BUSINESS REVIEW

LISTING

Q. The Listing Division had undergone a reorganisation in January 2004. Did the reorganisation improve its overall performance?

In January 2004, the Listing Division's operating structure was reorganised separating the review and processing of new listing applications from the ongoing monitoring of listed companies. This was achieved by setting up two separate departments, namely the IPO Department and the Compliance and Monitoring Department. The new operating structure was adopted to enhance the operational efficiency of these two related, but different, functions.

The organisational changes are natural progression from the structure that existed prior to January 2004. In particular, almost all of the underlying procedures that the Listing Division follows in reviewing new listing applications and monitoring listed companies have been retained.

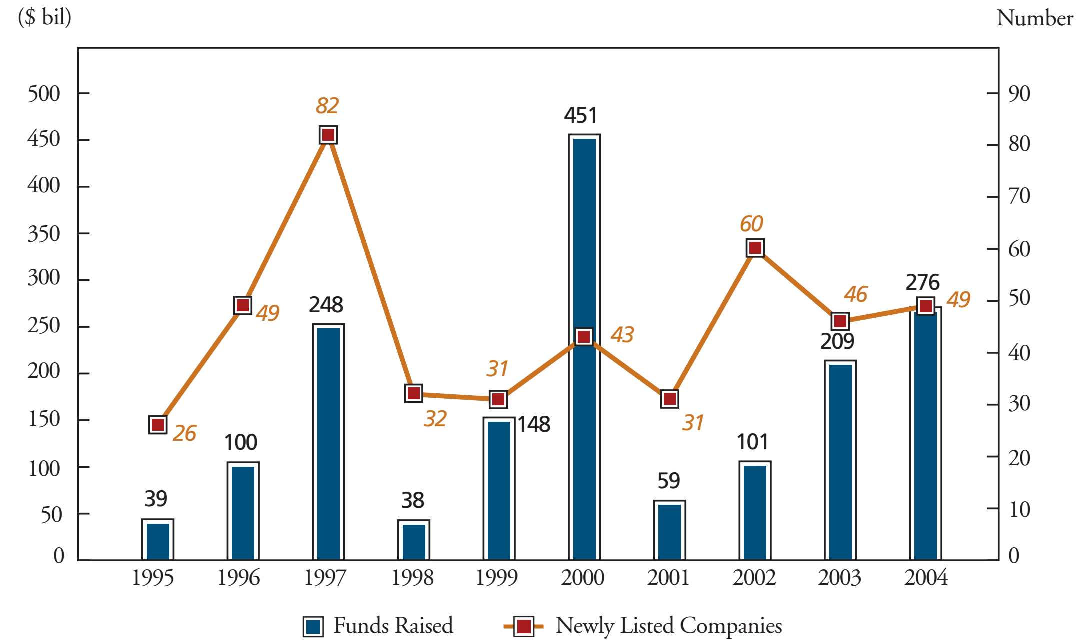
The IPO Department is responsible for reviewing new listing applications for both the Main Board and the GEM. This has enabled the IPO staff to better manage the process of reviewing applications, particularly during periods when high numbers of applications are received at approximately the same time.

Procedural changes were made to demonstrate our commitment to ensuring timely and high quality substantive input from the Listing Division when interpreting and applying the Listing Rules in connection with new listing applications for both the Main Board and the GEM. More frequent and regular senior staff meetings are held to ensure that the work of the IPO Department remains focused on the substantive issues associated with each listing application.

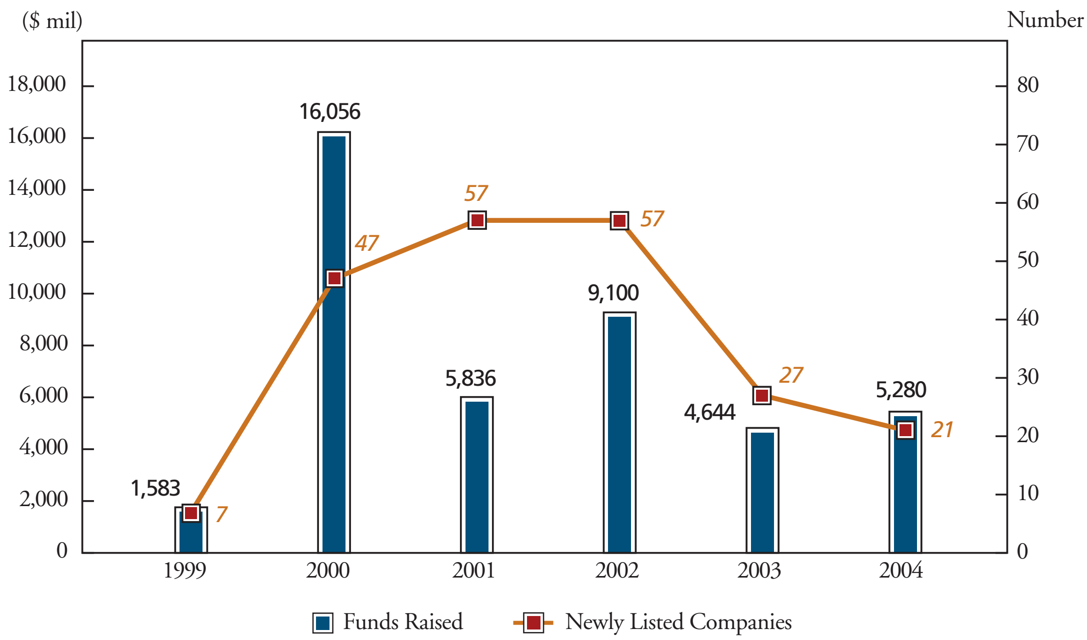
IPO Transactions

	2001	2002	2003	**2004**
Number of new listing applications accepted	153	205	101	**130**
Number of applicants listed on the Main Board	31	60	46	**49**
Number of applicants listed on the GEM	57	57	27	**21**
Number of new listing applications rejected	1	1	7	**15**
Number of applications in process	55	121	51	**44**
Number of applicants with approval granted but not yet listed	14	9	8	**7**

Main Board
Total Equity Funds Raised and Number of Newly Listed Companies



GEM
Total Equity Funds Raised and Number of Newly Listed Companies



Number of Listed Companies (as at year-end)

	2001	2002	2003	2004
Main Board	756	812	852	**892**
GEM	111	166	185	**204**
Total	**867**	**978**	**1,037**	**1,096**

Main Board
Number of Listed Companies by classification (as at year-end)

	2001	2002	2003	2004
Finance	59	71	75	**79**
Utilities	11	13	14	**15**
Properties	97	98	98	**100**
Consolidated Enterprises	240	257	269	**293**
Industrials	327	354	378	**388**
Hotels	14	14	13	**12**
Miscellaneous	8	5	5	**5**
Total	**756**	**812**	**852**	**892**

The Compliance and Monitoring Department continues to target its monitoring resources in those areas that the Division perceives to pose the biggest risks to the maintenance of a fair, orderly and informed market. In particular, it pays attention to companies' compliance with the rules governing the disclosure of price sensitive information and corporate governance standards. It also handles complaints relating to listed companies and their directors, and refers the cases to the Listing Enforcement Department for further investigation, if necessary. During 2004, it has reviewed more than 33,000 press articles on listed companies and about 800 enquiries had been made to the listed companies concerned upon review of the press articles.

Compliance and Monitoring Actions (as at year-end)

	2001*	2002*	2003	2004
Number of announcements of listed companies vetted	6,300	8,200	8,938	**9,092**
Number of circulars of listed companies vetted	1,300	1,600	1,773	**1,919**
Number of share price and trading volume monitoring actions undertaken	7,300	5,800	8,305	**6,116**
Number of clarification announcements published by listed companies in response to share price and/or trading volume movements in their securities	2,500	1,600	3,801	**3,383**
Number of complaints handled	150	320	170	**213**
Number of complaint cases referred to Listing Enforcement for investigation	N/A	64	21	**57**

* *Figures for 2001 and 2002 were rounded*

The Listing Enforcement Department, which is also under the Listing Division is responsible for investigating potential breaches of the Listing Rules, and where appropriate, initiating disciplinary action. Over the last 18 months, it has modified and refocused its approach to the enforcement of the Listing Rules. To improve the enforcement process, it has issued internal guidance and briefings to clarify the process for referring matters for their actions and developed a system of case prioritisation to maximise resources devoted to investigation and disciplinary action in respect of rule breaches. Disciplinary actions include issue of public censure, public statements involving criticism and private reprimands. In 2004, the Listing Enforcement Department has successfully completed a number of investigations and brought actions against those parties who were found to be in breach of the Listing Rules.

Disciplinary Actions (as at year-end)

	2001	2002	2003	2004
Number of investigations made	140	161	178	**201**
Number of public censures	8	6	4	**5**
Number of public statements/criticisms	8	1	8	**14**
Number of private reprimands	5	7	3	**3**
Number of warning letters and/or caution letters	117	147	134	**161**

The reorganisation has improved the Listing Division's overall performance by concentrating on areas where attention is needed, and managing the development of bottleneck situations when both resources and timing are tight.

Q. In terms of regulatory initiatives and achievements, what were the key milestones in 2004?

In 2004, a number of milestones were set aiming at promoting transparency and accountability for listed companies, their directors and their financial advisers alike.

Amendments to the Listing Rules relating to corporate governance and initial listing criteria were published in January 2004 which generally came into effect on 31 March 2004. They include new provisions on notifiable transactions, revised classifications of notifiable transactions and connected transactions, revised definitions of the terms "reverse takeover", "connected person" and "associate" of a connected person, revised requirements for refreshment of general mandate and revised requirements on the disclosure of directors' remuneration in annual reports. In addition, changes were introduced in respect of initial listing eligibility criteria, listed companies' continuing obligations, and the disclosure requirements at the time of listing.

To further enhance the transparency measures on the work of the Listing Division, proposals were submitted to the Listing Committee at its Quarterly Policy Meeting in April 2004. The proposals have resulted in an increase in the publication frequency of statements by the Listing Division about the application of the Listing Rules in specific circumstances and the working practices and approach of the Listing Division.

The Listing Division has published two articles in HKEx's quarterly publication – *Exchange* in recent months to explain and clarify its suspension policy and enforcement strategy. In December 2004, edited version of rejection letters were published on the HKEx website to promote understanding of the grounds for rejecting listing applications.

A complaints hotline was set up in May 2004 to deal with external enquiries relating to listing matters. The hotline is manned by executives of the Listing Division.

