Investment income decreased by 32 per cent to $135 million (2001: $199 million), mainly due to a decline in net interest income caused by the successive interest rate cuts in 2001 in Hong Kong following similar cuts in the US by the US Federal Reserve. During the two semi-annual periods under review, the average 6-month Hong Kong Exchange Fund Bill rate fell from 4.33 per cent in 2001 to 1.86 per cent in 2002 (a decrease of 57 per cent), and the average 90-day US Treasury Bill rate dropped from 4.34 per cent to 1.74 per cent (a decrease of 60 per cent).

For the six months ended 30 June 2002, the Group achieved a positive return on investments of 2.96 per cent (2001: 5.11 per cent). The portfolio recorded a spread of 110 basis points above the 6-month Hong Kong Exchange Fund Bill benchmark, higher than the 78 basis points spread achieved in 2001.

The average amount of funds available for investment shrank by 3 per cent to $9.0 billion, primarily due to a drop in margin funds received as a result of the lowering of margin requirements for various derivative products in line with volatility movements during the first half. As at 30 June 2002, 53 per cent of the funds were invested in cash or bank deposits, 45 per cent in investment-grade bonds with an average credit rating of Aa3, and 2 per cent in global equities.

Operating Expenses

Total operating expenses decreased by 3 per cent to $577 million (2001: $597 million).

Staff costs and related expenses were reduced by 9 per cent to $262 million (2001: $287 million), mainly on account of a lower headcount, a significant cut in variable pay and tight controls over other staff-related expenditures.

Due to the Group's commitment to constantly enhance the capability and resilience of its trading and settlement systems, information technology and computer maintenance expenses rose by 11 per cent from $119 million to $132 million, mainly attributable to expenditures incurred on the implementation of the upgraded Central Clearing and Settlement System (CCASS/3) during the period.

Legal and professional fees for the period decreased by 62 per cent from $16 million to $6 million, primarily attributable to professional fees incurred for several one-off consulting projects in 2001.

Other operating expenses rose by 17 per cent from $35 million to $41 million largely on account of redundancy costs incurred following the sale of Hong Kong Registrars Limited (HKRL).

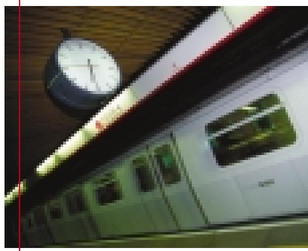
Taxation

The Group's taxation charge in 2002 declined by 32 per cent to $26 million (2001: $38 million), mainly due to the lower profit reported for the period and the reversal of overpayment for prior year tax following our negotiation for the deductibility of certain expenses.

Liquidity, Financial Resources and Capital Commitments

Working capital decreased by $35 million to $4,002 million as at 30 June 2002 (31 December 2001: $4,037 million) as bank balances and time deposits of corporate funds fell by $382 million to $1,218 million (31 December 2001: $1,600 million) following the distribution of the 2001 final dividend of $261 million and the settlement of accounts payable, accruals and other liabilities during the period.

Although the Group has consistently been in a very liquid position, credit facilities have nevertheless been put in place for contingency purposes. As at 30 June 2002, the Group's total available credit facilities amounted to $2,858 million (31 December 2001: $2,875 million), of which $1,600 million were repurchase facilities for maintaining the liquidity of the margin funds and $1,100 million were for meeting obligations of Hong Kong Securities Clearing Company Limited (HKSCC) in CCASS in circumstances where Broker Participants in CCASS default on their payment obligations. Borrowings of the Group have been very rare and, if required, are mostly event driven, with little seasonality. As at 30 June 2002, the only facility drawn down was a fixed rate bank loan of SGD11 million (equivalent to HK$49 million) with a maturity of less than one year which was used for the purpose of hedging the currency exposure of the Group's investment in Singapore (2001: HK$46 million).



As at 30 June 2002, the Group's gearing ratio, measured on the basis of total borrowings as a percentage of total shareholders' equity, was less than 1 per cent (31 December 2001: less than 1 per cent).

