



Hong Kong Exchanges and Clearing Limited
香港交易及結算所有限公司



2004
Interim Report



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Financial Highlights

(Financial figures are expressed in Hong Kong dollars)



	Unaudited for the six months ended 30 Jun 2004 \$'000	Unaudited for the six months ended 30 Jun 2003 \$'000	Change
RESULTS			
Income	1,166,862	907,048	29%
Operating expenses	565,627	660,691	(14%)
Operating profit	601,235	246,357	144%
Share of profits of associated companies	6,165	3,263	89%
Profit before taxation	607,400	249,620	143%
Taxation	(102,407)	(35,234)	191%
Profit attributable to shareholders	504,993	214,386	136%
Shareholders' funds	3,931,705	5,603,263 ^Φ	(30%)
Total assets*	16,312,303	19,802,264 ^Φ	(18%)
Net assets per share ^{# Ω}	\$3.72	\$5.34 ^Φ	(30%)
Earnings per share	\$0.479	\$0.205	134%
Interim dividend declared per share	\$0.43	\$0.18	139%
Dividend payout ratio	90%	88%	

* The Group's total assets include the margin funds received from Participants on futures and options contracts.

Φ Audited as at 31 December 2003.

Based on 1,056,472,846 shares issued and fully paid as at 30 June 2004 (31 December 2003: 1,048,998,846 shares).

Ω The drop in net assets per share is mainly attributable to the payment of 2003 special dividend of \$1.68 per share and 2003 final dividend of \$0.42 per share, totalling \$2.10 per share.

Financial Highlights

	Unaudited for the six months ended 30 Jun 2004	Unaudited for the six months ended 30 Jun 2003	Change
KEY MARKET STATISTICS			
Average daily turnover value on the Stock Exchange	\$16.8 billion	\$7.1 billion	137%
Average daily number of derivatives contracts traded on the Futures Exchange	57,651	39,099	47%
Average daily number of stock options contracts traded on the Stock Exchange	23,391	14,614	60%





Chronology of Events



2004

Jan

- 5 Hong Kong Exchanges and Clearing Limited (HKEx) held a listing promotion conference in Changchun, the capital of Jilin province
- 14 HKEx submitted its views on the Government's consultation document on proposals to enhance the regulation of listing in Hong Kong
- 30 HKEx announced amendments to the Main Board and Growth Enterprise Market (GEM) Listing Rules relating to corporate governance issues

HKEx published consultation conclusions on proposed amendments to the Main Board Listing Rules relating to initial listing criteria and continuing listing obligations

Feb

- 25 February - 9 March HKEx conducted several seminars in Hong Kong and Beijing for listed companies and market practitioners to promote a better understanding of Main Board and GEM Listing Rule Amendments aimed at raising corporate governance standards and market quality
- 26 Standard and Poor's reaffirmed HKEx's corporate governance score of 8.3 out of a possible 10

Mar

- 8 HKEx commenced dissemination of real-time odd lot information from the securities market to information vendors
- 25 Major securities and derivatives market systems, including those for trading, market data and clearing and settlement, reached the milestone of 100 per cent uptime for all systems for 12 consecutive months
- 26 The Government published its conclusions on its consultation on proposals to enhance the regulation of listing in Hong Kong. The document said The Stock Exchange of Hong Kong Limited (the Stock Exchange) would continue to receive listing applications at the frontline and administer the listing process

HKEx discontinued trading in MSCI China Free Index Futures

Chronology of Events

Apr

- 29** HKEx introduced a revamped version of the HKEx website featuring enriched content and a new design for easy navigation
- 31** HKEx shareholders elected John Strickland and re-elected Oscar Wong as Directors at the Annual General Meeting, and approved a resolution to declare a Special Dividend of HK\$1.68 per share (the payment date for the Special Dividend was 14 April 2004). The Government reappointed Tim Freshwater, Charles Lee and Lo Ka Shui as Public Interest Directors
- 2** HKEx's Board of Directors reappointed Charles Lee as Chairman of the Board
- 6** HKEx introduced DCASS, the Derivatives Clearing and Settlement System, and the derivatives component of CCMS, the Common Collateral Management System
- 8** Approval was obtained from the China Securities Regulatory Commission to station representatives from HKEx's Beijing Representative Office in the Mainland cities of Guangzhou and Shanghai
- 27-28** Chief Executive Paul Chow attended investment seminars in Tokyo to promote HKEx and Hong Kong's financial markets
- 30** The Stock Exchange reappointed all available members of the Listing Committees of the Main Board and GEM except for one member who did not seek reappointment. Marvin Cheung and Moses Cheng were reappointed Chairman and Deputy Chairman of the Committees respectively

Chronology of Events

2004 May

- 4 The Stock Exchange invited comments on draft sponsor and independent financial adviser rule amendments
- 10 The Government's first securitisation bonds were listed on the Stock Exchange
- 12 HKEx announced its 2004 first quarter results
- 12-14 HKEx and the Hong Kong Monetary Authority jointly hosted the Asia-Pacific Central Securities Depository Group's 6th Cross-training Seminar
- 14 HKEx revised its organisational structure

- 17 Gerald Greiner joined HKEx as Deputy Chief Operating Officer
- 28-29 HKEx held a listing promotion conference in the municipality of Chongqing
- 31 HKEx published consultation conclusions on a proposed operational model for a scripless securities market
- Zhang Dejiang, member of the Political Bureau of the Central Committee of the Communist Party of China and the Secretary of the Guangdong Provincial Party Committee, visited HKEx and the Stock Exchange's Trading Hall

Jun

- 14 HKEx introduced H-shares Index Options, four additional stock options and four additional stock futures
- 21 Patrick Conroy was appointed as the chief executive of the Stock Exchange and Gerald Greiner was appointed as the chief executive of the Hong Kong Futures Exchange Limited
- 21-24 Chief Executive Paul Chow attended an investor forum in New York and met investors in New York and in London to promote HKEx, its markets and the listing of Mainland enterprises in Hong Kong

Corporate Information



BOARD OF DIRECTORS

Non-executive Chairman

LEE Yeh Kwong, Charles GBS, JP* (*re-appointment effective on 1 April 2004*)

Executive Director, Chief Executive

CHOW Man Yiu, Paul JP

Non-executive Directors

FAN Hung Ling, Henry SBS, JP*

FONG Hup*

FRESHWATER, Timothy George* (*re-appointment effective on 1 April 2004*)

KWOK Chi Piu, Bill

LEE Jor Hung, Dannis BBS

LEE Kwan Ho, Vincent Marshall

LEONG Ka Chai JP*

LO Ka Shui GBS, JP* (*re-appointment effective on 1 April 2004*)

STRICKLAND, John Estmond GBS, JP (*elected on 31 March 2004*)

WEBB, David Michael

WONG Sai Hung, Oscar (*re-elected on 31 March 2004*)

* *Public Interest Directors*

AUDIT COMMITTEE

STRICKLAND, John Estmond (*Chairman*)

FONG Hup (*Deputy Chairman*)

FAN Hung Ling, Henry

LEE Kwan Ho, Vincent Marshall

WEBB, David Michael

EXECUTIVE COMMITTEE

LEE Yeh Kwong, Charles (*Chairman*)

CHOW Man Yiu, Paul

CONROY, Patrick Kevin

LEE Jor Hung, Dannis

LEONG Ka Chai



Corporate Information

INVESTMENT ADVISORY COMMITTEE

FRESHWATER, Timothy George (*Chairman*)
WONG Sai Hung, Oscar (*Deputy Chairman*)
SUN, David
WEBB, David Michael

NOMINATION COMMITTEE

LEE Yeh Kwong, Charles (*Chairman*)
KWOK Chi Piu, Bill
(*appointment effective on 1 April 2004*)
LO Ka Shui
(*appointment up to 31 March 2004*)
WONG Sai Hung, Oscar

REMUNERATION COMMITTEE

LO Ka Shui (*Chairman*)
LEE Jor Hung, Dannis
LEE Kwan Ho, Vincent Marshall

RISK MANAGEMENT COMMITTEE

(a committee established under Section 65 of the Securities and Futures Ordinance)

LEE Yeh Kwong, Charles (*Chairman*)
DICKENS, Mark**
FAN Hung Ling, Henry
KWOK Chi Piu, Bill
LAM Kin**
LAU James H. Jr**
(*appointment up to 30 June 2004*)
LEONG Ka Chai**
OR Ching Fai, Raymond**
YUE Wai Man, Eddie**
(*appointment effective on 1 July 2004*)

** *Appointed by the Financial Secretary under Section 65 of the Securities and Futures Ordinance*

COMPANY SECRETARY

MAU Kam Shing, Joseph

AUTHORISED REPRESENTATIVES

CHOW Man Yiu, Paul
MAU Kam Shing, Joseph

AUDITORS

PricewaterhouseCoopers

LEGAL ADVISORS

Allen & Overy

REGISTERED OFFICE

12th Floor
One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Telephone number: +852 2522 1122

Fax number: +852 2295 3106

HKEx REPRESENTATIVE OFFICE IN BEIJING

Suite 1002, W2, Oriental Plaza
Beijing

Telephone number: +8610 8518 3088

Fax number: +8610 8518 3288

Shareholder Information



WEBSITE

<http://www.hkex.com.hk>

E-MAIL ADDRESS

info@hkex.com.hk

REGISTRAR AND TRANSFER OFFICE

Hong Kong Registrars Limited
1712-1716, 17th Floor
Hopewell Centre, 183 Queen's Road East
Wanchai, Hong Kong

STAKEHOLDER RELATIONS

Issuer Services

Contact persons:

Peter Curley, Senior Vice President

Rebecca Chan, Senior Vice President

Address:

Hong Kong Exchanges and Clearing Limited
11/F One International Finance Centre
1 Harbour View Street, Central, Hong Kong

General telephone number: +852 2522 1122

General fax numbers: +852 2295 0198 / +852 2295 0590 / +852 2295 3599

Investor Services

Contact person:

Bonnie Chan, Vice President

Address:

Hong Kong Exchanges and Clearing Limited
10/F One International Finance Centre
1 Harbour View Street, Central, Hong Kong

Telephone number: +852 2840 3375

Fax number: +852 2295 0980



Shareholder Information

FINANCIAL CALENDAR

2004 annual general meeting	31 March 2004
Announcement of first quarter results	12 May 2004
Announcement of interim results	11 August 2004
Ex-dividend date for interim dividend	3 September 2004
Book closing dates for interim dividend	7-9 September 2004
Record date for interim dividend	9 September 2004
Payment date for interim dividend	on or about 13 September 2004
Announcement of third quarter results	November 2004*
Announcement of final results	February 2005*

* *subject to change*

SHARE INFORMATION

Stock Code

Stock Exchange, Hong Kong	388
Access to Reuters	0388.HK
Access to Bloomberg	388 HK Equity

Board lot 2,000 shares

Price and Turnover History

2004	Price per Share		Turnover (in millions)	
	High (HK\$)	Low (HK\$)	Shares	HK\$
January	21.90	16.90	164.3	3,187.0
February	21.15	18.60	128.0	2,572.3
March*	21.15	16.30	152.6	2,984.6
April	17.30	15.05	85.3	1,377.4
May	16.90	14.40	103.2	1,622.6
June	16.25	14.70	95.2	1,476.9

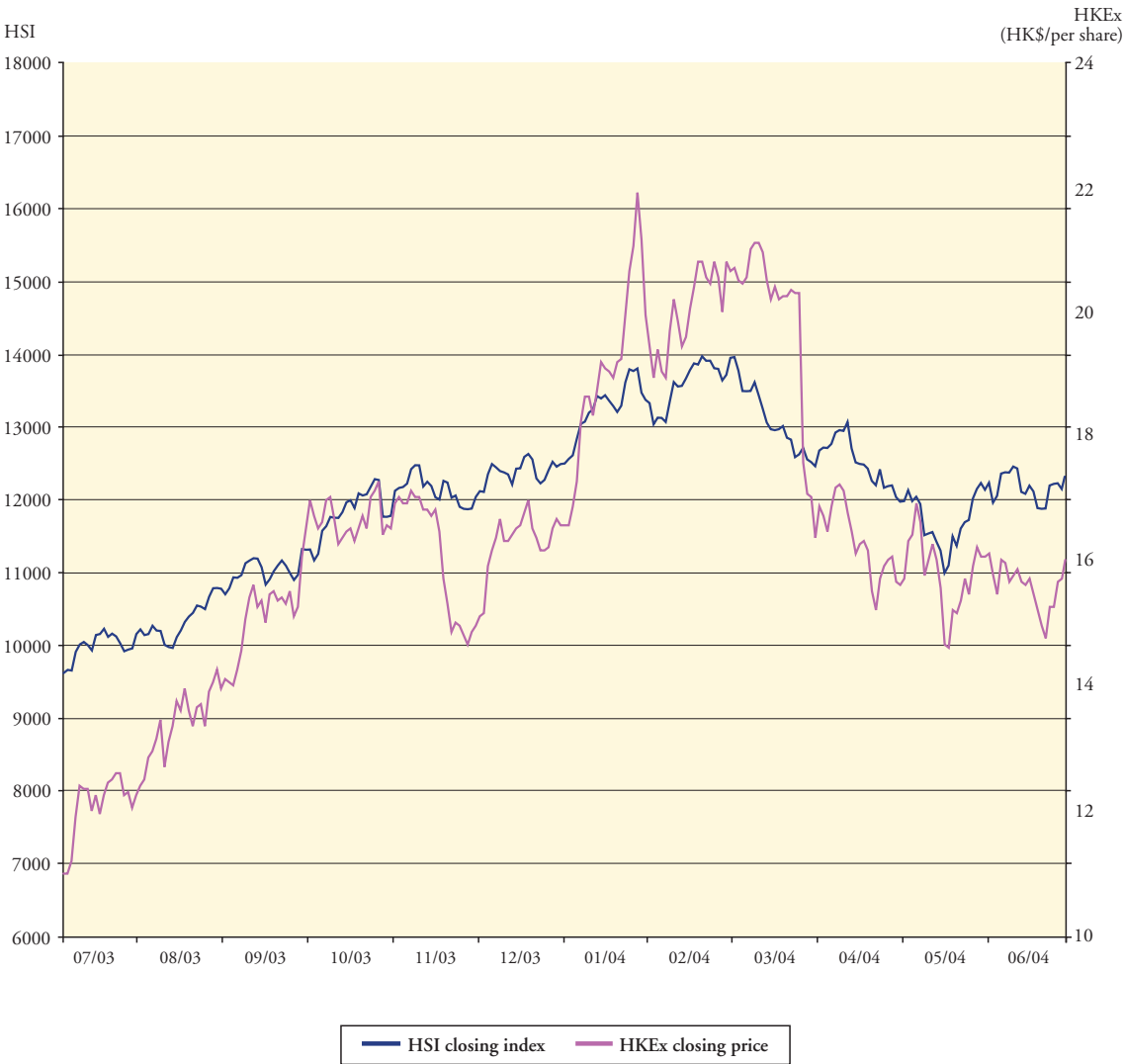
* *Shares traded ex-dividend on 24 March 2004 (2003 final and special dividends in the sum of HK\$0.42 per share and HK\$1.68 per share respectively)*

Shareholder Information

Market Capitalisation

Market Capitalisation as at 30 June 2004 HK\$16,904 million
(Issued capital: 1,056,472,846 shares, market price at 30 June 2004: HK\$16 per share)

Share Price of HKEx compared with Hang Seng Index



Shareholder Information

Analysis of Shareholdings

Shareholdings according to the Register of Members as at 30 June 2004

Size of holding	Number of shareholders	% of shareholders	Number of shares ('000)	% of total issued capital
1 – 1,000	19	1.42%	5	0.00%
1,001 – 5,000	582	43.43%	1,601	0.15%
5,001 – 10,000	312	23.28%	2,616	0.25%
10,001 – 100,000	267	19.93%	9,333	0.88%
100,001 and above	160	11.94%	1,042,918	98.72%
Total	1,340	100.00%	1,056,473	100.00%

Further analysis of share ownership as at 30 June 2004

Category	Number of shares ('000)	% of total issued capital
Individual ¹	136,843	12.95%
<i>Local</i>	<i>133,800</i>	<i>12.66%</i>
<i>Overseas</i>	<i>3,043</i>	<i>0.29%</i>
Corporate ²	22,181	2.10%
Institutions ³	517,980	49.03%
<i>Local</i>	<i>52,578</i>	<i>4.98%</i>
<i>Overseas</i>	<i>465,402</i>	<i>44.05%</i>
Exchange Participants ⁴	258,937	24.51%
Custodian banks ⁵	120,532	11.41%
Total	1,056,473	100.00%

The ownership analysis is according to the best estimate of information obtained from HKEx Register of Members, HKSCC Participant Shareholding Report, and a survey of selected custodian banks and Exchange Participants conducted in July 2004

Notes:

- ¹ Shares owned by individuals other than those who are Exchange Participants.
- ² Shares owned by companies other than those who are Institutions, Exchange Participants, Custodian banks, and HKSCC Nominees Limited.
- ³ Institutional investors identified by the five custodian banks and four Exchange Participants which are within top twelve holders of HKEx shares in HKSCC Nominees Limited, and the investment companies as shown in the HKEx Register of Members and HKSCC Participant Shareholding Report.
- ⁴ Exchange Participants include Stock Exchange Participants and Futures Exchange Participants.
- ⁵ Custodian banks excluding HKSCC Nominees Limited and holdings held for clients by the five custodian banks as mentioned in note 3 above.

Shareholder Information

Shareholdings according to the Register of Members as at 30 June 2003

Size of holding	Number of shareholders	% of shareholders	Number of shares ('000)	% of total issued capital
1 – 1,000	16	1.04%	6	0.00%
1,001 – 5,000	759	49.51%	2,143	0.20%
5,001 – 10,000	364	23.74%	3,026	0.29%
10,001 – 100,000	238	15.53%	7,511	0.72%
100,001 and above	156	10.18%	1,034,269	98.79%
Total	1,533	100.00%	1,046,955	100.00%

Further analysis of share ownership as at 30 June 2003

Category	Number of shares ('000)	% of total issued capital
Individual ¹	105,649	10.09%
<i>Local</i>	<i>102,681</i>	<i>9.81%</i>
<i>Overseas</i>	<i>2,968</i>	<i>0.28%</i>
Corporate ²	16,084	1.54%
Institutions ³	532,977	50.90%
<i>Local</i>	<i>31,176</i>	<i>2.97%</i>
<i>Overseas</i>	<i>501,801</i>	<i>47.93%</i>
Exchange Participants ⁴	275,410	26.31%
Other nominees/banks ⁵	116,835	11.16%
Total	1,046,955	100.00%

The ownership analysis is according to the best estimate of information obtained from HKEx Register of Members, HKSCC Participant Shareholding Report, and a survey of selected custodian banks conducted in July 2003

Notes:

- ¹ Shares owned by individuals other than those who are Exchange Participants.
- ² Shares owned by companies other than those who are Exchange Participants and nominees/banks.
- ³ Institutional investors identified by the six major custodians and HKSCC Nominees Limited.
- ⁴ Exchange Participants include Stock Exchange Participants and Futures Exchange Participants.
- ⁵ Other nominees/banks excluding HKSCC Nominees Limited and the six major custodians.



Review of Operations

(Financial figures are expressed in Hong Kong dollars)



MARKET ACTIVITY

Average daily turnover value on The Stock Exchange of Hong Kong Limited (the Stock Exchange) during the period under review was \$16.8 billion, compared with \$7.1 billion during the same period in 2003. There were 23 new equity listings on the Main Board, including one by a company formerly listed on the Growth Enterprise Market (GEM), and 15 new equity listings on GEM. In the first half of 2003, there were 16 new equity listings on the Main Board, including three by companies formerly listed on GEM, and 12 on GEM. Equity capital formation through initial public offering (IPO) and post-IPO fund-raising totalled \$210.2 billion on the Main Board and \$3.9 billion on GEM, compared with a total of \$134.9 billion on the Main Board and \$972.0 million on GEM in the first half of 2003. Funds raised by newly listed companies totalled \$55.3 billion, compared with \$7.2 billion in the first half of 2003.

The average daily number of derivatives contracts traded on Hong Kong Futures Exchange Limited (the Futures Exchange) and stock options traded on the Stock Exchange during the first six months of 2004 was 81,042, up from 53,713 in the first six months of 2003. Total open interest at the end of June 2004 was 697,178 contracts, compared with 537,185 contracts at the end of June 2003.

LISTING

The influx of Mainland China issuers into Hong Kong, boosted by economic reforms, has accelerated the growth of the Hong Kong market.

