Financial Review

HKEx GROUP – OVERVIEW OF 2005 RESULTS AND FINANCIAL POSITION

2004 Consolidated Balance Sheet

		As restated $'000
Assets		
Fixed assets, land and properties	6	432,818
Investments in associates	7	38,731
Funds	8	12,428,630
Investments and time deposits		2,801,874
Cash and cash equivalents		1,035,045
Other assets	10	4,706,306
		21,443,404
Liabilities		
Participants' contributions to Funds	11	11,828,444
Participants' admission fees received		87,700
Other liabilities	12	5,495,026
		17,411,170
Net assets		4,032,234
Capital and reserves		
Share capital, share premium and reserves		1,877,559
Retained earnings		1,658,055
Proposed/declared dividend		496,620
		4,032,234

$\left.\begin{array}{r}1,658,055\\496,620\end{array}\right\}$ 2,154,675

Key Market Statistics and Business Drivers – Cash Market

Average daily turnover value on the Stock Exchange	**$18.3 billion***
Number of newly listed derivative warrants	**1,682***
Number of newly listed companies on the Main Board	57
Number of newly listed companies on the GEM	10
Number of Main Board companies at 31 December 2005	934
Number of GEM companies at 31 December 2005	201
Total equity funds raised on the Main Board	$298.2 billion
Total equity funds raised on the GEM	$3.1 billion

** New record high in 2005*

Segment Profit for the Year

	Cash Market $'000	Derivatives Market $'000	Clearing Business $'000	Information Services $'000	Group $'000
Income	1,172,850	441,755	753,695	325,757	2,694,057
Operating expenses	544,956	147,961	384,910	67,655	1,145,482
	1	2	3	4	
Segment results	627,894	293,794	368,785	258,102	1,548,575
					5
Share of profits less losses of associates	(3)	–	18,436	–	18,433
Segment profits before taxation	627,891	293,794	387,221	258,102	1,567,008
Taxation					(227,460)
Profit attributable to shareholders					1,339,548

Cash Flows for the Year

		$'000
Net cash inflow from operating activities	13	1,399,898
Acquisition of interest in an associate	7	(24,876)
Capital expenditures		(62,080)
Dividends paid		(1,018,784)
Other net cash inflow		29,910
Net increase in cash and cash equivalents		324,068
Cash and cash equivalents at 1 January 2005		1,035,045
Cash and cash equivalents at 31 December 2005		1,359,113

Key Market Statistics and Business Drivers – Derivatives Market

Average daily number of derivatives contracts traded on the Futures Exchange	**68,157***
Average daily number of stock options contracts traded on the Stock Exchange	**35,385***

** New record high in 2005*

2005 Consolidated Balance Sheet

		$'000
Assets		
Fixed assets, land and properties	6	370,246
Investments in associates	7	64,581
Funds	8	15,027,401
Contributions to HKEx Employee Share Trust	9	30,037
Investments and time deposits		2,799,178
Cash and cash equivalents		1,359,113
Other assets	10	3,310,377
		22,960,933
Liabilities		
Participants' contributions to Funds	11	14,400,332
Participants' admission fees received		82,700
Other liabilities	12	4,110,412
		18,593,444
Net assets		4,367,489
Capital and reserves		
Share capital, share premium and reserves		1,911,695
Retained earnings		1,775,631
Proposed/declared dividend		680,163
		4,367,489

Retained Earnings for the Year

	$'000
Profit attributable to shareholders	1,339,548
Dividends paid during the year	(1,018,784)
Transfer to reserves	(19,645)
Net increase in retained earnings	301,119
Retained earnings at 1 January 2005, as restated	2,154,675
Retained earnings at 31 December 2005	2,455,794
Representing:	
Retained earnings	1,775,631
Proposed/declared dividend	680,163
	2,455,794

Notes

Due to the continued economic recovery, influx of foreign funds and upbeat market sentiment, activity on the Stock Exchange and the Futures Exchange increased substantially. Coupled with rising interest rates and increased Margin Fund size, the Group achieved record profit for the second consecutive year in 2005. The performance of the Group by business segment during 2005 was as follows:

1. Results of the Cash Market increased by $114 million mainly due to the higher turnover of the Cash Market and the rise in Stock Exchange listing fees attributable to the higher number of listed securities and newly listed derivative warrants during the year.

