

Review of Operations

(Financial figures are expressed in Hong Kong dollars)

Hong Kong Exchanges and Clearing Limited (HKEx) reported unaudited net profits for the six months ended 30 June 2003 of \$214 million (2002: \$289 million). The directors have resolved to pay an interim dividend of \$0.18 per share (2002: \$0.08). The share register will be closed on Tuesday, 9 September 2003 to Thursday, 11 September 2003 inclusive and dividend warrants will be despatched to shareholders on or about Monday, 15 September 2003.

Market sentiment in the first six months of 2003 was adversely affected by poor economic conditions in Hong Kong stemming from the onset of the Severe Acute Respiratory Syndrome (SARS), rising unemployment, continuing property market weakness and slow growth overseas. Average daily turnover on The Stock Exchange of Hong Kong Limited (Stock Exchange) decreased by 7 per cent compared with that of the same period last year. Average daily volume of futures and options contracts traded on the Stock Exchange and the Hong Kong Futures Exchange Limited (Futures Exchange) increased by 27 per cent compared with that of the same period last year. Both averages have an effect on HKEx's results.

In the six months to 30 June 2003, HKEx continued to focus on improving the quality of its markets, increasing the efficiency of its operations, and providing products and services that meet the needs of market participants.

Markets

Securities Market

Average daily turnover value on the Stock Exchange during the period under review was \$7.1 billion, compared with \$7.6 billion during the same period in 2002. A total of 16 new equity issues were listed on the Main Board, including three by companies formerly listed on the Growth Enterprise Market (GEM), and 12 were listed on GEM. In the first half of 2002, there were 34 new equity listings on the Main Board, including two by companies formerly listed on GEM, and 28 on GEM. Capital formation through initial public offering and post issue fund raising totalled \$134.9 billion on the Main Board and \$972 million on GEM, compared with a total of \$25.7 billion on the Main Board and \$3.8 billion on GEM in the first half of 2002.

Derivatives Market

The average daily number of futures and options contracts traded on the Stock Exchange and the Futures Exchange during the first six months of 2003 was 53,713 contracts, up from 42,443 in the first six months of 2002. Total open interest at the end of June 2003 was 537,185 contracts, compared with 671,967 at the end of June 2002.

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Developments since the Report for the Quarter to 31 March 2003

HKEx has started reporting its results on a quarterly basis. As a result, the following section highlights developments since the completion of the Report for the Quarter to 31 March 2003.

Listing Matters

On 30 May 2003, the Stock Exchange and the Securities and Futures Commission (SFC) jointly published their Consultation Paper on Regulation of Sponsors and Independent Financial Advisers (IFAs) to seek the views of market participants on proposals to reinforce the regulatory regime for sponsors, underwriters and IFAs, and to seek comments on issues involving other financial intermediaries. Seminars held by HKEx and the SFC for issuers and market practitioners to discuss the proposals were well attended. The consultation period ended at the close of business on 31 July 2003. The results are being compiled and analysed to help determine the way forward on the proposals.

The Stock Exchange distributed revised guidance on new listing applications to sponsors in early June. It applies to new applications submitted on or after 16 June 2003. The guidance provides a non-exhaustive list of potential issues which should be raised with the Listing Unit and sets out the checklists, information and documentary requirements applicable at each stage of the vetting process. The guidance is aimed at assisting sponsors in orderly submission of the information required so that listing applications can be assessed on a timely basis.

Market Development and Operations

The Stock Exchange will seek market participants' views on proposals to narrow its trading spreads by publishing a consultation paper later this year.

The Stock Exchange narrowed the strike intervals for options on HSBC Holdings and on Hang Seng Bank for the spot and next calendar months by 50 per cent with effect from 30 April 2003. In light of the positive market response, the narrowing of the strike intervals for other stock option classes is being considered.

The Futures Exchange suspended trading in International Stock Futures and Options (ISFO) after the market closed on 29 May 2003. The suspension followed a review of HKEx's product portfolio. Reviews are conducted from time to time to ensure that products meet the needs and demands of the market in a cost efficient manner.

The Futures Exchange and the Shanghai Futures Exchange have formed a working group comprising representatives from both organisations to look into the possibility of developing an Asian energy derivatives market. A study on a market and clearing model is now in progress.

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The Stock Exchange has been discussing the possible introduction of Capital Protected Instruments (CPI) under Chapter 15A of its Listing Rules with potential issuers. CPI offer investors a degree of capital protection along with potential gains based on the performance of designated assets. The Stock Exchange and the Futures Exchange are also studying the possible introduction of other products, including cash-settled Three-Year Exchange Fund Note Futures and Interest Rate Swap Futures.

