

Directors' Report

The directors present their annual report and the audited financial statements of the Company and of the Group for the year ended 31 December 2005.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company. The activities of its principal subsidiaries are set out in note 59 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year ended 31 December 2005 are set out in the consolidated income statement on page 55.

An interim dividend of HK\$0.01 per ordinary share, amounting to approximately HK\$11,258,000, was paid to the shareholders during the year. The directors now recommend the payment of a final dividend of HK\$0.01 per ordinary share to the shareholders on the register of members on 17 May 2006.

FIXED ASSETS

Details of movements in the investment properties and property, plant and equipment during the year are set out in notes 20 and 21, respectively, to the financial statements.

HOTELS AND ENTERTAINMENT COMPLEX UNDER DEVELOPMENT

Detail of movements in hotels and entertainment complex under development during the year are set out in note 22 to the financial statements.

SHARE CAPITAL AND SHARE OPTIONS

On 18 May 2005, an ordinary resolution was passed by the shareholders of the Company to approve the subdivision (the "Subdivision") of each issued and unissued share of HK\$1 each in the authorised share capital into two ordinary shares of HK\$0.5 each. The Subdivision became effective on 19 May 2005.

In order to finance the Group's expansion and general operations, the Company issued 140 million ordinary shares of HK\$0.5 each for consideration of HK\$9.125 per share. The issue was made on 20 May 2005 to independent investors. The new shares rank pari passu with the existing shares in all respects.

Details of movements during the year in the share capital and share options of the Company are set out in notes 48 and 50, respectively, to the financial statements.

SUMMARY FINANCIAL INFORMATION

A summary of the published results and assets, liabilities and minority interests of the Group for the last five financial years, as extracted from the audited financial statements and restated and reclassified as appropriate, is set out on page 138. This summary does not form part of the audited financial statements.

Directors' Report

DISTRIBUTABLE RESERVES OF THE COMPANY

At 31 December 2005, the Company's reserves available for distribution consisted of capital reserve of approximately HK\$337,841,000 (2004: HK\$354,009,000) of which HK\$11,604,000 has been proposed as final dividend. The Company considered it has fulfilled those conditions required for distribution of capital reserve. In addition, the Company's share premium account, in the amount of approximately HK\$1,776,248,000 (2004: HK\$567,980,000), may be distributed in the form of fully paid bonus shares. Save as disclosed above, the Company had no reserve available for distribution in accordance with the provisions of section 79B of the Hong Kong Companies Ordinance.

MAJOR CUSTOMERS AND SUPPLIERS

The aggregate revenues attributable to the Group's five largest customers taken together was less than 30% of the Group's total revenues for the year ended 31 December 2005.

The aggregate purchases attributable to the Group's largest supplier and five largest suppliers taken together accounts for 30% and 60% respectively of the Group's total purchases for the year ended 31 December 2005.

None of the directors, their associates, or any shareholder (which to the knowledge of the directors own more than 5% of the Company's issued share capital) has any interest in the Group's five largest suppliers.

DIRECTORS

The directors of the Company during the year and up to the date of this report were:

Executive directors:

Dr. Ho Hung Sun, Stanley (Resigned on 15 March 2006)
 Mr. Ho, Lawrence Yau Lung (Chairman and Chief Executive Officer from 15 March 2006)
 Mr. Tsui Che Yin, Frank

Non-executive directors:

Mr. Ng Ching Wo
 Mr. Ho Cheuk Yuet (Resigned on 5 September 2005)

Independent non-executive directors:

Sir Roger Lobo
 Mr. Kwan Chiu Yin, Robert (Resigned on 15 March 2006)
 Dr. Lo Ka Shui

In accordance with Article 103(A) of the Company's Articles of Association, Sir Roger Lobo and Mr. Ng Ching Wo will retire and, being eligible, will offer themselves for re-election at the forthcoming annual general meeting.

Directors' Report

DIRECTORS' SERVICE CONTRACTS

Each of Mr. Ho, Lawrence Yau Lung and Mr. Tsui Che Yin, Frank has a service contract with Melco Services Limited, a wholly-owned subsidiary of the Company, commencing on 1 January 2005 which may be terminated by either party by written notice of not less than three months.

Save as disclosed above, no director proposed for re-election at the forthcoming annual general meeting has a service contract which is not determinable by the Group within one year without payment of compensation (other than statutory compensation).

DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND CONVERTIBLE LOAN NOTES

As at 31 December 2005, the interests of each director and chief executive and their associates in the shares, underlying shares or convertible loan notes of the Company and its associated corporations, as recorded in the register maintained by the Company pursuant to Section 352 of the Securities and Futures Ordinance ("SFO"), or as otherwise notified to the Company and the Stock Exchange of Hong Kong Limited pursuant to the Model Code for Securities Transactions by Directors of Listed Companies ("Model Code") were as follows:

(i) Long position in shares and underlying shares of the Company

(a) Ordinary shares of HK\$0.50 each of the Company

Name of director	Capacity	Number of issued ordinary shares/ underlying shares held	Approximate percentage of the issued share capital of the Company (Note 1)
Dr. Ho Hung Sun, Stanley	Held by controlled corporations (Note 2)	7,298,456	0.65%
	Beneficial owner	22,749,278	2.02%
Mr. Ho, Lawrence Yau Lung	Held by controlled corporations (Note 3)	404,041,630	35.89%
	Beneficial owner	7,232,612 (Note 4)	0.64%
Mr. Tsui Che Yin, Frank	Beneficial owner	7,232,612 (Note 5)	0.64%
Dr. Lo Ka Shui	Beneficial owner	2,000,000	0.18%

Directors' Report

DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND CONVERTIBLE LOAN NOTES (continued)

(b) Share options of the Company

Name of director	At beginning of year	Granted during year	Exercised during year	At end of year	Date of grant	Exercisable period	Exercise price HK\$
Mr. Ho, Lawrence Yau Lung	1,800,000	-	(1,800,000)	-	19 February 2004	19 February 2005 to 7 March 2012	1.2025
	1,800,000	-	-	1,800,000	19 February 2004	19 February 2006 to 7 March 2012	1.2025
Mr. Tsui Che Yin, Frank	32,612	-	-	32,612	8 March 2002	8 September 2002 to 7 March 2012	0.5000
	1,800,000	-	(1,800,000)	-	19 February 2004	19 February 2005 to 7 March 2012	1.2025
	1,800,000	-	-	1,800,000	19 February 2004	19 February 2006 to 7 March 2012	1.2025
	<u>7,232,612</u>	<u>-</u>	<u>(3,600,000)</u>	<u>3,632,612</u>			

(c) Convertible loan notes of the Company (note 6)

Name of director	Capacity	Number of underlying shares of the Company	Approximate percentage of the issued share capital of the Company (Note 1)
Dr. Ho Hung Sun, Stanley	Held by trust	117,912,694	10.47%
Mr. Ho, Lawrence Yau Lung	Held by trust	117,912,694	10.47%

Notes:

- As at 31 December 2005, the total number of issued shares of the Company is 1,125,838,540.
- Dr. Ho Hung Sun, Stanley is taken to be interested in 7,298,456 shares of the Company as a result of him being beneficially interested in the entire issued share capital of each of Sharikat Investments Limited, Dareset Limited and Lanceford Company Limited which in turn hold an aggregate of approximately 0.65% of the issued share capital of the Company. Apart from that, Dr. Ho Hung Sun, Stanley personally holds 22,749,278 shares of the Company.

Directors' Report

DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND CONVERTIBLE LOAN NOTES (continued)

3. Mr. Ho, Lawrence Yau Lung is taken to be interested in 115,509,024 shares of the Company as a result of him being beneficially interested in the entire issued share capital of Lasting Legend Ltd. which in turn holds approximately 10.26% of the issued share capital of the Company. He is also taken to be interested in 288,532,606 shares of the Company as a result of him being interested in 65% of issued share capital of Better Joy Overseas Ltd. which in turn holds approximately 25.63% of the issued share capital of the Company.
4. The personal interests of Mr. Ho, Lawrence Yau Lung consist of 5,432,612 ordinary shares and 1,800,000 share options.
5. The personal interests of Mr. Tsui Che Yin, Frank consist of 5,400,000 ordinary shares and 1,832,612 share options.
6. Pursuant to an agreement dated 11 May 2005 entered into between Great Respect Limited ("Great Respect"), Melco PBL Entertainment (Greater China) Limited (formerly named as Melco Entertainment Limited) ("Melco PBL Entertainment") and the Company, convertible loan notes of the Company in the total principal amount of HK\$1,175,000,000 were issued to Great Respect on 5 September 2005 on the terms set out in the agreement. Upon exercise in full of such convertible loan notes, a total of 117,912,694 shares, representing 9.48% of the enlarged issued share capital of the Company, will be issued by the Company. Great Respect is a company controlled by a discretionary family trust of Dr. Ho Hung Sun, Stanley, the beneficiaries of which are members of Dr. Ho Hung Sun, Stanley's family including Dr. Ho Hung Sun, Stanley, Mr. Ho, Lawrence Yau Lung and Madam Lucina Laam King Ying. SG Trust (Asia) Ltd. is the trustee of the aforesaid discretionary family trust. The Shareholders have approved the issue of the convertible loan notes without the necessity for the making of an offer under Rule 26 of The Hong Kong Code on Takeovers and Mergers ("Takeovers Code") on conversion of the convertible loan notes. Hence, no offer under Rule 26 of the Takeovers Code would arise on full conversion.