As at 30 June 2002, the Group's capital expenditure commitments, mainly in respect of its ongoing investments in facilities and technology amounted to $257 million (31 December 2001: $317 million). The Group has adequate financial resources to fund its commitments on capital expenditure from its existing cash resources and cash flows generated from its operations.

Charges on Assets

As at 31 December 2001, the Group had a $10 million overdraft facility with a bank in Hong Kong, which was secured by a pledge of the Group's time deposits of an equivalent amount at that bank. This overdraft facility was not utilised and was terminated during the period. The Group did not have any charges on assets as at 30 June 2002.

Significant Investments Held and Material Acquisitions and Disposals of Subsidiaries

The Group has been holding 1 per cent (10 million shares) of the issued ordinary share capital of Singapore Exchange Limited since November 2000.

On 2 April 2002, the Group acquired 15.6 per cent (3.6 million shares) of the issued ordinary share capital of BondsInAsia Limited, an unlisted company incorporated in Hong Kong which provides an electronic trading platform for bond markets in Asia.

On 15 May 2002, the Group and Wilco International Limited, a wholly owned subsidiary of Automatic Data Processing, Inc., formed a new joint venture, Wilco International Processing Services Limited, to provide Brokers' Electronic Support Services to Stock Exchange Participants.

On 31 May 2002, the share registration operations of the Group's clearing business, HKRL, a wholly owned subsidiary, were sold and merged with those of Central Registration Hong Kong Limited, which has been renamed as Computershare Hong Kong Investor Services Limited (CHIS). The Group received 18 per cent of the issued share capital of CHIS as consideration for the sale of HKRL. On the same date, the Group increased its holding in CHIS to 24 per cent by acquiring a further 6 per cent of the issued share capital of CHIS by cash.

Exposure to Fluctuations in Exchange Rates and Related Hedges

The Group's foreign currency liabilities, in the form of margin deposits or collateral received, are hedged by investments in the same currencies. As at 30 June 2002, aggregate net open foreign currency positions amounted to HK$2,119 million, of which HK$217 million were non-USD exposures (31 December 2001: HK$1,947 million, of which HK$72 million were non-USD exposures).

Contingent Liabilities

(a) The Unified Exchange Compensation Fund (Compensation Fund) is a fund set up under the Securities Ordinance (SO) for the purpose of compensating any person dealing with a Stock Exchange Participant (other than another Stock Exchange Participant) for any pecuniary losses suffered as a result of defaults of the Stock Exchange Participant. According to section 109(3) of the SO, the maximum compensation amount is $8 million for each Stock Exchange Participant's default. Under section 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the Securities and Futures Commission of Hong Kong (SFC), allow an additional payment to the successful claimants before apportionment. Under section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the SFC's request to do so. The amounts to be replenished should be equal to the amount paid in connection with the satisfaction of the claims, including any legal and other expenses paid or incurred in relation to the claims but capped at $8 million per default. As at 30 June 2002, there were outstanding claims received in respect of 14 defaulted Stock Exchange Participants (31 December 2001: 15).

Under the new investor compensation arrangements to be implemented under the Securities and Futures Ordinance (SFO) enacted in March 2002, a new single Investor Compensation Fund would replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. The new arrangements would eliminate the existing requirement for Exchange Participants and non-exchange participant dealers to make deposits to the Compensation Funds and Dealers' Deposit Schemes respectively. Existing deposits would be returned to the Stock Exchange and the Futures Exchange and to non-exchange participant dealers in accordance with the provisions of the SFO. The arrangements would also remove the existing requirement for the Stock Exchange to replenish the Compensation Fund. The SFO will come into effect on a date to be announced.

(b) The Stock Exchange has undertaken to indemnify the Collector of Stamp Revenue against any loss of revenue resulting from any underpayment or default or delay in payment of stamp duty by its Participants, up to $200,000 in respect of defaults of any one Participant. In the unlikely event that all of its 481 trading Participants as at 30 June 2002 (31 December 2001: 492) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to $96 million (31 December 2001: $98 million).

