

ASSETS	\$m
Cash and cash equivalents of Corporate Funds	12,744
Cash and cash equivalents of Funds and prepayments for A-shares	138,611
Financial assets – Others	27,721
Financial assets – Base metals futures and options contracts	64,480
Goodwill and other intangible assets	17,872
Fixed assets and lease premium for land	1,582
Other assets	15,648
Total assets	238,193
LIABILITIES AND EQUITY	
Liabilities	
Margin deposits, Mainland security and settlement deposits, and cash collateral from CPs and CPs' contributions to Clearing House Funds	122,687
Financial liabilities – base metals futures and options contracts cleared through LME Clear	64,480
Borrowings	3,409
Other liabilities	17,655
Total liabilities	208,231
Equity	
Share capital and reserves	19,715
Shares held for Share Award Scheme	(590)
Retained earnings	10,691
Equity attributable to shareholders of HKEX	29,816
Non-controlling interests	146
Total equity	29,962
Total liabilities and equity	238,193

## Movements in Share Capital and Reserves for the Year

2015

	Share capital \$m	Employee share-based compensation reserve \$m	Various other reserves \$m	Total \$m
At 1 Jan 2015	12,225	142	588	12,955
Issue of shares for employee share options exercised	3	–	–	3
Issue of shares in lieu of cash dividends	3,180	–	–	3,180
Employee share-based compensation benefits	–	183	–	183
Currency translation differences of foreign subsidiaries	–	–	(7)	(7)
Transfer from retained earnings	–	–	135	135
Vesting of shares of Share Award Scheme	–	(126)	–	(126)
Conversion of Convertible Bonds	3,877	–	(409)	3,468
Put options written to non-controlling interests	–	–	(76)	(76)
At 31 Dec 2015	19,285	199	231	19,715

## Movements in Retained Earnings for the Year

2015

	\$m
Profit attributable to shareholders of HKEX	7,956
Dividends	(6,212)
Unclaimed dividends forfeited	18
Vesting of dividend shares of Share Award Scheme	(8)
Conversion of Convertible Bonds	266
Transfer to reserves	(135)
Other changes	6
Net increase in retained earnings	1,891
Retained earnings at 1 Jan 2015	8,800
Retained earnings at 31 Dec 2015	10,691

Revenue and other income experienced a significant uplift in 2015 and reached a record high of \$13.4 billion. The majority of this revenue growth was derived from:

- A substantial increase in market activity on the Cash and Derivatives Markets in Hong Kong, in particular during the second quarter, which drove significant growth in trading and clearing income;
- A considerable increase in the contribution from the Group's UK operations due to the commercialisation of LME's trading fees effective from 1 January 2015 and a full year's contribution from LME Clear, which was launched in September 2014; and
- A one-off gain of \$445 million on the disposal of a Hong Kong leasehold property in the third quarter.

Operating expenses increased by 11 per cent against 2014 primarily reflecting the cost of additional headcount to support strategic initiatives and higher operating costs following the launch of LME Clear. The overall increase was mitigated by lower litigation costs.

The EBITDA margin of 75 per cent was 5 per cent higher than 2014, as the significant growth in revenue and other income outpaced the increase in operating expenses.

Profit attributable to shareholders increased by 54 per cent to a record high of \$7,956 million, reflecting increased EBITDA, lower finance costs arising from the full conversion of the Convertible Bonds and a modest increase in depreciation and amortisation.

The EBITDA of the Group by operating segment during 2015 was as follows:

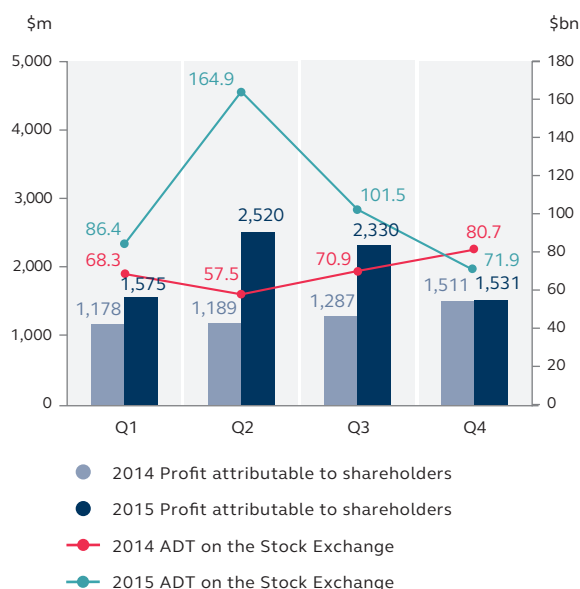
- EBITDA of the Cash segment increased by \$604 million mainly due to higher trading fees from increased ADT.
- EBITDA of the Equity and Financial Derivatives segment increased by \$467 million due to higher trading fees from increased ADT of DWs and CBBCs and increased average daily number of futures and options contracts traded.
- EBITDA of the Commodities segment increased by \$483 million as a result of commercialising the LME's trading fees effective from 1 January 2015.
- EBITDA of the Clearing segment increased by \$1,393 million. Revenue and other income increased due to higher revenue from increased ADT, higher volume of settlement instructions and a full year's contribution from LME Clear. The increase was partly offset by higher operating expenses following the launch of LME Clear.
- EBITDA of the Platform and Infrastructure segment increased by \$38 million mainly due to higher network income.
- Comprised financial assets and cash and cash equivalents of Margin Funds of \$114,416 million (2014: \$128,869 million), Corporate Funds of \$15,636 million (2014: \$10,264 million), Clearing House Funds of \$8,430 million (2014: \$10,289 million), and cash prepayments for A shares of \$129 million (2014: \$619 million).
- Base metals derivative financial assets and derivative financial liabilities of \$64,480 million (2014: \$59,679 million) represent the fair value of outstanding contracts of LME Clear that do not qualify for netting treatment under the relevant accounting standards, where LME Clear is acting in its capacity as a central counterparty to the contracts traded on the LME.
- Goodwill and intangible assets dropped by \$29 million mainly due to amortisation of \$445 million, but partly offset by additions of \$427 million.
- Fixed assets and lease premium for land decreased by \$44 million mainly due to depreciation of \$239 million and disposal of a Hong Kong leasehold property with net book value of \$59 million, but partly offset by additions of \$255 million.
- Other assets consisted of money obligations receivable under the CNS System of \$13,529 million (2014: \$20,410 million) and other receivables.
- Represented margin deposits, Mainland security and settlement deposits and cash collateral from CPs of \$115,213 million (2014: \$129,484 million) and CPs' contributions to Clearing House Funds of \$7,474 million (2014: \$9,426 million). The decrease in margin deposits, Mainland security and settlement deposits and cash collateral from CPs was due to lower margin deposits collected by LME Clear as more non-cash collateral was posted by LME Clear CPs in lieu of cash margin. The decrease in CPs' contributions to Clearing House Funds was due to less contributions required from CPs in response to market volatility and changes in risk exposures.
- In 2015, all of the US\$500 million of Convertible Bonds with carrying value of HK\$3,701 million at 31 December 2014 were converted into HKEX shares.
- Other liabilities mainly represented money obligations payable under the CNS System of \$13,658 million (2014: \$21,029 million) and other liabilities.
- Net cash inflow from operating activities increased by \$3,648 million compared with 2014 due to higher profit for the year.

## Analysis of Results by Quarter

### Quarterly Results

	Q1 2015 \$m	Q2 2015 \$m	Q3 2015 \$m	Q4 2015 \$m	Total 2015 \$m
Revenue and other income	2,796	4,057	3,747	2,775	13,375
Operating expenses	(718)	(862)	(881)	(829)	(3,290)
EBITDA	2,078	3,195	2,866	1,946	10,085
Depreciation and amortisation	(163)	(162)	(175)	(184)	(684)
Operating profit	1,915	3,033	2,691	1,762	9,401
Finance costs	(46)	(31)	(18)	(19)	(114)
Share of loss of a joint venture	(2)	(3)	(2)	(2)	(9)
Profit before taxation	1,867	2,999	2,671	1,741	9,278
Taxation	(298)	(485)	(347)	(217)	(1,347)
Profit for period/year	1,569	2,514	2,324	1,524	7,931
Loss attributable to non-controlling interests	6	6	6	7	25
Profit attributable to shareholders	1,575	2,520	2,330	1,531	7,956
	Q1 2014 \$m	Q2 2014 \$m	Q3 2014 \$m	Q4 2014 \$m	Total 2014 \$m
Profit attributable to shareholders	1,178	1,189	1,287	1,511	5,165

### Analysis of Quarterly Results



2015 was a very volatile year during which a strong bull market in the Mainland quickly reached its peak in Q2 2015. This abruptly turned into a bear market in the second half of the year, with a 30 per cent drop in the A-share index from its peak, due to the devaluation of Renminbi, concern over the Mainland's potential economic hard landing and the likely interest rate hikes in the US.