In July 2004, the Listing Committees published and posted on the HKEx website their first annual report which provided an account of the work of the Listing Committees during the period 16 May 2003 to 30 April 2004. The report had been prepared to enhance the transparency of the regulatory functions discharged by the Listing Committees and the Exchange.

By 30 September 2004, all companies listed on the Exchange were required to have at least three INEDs and the Exchange also recommended as a best practice that one third of the Board comprises INEDs. The Listing Division had been monitoring compliance with the new standards and actively handling the few on-going cases of non-compliance.

In October 2004, HKEx and the SFC jointly published a Consultation Conclusions Report on the Regulation of Sponsors and IFAs. At the same time, HKEx also published the relevant amendments to the Listing Rules. The rule amendments make abundantly clear what the Exchange expects of sponsors, compliance advisers and IFAs. Those expectations, whilst necessarily high, are subject to what is reasonable and appropriate in the unique circumstances of each transaction.

In November 2004, HKEx published its Conclusions on Exposure of Draft Code on Corporate Governance Practices and Corporate Governance Report which set out the final conclusions of the Exchange and summarised the main comments raised in response to the Exposure Paper published by HKEx in January 2004. The CG Code sets out the Exchange's views on the principles of good corporate governance. Issuers are required to include a CG Report in their annual reports containing prescribed information on their corporate governance practices. The CG Code represents a significant move towards adoption of international benchmarks of corporate governance, best practices, and the disclosure requirements.

The rule amendments published in 2004, along with the CG Code and the disclosure requirements relating to the CG Report, represent the most comprehensive overhaul of the Listing Rules in over a decade and set new standards for the market which should help contribute to maintaining Hong Kong's status as an international financial centre.

Q. What other initiatives did the Listing Division embark on in 2004? What are its plans for 2005?

Main Board issuers are currently required under the Main Board Listing Rules to publish their announcements in newspapers. Since May 2001, they have also been required to submit soft copies of announcements for parallel publication on the HKEx website. The Main Board Listing Committee has approved the Listing Division's proposal to amend the Main Board Listing Rules to require Main Board issuers to publish a short notification announcement in newspapers instead of the full announcement. The changes will be implemented subject to the system and operational readiness of HKEx and approval of the rule amendments by the SFC.

A number of other initiatives were put in hand and the Listing Division's plan is to resolve or make substantial progress in taking forward the following initiatives:–

- Review the role and structure of the Listing Committees
- Work with our Mainland counterparts to establish a framework for the simultaneous listing of H-shares in Hong Kong and A-shares on the Mainland
- Review the operation and regulatory policy of the GEM
- Introduce a revised trading halt policy
- Further reduce pre-vetting of announcements

The Listing Division is committed to continue the improvement in the efficiency of listing application and IPO vetting processes and to enhance corporate governance and effective quality management after listing. Continuing with the momentum set in 2004 is important for the future initiatives in building a quality market with improved investor protection via enhanced regulation.

CASH MARKET

Q. How was the performance of the securities market measured against HKEx's strategic targets in 2004?

In pursuing the strategic objectives of HKEx's three-year strategic plan (2004-2006), the responsibilities of the former Exchange Unit have been divided between the Exchange Division and the Business Development and Investor Services Division ("BDISD"). The Exchange Division, comprising the Cash Market Development and Operations Department ("CMDO"), the Derivatives Market Development and Operations Department ("DMDO") and the Participant Admission and Surveillance Department ("PAS"), is responsible for managing trading and market operations, developing new products, recruiting new EPs, providing support services and trainings to EPs and conducting market surveillance.

As in previous years, HKEx continued to play an important role in the ongoing capital formation of Mainland enterprises in 2004 and further reinforced its role as a Mainland partner. There were 44 newly listed Mainland enterprises in 2004, bringing the total number of listed Mainland enterprises to 304, up from 249 in 2003. Market capitalisation of Mainland enterprises reached $2,020.5 billion. Funds raised by Mainland enterprises were amounted to $76.7 billion, accounting for 79 per cent of the total funds raised through IPO in 2004, with post IPO funds raised by Mainland enterprises amounting to $36.9 billion or 20 per cent of the total of such funds raised. Since Mainland enterprises first began raising capital on the Exchange in 1993, they have raised a total of about $904 billion or 49 per cent of all funds raised during that period. Trading in Mainland enterprises stocks was very active in 2004 with an average daily turnover of $6,687.2 million, accounting for 49 per cent of the average daily equities turnover.

During 2004, 21 companies were listed on the GEM, and 49 companies were listed on the Main Board of which two companies were transferred from the GEM. A total of 49 debt securities, 14 equity warrants and 1,259 derivative warrants were newly listed. The all-time high new records reflect fruitful returns to the promotional effort in building up Hong Kong as one of the international exchanges in the region and the regulatory effort to ensure a fair and open market for investors. Statistical data to demonstrate the performance of the Cash Market in 2004 is laid out at the end of this answer.

▶ Main Board - New Listings

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Newly Listed Companies	26	49	82	32	31	43	31	60	46	**49**
New Warrants										
Equity warrants	39	80	101	31	51	46	31	27	10	**14**
Derivative Warrants	55	201	351	157	162	279	181	644	678	**1,259**
Total New Warrants	94	281	452	188	213	325	212	671	688	**1,273**
New Equity Linked Instruments	N/A							25	16	**46**
New Debt Securities	58	84	61	21	87	20	21	18	20	**49**
Exchange Traded Funds	1	1	0	0	1	0	1	1	1	**2**

Note: Equity Linked Instrument commenced trading on 5 August 2002.

Investors in Hong Kong and overseas can also obtain exposure to the Mainland economy through investing in Mainland-related ETFs which facilitate the trading of a basket of Mainland-related stocks in one single transaction. In particular, the iShares FTSE/Xinhua A50 China Tracker was the first and the only product which allows non-Qualified Foreign Institutional Investors to have a position in Mainland A-shares.

In pursuing the objective of building a quality and efficient market, a Consultation Paper on the Reduction of Minimum Spreads was published in August 2004, aiming at increasing the competitiveness of our market, improving market efficiency and enhancing market liquidity. HKEx believes that changes in minimum spreads should be implemented cautiously and has therefore proposed a phased approach for their reduction. A total of 462 submissions were received in response to the consultation. After taking into account the market responses, the Board decided to implement Phase 1 as stipulated in the consultation, which is to reduce the minimum trading spreads for shares priced above $30 per share. The consultation conclusions were published on the HKEx website on 4 February 2005. Implementation of Phase 1 is expected to be completed by the second quarter of 2005 subject to the approval of the SFC. HKEx will thoroughly review the market experience of Phase 1 before determining whether to implement Phase 2 for shares with lower prices.

The following tables and charts provide a comprehensive view of the performance of the Cash Market in 2004:

Market Performance (as at year-end)

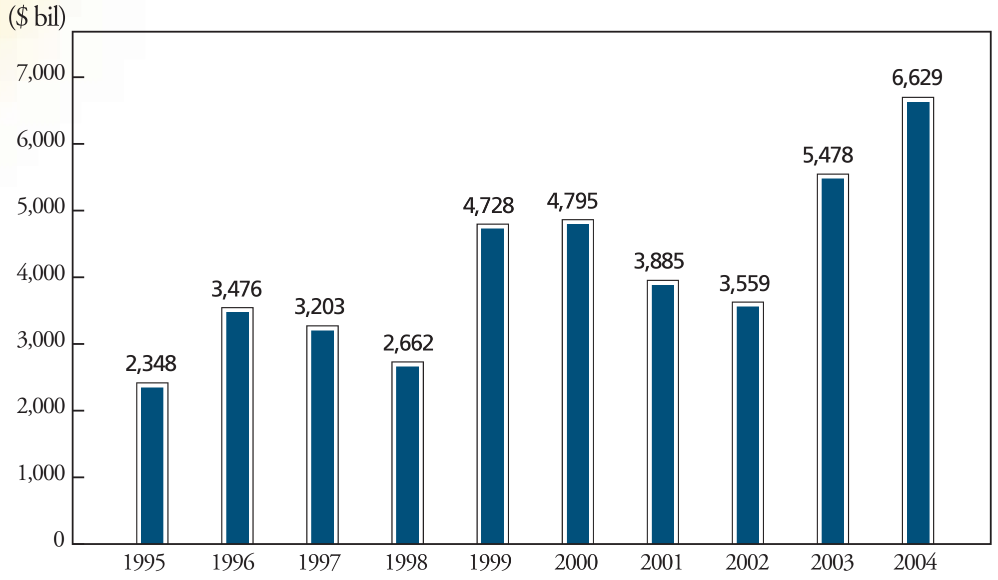
	Main Board			GEM		
	2004	2003	Change	**2004**	2003	Change
IPO funds raised for the year ($ bil)	**94**	57	65%	**2.69**	2.08	29%
Market capitalisation ($ bil)	**6,629**	5,478	21%	**66.72**	70.18	(5%)
Number of listed companies	**892**	852	5%	**204**	185	10%
Number of listed securities	**1,971**	1,598	23%	**205**	187	10%
Total turnover for year ($ bil)	**3,948**	2,546	55%	**26**	38	(32%)
Average daily turnover ($ mil)	**15,857**	10,265	54%	**103**	154	(33%)

Note: Figures have been rounded.