(c) Pursuant to Section 21 of the Exchanges and Clearing Houses (Merger) Ordinance, Hong Kong Exchanges and Clearing Limited (HKEx) gave an undertaking on 6 March 2000 in favour of HKSCC to contribute an amount not exceeding $50 million in the event of HKSCC being wound up while it is a wholly owned subsidiary of HKEx or within one year after HKSCC ceases to be a wholly owned subsidiary of HKEx, for payment of the debts and liabilities of HKSCC contracted before HKSCC ceases to be a wholly owned subsidiary of HKEx, and for the costs, charges and expenses of winding up.

Employees

HKEx has developed its human resources policies and procedures based on performance and merit. The Group ensures that the pay levels of its employees are competitive and employees are rewarded on a performance-related basis within the general framework of the Group's salary and bonus system.

Share options may be granted to Executive Directors and employees of the Group to subscribe for shares in HKEx in accordance with the terms and conditions of the Share Option Schemes approved by the shareholders of HKEx at an extraordinary general meeting held on 31 May 2000.

Amendments to the Post-Listing Share Option Scheme (Post-Listing Scheme) were approved by the shareholders on 17 April 2002 in order to comply with the new requirements of Chapter 17 of the Rules Governing the Listing of Securities on the Stock Exchange (Listing Rules) effected on 1 September 2001. No share option has been granted under the Post-Listing Scheme.

No similar amendments were made in relation to the Pre-Listing Share Option Scheme (Pre-Listing Scheme) because all options under the Pre-Listing Scheme were issued prior to HKEx's listing on 27 June 2000 and no further options can be issued thereunder. The Pre-Listing Scheme, and the options already granted thereunder, are unaffected by the amendments to Chapter 17 of the Listing Rules.

Following the merger of the businesses of the Stock Exchange Group, the Futures Exchange Group and the HKSCC Group in 2000, HKEx has succeeded in streamlining its workforce and the number of employees fell from 1,052 prior to the merger to 780 as at 30 June 2002. For the two semi-annual periods under review, total employees' cost (excluding Directors' emoluments) was reduced by 9 per cent to $258 million (2001: $283 million).

Prospects

As a substantial part of HKEx's income is derived from trading fees, clearing and settlement fees, listing fees and interest income, the performance of the Group is heavily influenced by external factors including, in particular, market sentiment, the level of activities on the Stock Exchange and Futures Exchange, and movements in interest rates.

Although the US economy grew by 5.0 per cent in the first quarter of 2002, GDP growth has slowed to a worse than expected 1.1 per cent in the second quarter. Political uncertainty in the Middle East, accounting scandals, deteriorating consumer confidence and fear of a double dip in the US economy have adversely affected investor confidence worldwide and recently led to a significant decline in most equity markets. In Hong Kong, negative economic growth, continued deflationary pressure, and rising bankruptcies and unemployment are expected to continue to weaken consumer confidence and investor sentiment. Consequently, activities on the Stock Exchange and Futures Exchange are likely to remain depressed and the Group's revenue in the second half of 2002 may continue to come under pressure.

Despite the unfavourable economic environment, the Group will continue to strive for the improvement of the quality and efficiency of its markets to increase their attractiveness. It will explore and pursue initiatives to attract investors and capital raising companies to Hong Kong. More efforts will be dedicated to developing and marketing new products to widen its revenue source. Capability and reliability of the Group's trading, clearing and risk management systems will be further enhanced to broaden access to its markets. It will proactively seek opportunities for business cooperation and alliances with the Mainland and overseas exchanges and clearing houses. Stringent control will be maintained over the Group's operating costs.

Following China's accession to the World Trade Organisation, there are signs that more private enterprises from the Mainland are planning to raise capital by listing in Hong Kong. The Group will closely monitor economic and capital market developments on the Mainland and explore opportunities arising from time to time.