2. Results of the Derivatives Market increased by $111 million mainly as a result of the increase in investment income from the Margin Funds and the increase in the level of activity on the Derivatives Market.

3. Results of the Clearing Business rose by $60 million mainly attributable to the increase in clearing and settlement fees generated from Cash Market transactions.

4. Results of the Information Services Business increased by $26 million as demand for information increased in tandem with the activities of the Cash and Derivatives Markets.

5. Share of profits less losses of associates increased due to the higher profitability of one of the associates and the acquisition of a further six per cent interest in that associate during the year.

6. Fixed assets, land and properties decreased by $63 million mainly attributable to depreciation during the year.

7. Investments in associates rose by $26 million as the Group acquired a further six per cent interest in an associate during the year for a consideration of $25 million.

8. Funds comprised Margin Funds of $13,649 million (2004: $10,530 million), Clearing House Funds of $1,340 million (2004: $1,862 million) and Compensation Fund Reserve Account of $38 million (2004: $37 million). The increase in Margin Funds was as a result of increased open interest in futures and options contracts. The decrease in Clearing House Funds reflected the decrease in additional contributions from Participants in response to market fluctuations and changes in risk exposure.

9. The HKEx Employees' Share Award Scheme ("HKEx Employee Share Trust") was set up in December 2005 under which $30 million of HKEx shares were acquired from the market and held by the Trust on behalf of eligible employees until the shares become vested.

10. Other assets mainly represented obligations receivable under the Continuous Net Settlement system of $2,890 million (2004: $4,261 million) and other receivables.

11. Participants' contributions to funds represented Margin deposits from Participants of $13,649 million (2004: $10,530 million) and Participants' contributions to Clearing House Funds of $752 million (2004: $1,299 million). The reasons for the movements in the contributions were similar to the movements in the funds as explained in note 8.

12. Other liabilities mainly represented obligations payable under the Continuous Net Settlement system of $2,890 million (2004: $4,261 million).

13. Net cash inflow from operating activities decreased by $416 million mainly due to more financial assets were converted into cash in 2004 for funding the special dividend.

OVERALL PERFORMANCE

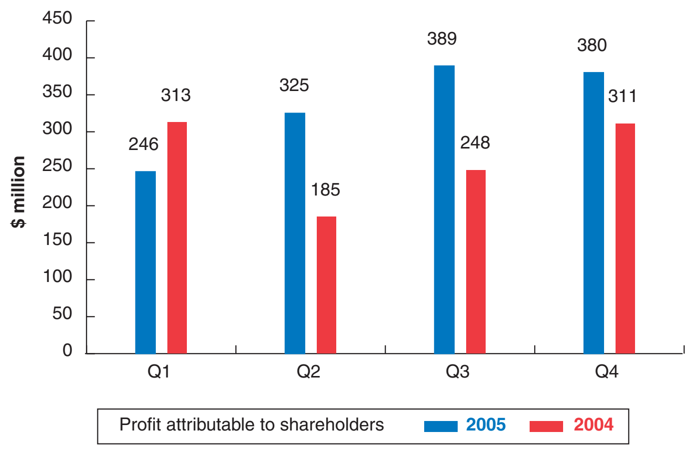
The financial performance of the Group is summarised below:

Analysis of results by quarter

	Q1 2005 $'000	Q2 2005 $'000	Q3 2005 $'000	Q4 2005 $'000	Total 2005 $'000
Income	574,252	664,213	732,835	722,757	2,694,057
Operating expenses	282,675	287,843	282,394	292,570	1,145,482
Operating profit	291,577	376,370	450,441	430,187	1,548,575
Share of profits less losses of associates	2,617	6,018	4,357	5,441	18,433
Profit before taxation	294,194	382,388	454,798	435,628	1,567,008
Taxation	(48,773)	(57,013)	(65,678)	(55,996)	(227,460)
Profit attributable to shareholders	245,421	325,375	389,120	379,632	1,339,548

	Q1 2004 $'000	Q2 2004 $'000	Q3 2004 $'000	Q4 2004 $'000	Total 2004 $'000
Profit attributable to shareholders	312,896	184,529	248,610	310,849	1,056,884

Analysis of Results by Quarter



With the exception of the first quarter, profit attributable to shareholders for each quarter of 2005 has shown a significant growth over 2004. The highest profit was recorded in the third quarter of 2005 when the average daily turnover value on the Stock Exchange for the quarter reached the peak at $20.6 billion during the year.

