

REVIEW OF OPERATION

(Amounts expressed in Hong Kong dollars)

Results for the Half Year to 30 June 2000

Hong Kong Exchanges and Clearing Limited (HKEx) reported an unaudited consolidated profit after taxation of \$554 million for the six months ended 30 June 2000, a 160 per cent increase over the same period last year. The directors have resolved to declare an interim dividend of \$0.08 per share. The share register will be closed from 9 to 11 October 2000 inclusive, and dividend warrants will be despatched to shareholders on or about 12 October 2000.

The subsidiaries of HKEx all operated profitably and reported active trading on their various markets and steady demand for their services.

Development Review

On 6 March, The Stock Exchange of Hong Kong Limited (the Stock Exchange), Hong Kong Futures Exchange Limited (the Futures Exchange) and Hong Kong Securities Clearing Company Limited became subsidiaries of HKEx.

HKEx's first Board of Directors was formed on 3 April, following government appointments and shareholder elections, and took over the direction of HKEx and its subsidiaries from the Preparatory Board and the Council and boards of directors of the subsidiaries.

Shares in HKEx were listed on the Stock Exchange on 27 June by way of introduction. This completed, three months ahead of schedule, the fundamental restructuring of the securities and derivatives markets called for by the government in March 1999 to increase Hong Kong's competitiveness in an increasingly globalised market place. HKEx is unique among leading international exchanges in that it operates both the cash and derivatives markets and offers a comprehensive range of pre- and post-trading services from initial public offerings to clearing and settlement services.

Integration of the three subsidiaries into business and functional units of HKEx is proceeding smoothly. The initial integration phase, involving most of the operations, is expected to be substantially completed by the end of this year.

An objective of HKEx is to become the Asia time zone pillar in the global market. In May, it introduced a pilot programme for trading seven NASDAQ listed securities. It is continuing discussions with NASDAQ on other forms of cooperation. It also entered into discussions with

nine other exchanges to explore the feasibility of inter-connecting the participating exchanges' trading systems for trading stocks of global companies.

Regulatory Rationalisation

Following their merger under HKEx on 6 March, the stock and futures exchanges transferred some of their regulatory functions to the Securities and Futures Commission (SFC) in order to reduce duplication of function, facilitate a smooth and cooperative working relationship and enable SFC to discharge its statutory obligation of supervision more effectively.

The SFC assumed primary responsibility for routine inspection of the businesses of exchange participants, monitoring their compliance with conduct rules and liquid capital requirements, and ensuring that they have proper systems of management and control.

However, HKEx continues to monitor some aspects of the businesses of its participants in order to assess and manage the risks inherent in its own operations. In particular, it continues to monitor and enforce compliance with the rules relating to trading, clearing and risk management.

HKEx and the SFC are discussing a draft Memorandum of Understanding to formalise these arrangements so as to enable them to discharge more effectively their regulatory responsibilities.

Operational Review

During the period under review, the markets and businesses operated by HKEx's subsidiaries, with the exception of the futures market, made good progress as the economy continued to improve after some two years of recession.

Primary Market

Main Board

A total of 18 new equity issues came to the Main Board of the Stock Exchange and raised \$74 billion in new capital. Market capitalisation on 30 June 2000 was \$4,807 billion. International institutions issued a further 11 debt securities with total funds represented by the new listings amounting to \$14 billion.

REVIEW OF OPERATION

A total of 120 warrants, comprising 25 equity and 95 derivative warrants were listed during the first six months of the year.

Growth Enterprise Market

The Growth Enterprise Market (GEM) commenced operations on 15 November last year. Its objective is to provide capital formation facilities for younger companies that cannot meet the operating and profit record criteria for listing on the Main Board.

Regulation of GEM is disclosure rather than merit-based. Investors are required to acknowledge that the risks of investing in GEM have been disclosed and accepted.

During the period under review, 22 companies were newly listed on GEM, raising \$10 billion in new capital.

A public consultation was held in May on a number of proposed rule changes. More than 100 responses were received. HKEx is in discussion with the SFC with a view to finalising the rule changes for publication before the end of this year.

The United States Securities and Exchange Commission recognised GEM as a designated offshore securities market. The practical effect is that all GEM-listed shares may generally be resold without restriction under the US Securities Act to US and non-US persons in and outside the US.

Secondary Market

Trading turnover during the period reflected the improving economy and greater confidence. Market turnover on the Main Board was \$1,757 billion, compared with \$767 billion during the same period last year. During the period, market turnover on GEM was \$51 billion.

