

DIRECTORS' REPORT

The Directors submit their report together with the audited accounts of HKEx and the Group for the year ended 31 December 2004.

PRINCIPAL ACTIVITIES

HKEx is the recognised exchange controller under the SFO. It owns and operates the only stock exchange and futures exchange in Hong Kong and their related clearing houses, namely HKSCC, HKCC and SEOCH.

The Stock Exchange and the Futures Exchange are recognised exchange companies under the SFO to operate and maintain a stock market and futures market in Hong Kong respectively. HKSCC, SEOCH and HKCC are the recognised clearing houses for the purposes of the SFO.

The Group's revenue is derived solely from business activities in Hong Kong. An analysis of the Group's income and contribution to operating profit for the year ended 31 December 2004 is set out in note 4 to the accounts.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2004 are set out in the consolidated profit and loss account on page 105.

An interim dividend of \$0.43 per share, amounting to a total of about \$454 million, was paid to Shareholders on 13 September 2004.

The Directors recommend the payment of a final dividend of \$0.47 per share to Shareholders whose names appear on the register of members on 12 April 2005, which together with the interim dividend payment amounts to a total of about \$951 million, and the retention of the remaining profit for the year.

RESERVES

The distributable reserves of HKEx as at 31 December 2004, calculated under Section 79B of the Companies Ordinance, amounted to \$3,221 million (2003: \$3,375 million).

Movements in reserves of the Group and HKEx during the year are set out in notes 33 to 36 and 38 to the accounts.

GROUP FINANCIAL SUMMARY

A summary of the results and the assets and liabilities of the Group for the past five financial years is set out on pages 63.

FIXED ASSETS

Movements in fixed assets of the Group and HKEx during the year are set out in note 17 to the accounts.

SHARE CAPITAL

Details of the movements in the share capital during the year are set out in note 32 to the accounts.

SHARE OPTION SCHEMES

HKEx operates two share option schemes, Pre-Listing Scheme and Post-Listing Scheme, under which the Board, may at its discretion, offer any employee (including any Executive Director) of HKEx or its subsidiaries, options to subscribe for shares in HKEx.

Details of the schemes and the option granted thereunder are set out in the "Corporate Governance Report – Remuneration and Interests" on page 76.

Apart from the schemes, at no time during 2004 was HKEx or any of its subsidiaries a party to any arrangements to enable the Directors of HKEx to acquire benefits by means of acquisition of shares in, or debenture of, HKEx or body corporate.

SUBSIDIARIES

Particulars of HKEx's subsidiaries, as at 31 December 2004 are set out in note 31 to the accounts.

DIRECTORS

The Directors of HKEx during the year and up to the date of this annual report were:

Independent Non-executive Chairman

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

Independent Non-executive Directors

FAN Hung Ling, Henry

FONG Hup

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

KWOK Chi Piu, Bill

LEE Jor Hung, Dannis

LEE Kwan Ho, Vincent Marshall

LEONG Ka Chai

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

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

WEBB, David Michael

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

Executive Director and Chief Executive

CHOW Man Yiu, Paul

As at 31 December 2004, the Board consisted of 13 Directors. Six of them are Government Appointed Directors, namely, Messrs Charles Y K Lee, Henry H L Fan, Fong Hup, Tim Freshwater, Leong Ka Chai, and Lo Ka Shui, who were appointed by the Financial Secretary in the interest of the investing public or in the public interest pursuant to Section 77 of the SFO. Six of them are Elected Directors, namely, Messrs Bill C P Kwok, Dannis J H Lee, Vincent K H Lee, John E Strickland, David M Webb and Oscar S H Wong, who were elected by Shareholders at annual general meetings. The Chief Executive of HKEx is an *ex-officio* member of the Board. The Board re-appointed Mr Charles Y K Lee as the non-executive Chairman on 1 April 2004 and his appointment was approved by the Chief Executive of Hong Kong in accordance with Section 69 of the SFO on 2 April 2004.

According to Article 93(1) and (2), at every annual general meeting after the 2003 AGM, one-third of the Directors who are subject to retirement by rotation or, if their number is not three or a multiple of three, then the number nearest to but not exceeding one-third of the Directors shall retire from office. The Government Appointed Directors and the Chief Executive are not subject to retirement by rotation. Article 93(3) further provides that the Directors to retire by rotation on each occasion shall be those who have been longest in office since their last appointment or re-appointment, but as between persons who became or were last re-appointed Directors on the same day, those to retire shall (unless they otherwise

agree among themselves) be determined by drawing lots. Article 93(5) provides that a retiring Director is eligible for re-appointment. Two of the Elected Directors who have been longest in the office, who are subject to retirement by rotation, shall retire at the 2005 AGM. Pursuant to Article 93(3), lots have been drawn and Dr Bill C P Kwok and Mr Vincent K H Lee shall retire at the conclusion of the 2005 AGM. Both of them are eligible for re-appointment. Shareholders are invited to elect up to two Elected Directors at the 2005 AGM to fill the vacancies available due to retirement of the two said Directors. Details of the proposed candidates standing for election are set out in the circular sent together with this annual report.