The Group achieved record high profit for the second consecutive year in 2005. Profit attributable to shareholders increased by 27 per cent to $1,340 million for the year ended 31 December 2005, compared with $1,057 million for 2004.

Due to the continued economic recovery, influx of foreign funds and upbeat market sentiment, activity on the Stock Exchange and the Futures Exchange increased substantially. Several new records were achieved in the Cash and the Derivatives Markets in 2005, including the highest equity capital raised by IPO, record annual turnover of the Cash Market and the highest number of contracts traded on the Derivatives Market. As a result, turnover-related income rose significantly.

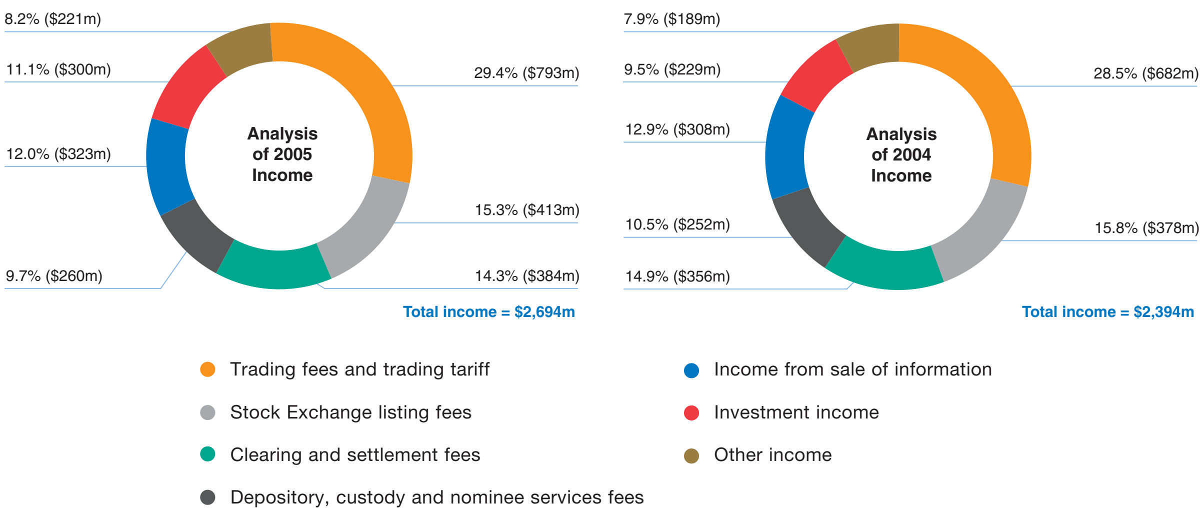
Investment income increased as interest income of the Margin Funds rose on the back of increased fund size and rising interest rates in 2005.

Stock Exchange listing fees also recorded considerable growth due to the higher number of listed securities and newly listed derivative warrants during the year.

Total level of operating expenses remained similar to that of last year despite an increase in staff costs.

The accounts have been prepared in accordance with HKFRSs issued by the HKICPA, which have been aligned with the requirements of International Financial Reporting Standards in all material respects as at 31 December 2005.

Income



(A) Income affected by market turnover

	2005 $'000	2004 $'000	Change
Trading fees and trading tariff	**793,247**	682,293	16%
Clearing and settlement fees	**384,019**	356,274	8%
Depository, custody and nominee services fees	**259,952**	251,722	3%
Total	**1,437,218**	1,290,289	11%

The increase in trading fees and trading tariff was mainly due to the higher turnover of the Cash and Derivatives Markets in 2005 against that of last year.

Clearing and settlement fees are derived predominantly from Cash Market transactions. Despite being mostly ad valorem fees, clearing and settlement fees are subject to a minimum and a maximum fee per transaction. Clearing and settlement fees did not increase linearly with the Cash Market turnover in 2005 as there was a higher proportion of transactions with value subject to the maximum fee.