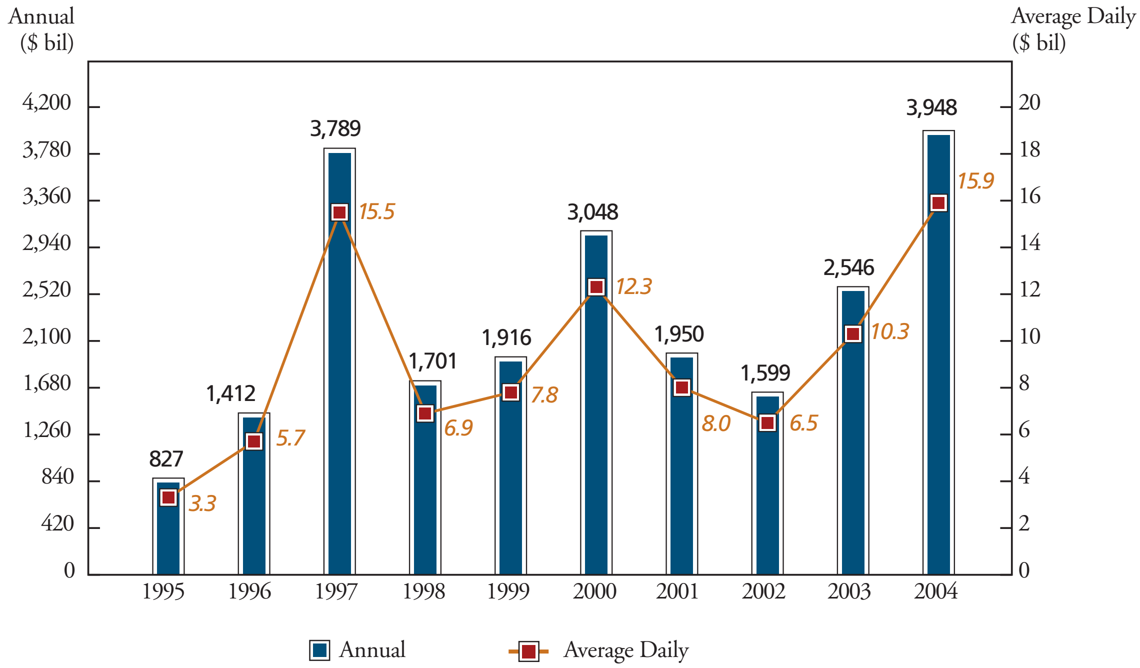
Closing Indices (as at year-end)

	2004	2003	Change
S&P/HKEx LargeCap Index	**15,740.43**	13,645.19	15%
Hang Seng Index	**14,230.14**	12,575.94	13%
Hang Seng Composite Index	**1,831.99**	1,621.61	13%
Hang Seng China Enterprises Index	**4,741.32**	5,020.18	(6%)
Hang Seng China-affiliated Corporation Index	**1,556.88**	1,427.71	9%
S&P/HKEx GEM Index	**988.60**	1,186.06	(17%)

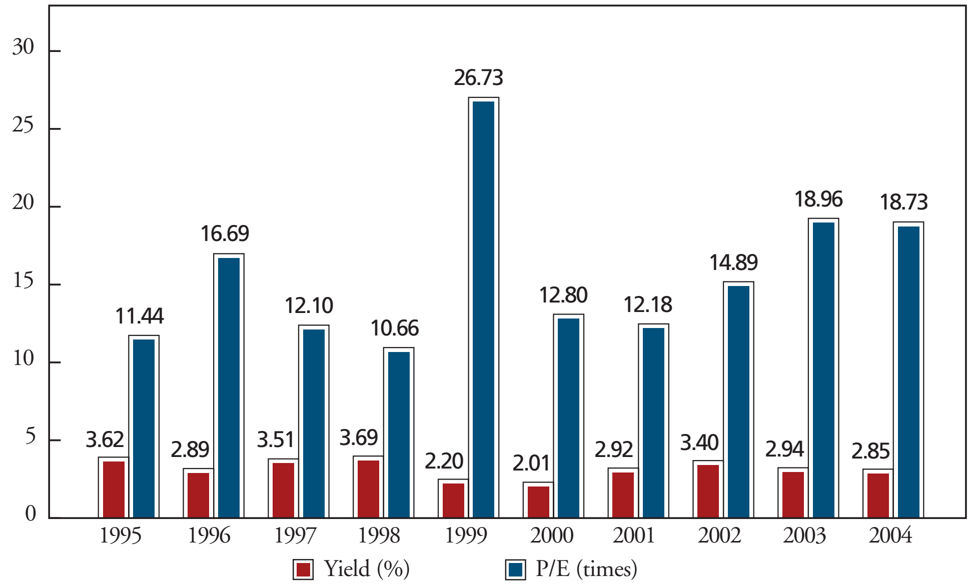
Main Board
Market Capitalisation (as at year-end)



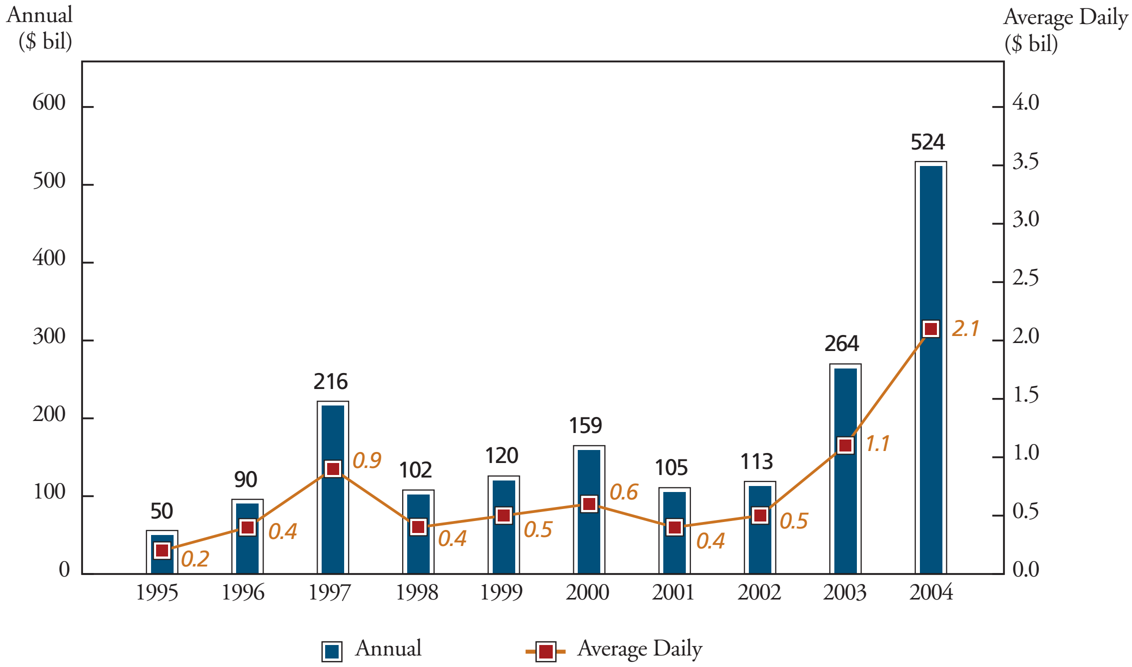
Main Board
Total Annual Trading Value



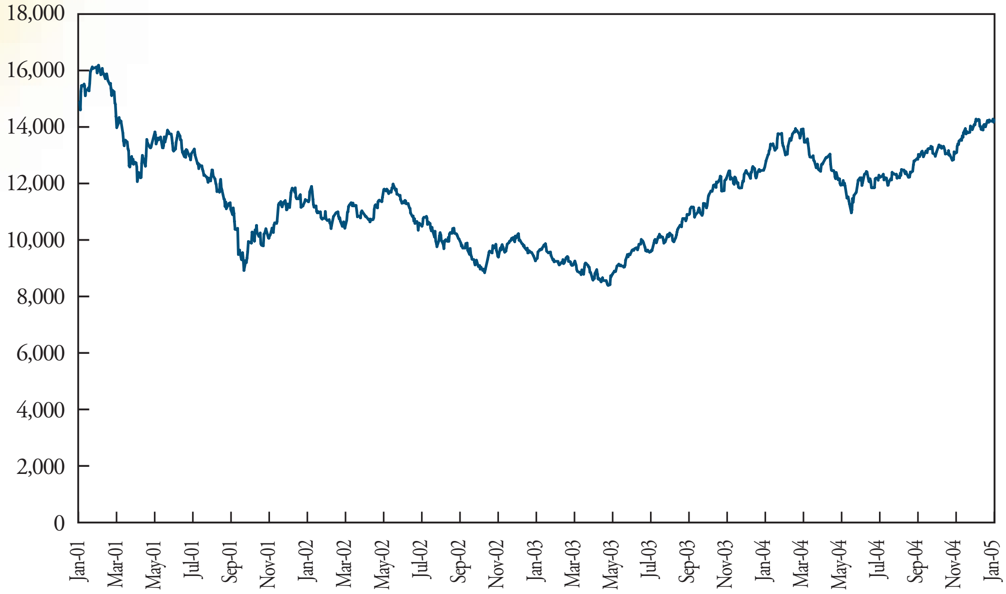
Main Board
Average Yield & P/E Ratio (year-end figures)



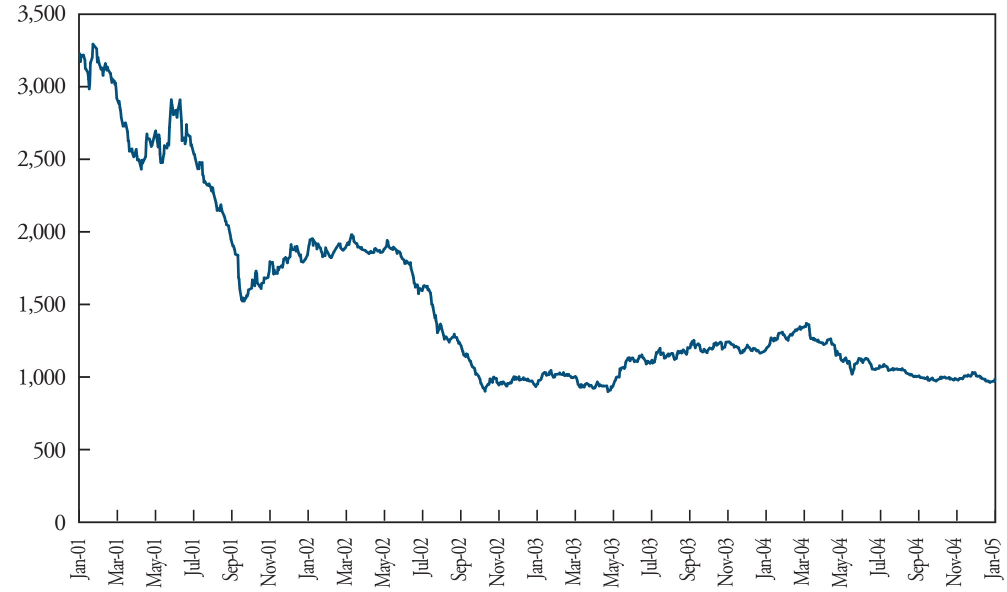
Main Board
Total Annual Trading Value of Derivative Warrants



Hang Seng Index
01/2001 – 01/2005



S&P/HKEx GEM Index
01/2001 – 01/2005



Performance of GEM (as at year-end)

	1999	2000	2001	2002	2003	2004
Newly Listed Companies	7	47	57	57	27	**21**
Total Funds Raised ($ bil)	2	16	6	9	5	**5**
Market Capitalisation as at year-end ($ bil)	7	67	61	52	70	**67**
Trading Value ($ bil)	4	84	39	44	38	**26**

Main Board and GEM Performance of Mainland Enterprises

	As at year-end		
	2004	2003	Change
Listed issuers	**304 (28%)**	249 (24%)	22%
Number of newly listed companies for year	**44 (63%)**	33 (45%)	33%
Market capitalisation ($ bil)	**2,020.5 (30%)**	1,679.7 (30%)	20%
	Up to year-end		
	2004	2003	Change
Average daily equity turnover ($ mil)	**6,687.2 (49%)**	4,241.4 (46%)	58%
IPO funds raised ($ bil)	**76.7 (79%)**	51.3 (87%)	50%
Post IPO funds raised ($ bil)	**36.9 (20%)**	4.8 (3%)	669%

The share of Mainland enterprises of the equity market total is presented in percentage in brackets.