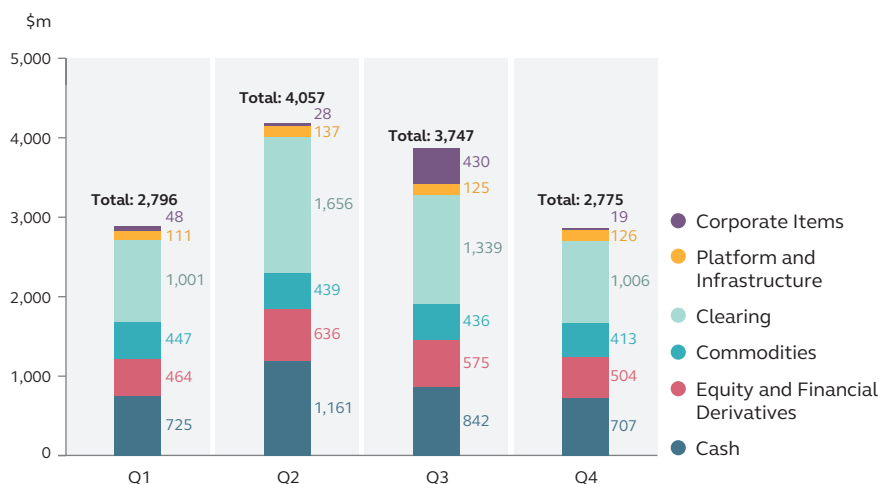
While the Hang Seng Index and H-share Index experienced similar significant movements, the volatility boosted trading volumes in Hong Kong.

LME and LME Clear provided solid and steady contributions due to Group profit following the commercialisation of LME's trading fees and a full year's operation of LME Clear.

Consequently, profit attributable to shareholders increased significantly in the first three quarters compared with 2014, and reached a record high in the second quarter.

Profit for the third quarter was boosted by a one-off gain on disposal of a leasehold property of \$445 million.

## Analysis of 2015 Segment Revenue and Other Income by Quarter



Revenue and other income from all segments generally moved in line with the respective market indicators in the table below.

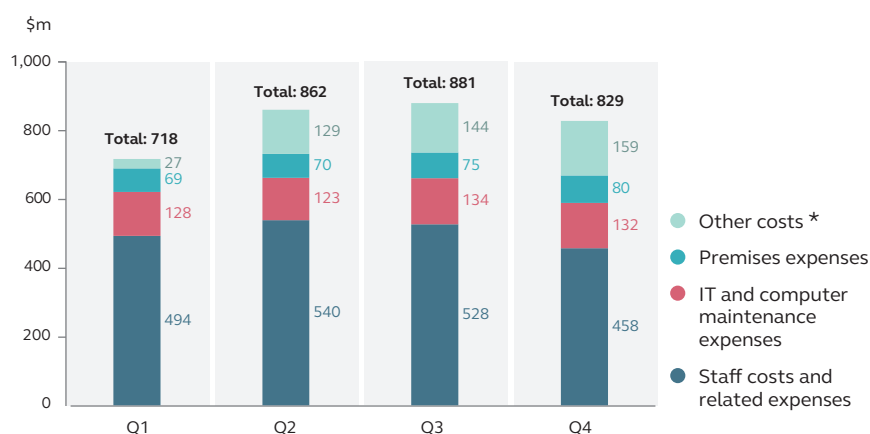
A one-off gain on disposal of a leasehold property of \$445 million was recorded under Corporate Items in the third quarter.