Depository, custody and nominee services fees increased due to higher scrip fee income, corporate action fees and dividend collection fees but partly offset by lower stock withdrawal fees in 2005. The fees were influenced by the level of Cash Market activities but did not move proportionately with changes in the Cash Market turnover as they varied mostly with the board lots rather than the value of the securities concerned and many were subject to a maximum fee. Moreover, scrip fee was only chargeable on the net increase in individual Participants' aggregate holdings of the securities. Effective 1 January 2006, deemed book close scrip fee (2005: $41 million; 2004: $46 million) was abolished.

Key market indicators

	2005	2004	Change
Average daily turnover value on the Stock Exchange	**$18.3 billion**	$16.0 billion	14%
Average daily number of derivatives contracts traded on the Futures Exchange	**68,157**	56,752	20%
Average daily number of stock options contracts traded on the Stock Exchange	**35,385**	22,720	56%

(B) Stock Exchange listing fees

	2005 $'000	2004 $'000	Change
Annual listing fees	**263,945**	252,358	5%
Initial and subsequent issue listing fees	**142,075**	119,468	19%
Others	**6,980**	6,601	6%
Total	**413,000**	378,427	9%

The increase in annual listing fees was attributable to the higher number of listed securities. The rise in initial and subsequent issue listing fees was due to the increase in the number of newly listed derivative warrants and newly listed companies on the Main Board, including notably the biggest IPO in Hong Kong, the China Construction Bank Corporation, and the Link REIT during 2005.

Key drivers for annual listing fees

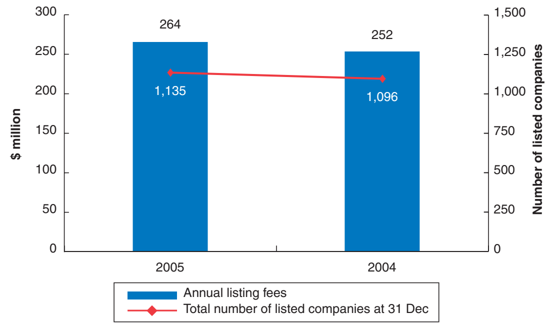
	As at 31 Dec 2005	As at 31 Dec 2004	Change
Number of companies listed on the Main Board	934	892	5%
Number of companies listed on the GEM	201	204	(1%)
Total	1,135	1,096	4%

Key drivers for initial and subsequent issue listing fees

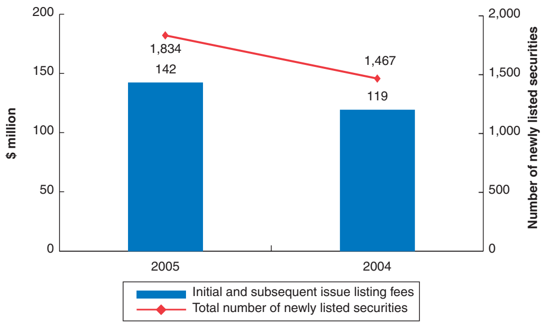
	2005	2004	Change
Number of newly listed derivative warrants	1,682	1,259	34%
Number of newly listed companies on the Main Board	57	49	16%
Number of newly listed companies on the GEM	10	21	(52%)
Number of other newly listed securities on the Main Board and the GEM	85	138	(38%)
Total	1,834	1,467	25%

	2005 $ billion	2004 $ billion	Change
Total equity funds raised on the Main Board	298.2	276.5	8%
Total equity funds raised on the GEM	3.1	5.3	(42%)
Total	301.3	281.8	7%

Annual listing fees increased in line with the total number of listed companies



Initial and subsequent issue listing fees increased in line with the total number of newly listed securities



(C) Income from sale of information

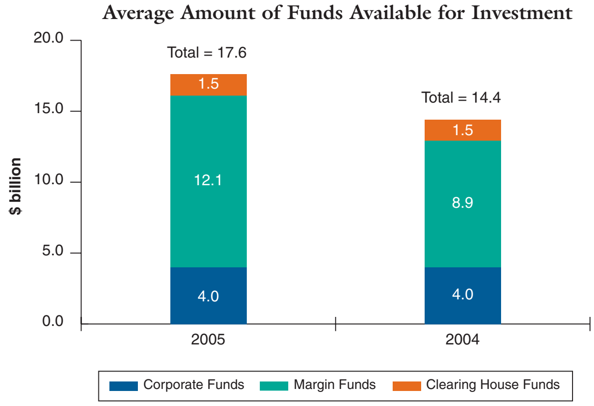
	2005 $'000	2004 $'000	Change
Income from sale of information	322,713	307,633	5%

Income from sale of information rose as demand for information increased in tandem with the activity on the Cash and Derivatives Markets.