Q. What is the current status of refurbishing the Trading Hall?

After considering the views expressed by market participants and various options, the Board, in November 2004, decided to retain the Trading Hall, and transform it into a multi-purpose facility, subject to satisfactory negotiation of the terms of a new lease with the Government. The existing Trading Hall premises will be renovated to provide new trading booths for EPs who wish to retain a seat in the Trading Hall on a user-pays principle, and create space for new facilities including areas for listing ceremonies, a visitor gallery, public exhibitions and broadcasting booths for the news media. In addition, there will be multi-function rooms and facilities for issuers to hold annual general meetings or press conferences and for HKEx or EPs to hold seminars and training sessions. Following the open invitation of concepts, three design consultants had submitted their proposals which are being evaluated. The refurbishment is expected to be completed around the first quarter of 2006.

According to attendance records, less than 300 out of the total of 723 trading booths in the Trading Hall are regularly used. Following the first launch of the Voluntary Relinquishment programme in 2002, HKEx launched the second Voluntary Relinquishment Programme in 2004 for all EPs enabling them to relinquish unused trading booths. For each trading booth relinquished, an EP is allowed to apply for either an additional AMS Terminal in its office or an increase of order throughput rate available via its Open Gateway. As at the end of 2004, a total of 27 EPs had applied to relinquish 46 booths in exchange for additional AMS terminals or increases in throughput rates. Installation of elected trading devices will be implemented in the second quarter of 2005. Another exercise will be conducted to confirm EP's wish on retaining a seat in the Trading Hall on a user-pays basis. The result would determine the final number of new trading booths to be built in the Trading Hall.

▶ Exchange Participants and Trading Rights Holders Status (as at year-end)

	Stock Exchange	Futures Exchange
Exchange Participants❖	**490**	**126**
Trading	434	126
Non-trading	56	N/A
Trading Rights Holders$^{\Omega}$	**32**	**65**
Corporate	2	56
Individual	30	9
Average number of trading rights held by Exchange Participants and Trading Rights Holders*	**1.77**	**1.18**

❖ *The Stock and Futures Exchanges require that any person who registers as a participant of the relevant exchange must hold a Trading Right of the respective exchange.*

Ω *Stock Exchange Trading Rights Holders refer to those non-trading members of the Stock Exchange as of 6 March 2000 when the exchange merger was completed.*

Futures Exchange Trading Rights Holders refer to former members and/or participants of the Futures Exchange who resigned as a participant and now solely hold a Trading Right of the Futures Exchange.

* *Average number of trading rights held by EPs and Trading Rights Holders = Total number of trading rights held / Total number of EPs and Trading Rights Holders. There were 922 Stock Exchange trading rights and 225 Futures Exchange trading rights as of 31 December 2004.*

Q. ETF is a successful new product in overseas exchanges. How is the performance of the ETF market in Hong Kong?

The ETF market is a steadily growing segment of the Cash Market. Since the launch of the first ETF, the Tracker Fund of Hong Kong ("TraHK") in 1999, four additional ETFs have been listed on the Exchange. In particular, the Hang Seng Index ETF and the iShares FTSE/Xinhua A50 China Tracker were listed in September and November 2004 respectively. Turnover of listed ETFs in Hong Kong increased gradually from $12.9 billion in 2002 and $13.3 billion in 2003 to $23.5 billion in 2004.

Similar to the trading of ETF in overseas exchanges, the Stock Exchange has approved market making to be allowed for all ETFs, including TraHK. On the other hand, the obligations of market makers have been tightened and a clawback mechanism on concessions given to market makers would be established. These enhancements to the ETF market would be launched upon approval of the relevant rule amendments by the SFC.

DERIVATIVES MARKET

Q. How did the derivatives market perform in 2004?

2004 was a fruitful year for the Hong Kong derivatives market, marked by the record high daily volume and/or open interest for Hang Seng Index Futures and Options, H-shares Index Futures and Options, and Stock Futures and Options markets. The details are shown in the following table.

▶ Record High Daily Volume and Open Interest Achieved in 2004

Products	Record High Daily Volume Date	Record High Daily Volume Number of Contracts	Record High Open Interest Date	Record High Open Interest Number of Contracts
Hang Seng Index Futures	24 September 2004	151,000	26 November 2004	172,282
Hang Seng Index Options	N/A	N/A	29 March 2004	169,319
Mini-Hang Seng Index Futures	14 June 2004	9,799	10 May 2004	5,141
H-shares Index Futures	25 November 2004	26,741	27 September 2004	40,699
H-shares Index Options	20 July 2004	2,371	29 December 2004	19,990
Stock Futures	4 October 2004	1,119	29 November 2004	2,181
Stock Options	N/A	N/A	29 December 2004	979,659

The total yearly volume for all futures and options markets increased 34.9 per cent from 14,546,213 contracts for 2003 to 19,629,692 contracts for 2004.

▶ Derivatives Market Statistics (as at year-end)

	2004 Volume (Contracts)	2004 Period-end Open Interest (Contracts)	2003 Volume (Contracts)	2003 Period-end Open Interest (Contracts)
Futures				
Hang Seng Index Futures	**8,601,559**	**125,860**	6,800,360	91,941
Mini-Hang Seng Index Futures	**1,457,681**	**2,044**	1,248,295	1,905
H-shares Index Futures(1)	**1,743,700**	**22,418**	47,941	6,299
MSCI China Free Index Futures(2)	**–**	**–**	190	–
Dow Jones Industrial Average Futures(3)	**2,673**	**96**	9,091	88
Stock Futures	**17,274**	**1,821**	18,654	1,020
Three-month HIBOR Futures	**58,307**	**6,570**	47,799	4,485
One-month HIBOR Futures	**733**	**30**	310	85
Three-Year Exchange Fund Note Futures	**2,225**	**–**	2,012	200
Options				
Hang Seng Index Options	**2,029,068**	**76,444**	2,118,792	72,469
Mini-Hang Seng Index Options	**26,882**	**613**	32,131	330
H-shares Index Options(4)	**77,758**	**9,265**	N/A	N/A
Stock Options	**5,611,832**	**684,052**	4,220,638	553,896

(1) *Commenced trading on 8 December 2003.*
(2) *Suspended trading with effect from 29 March 2004.*
(3) *Suspended trading with effect from 25 January 2005.*
(4) *Commenced trading on 14 June 2004.*

In addition to the improvement in Hong Kong's overall economic and investment climate in 2004, HKEx's continuing efforts to implement product and market infrastructure enhancements and effectively market them to practitioners and their clients, have contributed to the significant market growth experienced this past year.

Product and market infrastructure enhancement

In 2004, a total of nine products were launched by the DMDO. Leveraging on the success of H-shares Index Futures which were launched in December 2003, HKEx introduced H-shares Index Options in June 2004 to provide an additional trading and risk management tool for investors in H-shares and related derivatives, and 77,758 contracts had been traded since its launch. At the same time, stock options and stock futures on four H-shares, namely China Life Insurance, China Petroleum & Chemical Corporation, China Telecom and Aluminum Corporation of China, were also introduced. In total, there were 223,279 contracts traded in 2004 in these additional stock options and stock futures. The launches of the H-shares Index Options and the additional stock options and stock futures contracts are further evidence of HKEx's continuing efforts to meet the growing demand for China-related financial products.

The six-month pilot programme in relation to enhancements to the Block Trade Facility was made permanent on 1 March 2004. The enhancements comprised extending Block Trade executions in expiring contracts to the last two trading days, and increasing the Minimum Volume Thresholds for all stock option classes from 100 to 500 lots. There were 1,152,451 contracts traded via the Block Trade Facility in 2004, representing 5.9 per cent of the total futures and options contracts traded for the year, and an increase of 105.6 per cent against those in 2003.

The efficiency of futures brokers trading and order execution improved in 2004. The number of OMnet Application Programming Interface connections increased 55.4 per cent from 166 as at the end of 2003 to 258 as at the end of 2004, representing greater system flexibility for the market as a whole in establishing trading connections to HKATS and Internet trading facilities.

HKATS was upgraded from OMex version 17.1 DC to 17.1 CL and fully integrated with DCASS in April 2004. Under the integrated platform, both trading and clearing share the same operational facilities and network equipment. As a result, EPs enjoy the benefit of straight-through processing at a reduced cost.

Education and marketing

In 2004, a total of 59 derivatives market training courses and seminars were conducted, attracting more than 5,000 attendees, including staff of EPs and public investors. A 16-week programme for promoting stock index options to retail investors was conducted successfully during the second quarter of 2004, with HKEx participating as co-sponsor along with 11 EPs. We also held meetings with overseas brokers who were considered prospective EPs to expand the distribution network of HKEx products in the international investment community.

CLEARING

Q. Why DCASS was launched and what was the market response?

In April 2004, HKEx successfully launched DCASS, replacing two legacy systems, namely INTRACS/400 and TOPS, used respectively by HKCC and SEOCH since the mid-1990. Horizontally, DCASS provides a common platform for clearing and settlement of all products traded on the local derivatives markets. Vertically, DCASS shares the same technology platform with the derivatives trading system, HKATS, and offers a seamless operational environment for derivatives trading, clearing and settlement.

The implementation of DCASS has reinforced the clearing and settlement infrastructure to meet future challenges and market demands. Externally, DCASS has prompted changes in certain business features, including the introduction of a revised fee structure, an earlier post trade input cut-off time for HKCC Participants, and a new margining methodology known as the Portfolio Risk Margining System ("PRiME"), for both HKCC and SEOCH. Internally, the operational procedures and risk management processes of HKCC and SEOCH have been harmonised, resulting in optimal use of resources and improved efficiency.

HKEx conducted a Technical Survey on DCASS in October 2004 to evaluate its performance and users' satisfaction. A total of 128 Participants of HKCC and SEOCH responded to the survey, representing an overall response rate of 82 per cent. The results of the survey were very positive, showing that most of the respondents were satisfied with the on-line functions, reports, system response time and the hotline services.