Development of the third generation trading system, AMS/3, continued to make good progress. Wide-ranging tests have been completed, and subject to successful market rehearsals, AMS/3 is expected to be introduced in stages before the end of this year.

Derivatives

The average daily number of contracts traded in our derivatives market fell by about 36 per cent from 29,828 in the first six months of 1999 to 19,223 this year. This was primarily due to the uncertainty in the months prior to the introduction of the HongKong Futures Automated Trading System (HKATS).

The derivatives market became fully electronic following the migration of Hang Seng Index Futures and Options trading to HKATS in June. The US Commodity Futures Trading Commission approved on 14 June the placing in the US of HKATS terminals and automated order routing systems connected to HKATS. This will widen the distribution of Hong Kong derivative products in the US, increase liquidity for market users, and position the derivatives market for significant international growth.

Trading in HIBOR (Hong Kong interbank offered rate) Futures Strips is scheduled to begin on 26 September and will enable market participants to trade consecutive series of HIBOR futures contracts in a single transaction.

In addition, the SFC has approved the introduction in October of a smaller Hang Seng Index Futures contract (mini-HSI Futures). The contract will meet the varied needs of retail investors and provide market participants with a means to fine-tune their trading and risk management activities.

Traded Options

Average daily turnover in Stock Exchange traded options during the period under review was 10,945 contracts, an increase of 52 per cent over the same period last year. The average daily open interest more than doubled to 280,434 contracts.

The Stock Exchange continued to hold seminars and workshops as part of its investor education programme. In addition, it conducted an investment game in traded options and stocks on the Stock Exchange's website. More than 9,000 members of the investing public and 58 teams from seven local universities registered to participate in the investment game. Participants learned how options were traded and the application of options strategies.

REVIEW OF OPERATION

Information Technology

HKEx's three subsidiaries had taken all possible steps to prevent disruption to computer services caused by the arrival of the new millennium. No disruptions were experienced.

HKEx has continued to develop and improve its website in order to allow easier access to an increased range of services and information.

In May, the Stock Exchange introduced a web-based Investment Service Centre, offering investors free listed company news alert, portfolio valuation and other information services. By the end of June, 2,850 investors had registered for the service.

Subscribers to the service receive news alerts on up to ten securities nominated by them in their language of choice, by their preferred delivery mechanism – email, mobile telephone with short message service, or both.

The service also includes a selection of 3, 6, and 12-month price-volume charts. Adjusted prices and moving 5, 10, 20, or 50-day averages are used for charting and compared against the All Ordinaries Index or Growth Enterprise Index.

Clearing and Settlement Services

Average daily settlement efficiency of continuous net settlement stock positions was 99.33 per cent on settlement day, rising to 99.96 per cent on the following day.

An increasing number of investor participants made use of the electronic-Initial Public Offering (eIPO) service when subscribing for new share issues. In one recent issue, 20 per cent of all applications were received through eIPO instructions.

The eIPO service allows investor participants to subscribe for new share issues through Central Clearing and Settlement System (CCASS) terminals or the CCASS phone system without completing application forms or issuing cheques.

Payments are by electronic debit to investor participants' designated bank accounts and share allotments are credited to their CCASS accounts. Refunds are also made by electronic payment instructions.

HKEx will introduce Internet Initial Public Offering (iIPO) service in the final quarter of this financial year. Investors will be able to access the iIPO service directly over the Internet without using a CCASS terminal.

Development work was completed to allow CCASS to handle securities transactions denominated in foreign currencies. The US dollar was the first foreign currency in which securities and clearing services were provided and services began in August.

Compensation

The Unified Exchange Compensation Fund (the Fund) issued a notice on 27 January inviting claims in respect of Win Successful Securities Limited. It had received 285 claims by the 2 May deadline.

With the approval of the SFC, it was decided that successful, or partially successful claimants would each be able to receive payment of compensation not exceeding \$150,000 before settlement of all other claims.

During the period under review, processing of claims against the Fund continued in respect of four major default cases that arose in 1998. Processing of the majority of the claims against these four defaulting companies had been completed by the end of June this year. The balance of the Fund as at 30 June stood at \$272 million.

Outlook for the Rest of the Financial Year

The outlook for the rest of the year depends, of course, on the performance of the various markets operated by HKEx. The economic forecasts for Hong Kong, and internationally, are generally positive. These give cause for feeling reasonably optimistic about HKEx's results for the year as a whole.

Kwong Ki-chi

Chief Executive

Hong Kong, 6 September 2000