The key market indicators for the income of the Group by quarter are set out below:

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Total 2015
ADT of equity products traded on the Stock Exchange (\$bn)	65.5	129.0	75.9	51.3	79.9
ADT of DWs, CBBCs and warrants traded on the Stock Exchange (\$bn)	20.9	35.9	25.6	20.6	25.7
ADT on the Stock Exchange (\$bn)	86.4	164.9	101.5	71.9	105.6
Average daily number of derivatives contracts traded on the Futures Exchange	309,356	422,477	443,304	400,212	394,174
Average daily number of stock options contracts traded on the Stock Exchange	363,322	523,860	375,780	241,192	374,346
Average daily volume of metals contracts traded on the LME (lots)	695,771	695,399	654,770	636,638	670,189
Number of newly listed DWs	1,498	2,124	1,552	1,162	6,336
Number of newly listed CBBCs	2,287	3,066	3,799	2,061	11,213
Number of newly listed companies on Main Board <sup>1</sup>	19	18	26	41	104
Number of newly listed companies on GEM	9	5	7	13	34

<sup>1</sup> Including 14 (Q1: 3; Q2: 2; Q3: 7; Q4: 2) transfers from GEM

## Analysis of 2015 Operating Expenses by Quarter



\* Other costs include product marketing and promotion expenses, legal and professional fees, and other operating expenses.

Staff costs moved in line with profit in the first three quarters as variable pay was accrued based on profit of the quarter. The drop in staff costs in the fourth quarter was due to lower variable pay accrual after the Board had fixed the total amount of variable pay for the year in December.

Other costs were lower in the first quarter due to a \$77 million recovery from the liquidators of Lehman Brothers Securities Asia Limited.

## Changes to Key Items in Consolidated Statement of Financial Position

### (A) Financial Assets and Financial Liabilities

	At 31 Dec 2015 \$m	At 31 Dec 2014 \$m	Change
<b>Financial assets</b>			
Cash and cash equivalents	110,890	136,778	(19%)
Financial assets measured at fair value through profit or loss	72,705	62,686	16%
Financial assets measured at amortised cost	19,496	10,256	90%
<b>Total</b>	<b>203,091</b>	<b>209,720</b>	<b>(3%)</b>

The Group's financial assets comprised financial assets of Corporate Funds, Margin Funds, Clearing House Funds, base metals derivatives contracts, and cash prepayments for A shares traded under Stock Connect as follows:

	At 31 Dec 2015 \$m	At 31 Dec 2014 \$m	Change
<b>Financial assets</b>			
Corporate Funds	15,636	10,264	52%
Margin Funds <sup>1</sup>	114,416	128,869	(11%)
Clearing House Funds	8,430	10,289	(18%)
Base metals derivatives contracts cleared through LME Clear	64,480	59,679	8%
Cash prepayments for A shares	129	619	(79%)
<b>Total</b>	<b>203,091</b>	<b>209,720</b>	<b>(3%)</b>

<sup>1</sup> Excludes margin receivable from CPs and Settlement Reserve Fund and Settlement Guarantee Fund which have been paid to ChinaClear of \$797 million (31 December 2014: \$615 million)

	At 31 Dec 2015 \$m	At 31 Dec 2014 \$m	Change
<b>Financial liabilities</b>			
Base metals derivatives contracts cleared through LME Clear	64,480	59,679	8%
Other financial liabilities at fair value through profit or loss	6	1	500%
Margin deposits, Mainland security and settlement deposits, and cash collateral from CPs	115,213	129,484	(11%)
Participants' contributions to Clearing House Funds	7,474	9,426	(21%)
<b>Total</b>	<b>187,173</b>	<b>198,590</b>	<b>(6%)</b>

The decrease in financial assets of Margin Funds and the drop in margin deposits, Mainland security and settlement deposits, and cash collateral from CPs at 31 December 2015 against those at 31 December 2014 was mainly due to lower margin deposits collected by LME Clear as more non-cash collateral was posted by Participants in lieu of cash margin.

The decrease in financial assets of Clearing House Funds was mainly attributable to less contributions required from Participants in response to market volatility and changes in risk exposures.

Base metals derivative financial assets and derivative financial liabilities of \$64,480 million (31 December 2014: \$59,679 million) represented the fair value of outstanding contracts cleared through LME Clear that did not qualify for netting treatment under relevant accounting standards, where LME Clear is acting in its capacity as a central counterparty to the metals contracts traded on the LME.

Corporate Funds at 31 December 2015 increased by \$5,372 million or 52 per cent as compared to those at 31 December 2014 mainly due to the retention of cash generated by the business over the past year partly offset by the cash component of the 2014 final dividend and 2015 interim dividend.