Q. What is the progress of implementing a scripless securities market in Hong Kong?

In May 2004, HKEx issued its consultation conclusions summarising the views of respondents and HKEx's comments thereon, to the Consultation Paper on a Proposed Operational Model for a Scripless Securities Market issued in October 2003. The report proposed maintaining CCASS on a nominee basis under the Issuer Register Model and a progressive approach on implementation of scripless. HKEx is currently making progress in formulating operational arrangements with the share registrars for CCASS to hold scripless shares with them in the initial phase. In parallel, further discussions with the Federation of Share Registrars will be held to consider development of the other scripless initiatives, including the establishment of electronic linkages between CCASS and share registrars' systems. Subject to the completion of the legislative process and amendments to the Listing Rules and the General Rules of CCASS, CCASS would begin the process of dematerialising its holdings in 2006.

Q. What have been done in 2004 to improve the services for CCASS Participants, including IPs?

The Clearing Division continually reviews the clearing services offered by the three clearing houses, HKSCC, SEOCH, and HKCC to ensure that the highest quality services are provided to clients which serve to reinforce investor confidence in the securities and derivatives markets in Hong Kong. HKEx enhanced the CCASS Settlement Instruction ("SI") matching functions in October 2004 to provide a more efficient and centralised platform for the pre-matching of SIs between CCASS Participants (non-IPs). The enhancements include adding a new "hold matched SI" function, inserting two additional SI matching runs, displaying unmatched SI field content and modifying the client account number field for matching.

In addition, the General Rules of CCASS and CCASS Operational Procedures were amended in November 2004 to facilitate a CCASS Participant (non-IP) to appoint a Settlement Agent to operate its CCASS terminals, and hence CCASS accounts, without changing its principal obligations vis-à-vis HKSCC. The Settlement Agent can be a CCASS Participant, an affiliate to a CCASS Participant or a non-CCASS Participant located either in Hong Kong or overseas jurisdictions. HKEx will continue to facilitate the implementation of the operation model that best serves market participants' business needs.

Moreover, HKEx introduced enhanced features to the CCASS IP accounts services in August 2004. The enhanced features include extending the online window to operate 24 hours a day and seven days a week, allowing Internet access through user IDs and passwords, allowing SMS (short-message service) text messages to communicate with IPs, making electronic voting functions more user-friendly, and streamlining the stock transfer process by adding a simpler transfer instruction type.

With the increasing popularity of the CCASS eIPO service as one of the IPO application channels, CCASS enhanced its eIPO functions in 2004 to extend the CCASS input and file upload time window, release the file upload function to all participants, add upload file validation runs, and facilitate online enquiry of the application details during the eIPO application period.

▶ Number of CCASS Participants (as at year-end)

Brokers Participants	441
Custodian Participants	39
Stock Pledgee Participants	7
Clearing Agency Participants	1
Investor Participants	13,800

▶ CCASS Statistics (Up to year-end)

	2004	2003
Average Daily Exchange Trades Handled by CCASS		
– Number of trades	**149,572**	116,142
– Value of trades	**$16.0 billion**	$10.4 billion
– Share Quantity Involved	**16.2 billion**	9.7 billion
Average Daily SIs Settled by CCASS		
– Number of SIs	**23,778**	19,586
– Value of SIs	**$38.0 billion**	$25.1 billion
– Share quantity involved	**11.8 billion**	9.1 billion
Average Daily Investor SIs ("ISIs") Settled by CCASS		
– Number of ISIs	**413**	449
– Value of ISIs	**$119.0 million**	$86.0 million
– Share quantity involved	**82.2 million**	78.5 million
Average Daily Settlement Efficiency of CNS Stock Positions on Due Day (T+2)	**99.70%**	99.69%
Average Daily Settlement Efficiency of CNS Stock Positions on the Day following the Due Day (T+3)	**99.98%**	99.97%
Average Daily Buy-ins Executed on T+3		
– Number of brokers involved	**9**	9
– Number of buy-ins	**10**	10
– Value of buy-ins	**$3.7 million**	$2.5 million
Shares Deposited in the CCASS Depository		
– Number of shares	**1,217.7 billion**	1,012.8 billion
– Percentage of total issued share capital of the admitted securities	**60.71%**	57.86%
– Value of shares	**$2,465.0 billion**	$1,915.5 billion
– Percentage of the total market capitalisation of the admitted securities	**34.46%**	32.91%

Q. Risk management is one of the important responsibilities of the clearing function, what are the major measures in place to protect the interests of HKEx and investors?

In addition to the insurance and guarantee facilities to diversify the clearing houses' risk exposure in acting as the central counterparty to provide settlement guarantee to their participants, the Board had decided in February 2004 to set aside $1.5 billion in retained earnings to support the clearing and settlement functions.

To further harmonise the policies and procedures of the three clearing houses, HKSCC has aligned with HKCC and SEOCH in not accepting bank guarantees issued by a participant's group company to reduce concentration risk. Reviews of the capital requirements for clearing participants and their obligations in relation to the Guarantee and Reserve Funds are in progress.

No default event occurred in 2004. For the two default cases reported in 2003, the Tai Wah Securities Limited is in the process of liquidation and Yicko Futures Limited is still subject to legal proceedings. To improve risk management functions and better serve the markets, the clearing houses will continue to enhance their risk management measures including the introduction of new collateral types and the review of settlement bank agreements. The collateral services provided to the Clearing Participants will also be improved by further enhancing the Common Collateral Management System and automating the payment systems.

BUSINESS DEVELOPMENT AND INVESTOR SERVICES

Q. What have been done to bring increased awareness of the Hong Kong capital market and matters pertaining to listing to the Mainland market users?

The BDISD was set up to take full responsibility for improving investor relations and promoting new listings. In 2004, four large scale listing conferences were conducted to promote Hong Kong as a premier capital market to potential issuers on the Mainland. Conferences held in Jilin, Chongqing and Tianjin were major events of the Hong Kong Weeks co-organised with the Beijing Office of the Government and the local, provincial and municipal governments on the Mainland. In addition, a major conference in Shanghai was organised with the Research Centre of the State-owned Assets Supervision and Administration Commission of the State Council in October 2004. More than 1,600 people, including about 200 Hong Kong intermediaries who represented sponsors, legal firms, and accounting firms took part in these events.

In addition, HKEx collaborated with various Mainland government authorities, such as the Beijing Municipal Development and Reform Commission, the China Centre for Business Cooperation and Coordination under the National Development and Reform Commission and The Finance Office of Inner Mongolia Autonomous Regional People's Government, in organising various conferences and seminars on the Mainland and in Hong Kong. During 2004, HKEx also participated in the "Hong Kong-Zhejiang Week", "Guangdong-Hong Kong Cooperation and Exchange Seminar" and the "HK-Fujian Investment Environment Symposium" organised in Hong Kong. Moreover, more than 200 meetings were held with Mainland business delegations.

To enhance the awareness of corporate governance issues among listed issuers from the Mainland, 10 training programmes for the senior management of potential and listed Mainland issuers were organised in the Beijing representative office as well as in Hong Kong during 2004, jointly with the Hong Kong Institute of Company Secretaries, Hong Kong Securities Institute, Hong Kong Polytechnic University China Business Centre and Mainland government authorities, including the Research Centre of the Hong Kong and Macau Affairs Office of the State Council and the National Science and Technology Venture Capital Development Centre. The programmes provided participants with an overview and update of the relevant regulatory framework and rules and highlighted the importance of a high standard in corporate governance practices.

To enable Mainland issuers to have a better understanding of the regulatory framework and rules relating to listing in Hong Kong, the Listing Division conducted regular training seminars on the Mainland on the rules and regulations, including, in particular, the Listing Rules.

As part of our corporate website revamp exercise in March 2004, a "Listing in Hong Kong" section was created in our corporate website to provide a more comprehensive information platform for potential issuers. This section provides a wealth of information, including the key issues and considerations leading to a listing, and the requirements, procedures and obligations applicable to attaining a listing. It also sets out the answers to frequently asked questions on listing in Hong Kong.

Q. What are the services provided by the newly established Investor Services Department to strengthen the relationship between HKEx and its investors?

The BDISD maintains regular contacts and communication with fund managers and analysts. Between May and December 2004, more than 40 meetings with local and overseas fund managers and analysts have been held in and outside of Hong Kong. Meetings were arranged after the announcement of results to provide fund managers and analysts with the most up-to-date corporate public information regarding HKEx, including its strategic direction, financial performance, latest developments and prospects. Moreover, HKEx's press release, quarterly, interim, and annual reports were also sent to fund managers and analysts on a regular basis to provide a greater transparency and enhance shareholders' confidence.

HKEx also organised education seminars to introduce its products and services to the investing public. This included various educational seminars co-organised with different entities, such as universities, the Education and Manpower Bureau ("EMB") of the Government and the Institute of Financial Planners of Hong Kong. In particular, the seminar co-organised with the EMB was the first joint effort between HKEx and an education department of the Government with the aim to raise the awareness of secondary school teachers relating to financial products and the latest developments of the Hong Kong markets.

In August 2004, HKEx arranged the first session of SIMart, an online investment simulation game which attracted over 1,600 registrants. SIMart, a platform operated by HKEx, simulates the main features of the securities market for the hosting of online investment games. It provides an ideal educational platform for all levels of investors to learn about and test-trade HKEx products. More than 2,700 deals were transacted and the total value of all transactions was approximately $481 million.

Apart from educating local investors, HKEx also participated in seminars held in Macau and Shenzhen, and gave briefings to overseas delegates.

INFORMATION SERVICES

Q. What was the performance in the sale of information in 2004?

The Information Services Department manages the provision of market information to the investing public including real-time trading information through cooperation with authorised information vendors, market statistics, market summary information, and listed company disclosures. At the end of 2004, there were 66 real-time information vendors for the securities market (2003: 63) and 34 for the derivatives market (2003: 34). A total of 310 real-time data services were provided by these vendors, while the total number of delayed data services rose from 98 to 121. Eighteen information vendors participated in our extended China Promotion Programme that allows Mainland investors to follow the HKEx markets by subscribing to Hong Kong market data. Compared with 2003, the income from the sale of information for 2004 increased by 16 per cent, or $42 million, to $308 million.

Q. How did the information services help support the market development and investor needs?

Real-time odd lot securities market information including order prices, aggregated order quantity and order size of the five best bid and ask prices was first made available through information vendors from March 2004.

In 2004, HKEx also commenced providing the Issuer Information Feed, through which issuers' disclosures and announcements are transmitted via direct feed to information vendors in XML format. The XML, or Extensible Markup Language format facilitates exchange of data between computer applications. A number of international vendors have begun serving their institutional clients by incorporating data received through the Issuer Information Feed.