(D) Investment income

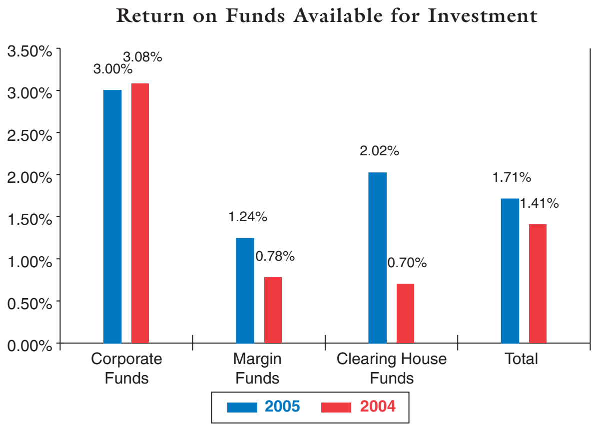
	2005 $'000	2004 $'000	Change
Income from:			
Funds available for investment	300,109	202,955	48%
Investment in Singapore Exchange Limited	–	25,632	(100%)
Total	300,109	228,587	31%

The average amount of funds available for investment was as follows:



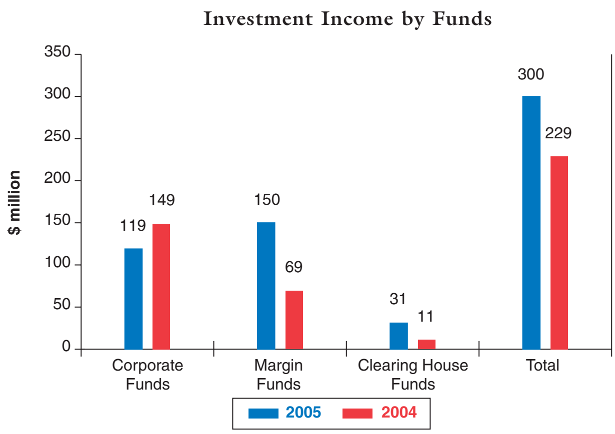
The increase in average amount of Margin Funds during the year was primarily due to increased open interest in futures and options contracts.

The performance of funds available for investment was as set out below:



The return on Margin Funds and Clearing House Funds increased mainly as a result of rising interest rates in 2005. The return on Margin Funds in 2005 was lower than that of the Clearing House Funds as there was a significant increase in margin deposits denominated in Japanese Yen, and Participants were paid interest on all of their margin deposits whereas only certain part of the clearing house contributions was eligible for interest. The return on Corporate Funds declined mainly due to the drop in fair value gains of financial assets held for trading, reflecting market movements due to rising interest rates and a stronger USD.

The movements in total investment income by Funds (including investment in Singapore Exchange Limited) were as follows:



Investment income from Margin Funds increased due to an increase in fund size and rising interest rates in 2005. Investment income from Clearing House Funds increased due to rising interest rates in 2005. The decrease in investment income from Corporate Funds was mainly due to the one-off gain on disposal of the investment in Singapore Exchange Limited of $24.8 million in 2004 and the drop in fair value gains of financial assets held for trading in 2005.

More details of the investment portfolio are set out in the Treasury section under the Business Review.

