

Review of Operations

(Financial figures are expressed in Hong Kong dollars)

Results for the Six Months Ended 30 June 2002

Hong Kong Exchanges and Clearing Limited (HKEx) reported unaudited net profits for the six months ended 30 June 2002 of \$290 million (2001: \$366 million). The directors have resolved to pay an interim dividend of \$0.08 per share (2001: \$0.08). The share register will be closed from Monday, 9 September 2002 to Wednesday, 11 September 2002 inclusive and dividend warrants will be despatched to shareholders on or about Thursday, 12 September 2002.

Market sentiment in the first six months of 2002 continued to be affected adversely by poor local economic performance and global economic uncertainty, especially in the United States with its string of major corporate scandals. Average daily turnover on The Stock Exchange of Hong Kong Limited (Stock Exchange) dropped by 20 per cent compared with that in the same period last year. Average daily contract volume of futures and options traded on HKATS (Hong Kong Futures Automated Trading System) decreased by 6.2 per cent compared with that in the same period last year. Both have a direct impact on HKEx's results.

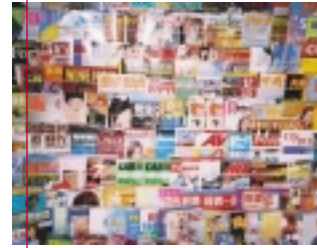
The foci of the company during the first six months were on raising the quality of our market, especially in corporate governance, developing new products and continuing control of operating costs.

Listing, Regulation and Risk Management Affairs

Raising market quality and corporate governance standards are two of our main objectives. Both are important to the long-term competitiveness of our market, and both require the support of all market participants.

As part of our efforts to bolster the quality of our market and the corporate governance standards of the companies listed on the Stock Exchange, we consulted the market on proposed changes to our Main Board Listing Rules related to corporate governance. The consultation covered many issues, including protection of shareholders' rights, directors and board practices, corporate reporting and disclosure of information.

We are considering and analysing the responses to the consultation and we aim to make substantive proposals during the second half of the year in consultation with the Securities and Futures Commission of Hong Kong (SFC).



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We issued a market consultation paper in July on Listing Rules related to listing admission conditions, continuing listing eligibility criteria and delisting procedures. To allow more time for comments, the deadline for submissions was subsequently changed from 31 August to 31 October. Also, the proposals on continuing listing eligibility criteria were removed from the original consultation document in order to refine the proposals for separate discussion with the market. We plan to publish a supplementary consultation paper on them around the end of October and will give the market some three months to respond.

We are cooperating fully with the independent panel of inquiry appointed by the Financial Secretary to examine the circumstances surrounding the publication of the original consultation document on Listing Rules related to listing eligibility.

The Listing Rules for the Main Board and Growth Enterprise Market (GEM) were amended with a view to reducing the volume of printed documents. As a result, listed companies may send corporate communications to their shareholders electronically and in English or Chinese only, subject to certain conditions and the shareholders' prior approval. Also, companies listed on the Main Board and GEM are required to submit a soft copy of all listing-related corporate communications for publication on our website.

Other ongoing projects include the implementation of proposed changes to our listing organisational structure and procedures.

Cash Market

Primary Market

Main Board

A total of 34 new equity issues were listed on the Main Board. During the period under review, capital formation through IPO (initial public offering) and post issue fund raising was \$17.4 billion. Market capitalisation at the end of the period amounted to \$3,792 billion. A number of major new issues are anticipated in the second half of the year.

International institutions issued a further 11 debt securities, amounting to a total of \$12 billion in value. A total of 403 warrants, comprising 18 equity and 385 derivative warrants were listed during the period.

GEM

GEM continued to meet its objective of providing capital formation facilities for younger companies which may not be able to meet the operating and profit record criteria to list on the Main Board.

A total of 28 companies, including five H shares, were listed on GEM. During the period under review, capital formation through IPO and post issue fund raising was \$3,476 million. Market capitalisation on 30 June amounted to \$60,521 million.

Secondary Market

Trading turnover on the Main Board amounted to \$881 billion during the first six months, compared with \$1,117 billion last year. Turnover on GEM was \$28.2 billion compared with \$25 billion during the same period last year.

A pre-opening session was introduced on 25 March for the cash market. The 30-minute pre-opening session helps determine a fair opening price for shares. It also reduces the loading of the trading system at the commencement of the morning session, when a large number of orders and trade execution messages are often entered into the system. An index basket order trading mechanism was also introduced on 25 March for the securities market. The mechanism enables investors to place an order for a batch of stocks in an index with a single order, and facilitates index basket trading, including index arbitrage. Initially, only basket orders based on the Hang Seng Index are allowed. Baskets on other tradable indices may be introduced later, depending on market needs.

The first derivative warrants issued under amended rules that came into effect at the end of last year were listed in January. They were among 238 derivative warrants listed between 28 January and 28 February. At the end of June, there were 386 derivative warrants listed on the Stock Exchange.

