Overall Performance

The Group recorded a profit attributable to shareholders of $366 million for the interim period, compared with $554 million for the same period in 2000. The 34 per cent drop in profit was mainly attributable to lower income brought about by the sharp drop in stock market activities this year.

Income

Total income for the period fell by 18 per cent to $1,001 million (2000: $1,227 million).

Due to the substantial correction in technology stocks since mid 2000, deteriorating global economic outlook and poor investor sentiment in Hong Kong, average daily turnover of the cash market decreased by 36 per cent in the first six months of 2001 compared to that in 2000. This, coupled with a reduction in the Group's entitlement to transaction levy from cash market trading from 0.007 per cent to 0.005 per cent since June 2000, brought total transaction levy, trading tariff and trading fees down by 41 per cent to $194 million (2000: $326 million).

Despite the poor market sentiment, listing fee income rose by 15 per cent to $144 million (2000: $126 million), attributable primarily to more applications for listing. New listings for derivative warrants on the Main Board increased by 91 per cent (181 in 2001 and 95 in 2000). As at 30 June 2001, there were 745 companies listed on the Main Board and 79 on the Growth Enterprise Market (GEM) (31 December 2000: 736 and 54 respectively).

As a result of the slowdown in cash market activities, clearing and settlement fee income dropped by 32 per cent to $119 million (2000: $176 million). Depository, custody and nominee services fee income also dropped by 23 per cent to $91 million (2000: $119 million) as corporate actions decreased during the period.

Interest income decreased moderately by 13 per cent to $199 million (2000: $229 million). This was attributable to a significant reduction of market interest rates and a reduction in margin funds received. The general level of interest rates fell substantially as the U.S. Federal Reserve continued to cut the Fed Fund rate aggressively from 6.50 per cent at the start of the year to 3.75 per cent at end-June, a reduction of 275 basis points. As at 30 June 2001, the 6-month Hong Kong Exchange Fund Bills rate was 3.45 per cent and the 90-day U.S. Treasury Bill rate was 3.66 per cent. Despite the above, for the first half of 2001, annualised gross yields of our fund investments by major currency were better than the market at 5.74 per cent for HKD and 4.97 per cent for USD.

With regard to funds available for investment, a significant proportion is made up of margin funds received from Participants. Notwithstanding the higher number of futures and options contracts traded within the period, the average level of margin funds fell by 22 per cent in 2001, largely as a result of the lowering of margin requirement for HSI futures contracts in line with changes in the market. As of 30 June 2001, the size of total investable funds (including corporate funds, margin funds and Clearing House Funds) of HKEx was $8.8 billion, 15 per cent lower than the $10.3 billion at end-June last year.

Operating Expenses

Total operating expenses remained flat at $597 million (2000: $600 million).

Staff costs and related expenses rose by 10 per cent to $287 million (2000: $262 million). Savings from net headcount reduction following the integration of the Group's activities (average headcount fell by 15 per cent) were offset by the average salary increase of 7 per cent in July 2000 and a shift from a lower-cost operational staff mix to a more knowledge-based (IT) and product/marketing oriented staff mix.

Due to the Group's commitment to further enhance its trading and settlement systems, information technology and computer maintenance expenses increased by 23 per cent from $97 million to $119 million, mainly attributable to expenditures incurred on the new Automatic Order Matching and Execution System (AMS/3) rolled out in October 2000 and the Order Routing System (ORS) launched in February 2001.

Premises expenses increased by 9 per cent to $52 million (2000: $48 million), mainly due to costs provided for reinstating leased premises in future.

Product marketing and promotion expenses decreased by 49 per cent to $10 million (2000: $19 million) as there were several large-scale one-off promotion events in 2000, such as the new Investor Account Services for the clearing business, the listing of the Group and the migration of HSI futures and options trading from the trading floor to the Hong Kong Futures Automated Trading System (HKATS) in June 2000.

Depreciation and amortisation declined by 22 per cent to $78 million (2000: $100 million), mainly attributable to a one-off depreciation charge of $25 million in 2000 as a result of the standardisation of the Group's policy on depreciation. Additional depreciation charge arising from the roll-out of AMS/3 in October 2000 was offset by the decrease in depreciation for the Traded Option System, which was fully depreciated in August 2000.

There were no merger, listing and integration expenses during the period as all such costs were incurred and fully provided for in 2000.

Taxation

The Group's taxation charge in 2001 decreased by 47 per cent to $38 million (2000: $73 million), primarily due to the lower profit reported for the period.