(E) Other income

	2005 $'000	2004 $'000	Change
Network, terminal user, dataline and software sub-license fees	**129,733**	120,261	8%
Participants' subscription and application fees	**34,351**	34,341	0%
Brokerage on direct IPO applications	**34,123**	17,586	94%
Fair value gain of an investment property	**4,400**	3,300	33%
Accommodation income	**2,154**	5,133	(58%)
Miscellaneous income	**16,256**	8,380	94%
Total	**221,017**	189,001	17%

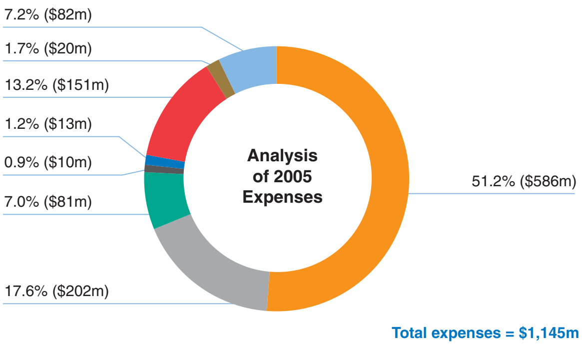
Despite the 20 per cent reduction in AMS/3 user fees that took effect on 1 January 2005, network, terminal user, dataline and software sub-license fees rose due to the increase in sales of additional throttle.

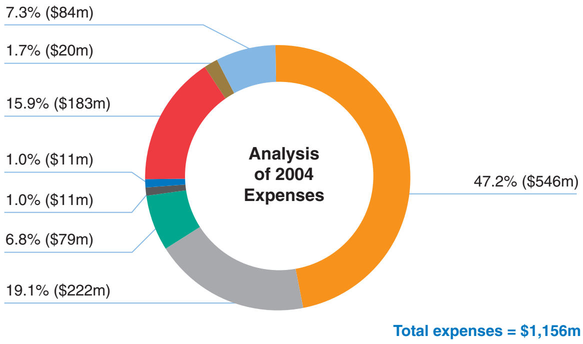
Brokerage on direct IPO applications increased in line with the funds raised by IPOs and unit trusts, in particular the Link REIT.

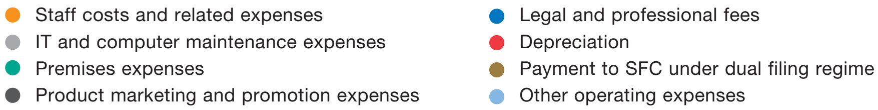
Accommodation income (i.e. retention interest charged on cash margin deposits in non-contract settlement currencies and securities deposited by Participants as alternatives to cash deposits of the Margin Funds) decreased mainly due to less cash margin deposits denominated in non-contract settlement currencies received in the first half of 2005. In addition, from 1 June 2005 onwards, accommodation charges on cash margin deposits were abolished and accommodation fee on utilised non-cash collateral charged by HKCC and SEOCH was reduced from 1.2 per cent and 2 per cent respectively to 0.5 per cent.

Miscellaneous income increased mainly due to an increase in other income from Participants, exchange gains on accounts payable denominated in foreign currencies due to the strengthening HKD and interest on late payment levied on information vendors.

Operating Expenses







	2005 $'000	2004 $'000	Change
Staff costs and related expenses	586,033	545,654	7%
Information technology and computer maintenance expenses	201,725	221,624	(9%)
Premises expenses	80,679	78,833	2%
Product marketing and promotion expenses	10,065	11,263	(11%)
Legal and professional fees	13,641	11,083	23%
Depreciation	150,995	183,400	(18%)
Payment to SFC under dual filing regime	20,000	20,000	0%
Other operating expenses	82,344	84,439	(2%)
Total	1,145,482	1,156,296	(1%)

Staff costs and related expenses increased by $40 million, primarily due to the increase in salary costs and contribution to provident funds of $21 million as a result of the increase in headcount and salary adjustment, and a $10 million increase in performance bonus as a result of the improved performance of the Group in 2005. Employee share-based compensation costs also rose by $9 million due to the costs of share options and shares granted under the Employees' Share Award Scheme ("Awarded Shares") arising from the amortisation of the fair value of the new grants of share options in March 2004, May 2004 and January 2005 and of Awarded Shares in December 2005.

Information technology and computer maintenance expenses of the Group, after excluding goods and services directly consumed by the Participants of $55 million (2004: $61 million), were $147 million (2004: $161 million). The decrease was mainly due to lower system maintenance costs and reduced network line rental charges.

Depreciation decreased as certain fixed assets became fully depreciated.

Other operating expenses decreased mainly as a result of the reduction in bank charges following the expiry of certain banking facilities that were no longer necessary.