A major element of Hong Kong Exchanges and Clearing Limited (HKEx)'s mission depends on demonstrating the effective discharge of its regulatory responsibilities. The Listing Division has a keen and continuing interest in demonstrating that it is discharging its responsibilities effectively and making itself more effective. HKEx welcomes the steady improvement of corporate governance in Mainland companies listed in Hong Kong and intends to do all it can to ensure that this improvement continues.

The Division's principal activities over the first six months of the year were to implement developments in regulatory policies and to review its working practices so as to be able to handle regulatory issues promptly and decisively by taking decisions at the right level. This work is ongoing. Below is an account of developments in the first half of the year.

Review of Operations

Reorganisation of Listing Division

In January 2004, the Listing Division reorganised its operating structure to separate the review and processing of new listing applications from the ongoing monitoring of listed companies. The new operating structure was adopted so as to focus more attention on the substantive quality of these two related, but different, functions.

The organisational changes are a natural progression from the structure that existed prior to January 2004. In particular, almost all of the underlying procedures that the Listing Division follows in reviewing new listing applications and monitoring listed companies have been retained.

Enhancement of Corporate Governance and Market Quality

Amendments to the Main Board and GEM Listing Rules designed to enhance corporate governance and market quality came into effect on 31 March 2004. They included new provisions on notifiable transactions and connected transactions, revised classifications of notifiable transactions and connected transactions, revised definitions of the terms “reverse takeover”, “connected person” and “associate” of a connected person, revised requirements for refreshment of general mandate and revised requirements on the disclosure of directors’ remuneration in annual reports. In addition, there have been changes in the initial listing eligibility criteria, listed companies’ continuing obligations and the disclosure requirements at the time of listing.

These rule amendments, along with the Code on Corporate Governance Practices and the disclosure requirements relating to the Report on Corporate Governance Practices that will be published later this year, represent the most comprehensive overhaul of the Listing Rules in over a decade.

Market Education on Rule Amendments

The Listing Division conducted market education seminars to promote a better understanding of the rule amendments. A total of six seminars (conducted in English, Putonghua and Cantonese) were held at the Hong Kong Convention and Exhibition Centre between 25 February and 5 March 2004 for listed companies and market practitioners and at the New Otani Hotel Beijing on 9 March 2004 for listed companies.

Review of Operations

Entry to the seminars was free, and they were well attended. To address the range of questions posed, the Division published further guidance on the HKEx website by way of a table setting out frequently asked questions.

Another innovation introduced to promote a better understanding of the rules was a brochure of charts prepared for guidance purposes and published on the HKEx website. While the charts do not form part of the Listing Rules, they should help to steer the user through areas where a graphical depiction may facilitate an understanding of the requirements.

While in Beijing, members of the Listing Division visited the China Securities Regulatory Commission (CSRC) in March 2004 to brief members of the staff there on the Listing Rule amendments and to exchange views and discuss experiences with them.

In addition to its own seminars, the Division has also worked alongside other representative organisations to support the dissemination and comprehension of the new requirements, including providing speakers at seminars organised by other organisations.

Consultation Conclusions on Proposals to Enhance the Regulation of Listing

On 26 March 2004, the Government published its Consultation Conclusions on Proposals to Enhance the Regulation of Listing. The Government's recommendations included giving statutory backing to certain more important listing requirements, such as those covering financial reporting and other periodic disclosure, disclosure of price-sensitive information and shareholders' approval for notifiable transactions, and expanding the dual filing system. As for the regulatory structure, the published conclusions said the Stock Exchange would continue to receive and approve initial public offer applications, the Stock Exchange would remain responsible for administering the listing process, and it would continue to be the primary point of contact for listing applicants and their advisers. As for ongoing compliance of listed companies, the recommendation was that the Stock Exchange should continue to enforce the non-statutory requirements in its Listing Rules.

HKEx will work closely with the Government and the Securities and Futures Commission (the SFC) on implementing the recommendations, which are aimed at raising the quality of Hong Kong's financial markets.

Review of Operations

Transparency

HKEx considers that the major practices of the Listing Committees and the Listing Division should be transparent. In the “Consultation Conclusions on Proposals to Enhance the Regulation of Listing”, the Government specifically invited HKEx to implement measures to enhance transparency in listing matters.

While expanding on its existing disclosure practices, the Division remains conscious of the confidentiality obligations owed to the parties concerned. It contemplates the following measures to enhance transparency in the short term: to increase the number of listing decisions to be published, with immediate effect; and to publish, on a regular basis, interpretations made by the Listing Division of provisions of the Listing Rules.

Furthermore, the “Listing Decisions” published on the HKEx website have been revised to include new formats to facilitate searching and to improve HKEx’s ability to include additional Listing Decisions in the future.

The Main Board and GEM Listing Committees have jointly issued an Annual Report for the period to 30 April 2004. This is the first such report that has been issued. It is an account of the work of the Committees in contributing to the success of the Hong Kong listing regime. The report was prepared for the Boards of the Stock Exchange and HKEx. It has been forwarded to the SFC and the Financial Services and Treasury Bureau, and it has been published on the HKEx website.

Restructuring of Listing Committees

HKEx first considered the idea of restructuring the Listing Committees in 2002. Substantive drafting of the relevant rules and procedures had been undertaken prior to the project being put on hold pending greater clarity over the overall direction of listing regulation in Hong Kong.

The “Consultation Conclusions on Proposals to Enhance the Regulation of Listing” has since clarified the Government’s position in this regard. The document also contains various suggestions from respondents on the composition and operation of the Listing Committees.

Review of Operations

HKEx is looking into the various suggestions and reviewing the current operational arrangements with a view to considering any further improvements. HKEx will keep the market informed of progress in due course.

Regulation of Sponsors and Independent Financial Advisers

On 4 May 2004, HKEx invited Hong Kong sponsor and financial advisory firms to comment on draft amendments to the Main Board and GEM Listing Rules on the regulation of sponsors and independent financial advisers (IFAs). The draft amendments reflect the policies developed by HKEx and the SFC after extensive public consultation in conjunction with the release in May 2003 of the joint Consultation Paper on the Regulation of Sponsors and Independent Financial Advisers.

HKEx and the SFC have agreed to proceed with reforms to the regulation of sponsors and IFAs in two stages. The first stage involves amendments to the Main Board and GEM Listing Rules and the introduction of a revised statement on conduct to clarify HKEx's expectations with regard to due diligence. The second stage involves modification of the SFC licensing regime to create specific licensing requirements for sponsors. HKEx expects that the relevant rule amendments will become effective in the fourth quarter of the year.

Operations

IPO Transactions

Fifty-nine (22 Main Board, 37 GEM) new listing applications were carried over from 2003.

In the six months ended 30 June 2004, 67 (44 Main Board, 23 GEM) new listing applications were received and accepted for processing by the Listing Division. Forty-nine (34 Main Board, 15 GEM) new listing applications were approved in principle by the Listing Committees. Four (one Main Board, three GEM) new listing applications were rejected. Six new listing applications (all GEM) were withdrawn by the applicants. Thirty-six (14 Main Board, 22 GEM) new listing applications lapsed. Twenty-two (six Main Board, 16 GEM) lapsed applications were refiled within 90 days. Of the decisions made on new listing applications, two decisions (relating to a Main Board applicant) were subject to review (i.e. appealed).

Review of Operations

As at 30 June 2004, the Listing Division was processing 49 (23 Main Board, 26 GEM) active applications. Seventeen (12 Main Board, five GEM) new listing applicants had been granted approval in principle by the Listing Committees but had not yet listed.

Compliance and Monitoring

In the six months ended 30 June 2004, Compliance and Monitoring (C&M) vetted 2,547 listed company announcements and 1,017 circulars. The Listing Division reviewed 12,923 press articles relating to listed companies of which 279 led to enquiries being made. C&M undertook 2,060 share price and trading volume monitoring actions, which resulted in 1,471 clarification announcements being published by listed companies. The Division continues to target its monitoring resources in those areas that it perceives to pose the biggest risks to the maintenance of a fair, orderly and well-informed market. In particular it pays close attention to companies' compliance with the rules governing the disclosure of price-sensitive information and the adequacy of financial reporting and compliance systems and procedures.

The Listing Division handled 140 complaints relating to listed companies and/or their directors, and 28 cases were referred to Listing Enforcement for further investigation.

Listing Enforcement

In the six months ended 30 June 2004, Listing Enforcement completed investigations of 77 cases involving possible breaches by listed companies, their directors and/or sponsors of the Listing Rules. Twelve formal disciplinary cases were completed. The Listing (Disciplinary) Committee issued one public censure, nine public statements involving criticism and two private reprimands. The public censure case related to a listed company's failure to inform the Stock Exchange and announce the presentation of a winding-up petition against the listed company's major subsidiary. The public statements cases related mainly to late financial reporting, and included one case involving a misstatement in a prospectus and another case relating to share repurchases. The private reprimand cases involved late financial reporting and non-disclosure of information.

In relation to disciplinary matters arising from late financial reporting, the Stock Exchange has adopted a 'fast-track' approach. Once a listed company is late in publishing its accounts it has breached the Listing Rules and therefore the main issue to consider is the sanction to be imposed on the company and directors having regard to any mitigating circumstances. Under the fast-track process, provided that certain conditions are met, public sanctions will be imposed against a listed company, and not its directors, for the late publication of accounts.

Review of Operations

Cases deemed to involve less serious breaches of the Listing Rules were dealt with at Listing Division level. This led to issuance of 71 warning letters and 13 caution letters by Listing Enforcement.

In a formal disciplinary matter in which a listed company sought judicial review of procedural directions issued by the Chairman of the Listing (Disciplinary) Committee, the judicial review hearing was held in February 2004 and the judgment was handed down in May 2004. The company has appealed to the Court of Appeal against the ruling made by the Court of First Instance.

EXCHANGE

Restructuring

The Exchange Division was established in May 2004 along with the Business Development and Investor Services Division as part of a corporate restructuring designed to further strengthen HKEx's regulatory and business operations, and raise the overall efficiency of its two exchanges and the associated clearing houses. The two divisions took up the responsibilities of the Exchange Unit, which was dissolved.

The Exchange Division manages trading and market operations, develops new products, conducts market surveillance, recruits new Exchange Participants and services and trains existing Exchange Participants.

The Business Development and Investor Services Division focuses on managing investor relations, attracting new listings and promoting HKEx and its markets to the general public through educational seminars.

New Products

H-shares Index Options were introduced on 14 June 2004 to complement the trading of H-shares Index Futures and provide an additional hedging and trading tool for investors in H shares and related derivatives. Four additional stock options and stock futures, all on H shares, were also added to the derivatives market on 14 June 2004. The new contracts are part of HKEx's efforts to meet the growing demand for China-related securities and derivatives instruments. H-shares Index Options' Open Interest rose to over 9,000 contracts in July 2004.

Review of Operations

Proposed Narrowing of Trading Spreads for Some Securities

Discussions on the possible narrowing of trading spreads in the securities market were held with a wide range of market participants during the first half of the year. A consultation paper was issued on 6 August 2004 on proposals for narrowing the trading spreads and alternatives for implementing the proposed changes.

Internal Review of Market Operations

HKEx is conducting an internal review of the formula for calculating closing stock prices and has sought comments from the Cash Market Consultative Panel. The Exchange Division is examining options for calculating closing prices in rare occasions where there is insufficient price data to determine the closing price under the present formula.

CLEARING

DCASS Launch

The Derivatives Clearing and Settlement System, DCASS, has been integrated with the clearing systems used by HKFE Clearing Corporation Limited (HKCC) and The SEHK Options Clearing House Limited (SEOCH), and with the derivatives trading system. DCASS has been running smoothly with no major incidents since its launch on 6 April 2004. DCASS has introduced changes in certain business disciplines, including a revised fee structure, an earlier post trade input cut-off time for HKCC Participants and a new margining methodology known as PRiME (Portfolio Risk Margining System of HKEx) for both HKCC and SEOCH, which the clearing houses' Participants have adapted to quickly. Through the use of DCASS, the operational procedures and risk management processes of HKCC and SEOCH have been harmonised, resulting in improved efficiency.

Scripless Consultation Conclusions and Way Forward

There were 26 submissions in response to the Consultation Paper on a Proposed Operational Model for a Scripless Securities Market issued in October 2003. A consultation conclusions report summarising the views of the respondents and the issues they raised together with HKEx's comments was published on 31 May 2004. The report proposed maintaining CCASS, the Central Clearing and Settlement System, on a nominee basis under the Issuer Register Model. It also proposed a progressive approach on implementation whereby CCASS would start to dematerialise part of its holdings subject to the enactment of the enabling legislation and the readiness of the share registrars to support uncertificated shares. A progressive approach on implementation would allow time for the investing public and other market participants to adjust to the scripless environment, and it would allow market forces to determine the pace of further development.

Review of Operations

New Features to Investor Participant Accounts

After reviewing the CCASS Investor Participant (IP) account service and identifying areas for improvement, in particular in the communication channels, HKEx has decided to upgrade the existing IP account service through new and enhanced features. The changes include extending the online window to 24 hours a day, seven days a week, allowing Internet access through user ID and password, using SMS (short message service) text messages to communicate with IPs, making electronic voting functions more user-friendly and streamlining the stock transfer process by adding a simpler transfer instruction type. The enhanced services will be launched in the third quarter and there will be a series of promotion programmes before the rollout.

SI Matching Enhancements

After working closely with some major market participants, HKEx is preparing to enhance the existing Settlement Instructions (SI) matching functions to facilitate the pre-matching of SI between Hong Kong Securities Clearing Company Limited (HKSCC) Participants. The enhancements include adding a new “hold matched SI” function, inserting two additional SI matching runs, displaying unmatched SI field content and modifying the client account number field for matching. The enhanced SI matching facilities will be introduced in the fourth quarter and there will be briefing sessions for Participants before the launch.

INFORMATION SERVICES

Real-time Information

At the end of June 2004, there were 62 real-time information vendors for the securities market, a decrease of one from the end of last year, and there were 34 vendors for the derivatives market, the same as at the end of last year.

Four real-time vendors signed up during the period, including two which replaced other vendors. The total real-time data services provided by all vendors rose from 353 to 356, while the total delayed data services rose from 98 to 111.

Sixteen information vendors participated in the extended Mainland China Promotion Programme that allows investors on the Mainland to subscribe for HKEx market data at a reduced, promotional price.

HKEx began disseminating real-time odd lot market information to information vendors in March 2004 to further increase market transparency and improve its services to investors, particularly retail investors. The information includes stock codes, order prices and both order quantities and the number of orders for the best five bid prices and the best five ask prices.

Review of Operations

HKEx Website

Issuer News

In the first half of the year, the average number of Issuer News items released on the HKEx website each month increased 21 per cent from the corresponding period last year to 6,017. About 20 per cent of those items were submitted electronically through HKEx's Internet e-submission system.

The HKEx website's hit rate for Issuer News increased 87 per cent from the same period last year, showing that accessing Issuer News through the Internet is becoming increasingly popular with the investing public.

Disclosure of Interests and Reports on Share Repurchases

The Stock Exchange publishes information relating to the Disclosure of Interests (DI) according to the Securities and Futures Ordinance (SFO) which prescribes the manner in which the Stock Exchange receives the information and the ways of filing notices with the Stock Exchange.

In the first half of the year, the average number of DI filings released each month through the HKEx website increased by 24 per cent from the corresponding period last year to 2,680. (Note: A new disclosure regime which reduced the reporting threshold from 10 per cent to 5 per cent became effective on 1 April 2003.) HKEx's web-based DI disclosure system was used extensively in the first half of the year, with page views of DI information averaging 1,008,657 per month. During the same period last year, which comprised three months under the old disclosure regime and three months under the new regime, there was an average of about 191,000 page views per month.

To further enhance the electronic information provided through the HKEx website, historical share repurchase reports dating back to 1991 were converted from archived microfilm to electronic images in May 2004.

Investment Service Centre

There were several enhancements to the Investment Service Centre (ISC) section of the HKEx website in late March 2004. They included increased search capabilities on stock/company information; links between data on related securities; enriched information in the company/securities profiles; an advanced charting mechanism; and an upgraded email alert service.

The ISC also has information now on H-share companies with A shares listed on the Mainland.

Review of Operations

Market Data and Statistics

The Data & Statistics section of the HKEx website was also enhanced in late March 2004. Archives of key market statistics going back to 1986 have been added along with a new sub-section of data that highlight the contribution of Mainland enterprises to the Hong Kong market.

Internal Operations

The Electronic Mail Stock Information Services (EMSIS) were upgraded in June 2004 for the early July 2004 migration of its delivery platform to the in-house Online Data Products System. EMSIS has been in place since 1990 to provide snapshots of market data and related information at different times of the day, mainly to the media.

The historical stock price database was moved in June 2004 from the Stock Statistics & Charting System to the Stock Market Database (SMD) to make the database more accessible. The SMD supports compilations of data products and regular data publications, and it facilitates the data distribution via the HKEx website.

INFORMATION TECHNOLOGY

System Development to Support New Products and Market Development Initiatives

The Information Technology (IT) Division managed and supported the April 2004 rollout of DCASS and the derivatives component of the Common Collateral Management System. It also supported the March 2004 introduction of the real-time odd lot market information feed for information vendors. In addition, the Division delivered technical solutions for the HKEx website revamp project in late March 2004. In line with the website revamp project and the rapid growth in demand for external access to the website, the Division upgraded the bandwidth and capacity of the HKEx website early in the year.

Ongoing projects include system upgrades for the enhancements to the IP accounts in CCASS, and CCASS/3 (the next generation of the Central Clearing and Settlement System) upgrades to support the pre-matching of SI prior to actual settlement and provide more detailed and timely information for follow-up on unmatched SI.

Review of Operations

IT Infrastructure, Operations and Support

In the first half of the year, all major market systems, including the trading, clearing and settlement, and market data systems for the securities and derivatives markets successfully achieved 100 per cent availability for more than 12 consecutive months.

The Hong Kong Productivity Council was appointed early in the year to assess the Quality Management System of HKEx's IT Computer Operations and it concluded that the IT Computer Operations were effective and compliant with the ISO 9001:2000 requirements.

A review is being conducted on the feasibility of consolidating the existing market systems network from Frame Relay to Optical Ethernet to achieve cost savings without sacrificing the network service quality and serviceability, and a study is being conducted on the feasibility of consolidating the backup data centres.

In managing the various new market development initiatives in the securities and derivatives markets, ongoing comprehensive system capacity monitoring and planning of the existing market system and infrastructure are conducted to deal with any potential growth of system capacity requirements in a timely and effective manner. As part of ongoing system modernisation and upkeep, HKEx plans to upgrade or replace obsolete hardware and software in three of its major market systems and fine-tune another system to further strengthen its stability and functionality.

FINANCE

The Finance Department supervises the investment of funds, which can be divided into three main categories: Corporate Funds (comprising mainly share capital and retained earnings of the Group), Clearing House Funds and margin funds received (which excludes contributions receivable from Participants and securities deposited by Participants as alternatives to cash deposits of margin funds).

An Investment Advisory Committee, comprised of non-executive directors of HKEx and an external member from the financial community, advises the Board on portfolio management and monitors the risk and performance of HKEx's investments. A Treasury team in the Finance Department is dedicated to the day-to-day management and investment of the funds. Three external fund managers have also been appointed to manage part of the Corporate Funds since July 2001.

Review of Operations

Investment and fund management is governed by investment policies and risk management parameters approved by the Board. Investment restrictions and guidelines form an integral part of risk control. Fund-specific restrictions and guidelines are set according to the investment objectives of each fund. In addition, specific limits are set for each fund to control risk (e.g. permissible asset type, asset allocation, liquidity, credit, counterparty concentration, maturity, foreign exchange, interest rate and market risks) of the investments.

The investment objective of the Corporate Funds is the provision of liquidity for funding ongoing operations and long-term capital preservation. Accordingly, the funds can be invested in cash, money market instruments, bonds, collective investment schemes and equities. Only the external fund managers are permitted, subject to compliance with guidelines on conflict of interest and to limits forming part of the investment policies, to invest in equities, which include convertible bonds. For Clearing House Funds and margin funds, the investment objective of which is to satisfy liquidity requirements and safeguard the financial assets of the funds, their portfolios only consist of cash, money market instruments and bonds.

In the first half of the year, the average amount of funds available for investment increased by 55 per cent or \$5.10 billion to \$14.30 billion (first half of 2003 average: \$9.20 billion), mainly due to a rise in margin funds received from Participants as a result of increased open interest in futures and options contracts. Following the payment of the 2003 special and final dividends of \$2.22 billion on 14 April 2004, the amount of Corporate Funds available for investment was reduced and, comparing with 31 March 2004, the overall fund size as of 30 June 2004 decreased by 19 per cent or \$2.85 billion to \$12.52 billion (31 March 2004: \$15.37 billion).