HKEx also enhanced its historical data product offering with the introduction of two new historical data products – Stock Master File (daily) and Stock Static Data (monthly). In addition, the archive of Corporate Documents, one of the most well-received data products, was extended back to 1990.

In 2004, HKEx entered into an agency agreement with the Shenzhen Stock Exchange on distribution of its real-time market data. Under the agreement, HKEx manages the commercial arrangements as well as the technical transmission of data to vendors outside of the Mainland. In 2004, we have signed up with international vendors such as Bloomberg L.P, Thomson Financial Limited, Quick Corporation and Hong Kong-based TVB's Galaxy TV under this agreement.

INFORMATION TECHNOLOGY

Q. What has been done to ensure that HKEx provides an IT infrastructure of highest standards of security, reliability and efficiency?

Competitive technology is a core asset of HKEx and is essential for fortifying investors' confidence in Hong Kong as a pre-eminent international financial centre. Throughout 2004, the Information Technology Division strived to maintain 100 per cent uptime for all major trading and clearing systems, as a result of disciplined operations, preventive and collaborative vendor management, quality and prudent change control management, a high level of security awareness, and strong team work. In particular, a series of improvements were implemented during the year to strengthen the availability, stability and reliability of the systems. They included benchmarking for ISO 9001 certification for computer operations by Hong Kong Productivity Council, strengthening the existing preventive maintenance plan with PCCW, Wharf T&T and HP for market systems' hardware and network, and enhancing market systems network security for intrusion detection.

In order to further enhance serviceability, HKEx will continuously upgrade obsolete technology and equipment of its core critical systems. The AMS/3 Tandem Operating System, namely Non-stop Kernel, was upgraded to secure continued system support from the vendor. Replacements of AMS/3 first and second terminals as well as the Trading Hall LAN cabling infrastructure will progress in line with the trading hall renovation project.

To cope with continuous business growth, HKEx conducts routine pro-active modelling and analysis of system capacity regularly to ensure that the system capacity can satisfy market needs and requirements. In early 2004, the bandwidth and capacity of the HKEx website were upgraded substantially to cope with the rapid growth of external access to the HKEx website as well as the planned rollout of the website revamp. A capacity sizing and planning was also conducted for all market systems during the year to cater for the new business and projected growth of market volume. Key capacity upgrade for AMS/3, HKATS and DCASS will be conducted, as necessary and appropriate, in 2005.

In view of the advances in technology, HKEx will continue to explore the possibility of consolidation and standardisation of the IT infrastructure and systems to ensure availability and cost efficiency. In late 2004, a market systems network consolidation was commenced to migrate the existing AMS/3, HKATS/DCASS, CCASS/3 and MDF system networks from the existing frame relay technology to a consolidated network with optical ethernet technology resulting in substantial network cost savings to EPs and HKEx.

TREASURY

Q. How does HKEx manage its available funds?

HKEx's investment funds comprise Corporate Funds, Margin Funds and Clearing House Funds, totalling $14.4 billion on average in 2004 (2003: $10.6 billion), an increase of $3.8 billion against that for 2003. The increase in investment fund size was primarily due to a rise in Margin Funds received from Participants as a result of increased open interest in futures and options contracts, which was partly offset by the reduction in Corporate Funds following the $2.2 billion payment of the 2003 special and final dividends in April 2004. Comparing with 31 December 2003, the overall fund size as of 31 December 2004 increased by 20 per cent or $2.7 billion to $16.3 billion (31 December 2003: $13.6 billion).

Details of the asset allocation as at 31 December 2004 against those as at the end of 2003 are set out below.

	Fund size ($ billion)		Bonds		Cash or bank deposits		Global equities	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003
Corporate Funds	**3.9**	5.0	**64%**	58%	**30%**	36%	**6%**	6%
Margin Funds	**10.5**	7.1	**34%**	31%	**66%**	69%	**0%**	0%
Clearing House Funds	**1.9**	1.5	**7%**	9%	**93%**	91%	**0%**	0%
Total	**16.3**	13.6	**38%**	39%	**60%**	59%	**2%**	2%

Investments are kept sufficiently liquid to meet HKEx's operating needs and possible liquidity requirements of the Clearing House Funds and Margin Funds. Excluding equities held under the Corporate Funds ($0.3 billion as at 31 December 2004 and $0.3 billion as at 31 December 2003), which have no maturity date, the maturity profile of the remaining investments as at 31 December 2004 ($16.0 billion) and 31 December 2003 ($13.3 billion) was as follows:

	Fund size ($ billion)		Overnight		>Overnight to 1 month		>1 month to 1 year		>1 year to 3 years		> 3 years	
	2004	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003	**2004**	2003
Corporate Funds	**3.6**	4.7	**15%**	22%	**16%**	10%	**21%**	18%	**31%**	34%	**17%**	16%
Margin Funds	**10.5**	7.1	**40%**	56%	**26%**	7%	**14%**	12%	**20%**	25%	**0%**	0%
Clearing House Funds	**1.9**	1.5	**83%**	82%	**3%**	0%	**6%**	0%	**8%**	18%	**0%**	0%
Total	**16.0**	13.3	**39%**	47%	**21%**	8%	**15%**	13%	**21%**	27%	**4%**	5%

Credit exposure is well diversified. As at 31 December 2004, all bonds held were of investment grade and had a weighted average credit rating of Aa2 (31 December 2003: Aa2) and a weighted average maturity of 1.5 years (31 December 2003: 1.9 years). Deposits are placed only with the note-issuing banks in Hong Kong and investment grade licensed banks and restricted licence banks approved by the Board from time to time.

Risk management techniques, such as Value-at-Risk ("VaR") and portfolio stress testing, are used to identify, measure, monitor and control market risks. VaR measures the expected maximum loss over a given time interval (a holding period of 10 trading days is used by HKEx) at a given confidence level (95 per cent confidence interval is adopted by HKEx) based on historical data (one year is used by HKEx). The overall risk, as measured by the VaR methodology, during 2004 and 2003 is as follows:

	Average VaR $ million		**Maximum VaR** $ million		**Minimum VaR** $ million	
	2004	2003	**2004**	2003	**2004**	2003
Corporate Funds	**15.8**	15.4	**18.3**	18.4	**13.2**	13.1
Margin Funds	**15.3**	8.5	**17.4**	11.5	**10.3**	5.7
Clearing House Funds	**1.1**	1.5	**1.2**	1.7	**0.8**	1.1

For more details of HKEx's investment income, please refer to the Overall Performance under the Financial Review and Note 7 to the accounts of this annual report.

FINANCIAL REVIEW

OVERALL PERFORMANCE

The financial performance of the Group is summarised below:

Analysis of results by quarter

	As restated* Q1 2004 $ million	As restated* Q2 2004 $ million	As restated* Q3 2004 $ million	Q4 2004 $ million	Total 2004 $ million
Income	649	515	571	659	2,394
Operating expenses	285	286	286	299	1,156
Operating profit	364	229	285	360	1,238
Share of profits less losses of associates	3	3	3	4	13
Profit before taxation	367	232	288	364	1,251
Taxation	(54)	(47)	(40)	(53)	(194)
Profit attributable to shareholders	313	185	248	311	1,057

	As restated* Q1 2003 $ million	As restated* Q2 2003 $ million	As restated* Q3 2003 $ million	As restated* Q4 2003 $ million	As restated* Total 2003 $ million
Profit attributable to shareholders	90	126	190	287	693

* *Following the adoption of certain new HKFRSs in the fourth quarter of 2004, certain figures previously reported have been restated to conform to the new standards.*

Following the fall in the stock and bond markets in the second quarter, the markets rebounded strongly in the third quarter, and this recovery continued into the fourth quarter as the macro-economic adjustments to the economy in China started to show some positive results, and the interest rate hikes in the US did not propagate to Hong Kong due to the abundant money market liquidity resulting from an influx of foreign funds.

Activity on the Stock Exchange and the Futures Exchange increased significantly, which culminated in several new records being achieved in the Cash and the Derivatives markets in 2004, including the highest annual turnover of the Cash market, highest annual turnover of H Shares and derivative warrants and the highest annual turnover of futures and options contracts traded. In addition, Hong Kong retained its position as the global leader in terms of annual turnover of listed warrants among member exchanges of the World Federation of Exchanges for the second consecutive year. As a result, total income of the Group increased significantly compared with 2003, in particular as a result of increases in trading fees and clearing and settlement fees.

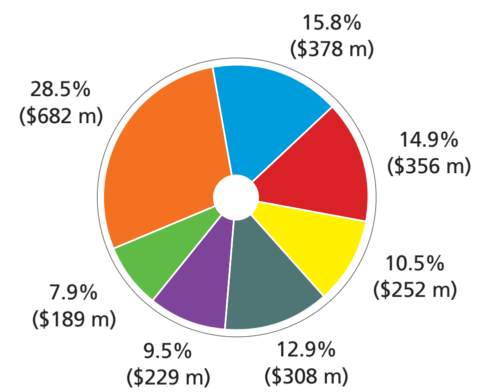
The increase in market income was partly offset by a decrease in investment income mainly due to lower interest rates and reduced investment portfolio following the distribution of the 2003 special and final dividends of $2.2 billion in the second quarter of 2004.

Total operating expenses for the year decreased by $68 million or 6 per cent to $1,156 million (2003:$1,224 million) despite taking into account additional expenses of $12 million following an early adoption of the new HKFRSs, in particular the requirement to expense employee share options under HKFRS 2 - Share-based Payment, and an additional $5 million paid to the SFC as a result of the full year operation of the dual filing regime against the partial year payment made in 2003. If such additional expenses were excluded, total operating expenses fell by $85 million or 7 per cent compared with 2003. The decrease was mainly due to non-recurring one-off restructuring costs ($52 million before tax) incurred in the second quarter 2003, and effective cost controls.

The HKICPA has undertaken to converge by 1 January 2005 all HKFRSs with IFRSs issued by the International Accounting Standards Board. As a result, the HKICPA has aligned HKFRSs with the requirements of IFRSs in all material respects as at 31 December 2004. The accounts have been prepared in accordance with HKFRSs issued by the HKICPA.

