

Chairman's Statement

LEE Yeh Kwong, Charles
Chairman



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(Financial figures are expressed in Hong Kong dollars)

I am pleased to present this annual report of Hong Kong Exchanges and Clearing Limited (HKEx) for the period from 1 January to 31 December 2002.

The following discussions should be read in conjunction with the Review of Operations which is presented by the Chief Executive to report on the details of the company's operations and development.

Financial Results

HKEx recorded a profit before taxation of \$650 million in 2002, down 21 per cent from 2001. Profit attributable to shareholders was \$593 million, 20 per cent lower than 2001. The decline in profit is principally attributable to the continued fall in securities market activities and the low level of interest rates, which have caused a significant drop in trading fees, net interest income, income from sale of information, and clearing and settlement fees. (The Trading Fee was introduced in 2001 when the Stock Exchange of Hong Kong's portion of the Transaction Levy was removed.)

The Board has recommended payment of a final dividend of \$0.43 per share. Together with the interim dividend of \$0.08 per share, this will bring the total dividend distribution for the year to \$0.51 per share.

Operating expenses fell by one per cent to \$1,164 million, compared with \$1,176 million in 2001. This is the second consecutive year we recorded a drop in operating expenses, which fell by 12 per cent in 2001. The decline was mainly due

to effective cost control. Staff costs and related expenses decreased by 7 per cent to \$493 million, compared with \$528 million in 2001. This was achieved after offsetting the increase in expenses incurred by additional headcount in the market regulation and information technology operations of the Group. The increase in staff will help us to better meet our commitment to raise the standard of market regulation and enhance the capability and resilience of our information technology operations. Since the merger and integration of The Stock Exchange of Hong Kong, the Hong Kong Futures Exchange, and their clearing houses in 2000, staff costs and related expenses have been reduced by about \$106 million, representing a reduction of about 18 per cent.

Shareholders' funds as at the end of 2002 were \$5,496 million.

Major International Centre for Capital Formation and the Trading of Securities and Derivatives

HKEx operates the securities and derivatives markets in Hong Kong and their clearing houses. In addition, the company provides a comprehensive range of pre- and post-trade investment services as well as market information services.

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Since the merger of the exchanges and clearing houses in 2000, HKEx has focused on integrating the various operating units. A new organisational structure was successfully implemented in 2002, in part to support the implementation of its new strategic plan. The structure enables HKEx to operate more efficiently and provide better service.

In the meantime, HKEx has also concentrated on initiatives that would foster long-term growth. For example, the trading and clearing systems are being upgraded; new products and services are being introduced, and other improvements to the market infrastructure are under consideration and development. Business development activities are continuing in Hong Kong, Mainland China, and overseas, and there are frequent discussions on mutually beneficial business co-operation with other exchanges.

HKEx has developed a profitable business model with diverse income sources. In 2002, increases in listing and derivatives income helped to offset income decreases in clearing and other areas. Operating expenses are tightly controlled. Continued investments in the market infrastructure are made to ensure that it remains robust, reliable, and competitive.

Despite adverse economic conditions and a challenging business environment, the Hong Kong stock market continues to serve as a major international capital formation centre in the region. In 2002, capital raised through Initial Public Offers and post-

listing activities on The Stock Exchange of Hong Kong amounted to \$110 billion (US\$14 billion), among the world's leaders. In the derivatives market, there was an increase in trading activity in 2002 and contract volume, at over 11 million, reached a record high.

These achievements reflected investors' confidence in the quality of Hong Kong's markets and the services of HKEx.

To further raise market quality, HKEx has modified some of the rules and procedures of the exchanges and clearing houses and proposed other changes. Chief among the modifications is a set of rule amendments that will strengthen the corporate governance requirements on issuers that list securities in Hong Kong. Studies have shown that investors are willing to pay a premium for the securities of issuers with good corporate governance practices. A separate set of proposals would tighten the listing eligibility requirements.

To enhance the competitiveness of the exchanges, the Board of Directors has agreed in principle to extend trading hours, subject to market readiness and regulatory approval. In addition, the Board has confirmed its earlier decision on minimum commission rates. With effect from 1 April 2003, commission rates will be freely negotiated between brokers and their clients. HKEx believes that making the rates freely negotiable is in the best interest of the investing public and the Hong Kong market.

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These developments and the new products and services discussed in the Review of Operations will reinforce the position of HKEx and Hong Kong in the international financial markets.

Outlook

As a substantial portion of HKEx's income comes from trading fees, clearing and settlement fees, listing fees, and interest income, HKEx's performance is heavily influenced by market sentiment, the level of activity on the securities and derivatives markets, changes in interest rates, and other external factors.

Given the importance of external factors to HKEx's performance, the year ahead is likely to remain challenging, not least because of the risk of war in the Middle East, fear of terrorist activities worldwide, and uncertainties over the economic performance in the United States, Europe and Japan.

The uncertain external environment, coupled with the likely continuation of high unemployment, deflation, and weak property prices domestically would suggest that activity on the securities and derivatives markets is likely to remain subdued, at least in the first half of 2003, and this could have an adverse impact on HKEx's revenue. To meet the challenges ahead, HKEx is seeking to further raise the quality of its markets and ensure that its services remain competitive. New products and

services are being explored to broaden the revenue base; additional opportunities are being pursued in Mainland China and overseas; and expenses are being kept under tight control.

With unmatched ties to Mainland China, Hong Kong and its financial markets are well positioned to benefit from the continued growth of the Mainland economy.

I acknowledge with a deep sense of gratitude the contributions of my fellow Board members, the executives, and all staff members. HKEx's achievements would not have been possible without their dedicated efforts and they have my sincere thanks.

Mr Kwong Ki-chi, Chief Executive of HKEx, notified the Board last year of his intention not to seek renewal of his employment contract on its expiry on 6 March 2003. At the invitation of the Board, Mr Kwong agreed to stay on until the end of the Annual General Meeting in April 2003. On behalf of the Board, I thank Mr Kwong for his enormous contribution to HKEx. He will leave the Group in a strong position to build on the solid foundation he and his team have established.

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Chairman

12 March 2003