BIOGRAPHICAL DETAILS OF DIRECTORS AND SENIOR MANAGEMENT

The biographical details of Directors and Senior Management are set out on pages 22 to 27.

DIRECTORS' INTERESTS IN CONTRACTS

Details of the connected transactions and related party transactions are set out in "Corporate Governance Report – Remuneration and Interests" on page 76 and note 44 to the accounts respectively.

Save for the above, no contracts of significance in relation to the Group's business to which HKEx or any of its subsidiaries was a party, and in which a Director of HKEx had a material interest, whether directly or indirectly subsisted at the year-end or at any time during the year.

CORPORATE GOVERNANCE

HKEx is committed to achieving high standards of corporate governance practices and has fully complied with the Code of Best Practice, as set out in Appendix 14 of the Listing Rules.

Further information on the HKEx's corporate governance practices is set out in the following reports:

- (a) "Corporate Governance Report" comprises three sections, namely:
 - Corporate Governance – it sets out details on how HKEx applied and complied with the corporate governance principles, including practices as set out in the newly promulgated CG Code, which became effective 1 January 2005.
 - Remuneration and Interests – it provides an overview of the remuneration policy of HKEx and a summary of the interests of Directors and Senior Management in HKEx, including information on Directors' service contracts, emoluments, and options granted.
 - Corporate and Social Responsibility – it explains how HKEx strives to achieve the well being of its stakeholders.
- (b) "Audit Committee Report" – it gives a summary of work performed by the Audit Committee during 2004.
- (c) "Remuneration Committee Report" – it gives a summary of work performed by the Remuneration Committee during 2004.

DIRECTORS' EMOLUMENTS

Details of the remuneration of the Directors for year 2004 are set out in the "Corporate Governance Report – Remuneration and Interests" on page 76. Particulars of the Directors' emoluments disclosed pursuant to Section 161 of the Companies Ordinance and Appendix 16 of the Listing Rules are set out in note 11 to the accounts.

DISCLOSABLE INTERESTS AND SHORT POSITIONS OF SHAREHOLDERS UNDER THE SFO

As at 31 December 2004, JP Morgan Chase & Co and its controlled corporations were holding 63,315,154 shares of HKEx, representing approximately 5.99 per cent of the issued share capital of HKEx, as recorded in the register required to be kept by HKEx under Section 336 of the SFO, of which 2,005,724 shares were held by JP Morgan Chase & Co and its controlled corporations as beneficial owner, 715,000 shares were held in the capacity of investment manager, and 60,594,430 shares were held in the capacity of a custodian corporation/approved lending agent pursuant to the Securities and Futures (Disclosure of Interests – Securities Borrowing and Lending) Rules.

Apart from the aforesaid, the Directors are not aware of any other party who was directly or indirectly interested in five 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.

MINORITY CONTROLLER

Under Section 61 of 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 five 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.

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 31 December 2004, the Minority Controllers were in aggregate holding 62.2 per cent of the issued share capital of HKEx (31 December 2003: 57.6 per cent).

PUBLIC FLOAT

As at the date of this report, the Directors acknowledge that 100 per cent of the issued capital of HKEx are held by the public.

MAJOR CUSTOMERS AND SUPPLIERS

Contracts with the HKEx's five largest suppliers combined by value which are not of a capital nature, contributed to less than 30 per cent in value of supplies purchased during the year ended 31 December 2004. HKEx's five largest customers combined by value contributed to less than 30 per cent in value of the income during the year ended 31 December 2004.

PURCHASE, SALE OR REDEMPTION OF HKEx'S LISTED SECURITIES

During the year ended 31 December 2004, HKEx had not redeemed and neither HKEx nor any of its subsidiaries had purchased or sold any of HKEx's listed securities.

PROVIDENT FUND SCHEMES

Particulars of provident fund schemes of the Group are set out in note 13 to the accounts.

AUDITORS

The accounts have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment at the 2005 AGM.

On behalf of the Board of Directors

LEE Yeh Kwong, Charles

Chairman

Hong Kong, 28 February 2005