Share of Profits less Losses of Associates

	2005 $'000	2004 $'000	Change
Share of profits less losses of associates	18,433	12,884	43%

Share of profits less losses of associates increased due to the higher profitability of one of the associates, CHIS, and the acquisition of a further six per cent interest in CHIS in May 2005.

Taxation

	2005 $'000	2004 $'000	Change
Taxation	**227,460**	193,641	17%

Taxation increased mainly attributable to an increase in operating profit, but partly offset by an increase in non-taxable investment income.

Key Changes to Financial Position

Key changes in the Group's financial position during the year were as follows:

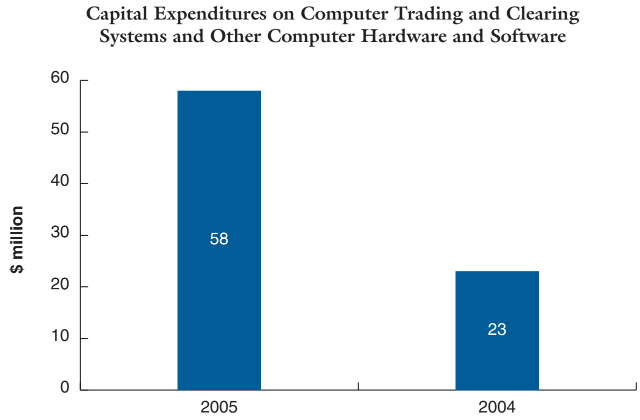
(A) Fixed assets and capital commitments

The Group's fixed assets consisted of leasehold buildings, computer trading and clearing systems, other computer hardware and software and miscellaneous assets such as leasehold improvements.

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.

As at 31 December 2005, the net book value of fixed assets dropped by $66 million compared with 31 December 2004 mainly due to $151 million of depreciation, but partly offset by $86 million of additions during the year. Computer trading and clearing systems and other computer hardware and software decreased by $76 million to $212 million (2004: $288 million), again mainly attributable to depreciation of $134 million, but partly offset by additions of $58 million during the year.

The total additions to computer trading and clearing systems and other computer hardware and software during the years 2005 and 2004 were as follows:



Capital expenditures on computer trading and clearing systems and other computer hardware and software increased during 2005 mainly due to the capacity upgrade of AMS/3.

The Group's capital expenditure commitments as at 31 December 2005, mainly related to the refurbishment of the Trading Hall and the development and purchases of computer systems, amounted to $137 million (2004: $78 million). The Group has adequate internal resources to fund its commitments on capital expenditures.

(B) Funds

	2005 $'000	2004 $'000	Change
Clearing House Funds	**1,340,410**	1,861,487	(28%)
Margin Funds	**13,648,581**	10,529,692	30%
Corporate Funds	**4,196,701**	3,874,370	8%
Total	**19,185,692**	16,265,549	18%

The decrease in Clearing House Funds during the year reflected the decrease in additional contributions from Participants in response to market fluctuations and changes in risk exposure.

The increase in Margin Funds was due to higher open interest in futures and options contracts.

The increase in Corporate Funds in 2005 was mainly due to the profit net of dividends paid during the year.

(C) Significant investments held and material acquisitions and disposals of investments and subsidiaries

There were no material acquisitions or disposals of investments and subsidiaries during the year.

(D) Accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities

	2005 $'000	2004 $'000	Change
CNS money obligations receivable	**2,889,804**	4,261,202	(32%)
Other accounts receivable, prepayments and deposits	**397,031**	430,644	(8%)
Total accounts receivable, prepayments and deposits	**3,286,835**	4,691,846	(30%)
CNS money obligations payable	**2,889,524**	4,261,382	(32%)
Other accounts payable, accruals and other liabilities	**751,546**	640,968	17%
Total accounts payable, accruals and other liabilities	**3,641,070**	4,902,350	(26%)

The Group's accounts receivable, prepayments and deposits and accounts payable, accruals and other liabilities mainly comprised CNS money obligations receivable and payable.

CNS money obligations receivable and payable are recognised when final acceptance of Stock Exchange trades is confirmed on T+1. Settlement will take place on T+2 unless it is not a settlement day in which case settlement will be effected on T+3.