As at 30 June 2004 and 31 March 2004, details of the asset allocation were as follows:

	Fund size		Bonds		Cash or		Global equities	
	\$ billion				bank deposits			
	Jun	Mar	Jun	Mar	Jun	Mar	Jun	Mar
Corporate Funds	3.46	5.61	68%	39%	25%	55%	7%	6%
Margin funds	7.96	8.17	41%	39%	59%	61%	0%	0%
Clearing House Funds	1.10	1.59	11%	8%	89%	92%	0%	0%
Total	12.52	15.37	46%	36%	52%	62%	2%	2%

Review of Operations

Investments of the three funds are kept sufficiently liquid to meet HKEx's operating needs and possible liquidity requirements of the Clearing House Funds and margin funds. Excluding equities held under the Corporate Funds (\$0.24 billion as at 30 June 2004 and \$0.32 billion as at 31 March 2004), which do not have a maturity date, the maturity profile of the remaining \$12.28 billion and \$15.05 billion of investments as at 30 June 2004 and 31 March 2004 was as follows:

	Fund size		Overnight		>Overnight		>1 month		>1 year		>3 years	
	\$ billion		to 1 month		to 1 month		to 1 year		to 3 years		> 3 years	
	Jun	Mar	Jun	Mar	Jun	Mar	Jun	Mar	Jun	Mar	Jun	Mar
Corporate Funds	3.22	5.29	17%	27%	11%	30%	22%	13%	36%	22%	14%	8%
Margin funds	7.96	8.17	45%	54%	8%	4%	12%	7%	35%	35%	0%	0%
Clearing House Funds	1.10	1.59	76%	72%	0%	11%	10%	7%	14%	10%	0%	0%
Total	12.28	15.05	40%	46%	9%	14%	14%	9%	33%	28%	4%	3%

In the maturity profile above, Corporate Funds with maturity of up to one month decreased by 29 per cent during the second quarter mainly on account of the payment of the 2003 special and final dividends mentioned above.

Credit exposure was well diversified. As at 30 June 2004, all bonds held were of investment grade and had a weighted average credit rating of Aa2 (31 March 2004: Aa2) and a weighted average maturity of 1.6 years (31 March 2004: 1.7 years). Deposits were placed only with the note-issuing banks in Hong Kong and licensed banks and restricted licence banks with a minimum credit rating of A3 by Moody's or equivalent approved by the Board from time to time.

Risk management techniques, such as Value-at-Risk (VaR) and portfolio stress testing, are used to identify, measure, monitor and control market risks. VaR measures the expected maximum loss over a given time interval (a holding period of 10 trading days is used by HKEx) at a given confidence level (95 per cent confidence interval is adopted by HKEx) based on historical data

Review of Operations

(one year is used by HKEx). The overall risk, as measured by the VaR methodology, during the first quarter and second quarter was as follows:

	Average VaR		Maximum VaR		Minimum VaR	
	\$ million		\$ million		\$ million	
	Apr-Jun	Jan-Mar	Apr-Jun	Jan-Mar	Apr-Jun	Jan-Mar
Corporate Funds	16.26	16.65	17.56	18.33	14.02	15.47
Margin funds	16.85	14.00	17.44	16.93	15.67	10.27
Clearing House Funds	1.15	1.15	1.24	1.22	1.01	1.03

For details of HKEx's investment income, please refer to the Overall Performance section of Management Discussion and Analysis and note 6 to the accounts of this Interim Report.

BUSINESS DEVELOPMENT AND INVESTOR SERVICES

Beijing Representative Office and Business Development Department

Beijing Office

To further support HKEx's efforts in strengthening Hong Kong's position as the premier international capital formation centre for China, the Beijing Representative Office continued to explore opportunities to strengthen communications between HKEx and the Mainland authorities, and promote HKEx's markets to potential listing candidates.

In April 2004, the CSRC approved HKEx's stationing of representatives from the Beijing Representative Office in the Mainland cities of Guangzhou and Shanghai to capture the robust economic growth in the Pearl River Delta and Yangtze River Delta regions.

Listing Promotion for Mainland Companies and Government Authorities

During the first half of the year, HKEx organised or co-organised listing conferences and seminars in Changchun, Chongqing and Beijing which attracted a total of more than 850 representatives from 335 Mainland enterprises. Marketing efforts helped identify 140 Mainland companies which are interested in listing in Hong Kong. Twenty-three of the 38 new listings during the first half of the year were Mainland enterprises which raised a total of \$46 billion, or 83 per cent of the funds raised through new listings.

Review of Operations

The Business Development Department hosted meetings with Mainland business delegations visiting Hong Kong to promote HKEx's markets, and the Department assisted Mainland groups in organising listing conferences in Hong Kong. One of the events, the Hong Kong-Zhejiang Week in Hong Kong, had more than 200 participants, including representatives from a number of potential listing candidates.

The Beijing Representative Office and the Business Development Department had a total of 88 meetings in the first half of the year with government authorities from the Mainland as part of their liaison and communications efforts.

Two training programmes were conducted for Hong Kong-listed Mainland companies and potential listing applicants from the Mainland to improve their understanding of corporate governance issues and promote listing in Hong Kong. These programmes were co-organised with the State Council's Office of Hong Kong and Macau Affairs, the National Science and Technology Venture Capital Development Centre, the Hong Kong Institute of Company Secretaries and the Hong Kong Securities Institute.

Investor Services Department

The Investor Services Department is a new department established to maintain and develop relationships with HKEx's existing and new shareholders, and attract more funds to HKEx's markets. In addition, the Department is responsible for investor education.

A three-week trial run of SIMart, the Simulated Investment Market, was completed in the middle of May 2004. Nearly 700 players participated in the three game sessions. SIMart is an online educational platform operated by HKEx for individuals who want to gain a better understanding of securities trading. Players trade selected securities from the Stock Exchange using delayed market data.

Forty educational seminars were organised in the first half of the year. They comprised 21 Continuous Professional Training courses for Exchange Participants and 19 public seminars for individual investors.

Review of Operations

RESEARCH AND PLANNING

During the first half of the year, HKEx released the findings of two market surveys for the reference of market participants and the general public.

Cash Market Transaction Survey 2002/03 (released on 9 March 2004)

The survey for the 12 months to September 2003 indicated that overseas institutional investors surpassed local retail investors for the third year in a row to be the largest investor group by turnover value in the HKEx securities market. There was also an increase in the contribution from local institutional investors for the third consecutive year.

Omnibus Retail Investor Survey 2003 (released on 6 April 2004)

The survey revealed that the number of Hong Kong retail investors investing in stocks and/or derivatives traded on the HKEx markets is close to one million and stock investors traded twice as frequently in 2003 as in 2002.

CORPORATE COMMUNICATIONS

Enquiries and Complaints

The Corporate Communications Department handled 7,610 enquiries and complaints in the first half of the year, compared with 4,426 in the first six months of 2003. They covered a variety of issues. Most of the initial contacts were by telephone, about 15 per cent were through email and a few were via letter or fax.

Revamped HKEx Website

Visits to the HKEx website, which was revamped in late March 2004 in a project led by the Department, rose in the first half of the year to 9,182,324 from 5,107,875 in the same period last year. Page views were also up, rising to 116,765,240 from 52,654,263 in the first half of 2003.

INTERNAL AUDIT

The Internal Audit Department conducted various audit reviews in the first half of the year. The reviews covered areas related to finance, operations and information systems, and the Department was not aware of any significant deficiencies.

Review of Operations

The Department conducted quality assurance reviews of the annual, quarterly and interim financial reports prior to their review by the Audit Committee.

In June 2004, the Department followed up on the status of the agreed audit recommendations raised this year together with those brought forward from the last status review. It concluded that the measures taken were effective and adequate in improving controls and reducing risks.

Paul Chow

Chief Executive

Hong Kong, 11 August 2004



Management Discussion and Analysis

(Financial figures are expressed in Hong Kong dollars)



OVERALL PERFORMANCE

The Group recorded a profit attributable to shareholders of \$505 million for the interim period (2004 first quarter: \$314 million; 2004 second quarter: \$191 million), compared with \$214 million for the same period in 2003 (2003 first quarter: \$89 million; 2003 second quarter: \$125 million).

Income increased on the back of a continuing high level of activity in cash and derivatives markets in 2004, which has resulted in an increase in trading fees and trading tariff, and clearing and settlement fees in comparison with the same period in 2003. This was partly offset by a drop in investment income mainly due to reduced interest income during the period on account of lower interest rates and, in April 2004, the decline in bond and equity prices as the markets reacted negatively to concerns over interest rate hikes and macro economic measures by Mainland authorities to slow credit growth in certain sectors.

Total operating expenses for the first six months decreased by \$95 million or 14 per cent to \$566 million (2003: \$661 million), which was mainly due to the non-recurring one-off costs incurred in 2003 (\$52 million less tax deduction of \$1 million) and savings in information technology and computer maintenance expenses and legal and professional fees during the current period. Taxation in 2003 also included a one-off increase in deferred tax charge of \$6 million following the implementation of the new Hong Kong Statement of Standard Accounting Practice (SSAP) 12: Income Taxes and the hike in Profits Tax rate.

Income

Total income (including share of profits of associated companies) for the period increased by \$263 million or 29 per cent to \$1,173 million (2003: \$910 million).

Management Discussion and Analysis

Improved market sentiment, which started in the second half of 2003, continued into 2004. In spite of the anxiety brought about by the macro economic measures introduced to adjust the Mainland economy, high oil prices and the interest rate rise in the United States, which has caused trading activities on the cash market to edge down in the second quarter, the average daily turnover on the Stock Exchange for the six-month period rose by 137 per cent to \$16.8 billion compared with \$7.1 billion in the corresponding period last year. Average daily number of stock options contracts traded on the Stock Exchange during the first six months of 2004 increased by 60 per cent compared to the same period of 2003. Moreover, the average daily number of derivatives contracts traded on the Futures Exchange increased by 47 per cent, which was mainly attributable to the increase in the trading of Hang Seng Index (HSI) Futures contracts and the launch of H-Shares Index Futures in December 2003. Consequently, trading fees and trading tariff rose by \$162 million or 88 per cent to \$347 million (2003: \$185 million).

Listing fee income increased by \$23 million or 14 per cent to \$183 million (2003: \$160 million), primarily because of an increase in initial listing fees mainly arising from an increase in the number of newly listed derivative warrants to 595 in 2004 (2003: 216), and a rise in annual listing fees due to a higher number of listed securities. There were 23 (2003: 16) and 15 (2003: 12) new listings on the Main Board and GEM respectively during the six-month period ended 30 June 2004. As at 30 June 2004, 12 Main Board and five GEM (31 December 2003: three Main Board and five GEM) IPO applications had obtained approval in principle from the Listing Committees for listing, and 23 Main Board and 26 GEM applications were under processing (31 December 2003: 19 Main Board and 32 GEM). As at 30 June 2004, there were 869 companies listed on the Main Board and 199 on GEM (31 December 2003: 852 and 185 respectively).

In line with the growth in cash market activities, clearing and settlement fee income increased by 101 per cent or \$94 million to \$186 million in the first six months (2003: \$92 million), and depository, custody and nominee services fees increased by 32 per cent or \$30 million to \$125 million during the six-month period ended 30 June 2004 (2003: \$95 million).

Income from sale of information for the first six months increased by \$33 million or 25 per cent to \$159 million (2003: \$126 million), as demand for information increased in tandem with the activities of cash and derivatives markets.

Management Discussion and Analysis

Investment income comprises income from investments supervised by the Finance Department, investment in Singapore Exchange Limited and accommodation income from Participants. Total investment income for the period decreased by \$98 million or 55 per cent to \$80 million (2003: \$178 million), predominantly due to the absence of market gains, and lower interest rates during the period.

For investments supervised by the Finance Department, income for the period amounted to \$75 million, 55 per cent or \$93 million lower than the \$168 million for the same period in 2003. In 2003, there was a gain of \$56 million, reflecting market movements in the period; in 2004, there was no net gain, again reflecting markets. Also, net interest income was lower at \$72 million (2003: \$110 million) due to lower interest rates.

During the period under review, the average 6-month Hong Kong Exchange Fund Bill rate dropped from 1.13 per cent in 2003 to 0.31 per cent in 2004, and the average 90-day US Treasury Bill rate declined from 1.1 per cent to 1.0 per cent.

For the six months ended 30 June 2004, the Finance Department achieved a positive return on investments of 1.06 per cent (2003: 3.64 per cent). The Corporate Funds returned 1.92 per cent (2003: 5.31 per cent), the margin funds 0.67 per cent (2003: 1.90 per cent), and the Clearing House Funds 0.64 per cent (2003: 2.15 per cent). Therefore, the overall portfolio recorded a spread of 75 basis points (2003: 251 basis points), with Corporate Funds registering a spread of 161 basis points (2003: 418 basis points), the margin funds 36 basis points (2003: 77 basis points) and the Clearing House Funds 33 basis points (2003: 102 basis points) above the 6-month Hong Kong Exchange Fund Bill yield.

The average amount of funds available for investment during the period increased by 55 per cent or \$5.1 billion to \$14.3 billion (2003: \$9.2 billion), primarily due to a rise in margin funds received from Participants as a result of increased open interest in futures and options contracts, which was partly offset by the reduction in Corporate Funds following the \$2.2 billion payment of 2003 special and final dividends on 14 April 2004. As at 30 June 2004, 52 per cent (31 December 2003: 59 per cent) of the funds were invested in cash and bank deposits, 46 per cent (31 December 2003: 39 per cent) in high-grade bonds with an average credit rating of Aa2, and 2 per cent (31 December 2003: 2 per cent) in global equities. For more details of the investment portfolio, please refer to the Finance section under Review of Operations.

Management Discussion and Analysis

Accommodation income (i.e. retention interest charged on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the margin funds) decreased by 56 per cent or \$5 million to \$4 million (2003: \$9 million). Income from the investment in Singapore Exchange Limited for the first six months increased by \$0.1 million or 20 per cent to \$0.8 million (2004: dividend of \$1.1 million less foreign exchange loss of \$0.2 million and interest expense of \$0.1 million for funding the investment; 2003: dividend of \$1.0 million, foreign exchange gain of \$0.1 million less interest expense of \$0.4 million). The investment in Singapore Exchange Limited was disposed of in July 2004 at a profit over cost of \$24.8 million.

Other income increased by \$16 million or 22 per cent to \$87 million (2003: \$71 million), mainly due to a \$8 million increase in brokerage on direct IPO applications, and an increase in terminal, dataline and network usage fees and software sub-license fees of \$7 million.

Share of profits of associated companies increased by \$3 million or 89 per cent to \$6 million (2003: \$3 million), due to the improved performance of one of the associated companies, Computershare Hong Kong Investor Services Limited, during the period under review.

Operating Expenses

Total operating expenses for the period under review decreased by 14 per cent or \$95 million to \$566 million (2003: \$661 million).

Staff costs and related expenses decreased by 3 per cent or \$8 million to \$259 million (2003: \$267 million), largely due to the \$9 million of one-off severance costs incurred following the reorganisation and streamlining of the Group's operations in May 2003. Savings in salaries as a result of reduced headcount was offset by an accrual for performance bonus on account of the Group's improved performance in 2004.

Information technology and computer maintenance expenses for the first six months fell by \$27 million or 20 per cent to \$110 million in 2004 (2003: \$137 million), mainly attributable to lower hardware and software rental. During the period under review, capital expenditures on computer systems, hardware and software amounted to \$11 million (2003: \$16 million).

Premises expenses fell by 9 per cent or \$4 million to \$39 million (2003: \$43 million) as lower rental was negotiated upon the renewal of certain leases and savings from reduced floor area leased during the first six months of 2004.

Management Discussion and Analysis

Product marketing and promotion expenses increased by \$2 million or 70 per cent to \$6 million (2003: \$4 million). The increase was mainly attributable to the advertising campaigns and incentive programmes launched for the introduction and promotion of the H-shares Index Futures and H-shares Index Options.

Legal and professional fees for the period decreased by \$16 million or 74 per cent to \$5 million (2003: \$21 million). The decrease was mainly attributable to professional fees incurred for several one-off consulting projects in the first half of 2003.

Depreciation and amortisation costs remained fairly stable at \$93 million (2003: \$93 million). The increase in depreciation attributable to the rollout of DCASS in April 2004 was offset by the decrease as a result of revising the estimated useful life of the hardware of trading and clearing systems from three years to five years to better reflect the useful life of the equipment.

Payment to the SFC was \$10 million for the first six months of 2004 (2003: \$5 million) under the dual filing regime, which started from 1 April 2003.

Other operating expenses dropped by \$47 million or 52 per cent to \$44 million (2003: \$91 million), mainly attributable to certain one-off costs incurred in 2003 (\$32 million for the write-down of the Group's investment in BondsInAsia Limited and \$10 million of retirement of redundant IT systems following the review of its business strategy and operations in May 2003), as well as a devaluation deficit of \$4 million of one of the Group's properties charged to the profit and loss account in 2003. Provision for doubtful debts fell by \$3 million or 96 per cent compared with 2003.

Taxation

The Group's taxation charge rose by \$67 million or 191 per cent to \$102 million (2003: \$35 million), principally by reason of a \$62 million rise in tax charge arising from an increase in profit before taxation in 2004, a \$11 million increase in tax charge due to a lower deferred tax credit from utilisation of tax losses of certain entities of the Group, but partly offset by a one-off deferred tax charge of \$6 million recognised in 2003 due to an increase in tax rate from 16.0 per cent in 2002 to 17.5 per cent in 2003 and the first time adoption of SSAP 12: Income Taxes, effective from 1 January 2003.

Management Discussion and Analysis

Comparison of 2004 second quarter performance with 2004 first quarter results

Profit attributable to shareholders was \$191 million for the second quarter of 2004, \$123 million or 39 per cent lower than the \$314 million registered in the first quarter of 2004. The reduction was mainly attributable to a \$130 million or 20 per cent reduction in income. Investment income fell from \$93 million in the first quarter to a negative \$13 million in the second quarter mainly due to the fall in the bond and equity markets and exchange losses which occurred in April. The decline in activities of the cash market in the second quarter has also led to a decrease in trading fees and trading tariff of \$38 million and clearing and settlement fees of \$27 million compared with the first quarter. The decrease was partly offset by \$50 million of higher depository, custody and nominee services fee on account of an increase in dividend collection and scrip fee income.

Total operating expenses has remained fairly stable at \$282 million for the second quarter of 2004 (first quarter of 2004: \$283 million).

Tax charge fell by \$7 million mainly due to a decrease of \$22 million in tax charge arising from lower profit before taxation in the second quarter, which was partly offset by an additional tax charge of \$5 million due to reduced non-taxable income net of expenses, and a \$10 million rise in tax charge due to a lower deferred tax credit from utilisation of tax losses of certain entities of the Group in the second quarter.

Liquidity, Financial Resources and Capital Commitments

Working capital fell by \$1,319 million or 32 per cent to \$2,751 million as at 30 June 2004 (31 December 2003: \$4,070 million). The decline was primarily due to the payment of the 2003 special and final dividends of \$2,219 million in April 2004, which was partly offset by a reduction in time deposits with maturity over one year and the profit generated during the period.

Although the Group has consistently been in a very liquid position, banking facilities have nevertheless been put in place for contingency purposes. As at 30 June 2004, the Group's total available banking facilities amounted to \$2,763 million (31 December 2003: \$2,764 million), of which \$1,500 million were repurchase facilities to augment the liquidity of the margin funds and \$1,100 million were for meeting the Group's Continuous Net Settlement money obligations of HKSCC in the 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 2004, the Group did not have any bank borrowings (31 December 2003: S\$11 million, equivalent to HK\$50 million, with a maturity of less than 1 year was used for the purpose of hedging the currency exposure of the Group's investment in Singapore Exchange Limited).

Management Discussion and Analysis

As at 30 June 2004, the Group had zero gearing (31 December 2003: gearing ratio, measured on the basis of total borrowings as a percentage of total shareholders' equity, was less than 1 per cent).

As at 30 June 2004, the Group's capital expenditure commitments, mainly in respect of its ongoing investments in facilities and technology, amounted to \$49 million (31 December 2003: \$91 million). The Group has adequate financial resources to fund its commitments on capital expenditures from its existing cash resources and cash flows generated from its operations.

As at 30 June 2004, 94 per cent (31 December 2003: 98 per cent) of the Group's cash and cash equivalents (comprise cash on hand, bank balances and time deposits within three months of maturity when acquired) were denominated in HKD and USD.

