

# Chairman's Statement

*2005 was a remarkable year for the Hong Kong Cash and Derivatives Markets. Several historic records were set and HKEx benefited from vibrant market activity.*

For HKEx, 2005 was an outstanding year. Our markets set many new records and HKEx posted the highest-ever income and earnings per share since its listing in 2000. Supported by a recovering economy, strong results were achieved due to increased activity in our core business areas, including listing, trading, clearing and information services.

Hong Kong's business environment improved markedly in 2005 with a broad-based recovery in many key sectors that led to falling unemployment rates and rising confidence. Hong Kong was one of the fastest-growing economies in Asia last year with a GDP growth of 7.3 per cent.



The Mainland registered strong economic growth of 9.9 per cent. The buoyant economy created a favourable environment for numerous listings of major Mainland enterprises, and Hong Kong remained their preferred listing venue in large part due to its high market liquidity, attributable to global investors' interest in the growth potential of Mainland companies and in acquiring Renminbi-denominated assets in anticipation of the currency revaluation. Since 1993, half of the total equity funds raised in the Hong Kong market have been by Mainland enterprises. Last year, Mainland enterprises accounted for the majority of the IPO funds raised and contributed to a larger and more diverse portfolio of listed companies. As a result of this vibrant fund raising activity, Mainland enterprises now account for over 40 per cent of Hong Kong's total market capitalisation.



In 2005, we continued to focus much of our effort on establishing new, and reinforcing existing, relationships with Mainland partners while further developing our market infrastructure and strengthening investor protection. We were able to rationalise costs by consolidating and streamlining operations to increase efficiency. These factors combined to advance Hong Kong to become the eighth largest market in the world in terms of market capitalisation, up from ninth in 2004, as well as yield high returns for the year.

### Financial Results

For 2005, HKEx achieved record income, net profit and market capitalisation levels.

Income for the year was \$2,694 million, a rise of 13 per cent as compared to 2004. Profit attributable to Shareholders was \$1,340 million, 27 per cent higher than that in the previous year. HKEx's market capitalisation increased to \$34.2 billion by the year end, a growth of 55 per cent from 12 months earlier, and a fourfold rise from \$8.6 billion at the close of the first day of trading on 27 June 2000.

The rise in income for the year is principally attributable to strong listing and trading activities in the Cash and Derivatives Markets, which boosted transaction and clearing fees and income from sale of information. The relatively higher interest rates during the year also raised the Group's net interest income. On the expense side, rigorous consolidation also contributed to the strong net profit recorded.

Earnings per share were \$1.26 and the Board recommended payment of a final dividend of \$0.64 per share. Combined with the interim dividend of \$0.49 per share, the total dividend for the year amounted to \$1.13 per share, in compliance with the Company's dividend policy of a 90 per cent payout ratio.

## New Records in the Securities Market 2005

	2005 (Up to year-end)	Pre-2005 Record
Market Capitalisation	\$8,260.3 bil (21 Dec 2005)	\$6,695.9 bil (31 Dec 2004)
Total Market Turnover	\$4,520.4 bil	\$3,974.1 bil (Year 2004)
<b>Securities Achieved Highest Turnover Record</b>		
Trading Turnover of H-shares	\$953.3 bil	\$941.1 bil (Year 2004)
Trading Turnover of Derivative Warrants	\$856.6 bil	\$524.5 bil (Year 2004)
Number of Newly Listed Derivative Warrants	1,682	1,259 (Year 2004)
<b>New Funds Raised Records by IPOs</b>		
IPO equity funds raised by H-shares	\$137.4 bil	\$52.4 bil (Year 2000)
IPO equity funds raised (including the three REITs)	\$191.5 bil	\$132.1 bil (Year 2000)
Largest single IPO by a listed company	\$71.6 bil	\$43.6 bil (Year 2000)

## New Records in the Derivatives Market 2005

	Volume	
	Number of Contracts in 2005 (Up to year-end)	Previous All-time high Contracts (All in 2004)
Total Futures and Options	25,523,007	19,629,692
Total Futures	13,433,386	11,884,152
Total Options	12,089,621	7,745,540
Hang Seng Index Futures	9,910,565	8,601,559
Stock Options	8,722,393	5,611,832

## A Record-setting Year

Both the Cash and Derivatives Markets set a number of new records in 2005.

Total market capitalisation of our Main Board and GEM, excluding REITs and government bonds, stood at \$8,179.9 billion at the end of December 2005, up 22 per cent from the end of 2004.

Total market turnover reached \$4,520.4 billion from the previous record of \$3,974.1 billion in 2004. Also surpassing the records set in 2004 were the trading turnover of H-shares (\$953.3 billion, up from \$941.1 billion in the previous year) and the trading turnover of derivative warrants (\$856.6 billion, up from \$524.5 billion in 2004).

Hong Kong continued to be a leading global capital formation centre in 2005. We introduced 65 new listings, which raised \$165.7 billion – up 70 per cent from 2004 and up 25 per cent from the previous high in 2000, of which \$137.4 billion was raised through H-share offerings. For the first time in the past two decades, IPO equity capital raised exceeded post-IPO capital raised, reflecting the strong new business potential for HKEx.

The Link REIT, Hong Kong's first exchange-listed REIT, raised approximately \$21.6 billion and is the world's largest ever REIT IPO. Subsequently, GZI REIT and Prosperity REIT also debuted on the market. In total, the three REIT listings raised \$25.8 billion. For 2005, the total funds raised (equities and the three REITs) amounted to \$327.1 billion, comprising \$191.5 billion and \$135.6 billion from IPO and post-IPO respectively.

A record of 1,682 newly listed derivative warrants was also achieved in 2005, up from 1,259 in 2004.