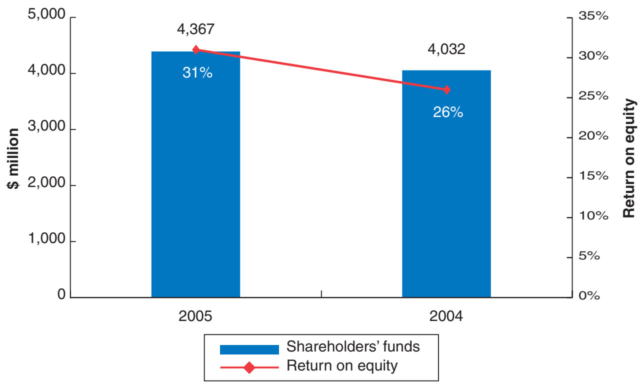
CNS money obligations receivable and payable in 2005 were lower than 2004 as the last trading day in 2004 was not a settlement day when the Stock Exchange was only opened for trading for half a day. Accordingly, the amounts outstanding as at 31 December 2005 represented unsettled transactions for one trading day whereas the amounts as at 31 December 2004 comprised two days of unsettled trades.

(E) Shareholders' funds and return on equity

Shareholders' funds as at 31 December 2005 increased by $335 million to $4,367 million (2004: $4,032 million). The increase was mainly attributable to a $321 million increase in retained profits before transfers to/from designated reserves. Share capital, share premium and employee share-based compensation reserve in aggregate rose by $70 million due to share options exercised and employee share-based compensation benefits recognised during 2005. Investment revaluation reserve, on the contrary, fell by $56 million mainly due to a drop in the fair values of available-for-sale financial assets caused by higher interest rates.

Return on equity rose from 26 per cent in 2004 to 31 per cent in 2005 as profit attributable to shareholders increased.

Shareholders' Funds and Return on Equity



Shareholders' funds and return on equity were boosted by the record high profit of the Group in 2005.

Liquidity, Financial Resources and Gearing

Working capital rose by $292 million or 10 per cent to $3,357 million as at 31 December 2005 (2004: $3,065 million). The increase was primarily due to the profit generated during the year of $1,340 million, which was partly offset by payment of the 2004 final dividend of $498 million and 2005 interim dividend of $521 million, the payment to the Employees' Share Award Scheme of $30 million and the increase in other net current assets of $1 million.

Although the Group has consistently maintained a very liquid position, banking facilities have nevertheless been put in place for contingency purposes. As at 31 December 2005, the Group's total available banking facilities amounted to $1,608 million (2004: $1,608 million), of which $1,500 million (2004: $1,500 million) represented repurchase facilities to augment the liquidity of the Margin Funds.

Borrowings of the Group have been rare and are mostly event driven, with little seasonality. As at 31 December 2005 and 31 December 2004, the Group had no bank borrowings, and therefore had zero gearing.

As at 31 December 2005, 99 per cent (2004: 99 per cent) of the Group's cash and cash equivalents (comprising cash on hand, bank balances and time deposits within three months of maturity when acquired) were denominated in HKD or USD.

Charges on Assets

None of the Group's assets was pledged as at 31 December 2005 and 31 December 2004.

Exposure to Fluctuations in Exchange Rates and Related Hedges

Details of the Group's exposure to fluctuations in exchange rates and related hedges are included in note 46(a)(i) – Foreign exchange risk to the consolidated accounts of this Annual Report.

Contingent Liabilities

In May 2005, the Court of Appeal issued its judgement in the New World and others judicial review appeal case. The Court allowed the appeal and quashed the direction of the Chairman of the Listing (Disciplinary) Committee in the New World disciplinary proceedings that legal advisers not be permitted to address the Listing (Disciplinary) Committee. New World was awarded costs which are presently unknown but estimated to be in the region of $4 million. The Stock Exchange has been granted leave to appeal to the Court of Final Appeal. The appeal is set down to be heard by the Court of Final Appeal on 21 and 22 March 2006. In the opinion of external legal counsel, the Stock Exchange has valid grounds for an appeal, a reasonable prospect of success and consequently it is not probable that the Stock Exchange will be required to bear the costs incurred by New World in the legal proceedings. Accordingly, no provision for such costs has been made in the accounts.

Details of the other contingent liabilities are disclosed in notes 40(a)(i), 40(a)(ii) and 40(b)(i) to the consolidated accounts of this Annual Report.