Charges on Assets

The Group did not have any charges on assets as at 30 June 2004 and 31 December 2003.

Significant Investments Held and Material Acquisitions and Disposals of Subsidiaries

The Group has been holding 1 per cent of the issued ordinary share capital of Singapore Exchange Limited since November 2000 (cost: \$49.1 million; and market value: \$76.1 million), 24 per cent of Computershare Hong Kong Investor Services Limited since May 2002 (cost: \$26.5 million; and book value: \$31.5 million) and 30 per cent of ADP Wilco Processing Services Limited since May 2002 (cost: \$1.8 million; and book value: \$1.3 million).

There were no material acquisitions or disposals of investments and subsidiaries during the six-month period but the investment in Singapore Exchange Limited was disposed of in July 2004.

Exposure to Fluctuations in Exchange Rates and Related Hedges

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. During the period, the Singapore dollar credit facility (31 December 2003: S\$11 million or HK\$50 million) used to hedge the currency exposure of the Group's investment in shares of Singapore Exchange Limited was fully repaid. Thereafter, only forward foreign exchange contracts are used to hedge the currency exposure of the Group's non-HKD investments to mitigate risks arising from fluctuations in exchange rates. As at 30 June 2004, aggregate net open foreign currency positions amounted to HK\$1,679 million, of which HK\$207 million were non-USD exposures (31 December 2003: HK\$1,663 million, of which HK\$204 million were non-USD exposures). The Group's foreign currency liabilities, in the form of margin deposits or collateral received, are hedged by investments in the same currencies.

Management Discussion and Analysis

Contingent Liabilities

The Unified Exchange Compensation Fund (Compensation Fund) is a fund set up under the repealed 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 a default 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 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the SFC, allow an additional payment to the successful claimants before apportionment. 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 SFC's request to do so. The amounts to be 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 but capped at \$8 million per default. As at 30 June 2004, there were outstanding claims received in respect of 12 defaulted Stock Exchange Participants (31 December 2003: 13).

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting for claims against the Compensation Fund in relation to any default of a Stock Exchange Participant occurring before 1 April 2003. The claims period expired on 3 October 2003 and no claims had been received in response to that notice. Claims made after the claims period shall, unless the Stock Exchange otherwise determines, be barred. Until 30 June 2004, no claims had been received.

Following the implementation of the new compensation arrangements under the SFO, an Investor Compensation Fund has been established to replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. Pursuant to the SFO, Exchange Participants are no longer required to make deposits to the Investor Compensation Fund and the Stock Exchange is not required to replenish the Investor Compensation Fund. Hence, deposits to the Commodity Exchange Compensation Fund had been returned to the Futures Exchange by the SFC in January 2004. The Futures Exchange had in turn reimbursed holders of Futures Exchange Trading Rights their contributions to the Commodity Exchange Compensation Fund. Similarly, deposits to the Compensation Fund would be returned to the Stock Exchange in accordance with the SFO pending completion of the determination of the outstanding claims and replenishment to the Compensation Fund.

Management Discussion and Analysis

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 default of any one Participant. In the unlikely event that all of its 436 trading Participants as at 30 June 2004 (31 December 2003: 437) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$87 million (31 December 2003: \$87 million).

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

HKEx has developed its human resources policies and procedures based on performance and merit. The Group ensures that the pay levels of its employees are competitive and employees are rewarded on a performance-related basis within the general framework of the Group's salary and bonus system.

Share options may further be granted to Chief Executive and employees of the Group to subscribe for shares in HKEx in accordance with the terms and conditions of the Post-Listing Share Option Scheme approved by the shareholders of HKEx at an extraordinary general meeting held on 31 May 2000.

Following the merger of the businesses of the Stock Exchange Group, the Futures Exchange Group and the HKSCC Group in 2000, HKEx has succeeded in streamlining its workforce and the number of employees fell from 1,052 (including 88 temporary staff) prior to the merger to 780 (including 31 temporary staff) as at 30 June 2004. For the two semi-annual periods under review, total employees' cost decreased by 3 per cent to \$259 million (2003: \$267 million), mainly due to one-off severance costs incurred following the reorganisation and streamlining of the Group's operations in May 2003.

There are no significant changes to the policies relating to remuneration, bonus, share option schemes and training schemes from the information disclosed in the 2003 annual report.

Management Discussion and Analysis

PROSPECTS

As a substantial part of HKEx's income comprises trading fees, clearing and settlement fees, listing fees and interest income, the performance of the Group is heavily affected by external factors including, in particular, market sentiment, the level of activity on the Stock Exchange and the Futures Exchange, and movements in interest rates.

Following the significant rebound in trading volume on the securities market, which started in the second half of 2003, trading appears to have peaked temporarily in the first quarter of 2004 before easing back to a level similar to that of the third quarter of 2003, as investors watched from the sidelines the likely impact of the macro economic adjustments in Mainland China, high oil prices and the beginning of a rising interest rate cycle in the United States. It is likely that market sentiment will continue to be affected by the uncertainties created by these issues.

HKEx will continue to exercise stringent control over its costs and target its resources at market needs. It will strive to improve the quality of its markets by strengthening market supervision and risk management, and adopting more world-class regulatory practices and market infrastructure. The revised organisational structure announced in May 2004 will further improve HKEx's efficiency and strengthen its regulatory, risk management and market operations.

HKEx will continue to develop new products and services to diversify revenue sources and attract more high quality companies to list in Hong Kong. It will also remain focused on seizing opportunities arising from the economic reform and development in Mainland China. These efforts will be supported by the recent stationing of representatives in Guangzhou and Shanghai, which enables HKEx to have a wider reach as it seeks potential listing candidates in these two key economic zones of Mainland China. With the concerted efforts of the Government, supervisory bodies and professional market practitioners to jointly promote its securities and derivatives markets, Hong Kong is well positioned to capitalise on the immense opportunities brought about by Mainland China's economic growth and strengthen its position as a major international financial centre in the region.



Condensed Consolidated Profit and Loss Account

(Financial figures are expressed in Hong Kong dollars)



	Note	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
INCOME	2		
Trading fees and trading tariff	4	347,172	184,509
Stock Exchange listing fees	5	182,970	160,059
Clearing and settlement fees		185,950	92,312
Depository, custody and nominee services fees		125,157	94,593
Income from sale of information		158,340	126,253
Investment income	6	80,371	178,290
Other income	7	86,902	71,032
	3	1,166,862	907,048
OPERATING EXPENSES			
Staff costs and related expenses		259,251	266,861
Information technology and computer maintenance expenses		110,017	137,453
Premises expenses		38,971	42,833
Product marketing and promotion expenses		5,696	3,342
Legal and professional fees		5,484	20,991
Depreciation and amortisation		92,520	93,025
Payment to SFC under dual filing regime		10,000	5,000
Other operating expenses	8	43,688	91,186
	3	565,627	660,691
OPERATING PROFIT	3	601,235	246,357
SHARE OF PROFITS OF ASSOCIATED COMPANIES	3	6,165	3,263
PROFIT BEFORE TAXATION	3	607,400	249,620
TAXATION	3/9	(102,407)	(35,234)
PROFIT ATTRIBUTABLE TO SHAREHOLDERS	3/22	504,993	214,386
DIVIDEND		454,283	188,452
Earnings per share	10	\$0.479	\$0.205
Interim dividend declared per share		\$0.43	\$0.18
Dividend payout ratio		90%	88%

Condensed Consolidated Statement of Changes in Equity

(Financial figures are expressed in Hong Kong dollars)



	Note	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Total equity at 1 Jan		5,603,263	5,490,364
Change in valuation of investment property		–	(200)
Change in valuation of other properties		22,107	(8,271)
Change in fair value of non-trading securities		(37,319)	8,053
Deferred tax arising from change in valuation of other properties		(3,870)	763
Deferred tax arising from change in fair value of non-trading securities		5,036	199
Net (deficits)/surplus not recognised in the condensed consolidated profit and loss account		(14,046)	544
Profit attributable to shareholders		504,993	214,386
Realisation of change in fair value of non-trading securities on maturity or disposal		(140)	(3,774)
2003 special and final dividends/2002 final dividends		(2,202,898)	(448,740)
Dividend on shares issued for employee share options exercised after declaration of 2003 special and final dividends /2002 final dividends		(15,661)	(647)
Proceeds from issue of shares under employee share option schemes	19	56,194	25,373
Total equity at 30 Jun		3,931,705	5,277,506



Condensed Consolidated Balance Sheet

(Financial figures are expressed in Hong Kong dollars)



	Note	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
NON-CURRENT ASSETS			
Fixed assets	11	527,348	585,627
Investments in associated companies	12	32,822	34,002
Clearing House Funds	13	1,142,014	1,551,330
Compensation Fund Reserve Account	14	36,899	36,859
Cash and Derivatives Market Development Fund	15	672	925
Non-trading securities		76,076	77,258
Time deposits with maturity over one year		85,999	393,456
Deferred tax assets		537	–
Other assets		13,163	4,814
		1,915,530	2,684,271
CURRENT ASSETS			
Margin funds on derivatives contracts	16	8,888,934	7,874,510
Accounts receivable, prepayments and deposits	17	2,173,389	4,644,680
Taxation recoverable		1,145	1,558
Trading securities		2,589,771	3,212,998
Bank balances and time deposits		743,534	1,384,247
		14,396,773	17,117,993
CURRENT LIABILITIES			
Bank loans		–	50,286
Margin deposits and securities received from Clearing Participants on derivatives contracts	16	8,888,934	7,874,510
Accounts payable, accruals and other liabilities	17	2,409,698	4,779,904
Participants' admission fees received		1,150	4,100
Deferred revenue		155,639	257,068
Taxation payable		166,456	57,370
Provisions	18	24,178	25,011
		11,646,055	13,048,249
NET CURRENT ASSETS		2,750,718	4,069,744
TOTAL ASSETS LESS CURRENT LIABILITIES		4,666,248	6,754,015

Condensed Consolidated Balance Sheet

	Note	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
NON-CURRENT LIABILITIES			
Participants' admission fees received		86,000	84,950
Participants' contributions to Clearing House Funds		574,896	984,045
Deferred tax liabilities		49,563	58,665
Provisions	18	24,084	23,092
		734,543	1,150,752
NET ASSETS			
		3,931,705	5,603,263
CAPITAL AND RESERVES			
Share capital	19	1,056,473	1,048,999
Share premium	19	103,058	54,338
Revaluation reserves	20	32,245	46,431
Designated reserves	21	687,676	689,657
Retained earnings	22	1,597,970	1,560,940
Proposed and declared dividends	22	454,283	2,202,898
SHAREHOLDERS' FUNDS			
		3,931,705	5,603,263



Condensed Consolidated Cash Flow Statement

(Financial figures are expressed in Hong Kong dollars)



	Note	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Net cash inflow from operating activities	23(a)	1,255,533	714,099
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments for purchases of fixed assets		(13,217)	(29,355)
Proceeds from sales of fixed assets		155	76
Proceeds from sales of other assets		1,175	–
Decrease in time deposits with original maturity more than three months		310,147	59,768
Dividends received from an associated company		6,000	2,400
Dividends received from non-trading securities		1,070	1,049
Interest received from non-trading securities		16,492	19,712
Interest paid on bank loan		(827)	(421)
Repayment of loan receivable from an associated company		–	2,000
Net cash inflow from investing activities		320,995	55,229
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issue of shares under employee share option schemes		56,194	25,373
Admission fees received less refunds to Participants		(1,900)	(1,650)
Repayment of bank loan		(50,286)	–
Dividends paid		(2,218,559)	(449,387)
Net cash outflow from financing activities		(2,214,551)	(425,664)
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS			
Cash and cash equivalents at 1 Jan		1,355,390	679,956
Cash and cash equivalents at 30 Jun	23(b)	717,367	1,023,620

Notes to the Condensed Consolidated Accounts

(Financial figures are expressed in Hong Kong dollars)



1. BASIS OF PREPARATION AND ACCOUNTING POLICIES

These unaudited condensed consolidated interim accounts are prepared in accordance with Hong Kong Statement of Standard Accounting Practice (SSAP) 25: Interim Financial Reporting, issued by the Hong Kong Society of Accountants (HKSA).

These condensed consolidated interim accounts should be read in conjunction with the 2003 annual accounts.

The accounting policies and methods of computation used in the preparation of these accounts are consistent with those used in the annual accounts for the year ended 31 December 2003.

2. TURNOVER

Turnover comprises trading fees and trading tariff from securities and options traded on The Stock Exchange of Hong Kong Limited (the Stock Exchange) and derivatives contracts traded on Hong Kong Futures Exchange Limited (the Futures Exchange), Stock Exchange listing fees, clearing and settlement fees, depository, custody and nominee services fees, income from sale of information, investment income (including investment income net of interest expenses of Clearing House Funds) and other income, which are **disclosed as Income** in the condensed consolidated profit and loss account.



Notes to the Condensed Consolidated Accounts

3. SEGMENT INFORMATION

The Group's income is derived solely from business activities in Hong Kong. An analysis of the Group's income and results for the period by business segments is as follows:

	Unaudited Six months ended 30 Jun 2004				
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Group \$'000
Income	513,727	149,239	344,266	159,630	1,166,862
Costs	265,151	70,924	191,931	37,621	565,627
Segment results	248,576	78,315	152,335	122,009	601,235
Share of profits of associated companies	2	–	6,163	–	6,165
Segment profits before taxation	248,578	78,315	158,498	122,009	607,400
Taxation					(102,407)
Profit attributable to shareholders					<u>504,993</u>
	Unaudited Six months ended 30 Jun 2003				
	Cash Market \$'000	Derivatives Market \$'000	Clearing Business \$'000	Information Services \$'000	Group \$'000
Income	360,924	162,867	255,583	127,674	907,048
Costs	320,647	104,803	181,759	53,482	660,691
Segment results	40,277	58,064	73,824	74,192	246,357
Share of profits of associated companies	35	–	3,228	–	3,263
Segment profits before taxation	40,312	58,064	77,052	74,192	249,620
Taxation					(35,234)
Profit attributable to shareholders					<u>214,386</u>

Notes to the Condensed Consolidated Accounts

3. SEGMENT INFORMATION (CONTINUED)

The **Cash Market** business mainly refers to the operations of the Stock Exchange, which covers all products traded on the cash market platforms, such as equities, debt securities, unit trusts, warrants and rights. Currently, the Group operates two cash market platforms, the Main Board and the Growth Enterprise Market. The major sources of income of the business are trading fees, trading tariff and listing fees. Direct costs of Listing Function (which were previously included under the Others Segment) are treated as segment costs under the Cash Market Segment. Comparatives for 2003 have been reclassified retrospectively to conform to this practice. Costs of Listing Function are further explained in note 5.

The **Derivatives Market** business refers to the derivatives products traded on the Futures Exchange and stock options traded on the Stock Exchange, which includes the provision and maintenance of trading platforms for a range of derivatives products, such as equity and interest rate futures and options. Its income mainly comprises trading fees and net interest income on the margin funds received.

The **Clearing Business** refers to the operations of the three Clearing Houses, namely Hong Kong Securities Clearing Company Limited (HKSCC), The SEHK Options Clearing House Limited (SEOCH) and HKFE Clearing Corporation Limited (HKCC), which are responsible for clearing, settlement and custodian activities and the related risk management of the cash and derivatives markets operated by the Group. Its income is derived primarily from interest earned on the Clearing House Funds and fees from providing clearing, settlement, depository and nominee services.

The **Information Services Segment** is responsible for developing and promoting e-commerce products, compiling and developing index and statistical data, and sales and business development of market data. Its income comprises primarily income from sale of Cash Market and Derivatives Market information. Since Information Services activities share similar business risks as the Cash and Derivatives Market segments, results of Information Services activities were previously grouped under the two business segments based on the nature of their business risks (e.g., income from sales of Cash Market information under the Cash Market). As Information Services activities generate a significant amount of income for the Group, from year ended 31 December 2003 onwards, their results are disclosed under a separate Information Services Segment. Accordingly, comparatives for 2003 have been reclassified to conform to the new disclosure.

Notes to the Condensed Consolidated Accounts

3. SEGMENT INFORMATION (CONTINUED)

In addition to the above, central income (mainly investment income of Corporate Funds) and central costs (mainly costs of the support functions that centrally provide services to all of the business segments) are allocated to the business segments and included in the segment income and costs. Accordingly, comparatives for 2003 have been reclassified to conform to this practice.

4. TRADING FEES AND TRADING TARIFF

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Trading fees and trading tariff are derived from:		
Securities traded on the Cash Market	236,807	98,578
Derivatives contracts traded on the Derivatives Market	110,365	85,931
	347,172	184,509

5. STOCK EXCHANGE LISTING FEES

Stock Exchange listing fees comprise the following:

	Unaudited Six months ended 30 Jun 2004			Unaudited Six months ended 30 Jun 2003		
	Equity \$'000	Debt & derivatives \$'000	Total \$'000	Equity \$'000	Debt & derivatives \$'000	Total \$'000
Income						
Annual listing fees	122,596	1,068	123,664	117,042	1,764	118,806
Initial listing fees	21,750	28,148	49,898	25,375	11,560	36,935
Prospectus vetting fees	1,855	–	1,855	1,150	–	1,150
Other listing fees	4,473	3,080	7,553	3,168	–	3,168
	150,674	32,296	182,970	146,735	13,324	160,059

Notes to the Condensed Consolidated Accounts

5. STOCK EXCHANGE LISTING FEES (CONTINUED)

Listing fee income is fees paid by issuers to enable them to gain access to the Stock Exchange and enjoy the privileges and facilities by being admitted, listed and traded on the Stock Exchange.

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Costs of Listing Function		
Staff costs and related expenses	51,119	49,224
Information technology and computer maintenance expenses	1,474	1,177
Premises expenses	3,857	4,398
Legal and professional fees	1,977	10,135
Depreciation and amortisation	8,405	6,906
Payment to SFC under dual filing regime	10,000	5,000
Other operating expenses	4,290	3,056
	81,122	79,896

The costs listed above are regulatory in nature, which comprise direct costs of the Listing Function on vetting IPOs and enforcing the Listing Rules, disseminating information relating to listed companies, and payments to the Securities and Futures Commission (the SFC) under dual filing regime. Other indirect costs, comprising costs incurred by other units on building the reputation of the Stock Exchange (e.g., marketing and promotion, brand-building, and providing an efficient market infrastructure and market access facilities) to attract issuers to list on the Stock Exchange, which contribute to the Stock Exchange listing fee income above, are not included as they are part and parcel of the activities of the Group and cannot be separately quantified. Moreover, the costs do not cover costs of support services and other central overheads attributable to the Listing Function.

Notes to the Condensed Consolidated Accounts

6. INVESTMENT INCOME

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Interest income		
– bank deposits	9,028	33,116
– listed securities	18,625	21,933
– unlisted securities	45,028	56,566
	72,681	111,615
Interest expenses	(119)	(969)
Net interest income	72,562	110,646
Accommodation income on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the margin funds	3,789	8,669
Non-interest investment income		
Net realised and unrealised gain/(loss) on investments (note a)		
– listed trading and non-trading securities	10,490	23,230
– unlisted trading and non-trading securities	(5,814)	13,547
– exchange difference	(5,078)	19,210
	(402)	55,987
Dividend income		
– non-trading securities	1,070	1,049
– trading securities	3,352	1,939
	4,422	2,988
Total non-interest investment income	4,020	58,975
Total investment income	80,371	178,290
Total investment income is derived from:		
Corporate Funds (note b)	44,226	124,312
Margin funds	31,416	43,088
Clearing House Funds	4,729	10,890
	80,371	178,290

Notes to the Condensed Consolidated Accounts

6. INVESTMENT INCOME (CONTINUED)

- (a) Includes net realised gain on disposal of non-trading securities of \$101,000 (2003: \$6,586,000), of which \$101,000 (2003: \$3,763,000) has been previously recognised in investment revaluation reserve.
- (b) Corporate Funds include investment income of Compensation Fund Reserve Account of \$263,000 (2003: \$391,000) and Cash and Derivatives Market Development Fund (CDMD Fund) of \$12,000 (2003: \$44,000).