The Derivatives Market broke all records set in 2004 for futures and options contracts traded. During the year, there were a total of 25.5 million contracts traded, comprising 13.4 million futures contracts traded, of which 9.9 million were for Hang Seng Index Futures, and 12.1 million options traded, of which 8.7 million were stock options. In terms of notional turnover, Hong Kong's Derivatives Market was the seventh largest in the world in 2005.

## Premier Capital Formation Market for China

Hong Kong has strengthened its pre-eminent position as the preferred market choice for Mainland issuers. Our market's capital-raising strength, its liquidity, and the opportunity it offers companies to improve their corporate governance through exposure to international standards and practices have continued to attract Mainland enterprises to seek listing in Hong Kong.

Over the past 12 years, Mainland enterprises that listed in Hong Kong, including H-shares, red chips and non-H-share Mainland private enterprises, have raised over \$1 trillion. In the history of our stock market, the top 10 IPOs have all been by Mainland enterprises.

Of those companies newly listed in 2005, 55 per cent, or 37 were Mainland enterprises and the \$150.8 billion raised by them accounted for 91 per cent of all IPO equity funds raised. Also, eight of the top 10 IPOs last year were by Mainland enterprises, including the China Construction Bank IPO, the largest in Hong Kong's history and the largest in the world since 2001. China Construction Bank chose to list exclusively in Hong Kong and its share offering raised more than \$71 billion, which further reinforced our market's position as the premier venue for listing of Mainland enterprises.

## Quality Recognition

The Board and our executive team recognise that investor confidence is vital to the continued success of HKEx's markets. In order to strengthen investor confidence, efforts have been made to continuously raise market quality by enhancing our structure, policies and operations.

All companies listed on the Exchange, including Mainland enterprises, are governed by the same regulatory regime and subject to the same accounting and corporate governance standards, many of which were enhanced during the year.

I am glad to report international recognition of our efforts. In the "Doing Business in 2006" survey cosponsored by the World Bank and International Finance Corporation, Hong Kong ranked fourth among 155 economies with a score of 8.7 out of 10 in terms of investor protection, achieving high marks in the transparency of transactions, director liability and shareholders' ability to sue over misconduct.

### Performance of Mainland Enterprises

As at 31 December 2005	Cash Market	Mainland Enterprises	(%)
Number of listed companies	1,135	335	30
Number of newly listed companies	67 <sup>^</sup>	37	55
Market capitalisation – equities	\$8,179.9 bil	\$3,192.1 bil	39
Average daily turnover – Cash Market (equities, warrants and other securities)	\$18.3 bil	\$6.7 bil	37
Average daily turnover – equities	\$14.6 bil	\$6.7 bil	46
Equity funds raised by IPOs (excluding the three REITs)	\$165.7 bil	\$150.8 bil	91
Funds raised by the three REITs	\$25.8 bil	N/A	N/A
Equity funds raised in secondary market	\$135.6 bil	\$47.0 bil	35
Total funds raised (equities and the three REITs)	\$327.1 bil	\$197.8 bil	60

<sup>^</sup> The figure includes two companies which switched their listings from the GEM to the Main Board

At HKEx, we have been setting the benchmarks for integrity and market quality. In 2005, we were honoured to receive a number of awards for good corporate governance, including receiving our third consecutive Diamond Award (top honour) from the HKICPA and the Directors of the Year Awards 2005 from the Hong Kong Institute of Directors.

## Outlook

We remain optimistic about the long-term prospects of our business and the markets. However, uncertainties on the external front over global oil prices, interest rates and valuation of the Renminbi could affect trading activity and hence our profitability.

With increasing globalisation and greater availability of products in other markets, we also foresee intensified competition among exchanges in the region and beyond for investor funds and issuers' listings both in the Cash and Derivatives Markets.

HKEx welcomes the Government's decision to abolish estate duties and exempt profits tax for offshore funds. These measures should help attract further inflow of funds to Hong Kong and support the city's development as a major fund management centre, complementing our role as the premier capital-formation market for Mainland China.

Our renovated Trading Hall opened earlier this year after extensive refurbishment while the adjacent Exchange Exhibition Hall will open in April 2006. Together they offer a variety of functions and the materials to be displayed will facilitate a better understanding of the extraordinary evolution of Hong Kong financial market by the public.

It is my firm belief that our markets' evolution, sustained by an emphasis on quality – through continuous improvements in regulation, education and infrastructure – will help distinguish Hong Kong as a pre-eminent international financial hub. Combined with the right business conditions, the ongoing success of our growth strategies and cost-saving programmes should keep us on track to continue to provide good returns to Shareholders.

At HKEx, the Board and executives will be preparing the next three-year plan, as the Strategic Plan of 2004-2006 approaches completion. The focus is expected to remain on pursuing organic growth opportunities, including building on our unique partnership with the Mainland, and providing a better platform to meet the growing fund-raising needs of potential issuers seeking listing in Hong Kong.

On a personal note, my term expires in April 2006, and this is my last statement to you as Chairman. I have greatly enjoyed working with my fellow Board members for the past six years and I am truly heartened to see that during that period our markets have grown and become more robust. Total market capitalisation has risen 73 per cent from \$4,734.8 billion at the end of 1999, with turnover in the Cash Market increasing more than twofold and volume in the Derivatives Market expanding almost threefold.

Achieving the growth of your Company over the years and at the same time upholding the public interest have been the steadfast goals of the Board as well as all the executives and staff at HKEx. I am honoured to have worked with my colleagues and shared their endeavours. I would like to acknowledge the exemplary hard work carried out with commitment and passion at every level within HKEx. This work ethic and spirit bode well for HKEx's long-term prospects.

**LEE Yeh Kwong, Charles**

*Chairman*

Hong Kong, 8 March 2006