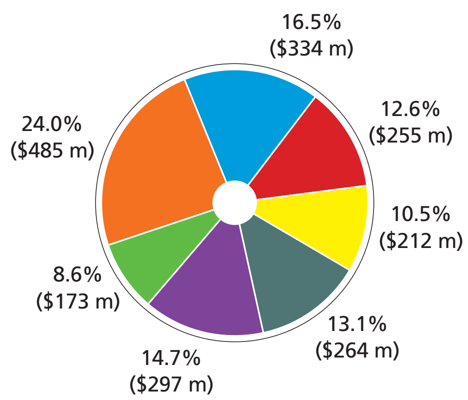
▶ INCOME

Analysis of 2004 income



Total income=$2,394 m

Analysis of 2003 income



Total income=$2,020 m

- Trading fees and trading tariff
- Stock Exchange listing fees
- Clearing and Settlement fees
- Depository, custody and nominee services fees
- Income from sale of information
- Investment income
- Other income

(A) Income directly affected by market turnover

	2004 $'000	2003 $'000	Change
Trading fees and trading tariff	**682,293**	485,211	41%
Clearing and settlement fees	**356,274**	254,907	40%
Depository, custody and nominee services fees	**251,722**	211,726	19%

The key business drivers of the significant increase in turnover-related income are:

Key market turnover

	2004	2003	Change
Average daily turnover value on the Stock Exchange	**$16.0 billion**	$10.4 billion	54%
Average daily number of derivatives contracts traded on the Futures Exchange	**56,752**	41,889	36%
Average daily number of stock options contracts traded on the Stock Exchange	**22,720**	17,122	33%

(B) Stock Exchange listing fees

	2004 $'000	2003 $'000	Change
Annual listing fees	**252,358**	238,451	6%
Initial and subsequent issue listing fees	**119,468**	88,668	35%
Others	**6,601**	6,667	(1%)
	378,427	333,786	13%

The increase in fees was attributable to the overall increase in the number of new listings (in particular, derivative warrants) and the higher number of companies listed on the Stock Exchange.

Key drivers for initial and subsequent issue listing fees

	2004	2003	Change
Number of newly listed derivative warrants	**1,259**	678	86%
Number of new listings on the Main Board	**49**	46	7%
Number of new listings on GEM	**21**	27	(22%)

	As at 31 Dec 2004	As at 31 Dec 2003	Change
Key drivers for annual listing fees			
Number of companies listed on Main Board	**892**	852	5%
Number of companies listed on GEM	**204**	185	10%

(C) Investment income

	2004 $'000	As restated 2003 $'000	Change
Income from:			
Investments supervised by the Finance Department	**202,955**	283,594	(28%)
Investment in Singapore Exchange Limited	**25,632**	13,358	92%
Total investment income	**228,587**	296,952	(23%)

The average market interest rates and the average amount of funds available for investment are as follows:

	2004	2003	Change
Interest rates:			
Average 6-month Hong Kong Exchange Fund Bill rate	**0.47%**	0.84 %	(37) basis pts
Average 90-day US Treasury Bill rate	**1.38%**	1.02 %	36 basis pts

	2004 $ billion	2003 $ billion	
Average amount of funds available for investment			
Corporate Funds	**4.0**	4.7	(15%)
Margin Funds	**8.9**	4.8	85%
Clearing House Funds	**1.5**	1.1	36%
Total	**14.4**	10.6	36%

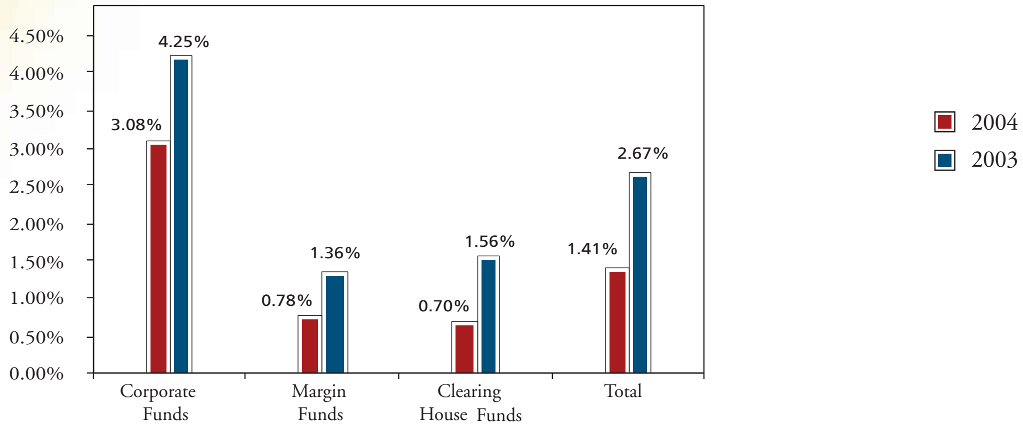
The increase in the average amount of Margin Funds available for investment during the year reflected the increased open interest in futures and options contracts. The reduction in Corporate Funds was mainly due to the $2.2 billion payment of 2003 special and final dividends in April 2004.

The increase in the average amount of Clearing House Funds available for investment during the year reflected the increase in additional contributions from Participants in response to market fluctuations and increased risk exposure.

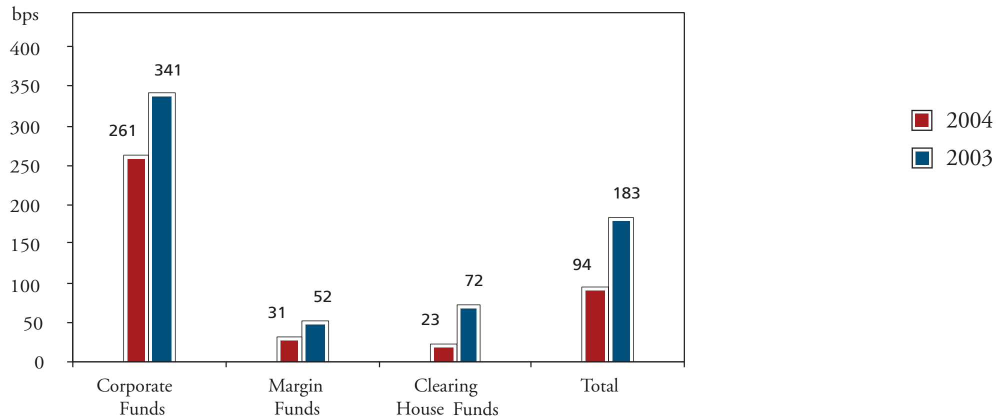
The drop in income from investments supervised by the Finance Department reflected lower interest rates, the reduced amount of Corporate Funds available for investment, and a drop in foreign exchange gains of $28 million during 2004.

The performance of funds supervised by the Finance Department is as follows:

▶ Return on Investments Supervised by the Finance Department



▶ Return above the 6-month Hong Kong Exchange Fund Bill yield in basis points



During the third quarter 2004, the investment in Singapore Exchange Limited was disposed of at a consideration of $76 million and a profit over cost of $24.8 million was recorded.

For more details of the investment portfolio, please refer to the Treasury section under the Business Review.

(D) Other operating income

	2004 $'000	As restated 2003 $'000	Change
Income from sale of information	**307,633**	264,239	16%
Other income			
Network, terminal user, dataline and software sub-license fees	**120,261**	101,491	18%
Participants' subscription and application fees	**34,341**	36,227	(5%)
Share registration services fees	**1,828**	1,600	14%
Brokerage on direct IPO applications	**17,586**	11,618	51%
Fair value gain of an investment property	**3,300**	–	N/A
Accommodation income	**5,133**	14,355	(64%)
Miscellaneous income	**6,552**	7,713	(15%)
	189,001	173,004	9%

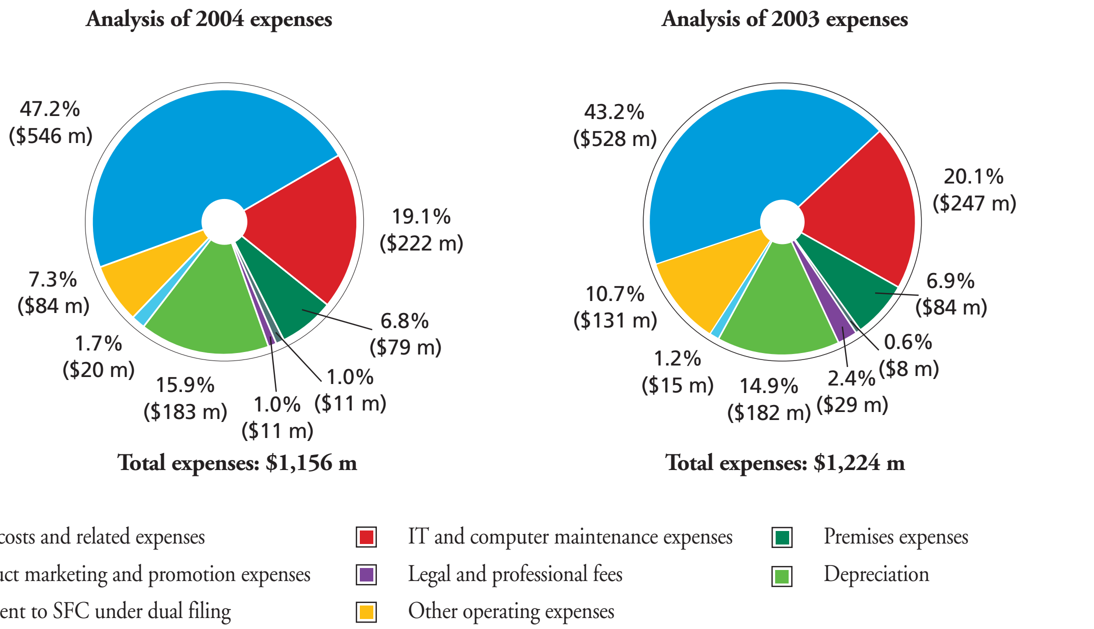
Income from sale of information increased as demand for information surged in line with the activity on the Cash and Derivatives markets.

Other income

Network, terminal user, dataline and software sub-license fees increased due to higher sales of additional throttles, the rise in software sub-licensing and an increase in the number of network lines used by Participants.

Accommodation income (ie, the retention interest charged on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the Margin Funds) declined as margin deposits received from Participants in non-contract settlement currencies or securities deposited dropped significantly during the year.

▶ OPERATING EXPENSES



	2004 $'000	As restated 2003 $'000	Change
Staff costs and related expenses	**545,654**	528,344	3%
Information technology and computer maintenance expenses	**221,624**	246,648	(10%)
Premises expenses	**78,833**	84,581	(7%)
Product marketing and promotion expenses	**11,263**	7,891	43%
Legal and professional fees	**11,083**	28,873	(62%)
Depreciation	**183,400**	181,739	1%
Payment to SFC under dual filing regime	**20,000**	15,000	33%
Other operating expenses	**84,439**	130,651	(35%)
Total operating expenses	**1,156,296**	1,223,727	(6%)

Staff costs and related expenses increased by $17 million during the year, mainly attributable to $12 million of higher employee options expensed and written-off in accordance with HKFRS 2, $1 million increase in training costs and a $34 million increase in the performance bonus pool as a result of the improved performance of the Group. The increase was partly offset by tighter control on staff costs resulting in savings of $21 million in 2004 and one-off severance costs of $9 million in 2003.