7. OTHER INCOME

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Exchange network, terminal user, dataline and software sub-license fees	55,574	48,617
Participants' subscription and application fees	17,230	18,543
Share registration services fees	1,030	727
Brokerage on direct IPO applications	8,382	133
Miscellaneous income	4,686	3,012
	86,902	71,032

8. OTHER OPERATING EXPENSES

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Write-down of strategic investments (note a)	–	32,667
Retirement of redundant IT systems	157	9,846
Impairment of other property – revaluation deficit	–	4,411
Provision for doubtful debts	130	3,574
Insurance	8,245	5,984
Financial data subscription fees	3,933	4,504
Custodian and fund management fees	3,963	4,238
Bank charges	3,959	3,098
Repair and maintenance expenses	3,389	3,250
Other miscellaneous expenses	19,912	19,614
	43,688	91,186

- (a) Write-down of strategic investments for 2003 includes a 100 per cent write-down (\$32,303,000) of the Group's investment in BondsInAsia Limited under non-trading securities following a review of the Group's business strategy and operations.

Notes to the Condensed Consolidated Accounts

9. TAXATION

Taxation in the condensed consolidated profit and loss account represents:

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Provision for Hong Kong Profits Tax (note a)	109,535	37,352
Deferred taxation (note b)	(8,473)	(2,871)
	101,062	34,481
Share of taxation of associated companies	1,345	753
	102,407	35,234

- (a) Hong Kong Profits Tax has been provided for at 17.5 per cent (2003: 17.5 per cent) on the estimated assessable profit for the period.
- (b) Deferred taxation for 2003 includes a one-off deferred tax charge of \$6,040,000, which arose from recomputing outstanding deferred tax liabilities carried forward from 2002 using the higher tax rate of 17.5 per cent and the adoption of SSAP12: Income Taxes in 2003.

10. EARNINGS PER SHARE

The calculation of basic earnings per share is based on the profit attributable to shareholders of \$504,993,000 (2003: \$214,386,000) and the weighted average of 1,053,391,703 shares (2003: 1,044,626,393) in issue during the six-month period.

The employee share options outstanding did not have a material dilutive effect on the basic earnings per share.

Notes to the Condensed Consolidated Accounts

11. FIXED ASSETS

The Group is heavily reliant on the capability and reliability of its computer systems for its business operations, including those required for its electronic trading platforms and for post-trading clearing and settlement services. The total cost of additions to fixed assets of the Group during the six months to 30 June 2004 was \$12,439,000 (2003: \$17,811,000) of which \$11,035,000 (2003: \$15,858,000) or 89 per cent (2003: 89 per cent) was on computer systems, hardware and software. The total cost and net book value of disposals and write-offs of fixed assets during the six months to 30 June 2004 were \$140,159,000 and \$305,000 respectively (2003: \$164,823,000 and \$10,048,000 respectively). During the period, the estimated useful life of hardware of trading and clearing systems was revised from 3 years to 5 years to better reflect the useful life of the equipment.

The Group's investment property and land and buildings were revalued as at 30 June 2004 on the basis of their open market value by Jones Lang LaSalle, an independent firm of qualified property valuers.

The value of the investment property remained unchanged during the six months ended 30 June 2004 (2003: deficit of \$200,000 was charged to the investment properties revaluation reserve).

A revaluation surplus of \$18,237,000 (\$22,107,000 net of applicable deferred taxes of \$3,870,000) for the land and buildings was credited to the other properties revaluation reserve during the six months ended 30 June 2004 (note 20). For the six months ended 30 June 2003, a revaluation deficit of \$7,508,000 (\$8,271,000 net of applicable deferred taxes of \$763,000) was taken to other properties revaluation reserve and \$4,411,000 was charged to the profit and loss account.

Notes to the Condensed Consolidated Accounts

12. INVESTMENTS IN ASSOCIATED COMPANIES

	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
Share of net assets of associated companies	11,851	11,707
Goodwill on acquisition of shares in associated companies less amortisation and impairment (note a)	20,971	22,295
	32,822	34,002

(a) Goodwill

	\$'000
Cost	
At 1 Jan 2004 and 30 Jun 2004	<u>26,889</u>
Accumulated amortisation and impairment	
At 1 Jan 2004	4,594
Charge for the period	<u>1,324</u>
At 30 Jun 2004	<u>5,918</u>
Net book value	
At 30 Jun 2004	<u>20,971</u>
At 31 Dec 2003	<u>22,295</u>

(b) Goodwill is amortised on a straight-line basis over 10 years.

Notes to the Condensed Consolidated Accounts

12. INVESTMENTS IN ASSOCIATED COMPANIES (CONTINUED)

(c) Details of the unlisted associated companies as at 30 June 2004 are as follows:

Name	Place of incorporation	Principal activities	Particulars of shares held	Interest held
Computershare Hong Kong Investor Services Limited	Hong Kong	Provision of share registration services	5,854 Class A ordinary shares	24%
ADP Wilco Processing Services Limited	Hong Kong	Provision of transaction processing services to Stock Exchange Participants	6 Class B ordinary shares	30%

ADP Wilco Processing Services Limited has an accounting year end of 30 June, which is not coterminous with the Group's accounting year end.

Notes to the Condensed Consolidated Accounts

13. CLEARING HOUSE FUNDS

	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
Net asset values of the Clearing House Funds are as follows:		
HKSCC Guarantee Fund	371,406	371,289
SEOCH Reserve Fund	128,121	131,274
HKCC Reserve Fund	642,487	1,048,767
	1,142,014	1,551,330
Net assets of the Clearing House Funds are composed of:		
Unlisted non-trading securities, at fair value		
– debt securities	124,574	125,643
Contributions receivable from Clearing Participants fully secured by bank guarantees	55,310	92,234
Bank balances and time deposits	975,281	1,349,644
	1,155,165	1,567,521
Less: Other liabilities	(13,151)	(16,191)
	1,142,014	1,551,330
The Clearing House Funds are funded by:		
Clearing Participants' contributions		
– cash	519,586	891,811
– bank guarantees	55,310	92,234
Clearing houses' contributions	320,200	320,200
Forfeiture of defaulted Clearing Participants' contributions	1,928	1,928
Accumulated investment income net of expenses included in designated reserves attributable to		
– Clearing Participants' contributions	184,297	183,305
– Clearing houses' contributions	60,399	60,233
Revaluation reserve (note 20(b))	294	1,619
	1,142,014	1,551,330

Notes to the Condensed Consolidated Accounts

13. CLEARING HOUSE FUNDS (CONTINUED)

The HKSCC Guarantee Fund provides resources to enable HKSCC to discharge the liabilities and obligations of defaulting Broker Participants in Central Clearing and Settlement System (CCASS) arising from their Stock Exchange trades accepted for settlement on the Continuous Net Settlement (CNS) basis and defective securities deposited into CCASS. The SEOCH Reserve Fund and the HKCC Reserve Fund were established for the exclusive purpose of supporting SEOCH and HKCC to fulfil their counterparty obligations in the event that one or more of their Clearing Participants fail to meet their obligations to SEOCH and HKCC respectively.

For the HKSCC Guarantee Fund, investment income was insufficient to cover the fund's expenses during the six months ended 30 June 2004 and a loss of \$3,064,000 (2003: \$451,000) arose. Accumulated losses of \$5,326,000 were included in the Group's retained earnings as at 30 June 2004 (31 December 2003: \$2,262,000). Future surplus investment income net of expenses of the fund will be offset against such accumulated losses before appropriation from the Group's retained earnings to the fund.

14. COMPENSATION FUND RESERVE ACCOUNT

The SFC is responsible for maintaining the Unified Exchange Compensation Fund (Compensation Fund). By virtue of Schedule 10 of the Securities and Futures Ordinance (SFO), the Stock Exchange's obligation under the repealed Securities Ordinance (SO) to deposit with the SFC and keep deposited \$50,000 in respect of each Stock Exchange Trading Right in the Compensation Fund remains. The Stock Exchange maintains an account known as the Compensation Fund Reserve Account for all receipts and payments in relation to the Compensation Fund under the Rules of the Exchange, in particular the following:

- (a) The interest received from the SFC on the statutory deposits paid in respect of each Stock Exchange Trading Right into the Compensation Fund maintained by the SFC;
- (b) Amounts received or paid out in relation to each of the Stock Exchange Trading Rights granted or revoked by the Stock Exchange respectively; and
- (c) Amounts reserved for the replenishment of the Compensation Fund.

The Compensation Fund is further explained in note 26(a).

Notes to the Condensed Consolidated Accounts

15. CASH AND DERIVATIVES MARKET DEVELOPMENT FUND

The CDMD Fund was established by the cash received from The Hong Kong Futures Guarantee Corporation Limited (the former clearing house of the Futures Exchange) for the purpose of providing funding for the development and betterment of the cash and derivatives markets in Hong Kong.

During the period ended 30 June 2004, \$243,000 (2003: \$Nil) of the CDMD Fund was utilised and transferred from the CDMD Fund reserve to the Group's retained earnings (note 22) for marketing expenses of certain derivatives products. The remaining sum of \$672,000 is expected to be utilised in the next twelve months.

16. MARGIN FUNDS ON DERIVATIVES CONTRACTS

	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
The margin funds comprise:		
SEOCH Clearing Participants' margin funds	1,184,570	1,083,679
HKCC Clearing Participants' margin funds	7,704,364	6,790,831
	8,888,934	7,874,510
The assets of the margin funds comprise:		
Bank balances and time deposits	4,685,092	4,900,011
Listed securities deposited as alternatives to cash deposits, at market value	932,388	805,430
Listed non-trading securities, at fair value – debt securities	260,246	102,780
Unlisted non-trading securities, at fair value – debt securities	3,011,208	2,066,289
	8,888,934	7,874,510
The Group's liabilities in respect of the margin funds are as follows:		
Margin deposits and securities received from SEOCH and HKCC Participants on derivatives contracts	8,888,934	7,874,510

Notes to the Condensed Consolidated Accounts

17. ACCOUNTS RECEIVABLE, PREPAYMENTS AND DEPOSITS/ACCOUNTS PAYABLE, ACCRUALS AND OTHER LIABILITIES

The Group's accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities amounted to \$2,173,389,000 (31 December 2003: \$4,644,680,000) and \$2,409,698,000 (31 December 2003: \$4,779,904,000) respectively. These mainly represent the Group's CNS money obligations under the T+2 settlement cycle. The Group's CNS money obligations receivable represents 86 per cent (31 December 2003: 87 per cent) of the total accounts receivable, prepayments and deposits. CNS money obligations payable represents 78 per cent (31 December 2003: 84 per cent) of the total accounts payable, accruals and other liabilities. CNS money obligations mature within two days as they are due for settlement two days after the trade date. The majority of the remaining accounts receivable, prepayments, deposits, accounts payable, accruals and other liabilities will mature within three months.

18. PROVISIONS

	Reinstatement costs \$'000	Employee benefit costs \$'000	Total \$'000
At 1 Jan 2004	24,578	23,525	48,103
Provision for the period	–	16,698	16,698
Amount used during the period	–	(14,254)	(14,254)
Amount paid during the period	(190)	(2,095)	(2,285)
At 30 Jun 2004	24,388	23,874	48,262
		Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
Analysis of provisions:			
Current		24,178	25,011
Non-current		24,084	23,092
		48,262	48,103

Notes to the Condensed Consolidated Accounts

19. SHARE CAPITAL AND SHARE PREMIUM

		Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000	
Authorised:				
2,000,000,000 shares of \$1 each		2,000,000	2,000,000	
Issued and fully paid:				
	No. of shares of \$1 each	Share capital \$'000	Share premium \$'000	Total \$'000
At 1 Jan 2003	1,043,580,846	1,043,581	19,012	1,062,593
Shares issued under employee share option schemes	5,418,000	5,418	35,326	40,744
At 31 Dec 2003	1,048,998,846	1,048,999	54,338	1,103,337
Shares issued under employee share option schemes	7,474,000	7,474	48,720	56,194
At 30 Jun 2004	1,056,472,846	1,056,473	103,058	1,159,531

Under the Pre-Listing Share Option Scheme (Pre-Listing Scheme) of HKEx, share options were granted to employees on 20 June 2000 which are exercisable between 6 March 2002 and 30 May 2010 at an exercise price of \$7.52 per share. Following the declaration of a special dividend and final dividend for 2003, at the annual general meeting (AGM) held on 31 March 2004, shareholders of HKEx approved the adjustments to the subscription price and the contract size of the outstanding options granted under the Pre-Listing Scheme. The subscription price of the shares issuable under the options granted was adjusted from \$7.52 per share to \$6.88 per share and the aggregate contract size of the options granted but not yet exercised as at 31 March 2004 was adjusted from 6,615,465 shares to 7,288,668 shares.

Under the Post-Listing Share Option Scheme (Post-Listing Scheme) of HKEx, share options were granted to:

- (a) an executive director on 2 May 2003 which are exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$9.05 per share;

Notes to the Condensed Consolidated Accounts

19. SHARE CAPITAL AND SHARE PREMIUM (CONTINUED)

- (b) an employee on 14 August 2003 which are exercisable between 14 August 2005 and 13 August 2013 at an exercise price of \$13.60 per share;
- (c) an employee on 18 August 2003 which are exercisable between 18 August 2005 and 17 August 2013 at an exercise price of \$13.65 per share;
- (d) an employee on 15 January 2004 which are exercisable between 15 January 2006 and 14 January 2014 at an exercise price of \$18.90 per share;
- (e) a number of employees on 31 March 2004 which are exercisable between 31 March 2006 and 30 March 2014 at an exercise price of \$16.96 per share; and
- (f) an employee on 17 May 2004 which are exercisable between 17 May 2006 and 16 May 2014 at an exercise price of \$15.91 per share.

At the AGM held on 31 March 2004, shareholders of HKEx approved the adjustments to the subscription price and the contract size of the options granted under the Post-Listing Scheme in (a) to (d) above that were not yet exercised prior to the AGM. The adjustments made to the first four option grants under the Post-Listing Scheme are as follows:

Date of grant	Exercise price after adjustment	Number of shares issuable under the options granted before adjustment	Number of shares issuable under the options granted after adjustment
2 May 2003	\$8.28	3,000,000	3,280,000
14 August 2003	\$12.45	1,000,000	1,094,000
18 August 2003	\$12.49	1,800,000	1,968,000
15 January 2004	\$17.30	1,000,000	1,094,000

During the period, Pre-Listing employee share options were exercised to subscribe for 7,474,000 shares (year ended 31 December 2003: 5,418,000) in HKEx at a consideration of \$7.52 per share on or before 31 March 2004 and \$6.88 per share after 31 March 2004, of which \$1.00 per share was credited to share capital and the balance was credited to the share premium account.

Notes to the Condensed Consolidated Accounts

19. SHARE CAPITAL AND SHARE PREMIUM (CONTINUED)

Movements of the employee share options during the period were as follows:

	Number of shares issuable under the employee share options outstanding as at 1 Jan 2004	Number of shares issuable under the new employee share options granted during the period	Number of shares issuable under the employee share options granted pursuant to the adjustment approved at the AGM	Number of shares issuable under the employee share options lapsed during the period	Number of shares issued under the employee share options exercised during the period	Number of shares issuable under the employee share options outstanding as at 30 Jun 2004
Pre-Listing Scheme	14,171,626	–	673,203	(362,829)	(7,474,000)	7,008,000
Post-Listing Scheme	5,800,000	6,888,000	636,000	(14,000)	–	13,310,000
	19,971,626	6,888,000	1,309,203	(376,829)	(7,474,000)	20,318,000

Currently, when the employee share options are exercised and new shares are issued, the share capital is increased by the nominal value of the new shares issued and the share premium account is increased by the remainder of the proceeds. HKEx has not expensed the employee share options to the profit and loss account. Had all the outstanding employee share options been fully exercised on 30 June 2004, the Group would have received \$231,913,300 in proceeds. The market value of the shares issued based on the closing price of \$16.00 per share on that date would have been \$325,088,000. The employees concerned under the Pre-Listing Scheme would have made a gain of \$9.12 per share, or, in aggregate, \$63,912,960. The executive director concerned under the Post-Listing Scheme would have made a gain of \$7.72 per share, or, in aggregate, \$25,321,600. The three employees concerned under the Post-Listing Scheme granted on 14 August 2003, 18 August 2003 and 17 May 2004 would have made a gain of \$3.55 per share, or, in aggregate, \$3,883,700, \$3.51 per share, or, in aggregate, \$6,907,680 and \$0.09 per share, or, in aggregate, \$18,000 respectively.

In April 2004, the HKSA issued a Hong Kong Financial Reporting Standard, HKFRS2: Share-based Payment, which covers the accounting treatment for employee share options. The new HKFRS2 is effective for accounting periods beginning on or after 1 January 2005.

Notes to the Condensed Consolidated Accounts

20. REVALUATION RESERVES

	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
Investment properties revaluation reserve	1,771	1,771
Other properties revaluation reserve (note 11)	28,905	10,668
Investment revaluation reserve (note b)	1,569	33,992
	32,245	46,431

- (a) The revaluation reserves are segregated for their respective specific purposes and are stated net of applicable deferred taxes.
- (b) Includes \$294,000, \$1,000 and \$95,000 (31 December 2003: \$1,619,000, \$11,000 and \$318,000 respectively) of gross revaluation surplus which are attributable to investments of the Clearing House Funds, the CDMD Fund and the Compensation Fund Reserve Account respectively. The significant decrease in investment revaluation reserve is mainly due to the decrease in fair value of non-trading securities of the margin funds.

21. DESIGNATED RESERVES

	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
Clearing House Funds reserves		
– HKSCC Guarantee Fund reserve	255,912	255,912
– SEOCH Reserve Fund reserve	48,589	48,571
– HKCC Reserve Fund reserve	262,323	261,183
	566,824	565,666
Compensation Fund Reserve Account reserve	36,804	36,541
CDMD Fund reserve	671	914
Development reserve (note b)	83,377	86,536
	687,676	689,657

- (a) These reserves are segregated for their respective purposes.
- (b) Development reserve was set aside for systems development for the Stock Exchange. During the period ended 30 June 2004, \$3,159,000 (2003: \$39,364,000) of the reserve was utilised and transferred to the Group's retained earnings (note 22) for funding systems development projects relating to the securities market.

Notes to the Condensed Consolidated Accounts

22. RETAINED EARNINGS

	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
At 1 Jan		
Retained earnings	1,560,940	3,221,321
Proposed and declared dividends	2,202,898	448,740
Profit for the period/year (note a)	504,993	691,765
Investment income net of expenses of Clearing House Funds for the period/year transferred to Clearing House Funds reserves	(1,158)	(8,430)
Investment income net of expenses of Compensation Fund Reserve Account for the period/year transferred to Compensation Fund Reserve Account reserve	(263)	(714)
Transfer from CDMD Fund reserve (note 15)	243	–
Transfer from Development reserve (note 21)	3,159	49,226
Dividends paid:		
2003 interim dividend	–	(188,452)
2003 special and final dividends/2002 final dividends	(2,202,898)	(448,740)
Dividend on shares issued for employee share options exercised after declaration of 2003 special and final dividends/2002 final dividends	(15,661)	(647)
Dividend on shares issued for employee share options exercised after declaration of 2003 interim dividend	–	(231)
At 30 Jun/31 Dec	<u>2,052,253</u>	<u>3,763,838</u>
Representing:		
Retained earnings	1,597,970	1,560,940
Proposed and declared dividends	454,283	2,202,898
At 30 Jun/31 Dec	<u>2,052,253</u>	<u>3,763,838</u>

- (a) The Group's profit for the period/year includes a net deficit attributable to investment income net of expenses of the Clearing House Funds, Compensation Fund Reserve Account and CDMD Fund for an aggregate amount of \$1,631,000 (year ended 31 December 2003: surplus of \$6,938,000).