Liquidity, Financial Resources and Capital Commitments

Working capital decreased by $266 million to $3,035 million as at 30 June 2001 (31 December 2000: $3,301 million) as bank balances and time deposits of corporate funds fell by $300 million to $3,335 million (31 December 2000: $3,635 million) mainly due to the distribution of $260 million of final dividend for 2000 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 2001, the Group's total available credit facilities amounted to $2,904 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 the Central Clearing and Settlement System (CCASS) in circumstances where CCASS Participants 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 2001, short-term bank borrowing under a repurchase agreement with a bank amounted to $105 million and the assets pledged amounted to $105 million (31 December 2000: Nil).

As at 30 June 2001, the Group's capital expenditure commitments amounted to $286 million (31 December 2000: $381 million) mainly in respect of its ongoing investments in facilities and technology. 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

Other than the $105 million of assets pledged under the repurchase agreement mentioned above, 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. As at 30 June 2001 and 31 December 2000, this overdraft facility was not utilised.

Significant Investments Held and Material Acquisitions and Disposals of Subsidiaries

Other than the 1 per cent holding (10 million shares) in the issued ordinary share capital of Singapore Exchange Limited, there were no other significant investments as at 30 June 2001. Also, there were no material acquisitions or disposals of subsidiaries during the period.

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 2001, aggregate net open foreign currency positions amounted to HK$514 million, of which HK$54 million was non-USD exposures (31 December 2000: HK$55 million and all non-USD exposures).

Contingent Liabilities

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 107(1) of the SO, the Stock Exchange has contingent liabilities to the Compensation Fund as it shall replenish the Compensation Fund upon the request of the Securities and Futures Commission (SFC) to do so. The amounts 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. As at 30 June 2001, there were outstanding claims received in respect of 18 defaulted Stock Exchange Participants (31 December 2000: 18).

Under the new investor compensation arrangements proposed by the SFC in March 2001 to be implemented under the Securities and Futures Bill, 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 Exchanges and to non-exchange participant dealers. The arrangements would also remove the existing requirement for the Stock Exchange to replenish amounts paid from 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 defaults of any one Participant. In the unlikely event that all of its 504 trading Participants as at 30 June 2001 (31 December 2000: 500) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to $101 million (31 December 2000: $100 million).

Pursuant to Section 21 of the Exchanges and Clearing Houses (Merger) Ordinance, 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

The integration of the businesses of The Stock Exchange of Hong Kong Limited (Stock Exchange) Group, the Hong Kong Futures Exchange Limited (Futures Exchange) Group and the HKSCC Group within a new business organisation structure has been completed. The total number of employees decreased from 937 as at 30 June 2000 to 825 as at 30 June 2001.

Employees' cost (excluding directors' emoluments) amounted to approximately $283 million (2000: $260 million). Please refer to Operating Expenses under Overall Performance for movements in staff costs and related expenses.

The Group ensures that the pay levels of its employees are competitive in the market and employees are rewarded on a performance related basis within the general framework of the Group's salary and bonus system.

Prospects

As a substantial part of the Group's income is derived from transaction levy, clearing and settlement fees and interest income on margin funds, the performance of the Group is dependent on external factors including, in particular, market sentiment, the level of activities on the Stock Exchange and on the Futures Exchange and movements in interest rates. Recent economic data suggest that the global economy is unlikely to improve in the short term. Also, while it is too early to assess the full impact on financial markets around the world of the tragic attack in the US on 11 September, the disruption caused would not help investor sentiments. In such an environment, activities on the Stock Exchange and Futures Exchange are likely to remain depressed and the Group's income is therefore prone to further deterioration in the second half of this year.

The Group will continue to exercise stringent control over its costs. It will also continue its strategy to attract investors and capital raising companies by improving investor education and issuer marketing, enhancing the efficiency of its trading and clearing systems and broadening access to facilitate trading. More efforts will also be dedicated to the development and marketing of new products, such as regional index funds and international stock futures and options, to attract both local and international investors. Resources will continue to be devoted to further promote the Group as one of the primary international capital raising centres for Mainland China companies.

Cognizant of the Mainland's efforts in developing its stock and futures markets, the Group will work with its counterparts in the Mainland to ensure that services provided by the exchanges in Shanghai, Shenzhen and Hong Kong complement each other.

In view of the deteriorating global economic outlook, the trading environment will continue to be difficult in the short-run. With China's impending accession to the World Trade Organisation (WTO), however, Hong Kong is likely to benefit from favourable economic development in the Mainland. With sophisticated technology, superior legal and regulatory environment, good market discipline and continuous product innovation, the Group is well positioned to capture the potential opportunities created by China's accession to the WTO.