New rules governing the listing of structured products, announced in June, came into effect on 1 July. The new rules permit a wider range of structured products, such as derivative warrants and ELI (Equity Linked Instruments), to be traded on the Stock Exchange. The first ELI were listed on 5 August and more listings are anticipated in the remainder of the year.

Rules for designated specialists as market makers for ETF (Exchange Traded Funds) were approved and came into effect on 29 April. Related market making open gateway and AMS/3 (Third Generation Automatic Order Matching and Execution System) terminal rules were also approved. The changes are part of our ongoing efforts to further develop the ETF market.



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Derivatives Market

During the period under review, 3,320,636 futures and options contracts were traded on Hong Kong Futures Exchange Limited (Futures Exchange) and 1,746,825 stock options contracts were traded on the Stock Exchange. Total open interest at the end of June was 671,967 contracts, compared with 443,189 a year ago.

The Block Trading Facility (BTF) introduced in October 2001 under a 6-month pilot programme became a standing facility on 29 April. Block trades comprise large buy and sell orders privately negotiated by Futures Exchange Participants and Options Trading Exchange Participants apart from the public auction market but subsequently reported through HKATS. The BTF makes the Derivatives Market more attractive and more competitive.

The Bulletin Board function on HKATS was extended beyond the Hang Seng Index Futures and Options markets to the Stock Options market. The function gives market participants additional flexibility when employing common trading strategies.

Dow Jones Industrial Average futures contracts were introduced on 6 May. This new contract tracks the performance of the 30 stocks in the widely recognised benchmark for the US stock market. It also expands HKEx's range of international products.

The size of HIBOR (Hong Kong Interbank Offered Rate) futures contracts was raised fivefold in late May in response to market demand. A revision of the trading fees resulted in an effective fee reduction of 50 per cent.

Rolling Forex (One-Day Rolling Currency Futures) contracts for the Euro, Yen, British Pound and Deutschemark were delisted on 21 May. The delistings resulted from a routine review to ensure products meet the needs and demands of the marketplace in a cost effective manner.

The power supply to HKATS was strengthened in July based on recommendations by an independent consultant commissioned to review the causes of an Uninterruptible Power Supply (UPS) failure which led to the brief suspension of derivatives trading in the afternoon of 28 May. The consultant found the UPS failure was due to internal component malfunction. New contingency procedures for the Derivatives Market came into effect on 1 August.

Clearing and Settlement Services

Average daily settlement efficiency of continuous net settlement stock positions stood at 99.64 per cent on settlement day, rising to 99.96 per cent the following day.

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The number of investor participant accounts increased by 26 per cent to 11,570; and the number of stock segregated accounts with statement service increased from 1,274 to 1,562.

The phased introduction of CCASS/3, the upgraded Central Clearing and Settlement System, began in May, following SFC approval. In Phase 1, CCASS Participants and their designated banks started migrating to the new CCASS/3 network and terminals.

Other phases involve functional infrastructure upgrades to support future market initiatives and demands, and the introduction of a participant gateway to facilitate straight-through-processing connectivity.

Development on DCASS, the new Derivatives Clearing and Settlement System, continued. DCASS will replace the two existing clearing and settlement systems for futures and options contracts.

HKEx also published a consultation paper on a proposed model and implementation and operating details for third party clearing in the cash market. The model gives Stock Exchange Participants the option of outsourcing the clearing and settlement of their Stock Exchange trades, allowing them to formulate their business models more flexibly and economically.

Other Developments

A number of organisational changes took place during the period to better support our strategic plan. A new Corporate Strategy Unit was formed to focus on strategy development, planning, research and policy support. The Cash and Derivatives units merged into the Exchange Unit. Participant admission for the Cash, Derivatives and Clearing units was consolidated and moved to the Listing, Regulation and Risk Management Unit.

The company acquired a 15.58 per cent interest in BondsInAsia Limited (BIA). BIA is the premier fixed income trading platform in Asia and the investment represents an opportunity to participate in an organisation with strategic benefits.

We also formed a joint venture with Wilco International Limited, a subsidiary of Automatic Data Processing, Inc. to provide securities market transaction processing services. The joint venture will provide BESS, Brokers' Electronic Support Services, to Stock Exchange Participants.



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Computershare Limited, the world's largest share registry, and HKEx merged their respective Hong Kong share registration businesses. Hong Kong Registrars Limited (a former subsidiary of HKEx) is now a subsidiary of Computershare Hong Kong Investor Services Limited (CHIS), formerly known as Central Registration Hong Kong Limited. CHIS holds a major position in the share registration services market. Its clients include 22 out of the 33 constituent companies in the Hang Seng Index and all 27 Mainland H-share issuers in the Hang Seng China Enterprises Index. CHIS is 76 per cent owned by Computershare and 24 per cent by HKEx, which has an option to acquire a further six per cent.

