

CHAIRMAN'S STATEMENT



LEE Yeh Kwong, Charles *Chairman*

Closer economic ties with the Mainland have led to a gradual recovery in Hong Kong's economy and market sentiment during 2004. Hong Kong has benefited from low interest rates, rising employment, firmer property prices, a sharp increase in retail sales resulting from the Mainland Individual Traveller Scheme, and an influx of liquidity. The rebounding economy, enhanced market transparency, improved trading information and increase in number of quality companies listed on the Stock Exchange have encouraged more retail investors to participate in the stock market and the derivatives market. According to a survey conducted in October 2004, the number of Hong Kong retail stock investors rose to a record 1.35 million. Meanwhile, Hong Kong has further reinforced its position as a leading market for the listing of Mainland enterprises.

These factors contributed to record highs being achieved in both market turnover and market capitalisation, and produced a positive impact on the Group's performance.

FINANCIAL RESULTS

HKEx achieved its highest income, net profits, and market capitalisation since its listing in 2000. Income for the year was \$2,394 million, an increase of 19 per cent compared to 2003. Profit attributable to shareholders rose 53 per cent from the previous year to \$1,057 million. The Group's market capitalisation reached a peak of \$23 billion on 27 January 2004, and remained at \$22 billion at the end of 2004, a rise of 24 per cent from that of last year.

As a result of cost rationalisation and prioritisation of projects, operating expenses for 2004 were successfully reduced by six per cent year on year to \$1,156 million.

Your Board has recommended payment of a final dividend of \$0.47 per share. Together with the interim dividend of \$0.43 per share, the total dividend for the year amounted to \$0.90 per share, in compliance with the Group's dividend policy of a 90 per cent payout ratio.

THE HONG KONG EXCHANGE: A PREFERRED LISTING VENUE

Hong Kong ranked third in capital formation among international exchanges in 2004. Total capital raised during 2004 amounted to \$281 billion. Hong Kong was also chosen as the world's freest economy for the 11th consecutive year by the Heritage Foundation, a US-based think-tank. Supported by high professional standards and services, free flow of capital and information, a sound legal and regulatory framework, HKEx offers a fair, open, and orderly trading platform for companies to raise funds, and for individual and institutional investors to place their investments. Apart from serving local businesses, HKEx is the largest capital formation centre for Mainland enterprises. Of the total of 1,096 companies listed on the Stock Exchange at the end of 2004, 304 are Mainland enterprises with a market capitalisation of \$2,021 billion, or about one-third of the market total. In 2004, funds raised by Mainland enterprises through IPO and post-IPO reached \$114 billion amounting to about 41 per cent of the capital raised during the year. Average daily turnover of Mainland stocks rose to \$6.7 billion accounting for about 49 per cent of the average daily turnover of equities.

Listing activities of Mainland enterprises are expected to continue as companies increasingly seek to access international pools of capital, and global investors look for investment opportunities in China. HKEx is committed to offering a range of services and products that meet market demand, which can be traded and cleared on efficient and reliable platforms.

Listed Mainland enterprises are subject to the same governance as well as accounting and reporting standards applicable to other publicly-listed companies in Hong Kong. Hence, the process of listing in Hong Kong contributes to the re-structuring and transformation of Mainland state-owned enterprises and private corporations into globally-orientated companies adopting international standards and best practices.

HIGH MARKET QUALITY: CRUCIAL FOR INVESTOR CONFIDENCE

HKEx strongly believes that high market quality is crucial for strengthening investor confidence and maintaining Hong Kong's leading position as the Asian hub in the global financial markets.

As the frontline regulator, HKEx has implemented a number of measures during 2004 to improve transparency in the listing approval process, and promulgated new chapters of the Listing Rules for better regulation of sponsors, IFAs, as well as listed issuers. Nevertheless, we believe that self-discipline of listed issuers is also a key to improving market quality. Enhancing a company's corporate governance standards can effectively underpin the company's competitive position, and Hong Kong as a pre-eminent international financial centre. HKEx is committed to taking a leadership role in setting and articulating corporate governance standards in Hong Kong. Our rules and regulations have been modelled on the best international standards. However, continued efforts will be made to monitor developments internationally and, where appropriate, consult market users on further enhancements.