## **(B) Fixed Assets, Intangible Assets and Capital Commitments**

The total net book value of the Group's fixed assets and intangible assets dropped by \$72 million from \$19,504 million at 31 December 2014 to \$19,432 million at 31 December 2015. The drop was due to the disposal of a leasehold property with a net book value of \$59 million, and exchange losses of \$11 million arising from the effect of the depreciation of USD against HKD on the Group's investment in overseas subsidiaries. Depreciation and amortisation of \$684 million were offset by additions of \$682 million. The additions mainly related to the development and upgrade of various trading and clearing systems including the commodities trading and clearing systems, a cash clearing system, trading and clearing systems to facilitate mutual stock market access between Mainland China and Hong Kong, and a corporate Enterprise Resource Planning system.

The Group's capital expenditure commitments at 31 December 2015, including those authorised by the Board but not yet contracted for, amounted to \$961 million (31 December 2014: \$574 million) and were mainly related to the development and enhancement of IT systems including cash and commodities trading and clearing systems, and trading and clearing systems to facilitate mutual stock market access between Mainland China and Hong Kong.

## **(C) Significant Investments Held, Material Acquisitions and Disposals of Subsidiaries, and Future Plans for Material Investments or Capital Assets**

Subsequent to 31 December 2015, the Group completed an internal reorganisation of its subsidiaries on 22 January 2016. Following the internal reorganisation, HKCC, SEOCH, The Stock Exchange Club Limited, HKEx Information Services Limited and HK Conversion Agency Services Limited, which were previously held by HKFE, SEHK and HKSCC, became direct wholly-owned subsidiaries of HKEX. The internal reorganisation will help the Group to focus its attention on complying with various regulatory obligations and better manage the risks associated with the businesses and operations of the recognised exchanges and clearing houses going forward.

Save for those disclosed in this Annual Report, there were no other significant investments held nor material acquisitions or disposals of subsidiaries during the year. Apart from as disclosed in this Annual Report, there was no plan authorised by the Board for other material investments or additions of capital assets at the date of this Annual Report.

## **(D) Accounts Receivable, Prepayments and Deposits and Accounts Payable, Accruals and Other Liabilities**

The Group's accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities at 31 December 2015 mainly comprised CNS money obligations receivable and payable and other receivables from and payables to EPs and CPs. Following the launch of Stock Connect, certain security deposits (Settlement Reserve Fund and Settlement Guarantee Fund) have been placed by HKSCC with ChinaClear to satisfy its obligations as a CP of ChinaClear. Further details are set out below.

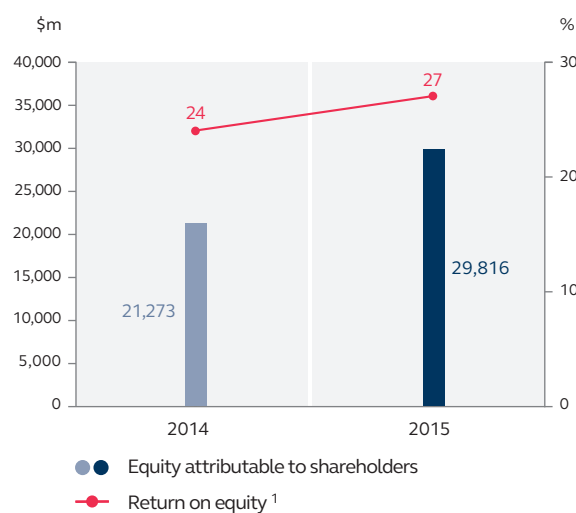
	At 31 Dec 2015 \$m	At 31 Dec 2014 \$m	Change
CNS money obligations receivable	13,529	20,410	(34%)
Settlement Reserve Fund and Settlement Guarantee Fund held by ChinaClear	794	611	30%
Other receivables from Participants	461	831	(45%)
Other accounts receivable, prepayments and deposits	776	753	3%
Less: provision for impairment losses of receivables	(4)	(82)	(95%)
<b>Total accounts receivable, prepayments and deposits</b>	<b>15,556</b>	<b>22,523</b>	<b>(31%)</b>
CNS money obligations payable	13,658	21,029	(35%)
Other payables to Participants	324	508	(36%)
Stamp duty payable to the Collector of Stamp Revenue	172	338	(49%)
Other accounts payable, accruals and other liabilities	1,131	974	16%
<b>Total accounts payable, accruals and other liabilities</b>	<b>15,285</b>	<b>22,849</b>	<b>(33%)</b>

The decrease in CNS money obligations receivable and payable was mainly due to lower market turnover of the Stock Exchange at the end of December 2015.