Under another agreement, HKEx and Standard & Poor's are cooperating to create a new series of equity indices covering stocks listed on the Stock Exchange. The new indices are expected to eventually replace our All Ordinaries and GEM indices. They are also expected to provide additional business opportunities through the licensing of index-based financial products.

HKEx Information Services Limited, a wholly owned subsidiary of HKEx, was appointed as a non-exclusive agent of Shenzhen Securities Information Company, Limited (SSIC) for providing real-time market information of the Shenzhen Stock Exchange (SSE) outside the Mainland of China, including Hong Kong, Macau and Taiwan. SSIC is a subsidiary of the SSE. The appointment helps meet the growing overseas demand for Mainland securities market information. It also expands HKEx's cooperation with the SSE on market information.

HKEx and the London Stock Exchange (LSE) announced that the two exchanges are working together to make it easier for companies to list both in Hong Kong and London. In addition, we plan to introduce trading on Hong Kong stocks on the LSE's SETS system, and LSE stocks on AMS/3.

Information technology (IT) systems and operations were strengthened through a series of initiatives. HKEx and its vendors introduced changes to reinforce the stability of the HKATS network and strengthen the robustness and reliability of the HKATS trading system. HKEx developed a quality development standard for critical software vendors and commissioned external reviews of the procedures for the Derivatives Market and Clearing data centres. We also announced plans for comprehensive reviews of mission critical systems, including AMS/3 and HKATS, along with plans to engage an independent consultant to conduct a comprehensive IT review and recommend a quality management and certification framework for IT system development and management.

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The Stock Exchange invited claims against the Unified Exchange Compensation Fund in respect of the default of two Stock Exchange Participants during the period under review. The period for lodging claims will close on 19 August and 18 September 2002 respectively. The claims received as of 1 August totalled about \$48 million. The Stock Exchange, with the approval of the SFC, has resolved that a per claim limit of \$150,000 be adopted in each of the two default cases.

Finally, the directors have approved in principle the extension of the afternoon trading hours by starting the afternoon trading session half an hour earlier and ending it half an hour later. We will work with market participants to develop detailed operational procedures with a view to introducing the new trading hours by the end of this year or early next year, subject to regulatory approval and market readiness.

Outlook for the Rest of the Year

The operating outlook for the rest of the year depends critically on market sentiments, which are in turn affected by domestic as well as global factors, including, in particular, economic performance in Hong Kong and in major economies such as the US and the EU. With economic uncertainty expected to continue in Hong Kong and around the world for the rest of 2002, investor sentiments are not expected to improve radically. Stock Exchange and Futures Exchange activities are therefore likely to remain subdued during the second half of the year.

We will continue to apply stringent cost controls. We will seek to strengthen our markets to attract more investors and issuers to Hong Kong. We also plan to explore additional opportunities for cooperation with exchanges and clearing houses in the Mainland of China and overseas.

KWONG Ki Chi
Chief Executive

Hong Kong, 15 August 2002



Management Discussion and Analysis



Overall Performance

The Group recorded a profit attributable to shareholders of \$290 million for the interim period, compared with \$366 million for the same period in 2001. The 21 per cent drop in profit was mainly attributable to the continued decline in cash market activities and low level of interest rates, which have caused a significant drop in trading fees (formerly known as transaction levy), income from sale of information, clearing and settlement fees and investment income.

Income

Total income for the period decreased by 11 per cent to \$893 million (2001: \$1,001 million).

In the face of negative economic growth and rising unemployment in Hong Kong, and increasing incidents of accounting scandals and corporate malfeasance in the US with their dampening effect on investor confidence in the US and other markets, average daily turnover on The Stock Exchange of Hong Kong Limited (Stock Exchange) dropped by 20 per cent in the first half of 2002 to \$7.6 billion (2001: \$9.5 billion). The average daily number of derivatives contracts traded dropped by 6.2 per cent as the 9 per cent increase in the average daily number of derivatives contracts traded on Hong Kong Futures Exchange Limited (Futures Exchange) was more than offset by a 26 per cent reduction in the average daily number of stock options contracts traded on the Stock Exchange. As a result, total trading fees, transaction levy and trading tariff dropped by 14 per cent to \$167 million (2001: \$194 million).

Despite the depressed market conditions, 34 new companies joined the Main Board and 28 the Growth Enterprise Market (GEM) during the period. Listing fee income rose by 14 per cent to \$165 million (2001: \$144 million) as a result of the higher number of listed securities and new listings of derivative warrants. As at 30 June 2002, there were 787 companies listed on the Main Board and 137 on GEM (31 December 2001: 756 and 111 respectively).

In line with the decreased cash market activities, clearing and settlement fee income dropped by 19 per cent to \$96 million (2001: \$119 million). Depository, custody and nominee services fee income also fell by 4 per cent to \$87 million (2001: \$91 million) due to lower scrip fee income for the period. Similarly, income from sale of information fell by 10 per cent to \$159 million (2001: 176 million) as the demand for stock information decreased.