HKEx supports the introduction of the new HKFRSs by the HKICPA, developed in conformity to the IFRSs. We believe that the enhancement of accounting and reporting standards of listed companies would further help safeguard public interest and the interest of the investing public. HKEx also supports the Government's proposed establishment of the Financial Reporting Council ("FRC") to regulate the accountancy profession for enhancing the accounting and reporting standards of listed companies. HKEx has agreed to contribute to the funding of, and participate in, the FRC to oversee the Audit Investigation Board and the Financial Reporting Review Committee(s).

MARKET REGULATION: STRENGTHENING THE LISTING REGULATION

HKEx welcomes and supports the Government's initiatives to strengthen the regulatory regime for Hong Kong's financial markets. Initiatives proposed in the Government's consultation on improving the listing regulatory structure have been gradually implemented. The dual filing system has been operating smoothly since its introduction in April 2003, and has been generally well received by market users as contributing to investors' confidence in the listing regime. Decisions relating to listing matters have been published for public information to enhance transparency and accountability. Complaint hotlines were established, and the first annual report was published by the Listing Committees in July 2004.

The Government and the SFC have published consultation papers on giving statutory backing to certain parts of the Listing Rules. HKEx believes that statutory backing for key portions of the Listing Rules will further reinforce the regulatory framework, and will be drawing up responses to the consultations.

PROSPECTS

The Hong Kong capital market is likely to benefit from another year of stable economic growth in Hong Kong and anticipated robust growth in the Mainland. However, increases in interest rates, macro-economic damping measures adopted in the Mainland, and sharp movements in global oil prices and the currency markets could adversely impact investor sentiment and activities in our markets. As a substantial portion of HKEx's income is derived from trading fees, clearing and settlement fees, listing fees, and interest income, the Group's performance is directly influenced by these external factors.

Looking ahead, HKEx will further enhance the quality of its markets by reinforcing its regulatory regime and strengthening its market infrastructure. It will also focus on improving its effectiveness as a market operator by consolidating its policies and procedures to raise operational efficiency, rationalise costs, and fortify risk management practices. Continued improvement of corporate governance practices in accordance with evolving global standards will be a key item on the agenda.

The commitment to provide a fair, quality, and reliable market will position HKEx well to capture the business opportunities arising from the economic growth in the Mainland. HKEx will further strengthen the co-operation with Mainland authorities as well as Mainland exchanges. HKEx will continually strive to attract the best quality Mainland enterprises to be listed in Hong Kong. We will also explore and introduce new Mainland-related products at appropriate times to meet investors' increasing interest and demand. With the Beijing Representative Office in full operation, and supported by representatives stationed in Guangzhou and Shanghai, HKEx has considerably widened its reach in the three key economic zones in the Mainland. Vigorous promotional campaigns have been planned to introduce HKEx's services to Mainland potential listed issuers.

HKEx will proactively facilitate the bond market in providing an alternative financial channel for the Government infrastructural and other investment projects, as well as a channel for securing financing for commercial activities. The favourable responses to the recent global offering of the Government's \$20 billion bond reflected international investors' confidence in the overall economic prospects of Hong Kong, which can help promote the development of the local retail bond market.

It is our key objective to deliver a world-class marketplace for Hong Kong and Mainland securities and derivatives products, and contribute towards maintaining Hong Kong as one of the pre-eminent international financial centres in the world.

DIRECTORS AND STAFF

I would like to express my deep thanks to my fellow directors for their wise counsel and valuable contributions, and to senior executives and staff of HKEx for their dedication and good work during the year.

LEE Yeh Kwong, Charles

Chairman

Hong Kong, 28 February 2005