Notes to the Condensed Consolidated Accounts

23. NOTES TO THE CONDENSED CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of profit before taxation to net cash inflow from operating activities

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Profit before taxation	607,400	249,620
Adjustments for:		
Net interest income	(72,562)	(110,646)
Accommodation income on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the margin funds	(3,789)	(8,669)
Dividends received from non-trading securities	(1,070)	(1,049)
Loss/(gain) on trading securities and exchange differences on investments	286	(33,530)
Depreciation and amortisation	92,520	93,025
Impairment of non-trading securities	–	32,303
Impairment of investments in associated companies	–	364
Impairment of other property	–	4,411
Changes in provisions	159	(3,815)
Provision for doubtful debts	130	3,574
Share of profits of associated companies	(6,165)	(3,263)
Loss on retirement of redundant IT systems	157	9,846
(Gain)/loss on disposal of other fixed assets	(7)	126
Operating profit before working capital changes	617,059	232,297
Net decrease in trading securities	623,931	300,709
Settlement of amount transferred from retained earnings to Clearing House Funds and Compensation Fund Reserve Account	(1,421)	(6,007)
Settlement of amount transferred from CDMD Fund reserve to retained earnings	243	–
Decrease in accounts receivable, prepayments and deposits	2,432,610	1,363,350
Decrease in other current liabilities	(2,478,468)	(1,266,083)
Net cash inflow from operations	1,193,954	624,266

Notes to the Condensed Consolidated Accounts

23. NOTES TO THE CONDENSED CONSOLIDATED CASH FLOW STATEMENT (CONTINUED)

- (a) Reconciliation of profit before taxation to net cash inflow from operating activities
(continued)

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Interest received	57,851	100,617
Accommodation income on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the margin funds	3,789	8,669
Interest paid	(25)	(1,118)
Hong Kong Profits Tax paid	(36)	(18,335)
Net cash inflow from operating activities	<u>1,255,533</u>	<u>714,099</u>

- (b) Analysis of cash and cash equivalents

	Unaudited Six months ended 30 Jun 2004 \$'000	Unaudited Six months ended 30 Jun 2003 \$'000
Time deposits with original maturity within three months	597,587	975,468
Cash at bank and in hand	119,780	48,152
Cash and cash equivalents at 30 Jun	<u>717,367</u>	<u>1,023,620</u>

- (c) The net assets in Clearing House Funds, Compensation Fund Reserve Account and margin funds are held in segregated accounts for specific purposes. Movements in individual items of the net assets of the funds during the period therefore do not constitute any cash or cash equivalent transactions to the Group.

Notes to the Condensed Consolidated Accounts

24. COMMITMENTS

	Unaudited at 30 Jun 2004 \$'000	Audited at 31 Dec 2003 \$'000
Commitments in respect of capital expenditures:		
Contracted but not provided for	4,786	18,359
Authorised but not contracted for	44,411	72,275
	<u>49,197</u>	<u>90,634</u>

The commitments in respect of capital expenditures were mainly for the development and purchases of computer systems.

25. FINANCIAL RISK MANAGEMENT

When seeking to optimise returns on its funds available for investment, the Group may invest in non-HKD securities from time to time. Forward foreign exchange contracts are used to hedge the currency exposures of the Group's non-HKD investments and liabilities to mitigate risks arising from fluctuations in exchange rates. As at 30 June 2004, the total nominal value of outstanding forward foreign exchange contracts amounted to HK\$319 million (31 December 2003: HK\$322 million). All contracts will mature within four months.

26. CONTINGENT LIABILITIES

- (a) The Compensation Fund is a fund set up under the repealed 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 a default 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 113(5A) of the SO, the Stock Exchange may, upon satisfying certain conditions, with the approval of the SFC, allow an additional payment to the successful claimants before apportionment. 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 SFC's request to do so. The amounts to be 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 but capped at \$8 million per default. As at 30 June 2004, there were outstanding claims received in respect of 12 defaulted Stock Exchange Participants (31 December 2003: 13).

Notes to the Condensed Consolidated Accounts

26. CONTINGENT LIABILITIES (CONTINUED)

Pursuant to the SFO, the Stock Exchange issued a notice on 3 April 2003 inviting for claims against the Compensation Fund in relation to any default of a Stock Exchange Participant occurring before 1 April 2003. The claims period expired on 3 October 2003 and no claims had been received in response to that notice. Claims made after the claims period shall, unless the Stock Exchange otherwise determines, be barred. Until 30 June 2004, no such claims had been received.

Following the implementation of the new compensation arrangements under the SFO, an Investor Compensation Fund has been established to replace the existing Compensation Fund, the Commodity Exchange Compensation Fund and the Dealers' Deposit Schemes for non-exchange participant dealers. Pursuant to the SFO, Exchange Participants are no longer required to make deposits to the Investor Compensation Fund and the Stock Exchange is not required to replenish the Investor Compensation Fund. Hence, deposits to the Commodity Exchange Compensation Fund had been returned to the Futures Exchange by the SFC in January 2004. The Futures Exchange had in turn reimbursed holders of Futures Exchange Trading Rights their contributions to the Commodity Exchange Compensation Fund. Similarly, deposits to the Compensation Fund would be returned to the Stock Exchange in accordance with SFO pending completion of the determination of the outstanding claims and replenishment to the Compensation Fund.

- (b) 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 default of any one Participant. In the unlikely event that all of its 436 trading Participants as at 30 June 2004 (31 December 2003: 437) default, the maximum contingent liability of the Stock Exchange under the indemnity will amount to \$87 million (31 December 2003: \$87 million).
- (c) 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.

Notes to the Condensed Consolidated Accounts

27. MATERIAL RELATED PARTY TRANSACTIONS

Certain Directors of HKEx are directors and/or shareholders of (i) Stock Exchange Participants and Futures Exchange Participants (Exchange Participants) and Clearing Participants; (ii) companies listed on the Stock Exchange; and (iii) Exchange Participants for buying shares on behalf of HKSCC. Securities and derivatives contracts traded by, and fees levied on, these Exchange Participants and Clearing Participants, fees levied on these listed companies and fees paid to these Exchange Participants for buying shares on behalf of HKSCC are all undertaken in the ordinary course of business of the Group on the standard terms and conditions applicable to all other Exchange Participants and Clearing Participants, listed companies and Exchange Participants for buying shares on behalf of HKSCC.

In addition to the above, on 5 February 2003, the Futures Exchange as the tenant entered into a tenancy agreement (the Lease) with Shine Hill Development Limited (Shine Hill) as the landlord. The Futures Exchange is a wholly-owned subsidiary of HKEx. Shine Hill is a subsidiary of Great Eagle Holdings Limited (Great Eagle). Dr LO Ka Shui is an independent non-executive director of HKEx and the managing director of Great Eagle. The Lease was an arm's length transaction entered into on normal commercial terms. The rental payments, including air conditioning and cleaning service charges for the six-month period ended 30 June 2004 amounted to \$1,980,100 (2003: \$1,929,427).

During the period, share registration service fees amounted to \$171,996 (2003: \$345,186) were paid to and dividends and loan interest amounted to \$6,000,350 and \$Nil respectively (2003: \$2,400,140 and \$20,652 respectively) were received from an associated company, Computershare Hong Kong Investor Services Limited.

During the six months ended 30 June 2004, bank charges of \$2,597,091 (2003: \$1,420,780) were paid to The Hongkong & Shanghai Banking Corporation Limited where Dr LO Ka Shui was a non-executive director.

During the corresponding period in 2003, consultancy fee of \$862,285 was paid to Goldman Sachs (Asia) LLC where Mr FRESHWATER, Timothy George, an independent non-executive director of HKEx, is a director. The transaction was carried out in the ordinary course of business on normal commercial terms.

Save as aforesaid, HKEx had entered into other transactions with companies where there are common directors but the amount was immaterial.

Notes to the Condensed Consolidated Accounts

28. OFF-BALANCE SHEET RISKS

In the normal course of business, the clearing houses of the Group, HKSCC, SEOCH and HKCC, act as the counterparties to eligible trades concluded on the Stock Exchange and the Futures Exchange through the novation of the obligations of the buyers and sellers. HKSCC is also responsible for the good title to the securities deposited and accepted in the CCASS depository. As a result, the Group has considerable market risk and credit risk since the Participants' ability to honour their obligations in respect of their trades and securities deposited may be adversely impacted by economic conditions affecting the cash and derivatives markets. If the Participants default on their obligations on settlement or there are defects in the title of securities deposited and accepted in the CCASS depository, the Group could be exposed to potential risks not otherwise accounted for in these condensed consolidated interim accounts.

The Group mitigates its exposure to the risks described above by requiring the Participants to meet the Group's established financial requirements and criteria for admission as Participants, monitoring compliance with risk management measures such as position limits established by the Group and requiring Clearing Participants to contribute to the Clearing House Funds set up by HKSCC, SEOCH and HKCC. HKSCC also retains recourse against those Participants whose securities are deposited and accepted in the CCASS depository. Moreover, insurance has been taken out by the Group to cover the risks.

29. EVENTS AFTER BALANCE SHEET DATE

Subsequent to 30 June 2004, the Group has disposed of its entire investment in Singapore Exchange Limited included under non-trading securities for a consideration of approximately \$76 million and realised a profit over cost of \$24.8 million.

30. COMPARATIVE FIGURES

- (a) The comparative figure of time deposits with maturity over one year has been reclassified to non-current assets in order to conform with the current period's presentation.
- (b) For non-trading securities sold or matured, changes in fair value during the period up to disposal or maturity are no longer recognised as "change in fair value of non-trading securities" during the period and accordingly not reversed in the "realisation of change in fair value of non-trading securities on maturity or disposal" (there is no impact on the profit and loss account). The 2003 comparatives for "change in fair value of non-trading securities" and "realisation of change in fair value of non-trading securities on maturity or disposal" in the Condensed Consolidated Statement of Changes in Equity have been amended to conform to the current period's presentation.

Other Information

(Financial figures are expressed in Hong Kong dollars)



THE CHAIRMAN AND BOARD OF DIRECTORS

At the annual general meeting held on 31 March 2004 (AGM), shareholders elected Mr John Estmond Strickland and re-elected Mr Wong Sai Hung, Oscar as Directors. Mr Strickland, a former Public Interest Director, was appointed by the Board last year to fill a vacancy on the Board, while Mr Wong was elected to the Board at last year's annual general meeting. They both retired at the conclusion of the AGM in accordance with the Articles of Association, and were eligible for re-election. The Financial Secretary had also on the same day reappointed Mr Lee Yeh Kwong, Charles, Mr Tim Freshwater and Dr Lo Ka Shui as Public Interest Directors for a term of two years from 1 April 2004 until the conclusion of the annual general meeting to be held in 2006.

At the board meeting held on 1 April 2004, the Board also reappointed Mr Lee Yeh Kwong, Charles as the Chairman for a term to be co-terminous with his term of directorship, and his appointment was subsequently approved by the Chief Executive of the Hong Kong Special Administrative Region (HKSAR) in accordance with Section 69 of the SFO on 2 April 2004.

INTERIM DIVIDEND AND CLOSE OF REGISTER

The Board of Directors has resolved to declare an interim dividend of \$0.43 per share (2003: \$0.18 per share) for the year ending 31 December 2004, amounting to a total of about \$454 million (2003: \$188 million).

The share register will be closed from Tuesday, 7 September 2004 to Thursday, 9 September 2004, both dates inclusive, during which period no transfer of shares will be registered. Dividend warrants will be despatched to shareholders on or about Monday, 13 September 2004. In order to qualify for the interim dividend, all properly completed transfer forms accompanied by the relevant share certificates must be lodged with HKEx's registrar, Hong Kong Registrars Limited, at Rooms 1712-1716, 17th Floor, Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong not later than 4:00 p.m. on Monday, 6 September 2004.

SHARE OPTION SCHEMES

On 31 May 2000, the Pre-Listing Share Option Scheme (Pre-Listing Scheme) and the Post-Listing Share Option Scheme (Post-Listing Scheme) were approved by shareholders under which the Directors of HKEx may, at their discretion, offer any employee (including any executive director) of HKEx or of any of its subsidiaries, options to subscribe for shares in HKEx subject to the terms and conditions stipulated in the two schemes. No further options can be, or have been, issued under the Pre-Listing Scheme from 27 June 2000, the date of listing of HKEx on the Stock Exchange.



Other Information

The Post-Listing Scheme was subsequently amended by shareholders on 17 April 2002 to comply with the new requirements of Chapter 17 of the Rules Governing the Listing of Securities on the Stock Exchange (Listing Rules) effected on 1 September 2001.

At the AGM, shareholders approved the adjustments to the subscription price and the contract size of the unexercised options granted under the Pre-Listing Scheme and those granted under the Post-Listing Scheme prior to the AGM. The adjusted subscription price and contract size of the relevant unexercised options are specifically set out in notes 2 and 7 below.

As at 30 June 2004, the total number of shares available for issue was 67,940,484 which represented about 6.43 per cent of the issued share capital of HKEx. Since the first grant of options in 2000, options for the issue of 12,761,465 shares had lapsed up to and including 30 June 2004. No options granted under the Pre-Listing Scheme and Post-Listing Scheme were cancelled during the six months ended 30 June 2004.

Details of the share options outstanding as at 30 June 2004 under the Pre-Listing Scheme and Post-Listing Scheme were as follows:

(a) Pre-Listing Scheme

	Date of grant	Exercise price	No. of shares				Exercise period
			issuable as at 1 January 2004	issued during the six months ended 30 June 2004	lapsed during the six months ended 30 June 2004	issuable as at 30 June 2004	
Aggregate total for employees (note 1)	20 June 2000	\$6.88 (note 2)	14,171,626	7,474,000 (note 3)	362,829 (note 4)	7,008,000 (note 2)	6 March 2002 – 30 May 2010 (note 5)

Other Information

(b) Post-Listing Scheme

Date of grant	Exercise price	No. of shares issuable under the options granted	Option value as at the date of grant	No. of shares			Exercise period
				issued during the six months ended 30 June 2004	lapsed during the six months ended 30 June 2004	issuable as at 30 June 2004	
Director (note 6)							
2 May 2003	\$8.28 (note 7)	3,280,000 (note 7)	\$8,036,000 (note 8)	–	–	3,280,000	2 May 2005 – 1 May 2013 (note 9)
Employees (note 1)							
14 August 2003	\$12.45 (note 7)	1,094,000 (note 7)	\$4,561,980 (note 8)	–	–	1,094,000	14 August 2005 – 13 August 2013 (note 10)
18 August 2003	\$12.49 (note 7)	1,968,000 (note 7)	\$8,226,240 (note 8)	–	–	1,968,000	18 August 2005 – 17 August 2013 (note 11)
15 January 2004	\$17.30 (note 7)	1,094,000 (note 7)	\$6,564,000 (note 8)	–	–	1,094,000	15 January 2006 – 14 January 2014 (note 12)
31 March 2004 (note 13)	\$16.96 (note 14)	5,688,000	\$32,250,960 (note 8)	–	14,000 (note 15)	5,674,000	31 March 2006 – 30 March 2014 (note 16)
17 May 2004 (note 13)	\$15.91 (note 17)	200,000	\$1,156,000 (note 8)	–	–	200,000	17 May 2006 – 16 May 2014 (note 18)

Other Information

Notes:

1. Employees working under employment contracts that were regarded as “continuous contracts” for the purpose of the Employment Ordinance of Hong Kong.
2. At the AGM, shareholders of HKEx approved the adjustments to the subscription price and the contract size of the unexercised options granted under the Pre-Listing Scheme and those granted under the Post-Listing Scheme prior to the AGM. The subscription price of the shares issuable under the unexercised options granted under the Pre-Listing Scheme was adjusted from \$7.52 per share to \$6.88 per share. The aggregate contract size of the unexercised options granted was adjusted, resulting in the additional grant of 673,203 shares. After taking into account the shares issued and lapsed under the Pre-Listing Scheme during the six months ended 30 June 2004, the number of shares issuable as at 30 June 2004 was 7,008,000.
3. The weighted average closing price immediately before the dates on which the options were exercised was \$20.10.
4. Options lapsed in accordance with the terms of the Pre-Listing Scheme due to resignation of employees.
5. Options granted are exercisable between 6 March 2002 and 30 May 2010, in tranches of 25 per cent each reaching 100 per cent as from 6 March 2005.
6. The option was granted to Mr Chow Man Yiu, Paul, a Director and the Chief Executive of HKEx.
7. At the AGM, shareholders approved the adjustments to the subscription price and the contract size of the unexercised options granted under the Post-Listing Scheme prior to the AGM. Adjustments made to the four unexercised options granted under the Post-Listing Scheme prior to the AGM are as follows:

Date of grant	Exercise price before adjustment	Exercise price after adjustment	No. of shares issuable under the options granted before adjustment	No. of shares issuable under the options granted after adjustment	Closing price immediately before the date on which the option was granted	Closing price immediately before the date on which the option was adjusted
2 May 2003	\$9.05	\$8.28	3,000,000	3,280,000	\$9.10	\$16.85
14 August 2003	\$13.60	\$12.45	1,000,000	1,094,000	\$13.95	\$16.85
18 August 2003	\$13.65	\$12.49	1,800,000	1,968,000	\$13.35	\$16.85
15 January 2004	\$18.90	\$17.30	1,000,000	1,094,000	\$19.00	\$16.85

Other Information

8. According to the Binomial Option Pricing Model, the value of the options granted as at the date of grant and the revaluation of the adjusted options (as approved by shareholders at the AGM) were as follows:

	Date of grant					
	2 May 2003	14 August 2003	18 August 2003	15 January 2004	31 March 2004	17 May 2004
<u>Option value</u>						
Before adjustment	\$8,010,000	\$4,560,000	\$8,226,000	\$6,550,000	\$32,250,960	\$1,156,000
After adjustment	\$8,036,000	\$4,561,980	\$8,226,240	\$6,564,000	(note 13)	(note 13)
<u>Variables</u>						
Risk Free Rate (being the yield of 10-year Exchange Fund Notes)	4.3% as at 30 April 2003	4.84% as at 14 August 2003	4.76% as at 18 August 2003	3.96% as at 15 January 2004	3.78% as at 31 March 2004	4.55% as at 17 May 2004
Expected Volatility (annualised volatility for 1 year immediately preceding the grant date)	36%	36%	36%	34%	35%	37%
Expiration of the option	10 years from 2 May 2003	10 years from 14 August 2003	10 years from 18 August 2003	10 years from 15 January 2004	10 years from 31 March 2004	10 years from 17 May 2004
Expected ordinary dividend	5.6% (2003 prospective dividend yield of the shares as at 2 May 2003)	4.49% (2003 prospective dividend yield of the shares as at 14 August 2003)	4.47% (2003 prospective dividend yield of the shares as at 18 August 2003)	3.23% (2004 prospective dividend yield of the shares as at 15 January 2004)	3.59% (2004 prospective dividend yield of the shares as at 31 March 2004)	3.77% (2004 prospective dividend yield of the shares as at 17 May 2004)

The above calculation is based on the assumption of no material difference between the expected volatility over the whole life of the options and the historical volatility of the shares in HKEx over the respective periods.

The Binomial Option Pricing Model is developed to estimate the fair value of American style options. It is one of the commonly used models to estimate the fair value of an option which can be exercised before the expiry of the option period. The value of an option varies with different variables of certain subjective assumptions. Any change in variables so adopted may materially affect the estimation of the fair value of an option.

9. Option granted is exercisable between 2 May 2005 to 1 May 2013, in tranches of 25 per cent each reaching 100 per cent as from 2 May 2008.
10. Option granted is exercisable between 14 August 2005 to 13 August 2013, in tranches of 25 per cent each reaching 100 per cent as from 14 August 2008.
11. Option granted is exercisable between 18 August 2005 to 17 August 2013, in tranches of 25 per cent each reaching 100 per cent as from 18 August 2008.
12. Option granted is exercisable between 15 January 2006 to 14 January 2014, in tranches of 25 per cent each reaching 100 per cent as from 15 January 2009.
13. Options granted on or after 31 March 2004 under the Post-Listing Scheme, and are not subject to the adjustments as referred to in note 7.

Other Information

14. The closing price immediately before the date on which the options were granted was \$16.85.
15. Options lapsed in accordance with the terms of the Post-Listing Scheme due to resignation of employees.
16. Options granted are exercisable between 31 March 2006 to 30 March 2014, in tranches of 25 per cent each reaching 100 per cent as from 31 March 2009.
17. The closing price immediately before the date on which the options were granted was \$15.55.
18. Options granted are exercisable between 17 May 2006 to 16 May 2014, in tranches of 25 per cent each reaching 100 per cent as from 17 May 2009.

DIRECTORS' AND CHIEF EXECUTIVE'S INTERESTS AND SHORT POSITIONS

As at 30 June 2004, the Directors, the Chief Executive and their respective associates had the following interests in the shares and underlying shares of HKEx, as recorded in the register maintained by HKEx pursuant to Section 352 of the SFO:

(i) Shares

Name of Director	Number of shares held			Total
	Personal Interests	Family Interests	Corporate Interests	
Lee Jor Hung, Dannis	–	–	1,610,000 <i>(note 1)</i>	1,610,000
David Michael Webb	2 <i>(note 2)</i>	2 <i>(note 3)</i>	6 <i>(note 4)</i>	10
John Estmond Strickland	18,000 <i>(note 5)</i>	–	–	18,000

Notes:

1. 1,610,000 shares were owned by DL Brokerage Limited, a private company beneficially wholly-owned by Mr Lee Jor Hung, Dannis, representing approximately 0.15 per cent of the issued share capital of HKEx.
2. The shares held by Mr David Michael Webb as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.
3. The shares were owned by the spouse of Mr David Michael Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.

