HKEx 香港交易所

HKEx's Elaboration on HKEx's 2012 Results Announcement
27 February 2013

1. What's the implication of HKEx's 2012 results on its recently announced three-year strategic plan?

HKEx experienced a down year in 2012 due to subdued market conditions and increased operating expenses incurred to carry out various strategic initiatives. However, our capital expenditure investments have peaked and we have witnessed a shift in market momentum towards the positive since the start of 2013, which suggests that we are likely turning the corner in 2013.

The acquisition of the LME as well as various investments in infrastructure in 2012 have laid the foundation for HKEx Group to further grow its business, both in terms of scale and in terms of new asset classes. Now that a solid foundation has been laid, we are prepared to build on it according to our Strategic Plan 2013-2015.

Apart from organic growth, we also strongly believe the acquisition of the LME and other recent market infrastructure improvements will be the catalyst for greater market connectivity between the Mainland and international markets. We are well positioned to capitalise on the opportunities arising from the accelerated opening of Mainland China's capital account.

2. HKEx's operating expenses (excluding depreciation and amortisation) rose by 13 per cent from $1,733 million in 2011 to $1,957 million in 2012. Will operating expenses keep escalating at this rate?

We are investing in our future and have undertaken a number of initiatives to:

- further improve market quality;
- upgrade our infrastructure to capture new business opportunities; and
- embark on new businesses as part of our strategy.

We will experience some growth in headcount and operating expenses with the implementation of these initiatives. Some of the new initiatives will generate incremental or new sources of income over time.

The operating expenses for 2012 also include the LME Group's operating expenses since the date of acquisition (6 December 2012). The LME Group's full-year operating expenses will be included in the accounts for 2013.

3. Staff costs accounted for the largest component of the increase in operating expenses before depreciation and amortisation ($148 million out of $224 million). What were the major reasons for the increase?

Staff costs accounted for the largest component of the increase in operating expenses ($148 million out of $224 million). The increase in staff costs was mainly as a result of an increase in headcount primarily for various initiatives under our Strategic Plan (from 940 employees at the end of 2011 to 1,030 employees at the end of 2012 excluding the LME Group), salary adjustments to keep up with market trends, and higher share-based compensation expenses arising from the shares granted to employees in 2011. The increase was partly offset by a reduction in performance bonus due to the lower profit in 2012.

The staff costs also covered 26 days of the LME Group's staff costs in 2012.

4. Why did depreciation and amortisation increase from $90 million in 2011 to $158 million in 2012? Will it go up in the future?

Depreciation and amortisation increased mainly due to the upgrade of the Cash Market trading system (AMS/3.8) and Market Data system (MDS/3.8) rolled out in December 2011, the completion of phase one of the construction of the new Data Centre at Tseung Kwan O, and the acquisition of LME Group.

With the completion of phase one of the new Data Centre, approximately $1,247 million of capital expenditures (capex) with an average useful life of 17 years commenced depreciation in September 2012. Moreover, OTC Clearing and other initiatives will be completed and rolled out in 2013. Together with the full year impact of the depreciation and amortisation of LME Group's own capex and the amortisation of intangible assets arising from the acquisition of LME Group (which totalled $22 million in December 2012), depreciation and amortisation will increase further in 2013.

5. How much in fees and expenses did HKEx incur to acquire the LME Group?

We have incurred $138 million mainly on professional fees and travelling expenses, $30 million for establishing a bank facility and there was a one-off mark-to-market loss of $55 million on the conversion option of the convertible bonds we issued.

Excluding this $223 million of one-off acquisition related expenses, the Group's profit attributable to shareholders would be $4,307 million or 15 per cent lower than 2011.

6. How much did LME Group contribute to the Group's results and what are its future prospects?

Since its date of acquisition (6 December 2012) to 31 December 2012, the LME Group contributed:

- Revenue and other income: $76 million
- Costs: $52 million (operating expenses: $41 million; depreciation: $11 million)
- Profit after taxation: $19 million
- EBITDA: $35 million

The LME raised its exchange user fees starting on 2 July 2012 (All-in cost of segregated trades rose from 16 pence per lot and non-segregated trades from 7 pence per lot to a flat rate of 50 pence per lot, re-denominated in USD). The total revenue and other income in the second half of 2012 was more than 40 per cent higher than the first half of 2012 largely due to the fee increase. The full year benefit of the fee increase will be reflected in 2013.

For the full-year in 2012, the LME Group had:

- Revenue and other income of $976 million
- Operating expenses excluding depreciation and amortisation and non-recurring items of $639 million
- EBITDA from continuing operations of $337 million

7. In 2012, the Group incurred additional capex of $1,097 million (2011: $743 million). What were the major capex items? Will capex continue to increase in 2013?

The capex increase was mainly because of the:

- new data centre at Tseung Kwan O with Hosting Services capability;
- upgrade and enhancement of the Derivatives Market's trading and clearing systems;
- development of the over-the-counter derivatives clearing system; and
- the LME Group's additions (mainly software)

The capex for Hong Kong has already peaked.

As we have now acquired the LME Group, it will also have capex projects. For example, the LME Clear system development is already underway. We will monitor the Group's capex closely and ensure that it is properly prioritised and controlled.

The capital commitments approved by the Board for HKEx Group as at 31 December 2012 was $832 million (31 December 2011: $1,605 million). The capital commitments relate mainly to:

- the relocation of the primary data centres to the new Data Centre at Tseung Kwan O;
- the development of Hosting Services;
- a new market data system;
- a clearing system for OTC derivatives;
- a Central Gateway for the Cash Market,
- the upgrade and enhancement of the Derivatives Market trading and clearing systems, and
- LME Clear

8. What will be the impact of the share placement and convertible bond issue on HKEx's Earnings per Share in 2013?

Assuming there is no conversion of the convertible bonds in 2013, and the profit after taxation remains constant, the basic earnings per share and the diluted earnings per share will drop by approximately 5 per cent compared with 2012 due to the full-year effect of the share placement.

9. Will the Group raise more funds in the near future?

We do not have any urgent need to raise more funds. After the successful CB issue and share placement, the Group's financial position is very healthy with a debt to equity ratio of 37 per cent as at 31 December 2012, which is within the range we are comfortable with.

10. What progress has been made on integration with the LME?

HKEx launched a full integration programme with support from expert external consultants. Specific achievements include:

- All necessary corporate changes were effected and the transition of ownership was executed smoothly on 6 December 2012;
- Year-end reporting of the new group was achieved on schedule;
- A new integrated group organisation structure was implemented on 7 January;
- A new Asian Commodities Development team has been formed under the leadership of Liz Milan focusing on development of commodities in Asia;

- The Boards of the UK-based subsidiaries have been constituted with a mix of LME and HKEx executives and Independent Non-Executive Directors.

The Asian Commodities Development team has been looking at Asia benchmark pricing, as well as various product development and other business development initiatives. An "LME Week Asia" is also planned for June in Hong Kong as a means to further build the LME franchise in the region.