Information technology and computer maintenance expenses declined by $25 million. Cost of goods and services directly consumed by Participants increased to $61 million (2003: $51 million) due to increased hardware purchases and a higher number of network lines used and software licencing for derivatives trading and clearing systems. Excluding the goods and services directly consumed by Participants, the amount consumed by the Group was $161 million in 2004, a drop of $35 million against that of 2003 (2003: $196 million) mainly due to lower hardware rental and system maintenance costs. In 2004, capital expenditures on computer systems, hardware and software amounted to $23 million (2003: $30 million).

Premises expenses dropped as lower rental was negotiated upon the renewal of certain leases and savings achieved from reduced floor area leased during the year.

Product marketing and promotion expenses rose mainly attributable to higher expenditure on corporate marketing and advertising campaigns and incentive programmes launched for the introduction and promotion of the H-Shares Index Futures and Index Options.

Legal and professional fees fell mainly attributable to professional fees incurred on several one-off consulting projects in 2003.

Depreciation remained fairly stable during the year. The increase in depreciation following the roll out of DCASS in April 2004 was offset by the decrease arising from revising the estimated useful life of the hardware of trading and clearing systems from three years to five years to better reflect the actual useful life of equipment.

Payment to the SFC under the dual filing regime increased as the arrangement took effect from 1 April 2003, and the full year impact was recorded in 2004.

Other operating expenses dropped significantly mainly attributable to certain one-off costs incurred in 2003 ($32 million for the write-down of the Group's investment in BondsInAsia Limited and $10 million relating to the retirement of redundant IT systems following a business strategy and operations review conducted in May 2003). Provision for impairment loss of trade receivables also declined by $3 million with a net recovery of $1 million (2003: charge of $2 million).

SHARE OF PROFITS LESS LOSSES OF ASSOCIATES

	2004 $'000	As restated 2003 $'000	Change
Share of profits less losses of associates	**12,884**	8,642	49%

Share of profits less losses of associates (after taxation) increased due to the improved performance of one of the associates, Computershare Hong Kong Investor Services Limited.

TAXATION

	2004 $'000	As restated 2003 $'000	Change
Taxation	**193,641**	112,054	73%

Taxation increased mainly attributable to an increase in operating profit and a drop in non-taxable investment income.

LIQUIDITY, FINANCIAL RESOURCES, GEARING AND CAPITAL COMMITMENTS

Working capital decreased by $1,005 million or 25 per cent to $3,065 million as at 31 December 2004 (2003: $4,070 million). This decline was primarily due to the payment of the 2003 special and final dividends of $2,219 million and the payment of 2004 interim dividend of $454 million, which was partly offset by the $1,057 million profit generated during the year, the proceeds on the sale of the investment in Singapore Exchange Limited of $76 million and $355 million of time deposits brought forward from 31 December 2003 with a maturity over one year that became current assets during the year due to the lapse of time, and the increase in other net current assets of $180 million.

Although the Group has consistently maintained a very liquid position, banking facilities have nevertheless been put in place for contingency purposes. As at 31 December 2004, the Group's total available banking facilities amounted to $1,608 million (2003: $2,764 million), of which $1,500 million (2003: $1,500 million) represented repurchase facilities to augment the liquidity of the Margin Funds.

During the year, the $1,100 million of banking facilities for meeting the Group's Continuous Net Settlement ("CNS") money obligations in CCASS expired and was not renewed as the Group has set aside $1,500 million of retained earnings for the purpose of strengthening the risk management regime of the clearing houses and supporting their roles as central counterparties. Furthermore, the SGD 12 million banking facility of the bank loan for hedging the Group's investment in Singapore Exchange Limited was not renewed following the disposal of the investment.

Borrowings of the Group have been rare and are mostly event driven, with little seasonality. As at 31 December 2004, the Group had no bank borrowings (2003: SGD11 million, equivalent to HK$50 million, with a maturity of less than 1 year).

As at 31 December 2004, the Group had zero gearing (2003: gearing was less than 1 per cent).

The Group's capital expenditure commitments as at 31 December 2004, mainly in respect of its ongoing investments in facilities and technology, amounted to $78 million (2003: $91 million). The Group has adequate financial resources to fund its commitments on capital expenditures from internal resources.

As at 31 December 2004, 99 per cent (2003: 98 per cent) of the Group's cash and cash equivalents (comprise cash on hand, bank balances and time deposits within three months of maturity when acquired) were denominated in HKD or USD.

CHARGES ON ASSETS

None of the Group's assets was pledged as at 31 December 2004 and 31 December 2003.

SIGNIFICANT INVESTMENTS HELD AND MATERIAL ACQUISITIONS AND DISPOSALS OF INVESTMENTS AND SUBSIDIARIES

The Group has held a 24 per cent interest in Computershare Hong Kong Investor Services Limited since May 2002 (cost: $26.5 million; and book value: $37.4 million) and a 30 per cent interest in ADP Wilco Processing Services Limited ("AWPS") since May 2002 (cost: $1.8 million; and book value: $1.3 million).

The Group disposed of its entire investment in Singapore Exchange Limited in July 2004 at a profit over cost of approximately $24.8 million.

The Group resolved to liquidate its investment in AWPS in the fourth quarter 2004. As at 31 December 2004, the book value of AWPS, representing the Group's share of AWPS's net assets, which comprise predominantly cash and bank balances, amounted to $1.3 million. The liquidation proceeds are expected to approximate the investment book value. The voluntary liquidation of AWPS is in progress.

Apart from the above, there were no other material acquisitions or disposals of investments and subsidiaries during the year.

EXPOSURE TO FLUCTUATIONS IN EXCHANGE RATES AND RELATED HEDGES

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. During the year, the Singapore dollar credit facility (2003: SGD11 million or HK$50 million) used to hedge the currency exposure of the Group's investment in shares of Singapore Exchange Limited was fully repaid. Thereafter, only forward foreign exchange contracts have been used to hedge the currency exposure of the Group's non-HKD investments and liabilities to mitigate risks arising from fluctuations in exchange rates.

As at 31 December 2004, aggregate net open foreign currency positions amounted to $1,996 million, of which $170 million were non-USD exposures (2003: $1,663 million, of which $204 million were non-USD exposures), and the total nominal value of outstanding forward foreign exchange contracts amounted to $358 million (2003: $322 million). All foreign exchange contracts mature within one month.

The Group's foreign currency liabilities, in the form of margin deposits or collateral received, are hedged by investments in the same currencies.

CONTINGENT LIABILITIES

The Unified Exchange Compensation Fund ("Compensation Fund") is a fund set up under the repealed Securities Ordinance ("SO") for the purpose of compensating any person (other than a Stock Exchange Participant) dealing with a Stock Exchange Participant for any pecuniary losses suffered as a result of a default by 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, and with the approval of the SFC, allow an additional payment to successful claimants before apportionment. Under Section 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it is obligated to replenish the Compensation Fund upon the SFC's request. 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 31 December 2004, there were outstanding claims received in respect of 10 defaulted Stock Exchange Participants (2003: 13).

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting claims against the Compensation Fund in relation to any default of a Stock Exchange Participant occurring before 1 April 2003. The claims period expired on 3 October 2003 and no claims were received in response to that notice. Claims made after the claims period are, unless the Stock Exchange otherwise determines, barred. As at 31 December 2004, no claims had been received in response to said notice.

Following the implementation of the new compensation arrangements under the SFO, an Investor Compensation Fund has been established to replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. Pursuant to the SFO, EPs are no longer required to make deposits to the Investor Compensation Fund and the Stock Exchange is not required to replenish the Investor Compensation Fund. Hence, deposits to the Commodity Exchange Compensation Fund were returned to the Futures Exchange by the SFC in January 2004. The Futures Exchange had in turn reimbursed holders of Futures Exchange Trading Rights their contributions to the Commodity Exchange Compensation Fund. Similarly, deposits to the Compensation Fund would be returned to the Stock Exchange in accordance with the SFO pending completion of any determination of outstanding claims and replenishment to the Compensation Fund.

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 the default of any one Participant. In the unlikely event that all of its 434 trading Participants as at 31 December 2004 (2003: 437) defaulted, the maximum contingent liability of the Stock Exchange under the indemnity will amount to $87 million (2003: $87 million).

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.

HKEx has given a guarantee to secure banking facilities granted to HKSCC since 13 December 2000. These facilities, on a committed basis of an aggregate amount of $1.1 billion, were granted to HKSCC by five banks to provide stand-by liquidity to meet potential obligations of HKSCC in CCASS in circumstances where CCASS Participants default on their payment obligations. None of these bank facilities had ever been utilised as at 31 December 2003. During the year, the bank facilities were not renewed and the guarantee given by HKEx expired.

HKEx has given a guarantee to secure banking facilities of SGD 12 million to HKEx (Singapore) Limited for financing its investments since 16 April 2001. During the year, the Singapore dollar credit facility (31 December 2003: SGD11 million or HK$50 million) was fully repaid, and the guarantee given by HKEx had expired.

FIVE-YEAR STATISTICS

	2004 $ million	As restated* 2003 $ million	As restated* 2002 $ million	As restated* 2001 $ million	As restated* 2000 $ million
Results					
Income #	**2,407**	2,029	1,813	1,998	2,312
Profit attributable to shareholders	**1,057**	693	589	734	883
Assets and liabilities					
Non-current assets	**2,423**	2,690	1,886	1,803	2,199
Current assets	**19,020**	17,118	12,147	11,927	11,948
Current liabilities	**(15,955)**	(13,048)	(7,939)	(7,888)	(8,672)
Net current assets	**3,065**	4,070	4,208	4,039	3,276
Total assets less current liabilities	**5,488**	6,760	6,094	5,842	5,475
Non-current liabilities	**(1,436)**	(1,146)	(600)	(620)	(620)
Shareholders' funds	**4,052**	5,614	5,494	5,222	4,855

* *Following the adoption of certain new HKFRSs issued by the HKICPA in 2004, certain comparatives previously reported have been restated to conform to the new policies.*

\# *Income includes share of profits less losses of associates.*

FIVE-YEAR RESULTS