### (E) Equity attributable to Shareholders and Return on Equity

Equity attributable to shareholders increased to \$29,816 million at 31 December 2015 from \$21,273 million at 31 December 2014. This arose from \$3,165 million of shares issued in lieu of cash dividends, \$3,734 million of shares issued for conversion of the Convertible Bonds (excluding the transfer from the convertible bond reserve to share capital and retained earnings which were all part of shareholders' equity) and an increase in retained earnings of \$1,744 million attributable to profit for the year less dividends declared, but was partly offset by the purchase of shares for Share Award Scheme of \$227 million.

#### Equity attributable to Shareholders and Return on Equity



Return on equity rose by 3 per cent due to the increase in profit attributable to shareholders in 2015.

<sup>1</sup> Based on equity attributable to shareholders at year-end

### Liquidity, Financial Resources and Gearing

Working capital rose by \$4,971 million to \$14,595 million at 31 December 2015 (31 December 2014: \$9,624 million). The increase was mainly due to profit attributable to shareholders of \$7,956 million, which was partly offset by the 2014 final dividend and 2015 interim dividend, net of scrip dividends, of \$3,047 million.

In 2015, all of the US\$500 million of Convertible Bonds with carrying value of HK\$3,701 million at 31 December 2014 were converted into HKEX shares at the adjusted conversion price of HK\$157.62 per share and cancelled upon the exercise of the conversion rights by the bondholders.

At 31 December 2015, the Group had the following outstanding borrowings:

	At 31 Dec 2015		At 31 Dec 2014	
	Carrying value \$m	Maturity	Carrying value \$m	Maturity
USD floating rate bank borrowings	1,585	Jul 2020 & Jul 2021	1,585	Jul 2020 & Jul 2021
2 USD fixed rate notes with average coupon of 2.8 per cent	1,516	Dec 2018 & Jan 2019	1,515	Dec 2018 & Jan 2019
Convertible Bonds	–	N/A	3,701	Oct 2017
Written put options to non-controlling interests	308	N/A	225	N/A
	3,409		7,026	

At 31 December 2015, the Group had a gross gearing ratio (ie, gross debt divided by adjusted capital) of 12 per cent (31 December 2014: 34 per cent), and a net gearing ratio (ie, net debt divided by adjusted capital) of zero per cent (31 December 2014: zero per cent). For this purpose, gross debt is defined as total borrowings and net debt is defined as total borrowings less cash and cash equivalents of Corporate Funds (and will be zero when the amount of cash and cash equivalents of Corporate Funds is greater than total borrowings), and adjusted capital as all components of equity attributable to shareholders other than designated reserves.

Apart from the borrowings used to fund the acquisition of the LME Group, banking facilities have been put in place for contingency purposes. At 31 December 2015, the Group's total available banking facilities for its daily operations amounted to \$17,012 million (31 December 2014: \$17,012 million), which included \$10,000 million (31 December 2014: \$10,000 million) of committed banking facilities and \$7,000 million (31 December 2014: \$7,000 million) of repurchase facilities.

The Group has also put in place foreign exchange facilities for the RMB Trading Support Facility to support the trading of RMB stocks listed on the Stock Exchange. At 31 December 2015, the total amount of the facilities was RMB17,000 million (31 December 2014: RMB17,000 million).

In addition, the Group has arranged contingency banking facilities amounting to RMB13,000 million (31 December 2014: RMB13,000 million) for settling payment obligations to ChinaClear should there be events that disrupt normal settlement arrangements for Stock Connect, eg, natural disasters or extreme weather conditions in Hong Kong.

At 31 December 2015, 92 per cent (31 December 2014: 93 per cent) of the Group's cash and cash equivalents were denominated in HKD or USD.

## Charges on Assets

Details of charges on assets are included in note 50 to the Consolidated Financial Statements of this Annual Report.

## Exposure to Fluctuations in Exchange Rates and Related Hedges

Details of the Group's exposure to fluctuations in exchange rates and related hedges are included in note 52(a)(i) – Foreign exchange risk management to the Consolidated Financial Statements of this Annual Report.

## Contingent Liabilities

Details of contingent liabilities are included in note 46 to the Consolidated Financial Statements of this Annual Report.