Other Information

4. The shares were owned by Fundamental Consultants Limited, Member One Limited and Member Two Limited which are under the control of Mr David Michael Webb, representing approximately 0.00 per cent of the issued share capital of HKEx.
5. The shares held by Mr John Estmond Strickland as beneficial owner represent approximately 0.00 per cent of the issued share capital of HKEx.

(ii) Underlying Shares

As at 30 June 2004, the outstanding number of shares issuable under a share option granted pursuant to the Post-Listing Scheme to Mr Chow Man Yiu, Paul, a Director and the Chief Executive of HKEx, was 3,280,000, which represents approximately 0.31 per cent of the issued share capital of HKEx. The said option was granted on 2 May 2003, and is exercisable between 2 May 2005 and 1 May 2013 at an exercise price of \$8.28 per share. The number of shares issuable under the option granted and the exercise price have been adjusted in accordance with the resolution passed by shareholders at the AGM. Please refer to note 7 under “Share Option Schemes” for more information.

Other than the holdings disclosed above, no interests and short positions were held or deemed or taken to be held under Part XV of the SFO by any Director or the Chief Executive of HKEx or their respective associates in the shares, underlying shares and debentures of HKEx or any of its associated corporations (within the meaning of Part XV of the SFO) which were required to be notified to HKEx and the Stock Exchange pursuant to Part XV of the SFO or pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers (Model Code) or which are required pursuant to Section 352 of the SFO to be entered in the register referred to therein. Nor any of the Directors and the Chief Executive (including their spouses and children under the age of 18) had, as at 30 June 2004, any interest in, or had been granted any right to subscribe for the securities and options of HKEx and its associated corporations within the meaning of the SFO, or had exercised any such rights.

DISCLOSABLE INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS UNDER THE SFO

As at 30 June 2004, the Directors are not aware of any party who was directly or indirectly interested in 5 per cent or more of the issued share capital of HKEx, as recorded in the register required to be kept by HKEx under Section 336 of the SFO.

Other Information

MINORITY CONTROLLERS

Under the SFO, no person shall be or become a Minority Controller, i.e. a person who either alone or with any associate or associates, is entitled to exercise, or control the exercise of 5 per cent or more of the voting power at any general meeting of the recognised exchange controller, except with the approval in writing of the SFC after consultation with the Financial Secretary of the HKSAR.

The SFC has so far granted approval to five entities to be Minority Controllers of HKEx, on the basis that the shares are held by them in custody for their clients.

As at 30 June 2004, the Minority Controllers were in aggregate holding 52.9 per cent of the issued share capital of HKEx (30 June 2003: 48.0 per cent).

CONTINUING CONNECTED TRANSACTION

On 5 February 2003, the Futures Exchange as the tenant entered into a tenancy agreement with Shine Hill Development Limited (Shine Hill) as the landlord (the Lease). The Futures Exchange is a wholly-owned subsidiary of HKEx. Shine Hill is a subsidiary of Great Eagle Holdings Limited (Great Eagle). Dr Lo Ka Shui is an independent non-executive director of HKEx and the managing director of Great Eagle. Pursuant to the revised Listing Rules that took effect from 31 March 2004, Shine Hill becomes an associate of Dr Lo Ka Shui. The Lease was entered into in the ordinary and usual course of business of HKEx for a period of two years commencing 1 January 2003. The premises of Suites 501-3 (including the store room on the 5th Floor), 1101 & 1109-11, Asia Pacific Finance Tower, Citibank Plaza, 3 Garden Road, Hong Kong (the Premises) under the Lease are used by the Futures Exchange as offices. The lettable area of the Premises is in a total of 10,348 square feet. The rent and management charges payable to Shine Hill per calendar month are respectively \$285,604.80 and \$62,812.36 (subject to increase at any time during the continuance of the Lease).

The Lease constitutes a continuing connected transaction under Rule 14A.14 of the Listing Rules (the Transaction). The Transaction was an arm's length transaction entered into on normal commercial terms. The rental payments, including air conditioning and cleaning service charges, for 2003 and the six-month period ended 30 June 2004 amounted to \$4,487,432 (as reported in the 2003 Annual Report under "Material Related Party Transactions") and \$1,980,100 respectively (six months ended 30 June 2003: \$1,929,427).

Other Information

Since the total annual rental payment under the Lease represents less than 2.5 per cent of the applicable percentage ratios of HKEx as defined in the Listing Rules, the Transaction is exempt from the requirement of having to seek independent shareholders' approval and will be reported in the next published annual report and accounts in accordance with Rule 14A.34 of the Listing Rules, and included in the results announcement for the six months ended 30 June 2004.

CORPORATE GOVERNANCE

HKEx is committed to maintaining and building high standards of corporate governance. Members of the Board are independent non-executive directors with the exception of the Chief Executive who is an ex-officio Board member and the only executive director of HKEx. Three of the independent non-executive directors are qualified accountants with substantial experience in financial matters.

None of the directors of HKEx is aware of information that would reasonably indicate that HKEx is not, or was not for any part of the six-month period to 30 June 2004, in compliance with the Code of Best Practice as set out in Appendix 14 to the Listing Rules.

For the six-month period to 30 June 2004, HKEx has adopted the Model Code as set out in Appendix 10 to the Listing Rules. HKEx has made specific enquiry of all directors regarding any non-compliance with the Model Code during the six months ended 30 June 2004, and they all confirmed that they have fully complied with the required standard set out in the Model Code.

PURCHASE, SALE OR REDEMPTION OF HKEx'S LISTED SECURITIES

During the six months ended 30 June 2004, HKEx had not redeemed, and neither HKEx nor any of its subsidiaries had purchased or sold any of HKEx's listed securities.



Audit Committee Report



The Audit Committee (AC) comprises a total number of five members, all of whom are independent non-executive directors. Two members are Certified Public Accountants with extensive experience in financial matters. External auditors are invited to attend the AC meetings, as and when necessary.

The AC examines any matter relating to accounting principles and practices adopted by the Group, and discusses auditing, internal control issues, information systems and financial reporting matters. It is scheduled to meet at least four times a year to review audit reports, status of the Group's audits, internal controls, and the interim and final accounts of the Group prior to recommending them to the Board for approval.

The AC has reviewed the Group's unaudited interim accounts for the six months ended 30 June 2004 in conjunction with HKEx's external auditors. It has also reviewed the accounting principles and practices adopted by the Group, and the independent review report of the external auditors as set out on page 82.

Based on these reviews, and discussions with the management and external auditors, the AC endorses the accounting treatment adopted by HKEx, and has to the best of its ability assured itself that the disclosure of the financial information in this report complies with the applicable accounting standards and the Appendix 16 of the Listing Rules. The AC therefore recommended to the Board approval of the unaudited financial statements for the six months ended 30 June 2004 for public release.

Members of the Audit Committee

STRICKLAND, John Estmond (*Chairman*)

FONG Hup (*Deputy Chairman*)

FAN Hung Ling, Henry

LEE Kwan Ho, Vincent Marshall

WEBB, David Michael

Hong Kong, 11 August 2004

Independent Review Report to the Board of Directors of Hong Kong Exchanges and Clearing Limited



INTRODUCTION

We have been instructed by HKEx to review the interim financial report set out on pages 41 to 71.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with Statement of Standard Accounting Practice 25: Interim Financial Reporting, issued by the Hong Kong Society of Accountants. The interim financial report is the responsibility of, and has been approved by, the Directors.

It is our responsibility to form an independent conclusion, based on our review, on the interim financial report and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

REVIEW WORK PERFORMED

We conducted our review in accordance with Statement of Auditing Standard 700: Engagements to review interim financial reports, issued by the Hong Kong Society of Accountants. A review consists principally of making enquiries of the Group's management and applying analytical procedures to the interim financial report and based thereon, assessing whether the accounting policies and presentation have been consistently applied unless otherwise disclosed. A review excludes audit procedures such as tests of controls and verification of assets, liabilities and transactions. It is substantially less in scope than an audit and therefore provides a lower level of assurance than an audit. Accordingly we do not express an audit opinion on the interim financial report.

REVIEW CONCLUSION

On the basis of our review which does not constitute an audit, we are not aware of any material modifications that should be made to the interim financial report for the six months ended 30 June 2004.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 11 August 2004





Market Statistics

(Financial figures are expressed in Hong Kong dollars)

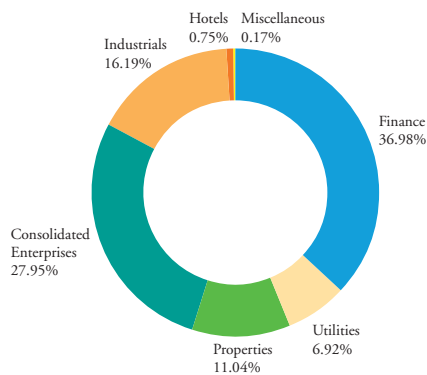


Market Value of All Listed Companies

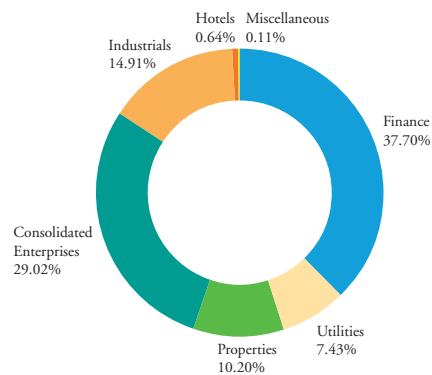
As at the end of June

	2004 (\$mil)	2003 (\$mil)	% Change
Finance	2,027,248.19	1,472,856.01	+37.64
Utilities	379,578.60	290,137.32	+30.83
Properties	605,261.01	398,362.31	+51.94
Consolidated Enterprises	1,532,319.44	1,133,881.09	+35.14
Industrials	887,541.33	582,567.01	+52.35
Hotels	41,088.50	25,089.58	+63.77
Miscellaneous	9,537.16	4,393.34	+117.08
Sub-total	5,482,574.23	3,907,286.66	+40.32
GEM	72,670.33	60,965.10	+19.20
Total	5,555,244.56	3,968,251.76	+39.99

Market value as at the end of June 2004
(Main Board)



Market value as at the end of June 2003
(Main Board)



Number of Listed Companies

As at the end of June

	2004	2003	% Change
Main Board			
Finance	79	71	+11.27
Utilities	14	13	+7.69
Properties	99	99	0.00
Consolidated Enterprises	279	263	+6.08
Industrials	380	361	+5.26
Hotels	13	13	0.00
Miscellaneous	5	4	+25.00
Sub-total	869	824	+5.46
GEM	199	175	+13.71
Total	1,068	999	+6.91

Market Statistics

Number of Listed Securities, Main Board & GEM

As at the end of June

	2004	2003	% Change
Ordinary shares	1,068	999	+6.91
Preference shares	4	4	0.00
Warrants	840	351	+139.32
– <i>Equity Warrants</i>	37	55	-32.73
– <i>Derivative Warrants</i>	803	296	+171.28
Equity Linked Instruments	33	10	+230.00
Unit trusts	8	9	-11.11
Debt securities	151	160	-5.63
Total	2,104	1,533	+37.25

Market Value by Type of Securities, Main Board & GEM

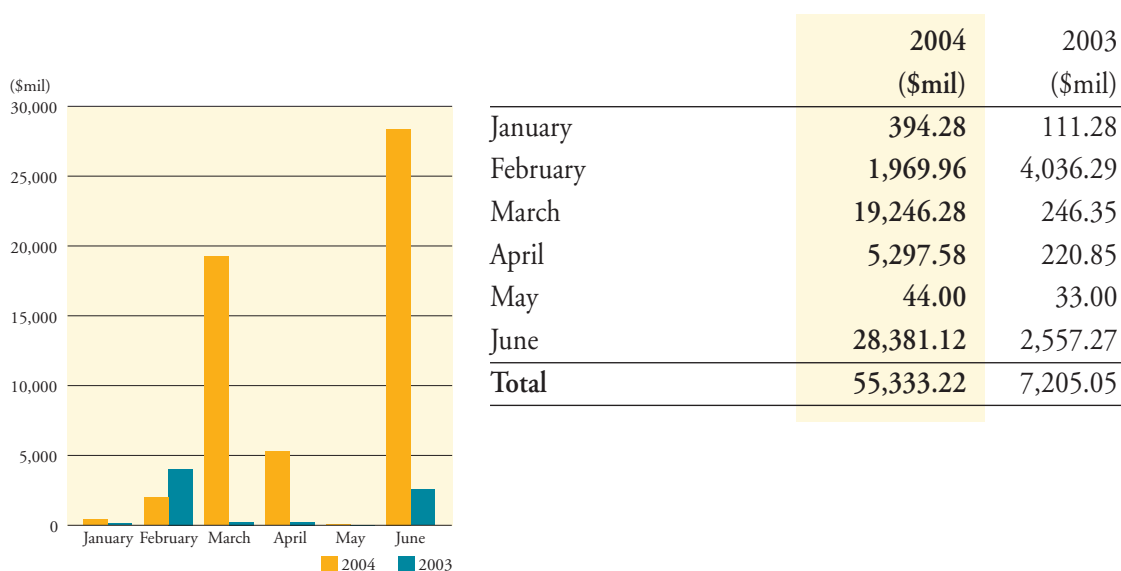
As at the end of June

	2004 (\$mil)	2003 (\$mil)	% Change
Equities	5,555,244.56	3,968,251.76	+39.99
Warrants	56,348.30	20,055.17	+180.97
– <i>Equity warrants</i>	1,222.24	978.08	+24.96
– <i>Derivative warrants</i>	55,126.06	19,077.09	+188.96
Equity linked instrument	1,049.46	387.86	+170.58
Debt securities	407,182.40*	494,971.10*	-17.74
Unit trusts	N/A	N/A	N/A
Total	6,019,824.72	4,483,665.89	+34.26

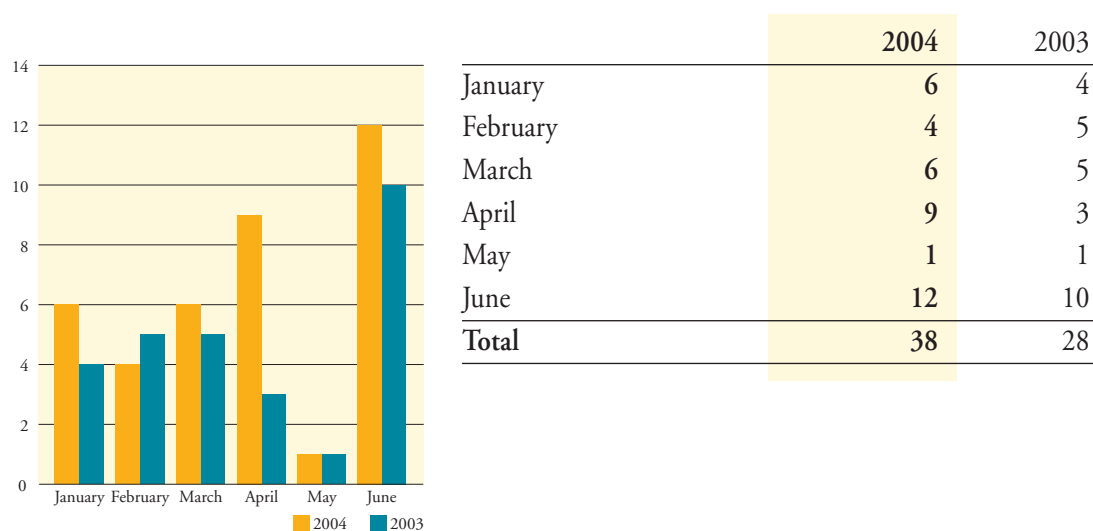
* *Nominal value*

Market Statistics

Funds Raised by Newly Listed Companies, Main Board & GEM

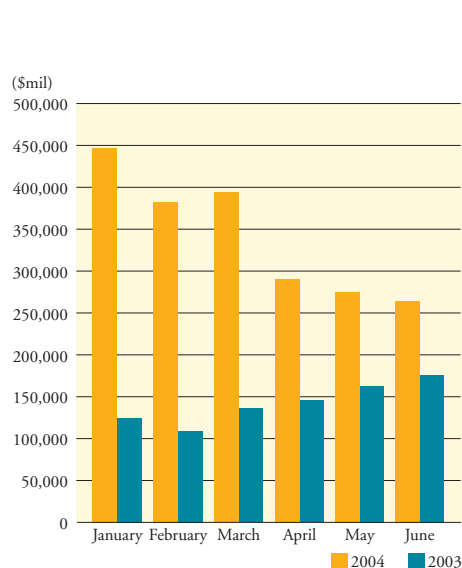


Number of Newly Listed Companies, Main Board & GEM



Market Statistics

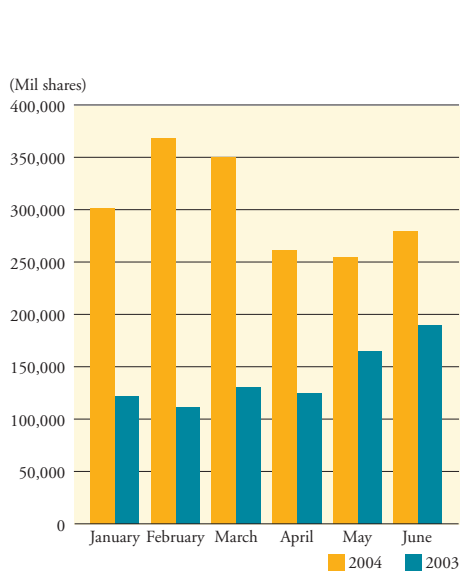
Monthly Turnover, Main Board & GEM (Value)



	2004 (\$mil)	2003 (\$mil)	% Change
January	447,041.68	124,842.68	+258.08
February	382,762.18	109,006.34	+251.14
March	393,889.84	135,937.04	+189.76
April	290,591.92	145,418.88	+99.83
May	275,284.28	162,648.30	+69.25
June	264,526.37	176,202.38	+50.13
Total	2,054,096.27	854,055.62	+140.51

Note: Market turnover values have been adjusted for late reported and rejected sales

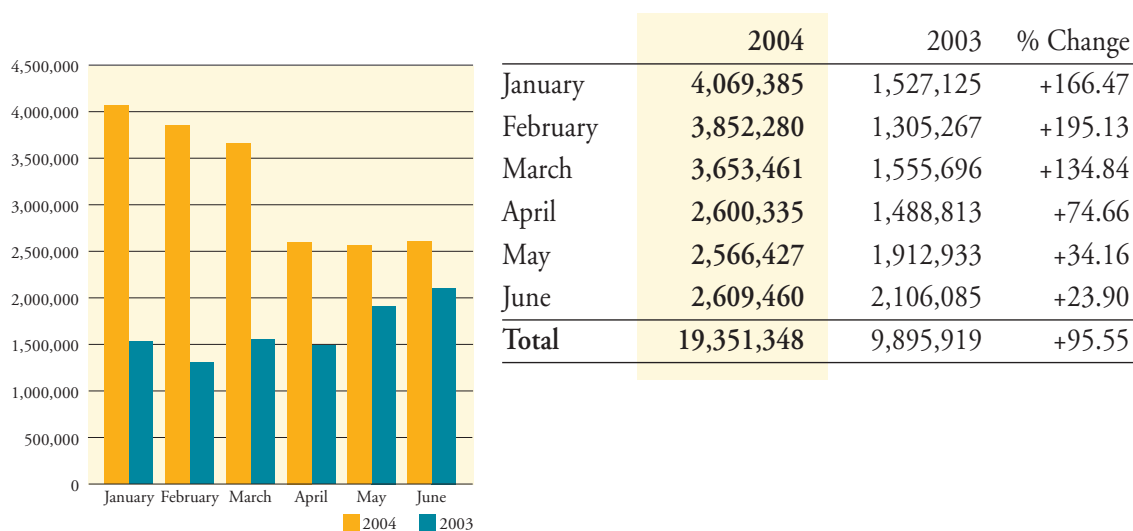
Monthly Turnover, Main Board & GEM (Volume)



	2004 (Mil shares)	2003 (Mil shares)	% Change
January	301,544.60	122,025.27	+147.12
February	368,331.43	110,816.44	+232.38
March	349,591.57	130,454.71	+167.98
April	261,100.69	125,044.76	+108.81
May	254,749.31	164,760.38	+54.62
June	279,413.29	189,950.59	+47.10
Total	1,814,730.88	843,052.15	+115.26