Clearing

The final phase of CCASS/3, the upgraded Central Clearing and Settlement System (CCASS), was introduced on 26 May 2003 with the rollout of the Participant Gateway. The Participant Gateway serves as an additional communication channel to the CCASS/3 Terminal and provides a direct electronic interface between CCASS/3 and CCASS Participants' back office systems to facilitate straight-through processing. CCASS Participants may subscribe for the use of the Participant Gateway according to their requirements.

Market views will be sought in the coming months on a proposed model for an upgraded version of the Investor Participant account in CCASS and the technical details of the scripless model to be implemented. HKEx will continue to discuss with market participants the possible introduction of Third Party Clearing in the securities market, which was first discussed in a July 2002 consultation paper.

Corporate Treasury

The Corporate Treasury manages funds amounting to about \$9.24 billion, comprising mainly accumulated operating profits, Clearing House Funds, and margin funds received. Investment income represents approximately 20 per cent of HKEx's total income.

Investments are kept sufficiently liquid to meet operating and possible requirements of the Clearing House Funds and margin funds. As at 30 June 2003, 49 per cent of funds were invested in highly liquid investment-grade bonds, 50 per cent in cash or bank deposits and 1 per cent in global equities. The maturity profile of the investments as at 30 June 2003 was as follows:

Overnight	>Overnight to 1 month	>1 month to 1 year	>1 year to 3 years	>3 years
38%	8%	12%	32%	10%

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Credit exposure was well diversified. All bonds held were of investment grade and had a weighted average credit rating of Aa2 and a weighted average maturity of 2.3 years. Deposits were placed with the note-issuing banks in Hong Kong or financial institutions with a minimum credit rating of A3 which are approved by the Board from time to time.

Investment and fund management is governed by guidelines approved by the Board, aimed at optimising return, safeguarding assets and satisfying liquidity requirements. A professional Treasury team in Corporate Treasury is dedicated to the day-to-day management and investment of the funds. External fund managers have also been appointed to manage part of the Corporate Funds.

An Investment Advisory Committee, comprising non-Executive Directors of the Board and external members from the financial community, advises HKEx on portfolio management and monitors the risk and performance of its investments.

Risk management techniques, such as Value-at-Risk (VaR) and portfolio stress testing, are used to identify, measure, monitor and control market risks. For the first half year of 2003, the overall portfolio risk, as measured by the VaR methodology, recorded an average, maximum and minimum VaR of \$21 million, \$26 million and \$18 million respectively.

China Development and Listing Promotion

HKEx has been granted approval to establish a representative office in Beijing under the Mainland and Hong Kong Closer Economic Partnership Arrangement (CEPA) signed on 29 June 2003. The representative office will be opened upon completion of the application process, anticipated to be in the fourth quarter of this year.

As part of ongoing efforts to provide potential listing candidates with a greater understanding of the requirements for listing in Hong Kong, HKEx arranged two August 2003 conferences on the Mainland, one in Guangzhou, the capital of Guangdong province, and one in Fuzhou, the capital of Fujian province.

SARS

There were no SARS-related interruptions to the trading, clearing, or business operations of HKEx and its subsidiaries (the Group).

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Board of Directors

Dr Liu Jinbao tendered his resignation as a Non-executive Director with effect from 28 May 2003 due to personal reasons. He was one of the six Non-executive Directors appointed by the Government to represent public and market interests to the Board.

Reorganisation

As part of continuing efforts to rationalise HKEx's operations and further strengthen its competitiveness, a new organisation structure has been put in place. The main changes involved the Exchange Business Unit and the Listing, Regulation and Risk Management Unit.

Outlook for the Remainder of the Financial Year

The outlook for the remainder of the year depends on the performance of the markets operated by HKEx. Market sentiment and the factors that influence it will continue to affect the results of the Group. Investor confidence remains fragile due to weak economic conditions in Hong Kong and overseas despite recent increases in trading activities in the cash and derivatives markets.

HKEx will continue to review its operations to ensure that they are efficient. Stringent cost controls remain in place and effects of the measures will be reflected in future results. The Group will seek to further improve the quality of its markets to attract more investors. The Group will also encourage more fund-raising activities on the Stock Exchange, strengthen its position among the world's equity markets and maintain its role as the prime international capital formation centre for enterprises from Mainland China.

I was very fortunate to succeed Mr Kwong Ki-chi as the Chief Executive of HKEx. I must express my deepest appreciation to Mr Kwong for having made HKEx into an internationally respected organisation despite its short history. He has also left me with a team of dedicated, professional and quality staff. I am confident that by working together under the leadership of the Board of Directors we can successfully build on the foundation in place and continue to flourish.

Paul Chow

Chief Executive

Hong Kong, 13 August 2003