Market Statistics

Number of Transactions, Main Board & GEM



Turnover Value by Type of Securities, Main Board & GEM

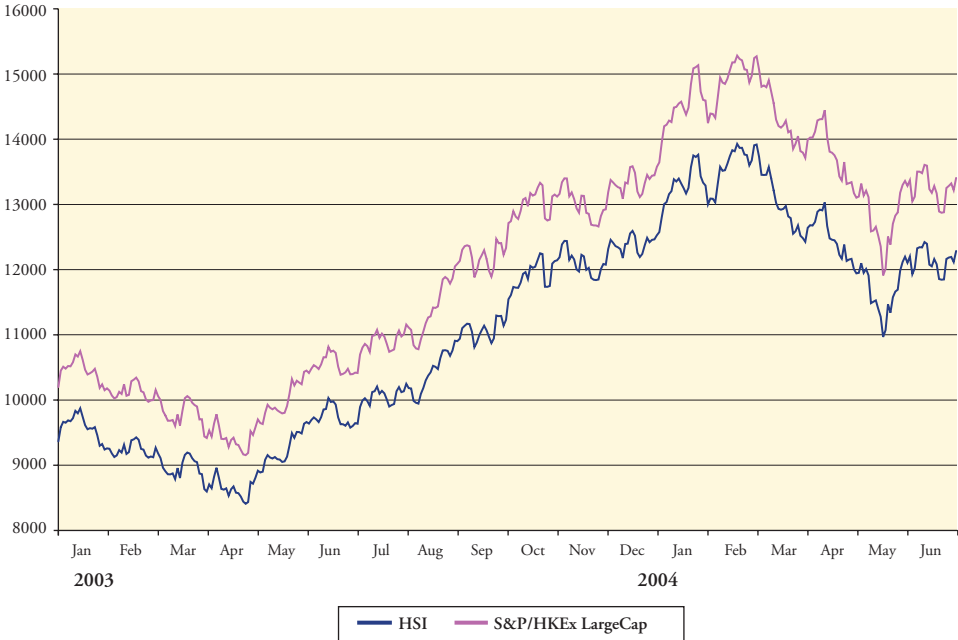
For the six months ended 30 June

	2004 (\$mil)	2003 (\$mil)	% Change
Equities	1,793,286.58	773,886.34	+131.72
Warrants	246,955.45	75,182.13	+228.48
– Equity warrants	1,152.43	197.10	+484.69
– Derivative warrants	245,803.02	74,985.03	+227.80
Equity linked instrument	168.67	363.23	-53.56
Debt securities	23.59	8.76	+169.29
Unit trusts	13,655.14	4,608.84	+196.28
iShares	6.85	6.33	+8.22
Total	2,054,096.28	854,055.63	+140.51

Market Statistics

Hang Seng Index and S&P/HKEx LargeCap Index

January 2003 – June 2004



S&P/HKEx GEM Index

January 2003 – June 2004



Market Statistics

Volume of Derivatives Products (Contracts)

2004	Hang Seng Index Futures	Mini-Hang Seng Index Futures	H-shares Index Futures*	3-Month HIBOR Futures	Hang Seng Index Options	Stock Options
January	604,098	98,816	119,148	5,611	120,893	584,671
February	666,243	109,276	104,043	3,887	153,091	481,371
March	787,932	134,228	116,074	7,346	219,879	515,910
April	679,051	111,907	152,048	6,862	181,320	359,072
May	747,300	131,527	194,991	6,996	237,859	443,658
June	772,596	141,695	166,835	5,053	183,994	457,379

2003	Hang Seng Index Futures	Mini-Hang Seng Index Futures	H-shares Index Futures*	3-Month HIBOR Futures	Hang Seng Index Options	Stock Options
January	430,860	94,158	–	4,398	169,890	336,124
February	407,789	74,709	–	3,202	146,423	258,752
March	528,266	97,051	–	6,015	210,314	371,773
April	575,935	111,723	–	3,523	195,957	250,610
May	533,295	94,652	–	2,898	186,196	239,556
June	519,912	91,723	–	4,693	202,617	311,464

Open Interest of Derivatives Products (Month-end, Contracts)

2004	Hang Seng Index Futures	Mini-Hang Seng Index Futures	H-shares Index Futures*	3-Month HIBOR Futures	Hang Seng Index Options	Stock Options
January	100,111	1,741	10,182	5,814	93,198	662,423
February	104,185	2,055	12,454	5,850	103,908	742,199
March	93,342	2,572	15,232	5,579	103,695	635,115
April	91,578	3,624	18,543	5,420	107,254	618,197
May	86,336	1,840	19,103	6,397	113,042	645,294
June	83,501	2,412	21,991	6,285	92,672	485,786

2003	Hang Seng Index Futures	Mini-Hang Seng Index Futures	H-shares Index Futures*	3-Month HIBOR Futures	Hang Seng Index Options	Stock Options
January	53,757	1,840	–	14,833	65,090	452,740
February	54,158	2,528	–	14,960	88,342	482,252
March	56,346	3,056	–	11,851	85,571	374,622
April	63,517	2,758	–	12,774	92,808	389,769
May	71,770	3,163	–	12,776	83,959	402,437
June	68,828	2,310	–	7,686	89,670	367,713

* Commenced trading on 8 December 2003

Market Statistics

Exchange Participants and Trading Right Holders Status

As at 30 June 2004

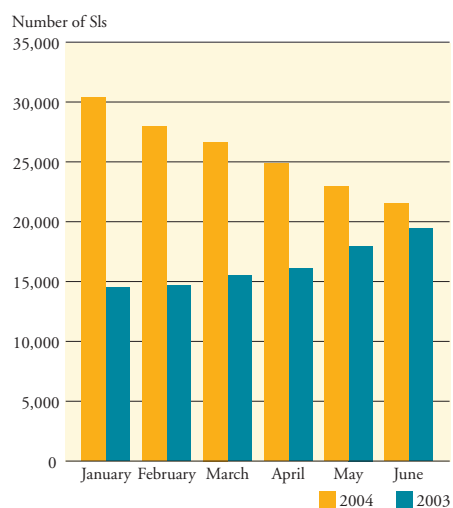
	Stock Exchange	Futures Exchange
Exchange Participants ⁽¹⁾	495	126
<i>Trading</i>	436	126
<i>Non-trading</i>	59	0
Trading Right Holders ⁽¹⁾	33	67
<i>Corporate</i>	2	58
<i>Individual</i>	31	9
Average no. of trading rights held by Exchange Participants and Trading Right Holders ⁽²⁾	1.75	1.17

⁽¹⁾ Exchange Participants and Trading Right Holders were Members of the two exchanges before the merger of the exchanges was completed on 6 March 2000.

⁽²⁾ Average no. of trading rights held by Exchange Participants and Trading Right Holders = Total no. of trading rights held/ Total no. of Exchange Participants and Trading Right Holders.

Market Statistics

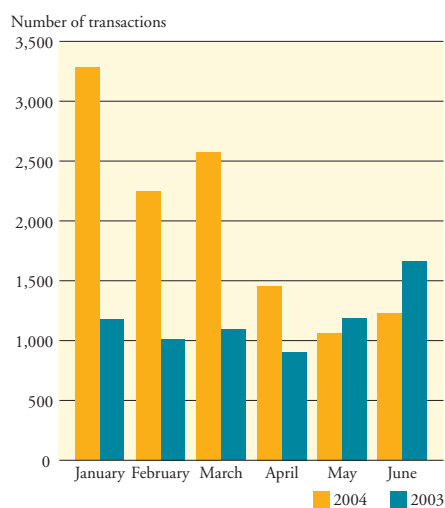
Average Daily Settlement Instruction (SIs) Settled in CCASS (both delivering and receiving SIs are counted)



	2004 Number of SIs	2003 Number of SIs	2004 HKD securities SIs by shares (bil)	2003 HKD securities SIs by shares (bil)	2004 SIs by value (\$ bil)	2003 SIs by value (\$ bil)
January	30,392	14,518	14.7	5.9	53.0	16.1
February	27,971	14,662	13.4	5.7	42.6	16.8
March	26,654	15,494	12.6	6.9	43.1	17.9
April	24,889	16,093	11.6	7.3	44.2	19.9
May	22,914	17,977	10.4	8.9	36.8	21.4
June	21,516	19,420	10.0	9.1	33.7	22.7

Market Statistics

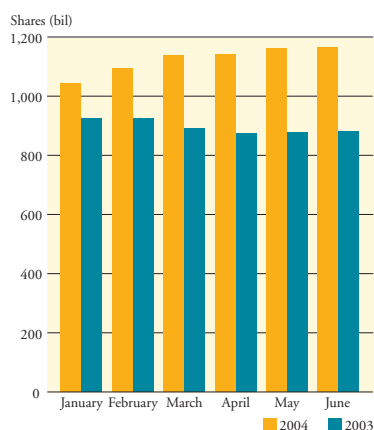
Average Daily Transactions Handled by CCASS Depository (both deposit and withdrawal transactions are counted)



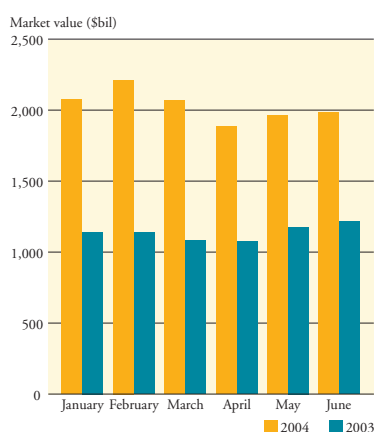
	2004 Number of transactions	2003 Number of transactions	2004 HKD securities Number of shares (bil)	2003 HKD securities Number of shares (bil)	2004 Value of transactions (\$ bil)	2003 Value of transactions (\$ bil)
January	3,281	1,178	1.6	0.8	2.8	0.5
February	2,249	1,013	2.1	0.3	2.1	0.5
March	2,577	1,092	1.5	0.3	2.2	0.5
April	1,454	907	0.8	0.4	2.0	0.4
May	1,064	1,189	1.1	0.6	1.8	0.7
June	1,228	1,661	0.9	0.8	1.7	0.6

Market Statistics

Securities under CCASS Custody (balances at the end of each month)



	2004 Number of shares (bil)	2003 Number of shares (bil)	2004 % of issued shares of admitted securities	2003 % of issued shares of admitted securities
January	1,042.4	924.4	59.4	54.6
February	1,092.2	925.9	60.6	54.2
March	1,138.7	889.7	58.7	52.0
April	1,142.2	872.8	58.1	53.0
May	1,161.0	876.7	58.9	53.8
June	1,163.7	880.4	58.6	53.6

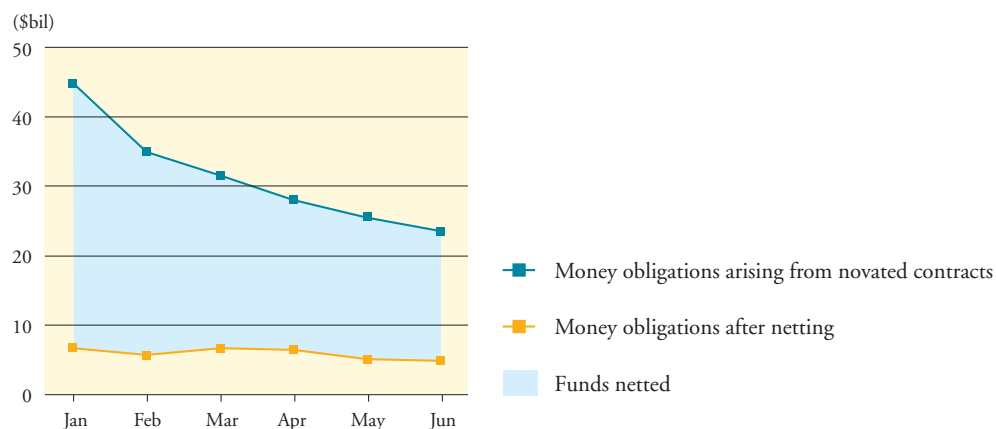


	2004 Market value (\$ bil)	2003 Market value (\$ bil)	2004 % of market capitalisation of admitted securities	2003 % of market capitalisation of admitted securities
January	2,076	1,142	33.8	29.9
February	2,213	1,136	34.2	30.0
March	2,071	1,084	33.5	30.0
April	1,883	1,072	32.7	29.7
May	1,963	1,177	34.0	29.0
June	1,985	1,218	33.4	29.3

Market Statistics

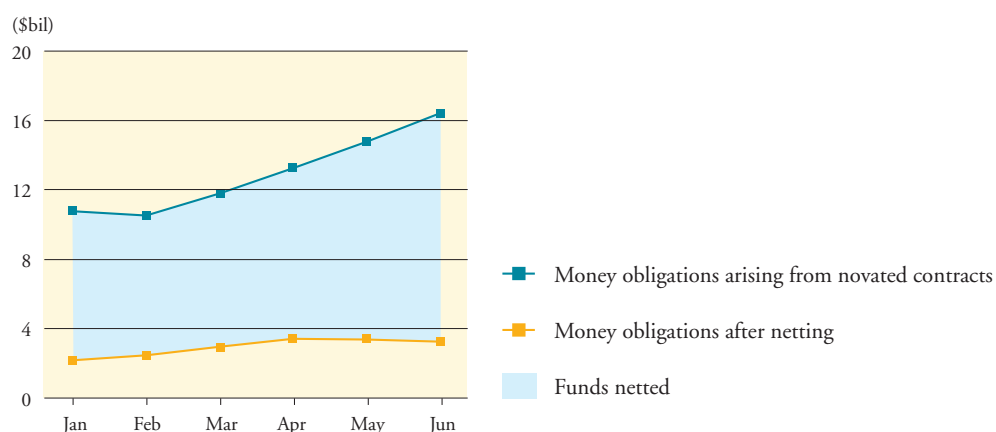
Average Daily Funds Netting Efficiency of CNS Trades

2004



2004	Money obligations arising from novated contracts (\$ billion)	Money obligations after netting (\$ billion)	Funds netting efficiency (%)
January	45.0	6.9	84.5
February	35.1	5.8	83.3
March	31.5	6.5	79.1
April	28.2	6.3	78.1
May	25.5	5.2	79.8
June	23.7	4.9	79.4

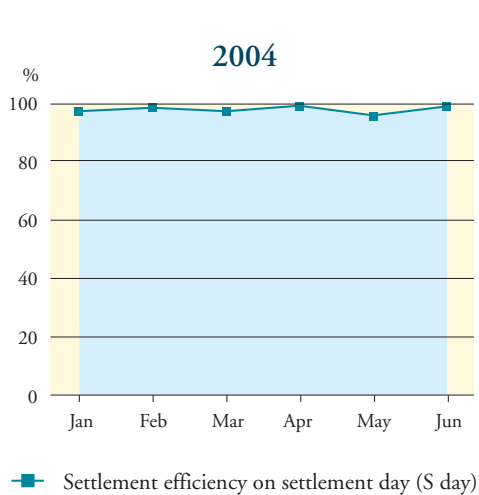
2003



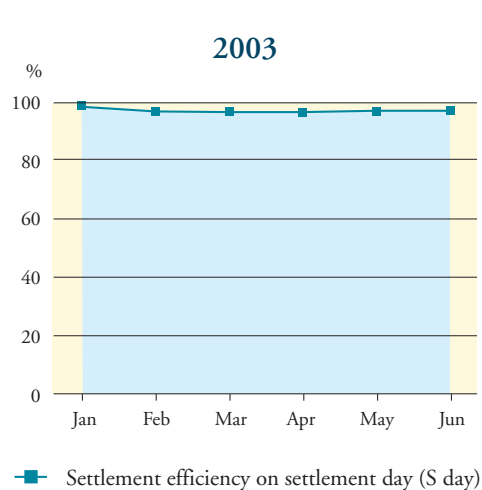
2003	Money obligations arising from novated contracts (\$ billion)	Money obligations after netting (\$ billion)	Funds netting efficiency (%)
January	10.8	2.1	76.2
February	10.5	2.4	77.4
March	11.8	3.0	74.5
April	13.3	3.4	75.1
May	14.8	3.4	77.5
June	16.4	3.3	79.9

Market Statistics

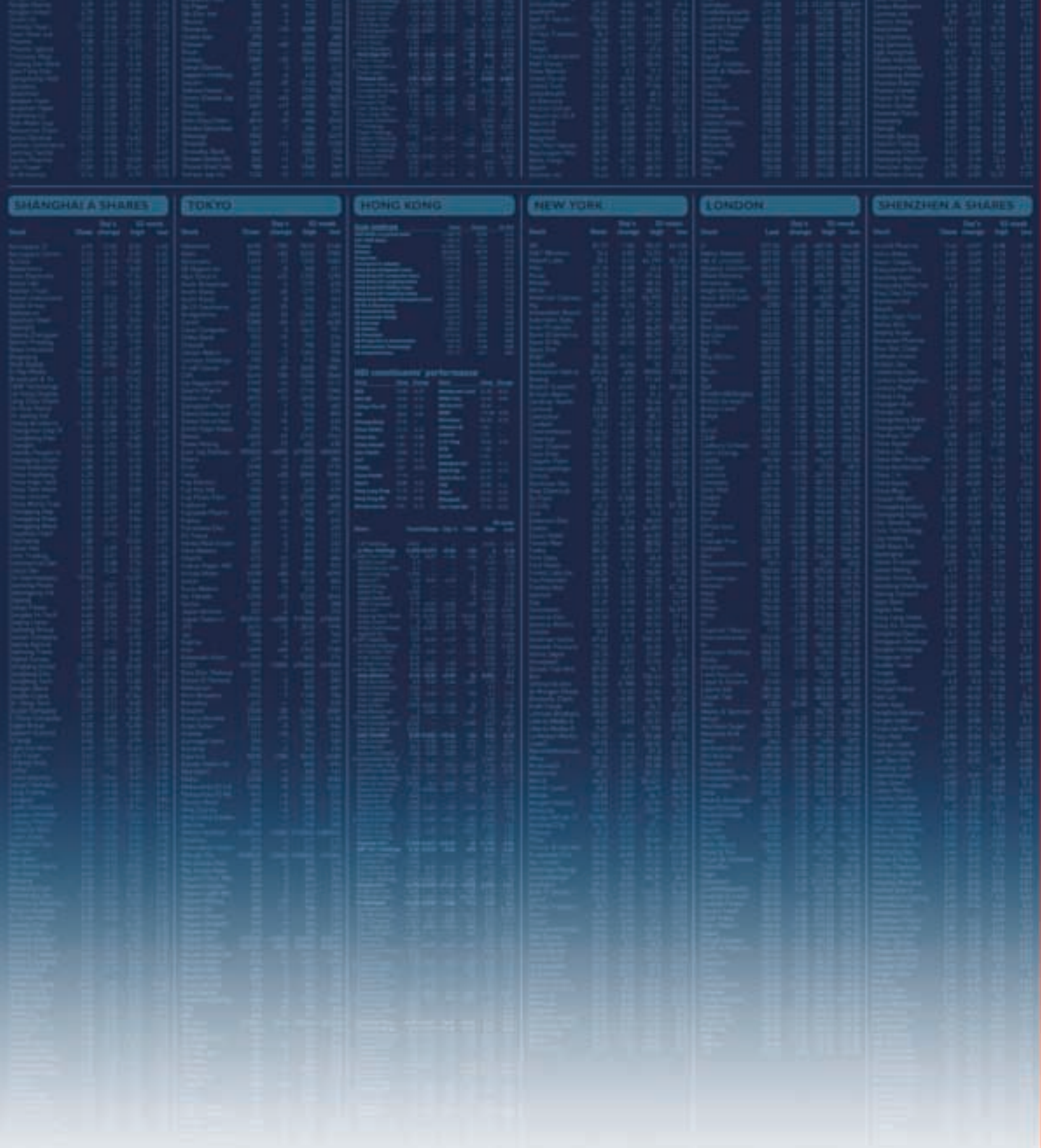
Average Daily Settlement Efficiency of CNS Stock Positions



2004	Settlement efficiency (%) HKD securities	
	S Day	S+1 Day
January	99.64	99.97
February	99.72	99.98
March	99.68	99.98
April	99.79	99.98
May	99.59	99.97
June	99.74	99.97



2003	Settlement efficiency (%) HKD securities	
	S Day	S+1 Day
January	99.73	99.97
February	99.71	99.97
March	99.71	99.97
April	99.63	99.97
May	99.71	99.97
June	99.65	99.97



Hong Kong Exchanges and Clearing Limited

香港交易及結算所有限公司

12/E, One International Finance Centre, 1 Harbour View Street, Central, Hong Kong
香港中環港景街一號國際金融中心一期 12 樓

Tel 電話 : +852 2522 1122
Fax 傳真 : +852 2295 3106
Website 網址 : www.hkex.com.hk
E-mail 電郵 : info@hkex.com.hk