(ii) Long position in shares and underlying shares of the associated corporation of the Company, Value Convergence Holdings Limited ("Value Convergence")

(a) Ordinary shares of HK\$0.1 each of Value Convergence

Name of director	Capacity	Number of issued ordinary shares of Value Convergence held	Approximate percentage of the issued share capital of Value Convergence (Note 1)
Dr. Ho Hung Sun, Stanley	Held by controlled corporation	7,384,651 (Note 2)	2.96%
Mr. Ho, Lawrence Yau Lung	Held by controlled corporation	4,232,627 (Note 3)	1.70%

Directors' Report

DIRECTORS' INTERESTS IN SHARES, UNDERLYING SHARES AND CONVERTIBLE LOAN NOTES (continued)

Notes:

1. As at 31 December 2005, the total number of issued shares of Value Convergence is 249,641,226.
2. Dr. Ho Hung Sun, Stanley is taken to be interested in 7,384,651 shares of Value Convergence as a result of him being beneficially interested in 65% of the issued share capital of Bailey Development Limited which in turn holds approximately 2.96% of the issued share capital of Value Convergence.
3. Mr. Ho, Lawrence Yau Lung is taken to be interested in 4,232,627 shares of Value Convergence as a result of him being beneficially interested in the entire issued share capital of Golden Mate Co., Ltd. which in turn holds approximately 1.70% of the issued share capital of Value Convergence.

(b) Share options of Value Convergence

Name of director	Nature of interest	Number of underlying shares of Value Convergence held	Approximate percentage of the issued share capital of Value Convergence
Mr. Ho, Lawrence Yau Lung	Beneficial owner	491,057 (Note)	0.20%

Note:

The personal interest of Mr. Ho, Lawrence Yau Lung represents his derivative interest in Value Convergence comprising the options which were granted on 9 July 2002 and may be exercised during the period from 9 July 2002 to 8 July 2012 at an exercise price of HK\$1.00 per Value Convergence's share.

Save as disclosed above, none of the directors or chief executives and their associates had any interests or short positions in any shares, underlying shares or convertible loan notes of the Company or any of its associated corporations as at 31 December 2005.

Directors' Report

SUBSTANTIAL SHAREHOLDERS

As at 31 December 2005, the register of substantial shareholders maintained by the Company, pursuant to Section 336 of the SFO shows that the following shareholders had notified the Company of relevant interests and short positions in the issued share capital of the Company.

(a) Ordinary shares of HK\$0.50 each of the Company

Name	Capacity	Number of issued ordinary shares/ underlying shares held	Approximate percentage of the issued share capital of the Company (Note 1)
Better Joy Overseas Ltd.	Beneficial owner	288,532,606 (Note 2)	25.63%
Lasting Legend Ltd.	Beneficial owner	115,509,024 (Note 2)	10.26%
Dr. Ho Hung Sun, Stanley	Held by controlled corporations	7,298,456 (Note 3)	0.65%
	Beneficial owner	22,749,278	2.02%
Mr. Ho, Lawrence Yau Lung	Held by controlled corporations	404,041,630 (Note 4)	35.89%
	Beneficial owner	7,232,612 (Note 5)	0.64%
Ms. Sharen Lo	Family	411,274,242 (Note 6)	36.53%
Shun Tak Shipping Company, Limited	Held by controlled corporations	78,166,294	6.94%
Janus Capital Management LLC	Beneficial owner	91,473,000	8.12%

Directors' Report

SUBSTANTIAL SHAREHOLDERS (continued)

(b) Convertible loan notes

Name	Capacity	Number of underlying shares of the Company	Approximate percentage of the issued share capital of the Company (Note 1)
Great Respect Limited	Beneficial owner	117,912,694 (Note 7)	10.47%
Dr. Ho Hung Sun, Stanley	Held by trust	117,912,694 (Note 7)	10.47%
Mr. Ho, Lawrence Yau Lung	Held by trust	117,912,694 (Note 7)	10.47%
Ms. Sharen Lo	Held by trust	117,912,694 (Note 7)	10.47%
SG Trust (Asia) Ltd.	Held by controlled corporation	117,912,694 (Note 7)	10.47%
Sociedade de Turismo e Diversões de Macau, S.A. ("STDM")	Beneficial owner	85,880,758 (Note 8)	7.63%

Notes:

- As at 31 December 2005, the total number of issued shares of the Company is 1,125,838,540.
- The shares held by Better Joy Overseas Ltd. and Lasting Legend Ltd. also represent the corporate interests of Mr. Ho, Lawrence Yau Lung in the Company.
- Dr. Ho Hung Sun, Stanley is taken to be interested in 7,298,456 shares of the Company as a result of him being beneficially interested in the entire issued share capital of each of Sharikat Investments Limited, Dareset Limited and Lanceford Company Limited which in turn hold an aggregate of approximately 0.65% of the issued share capital of the Company.
- Mr. Ho, Lawrence Yau Lung is taken to be interested in 115,509,024 shares of the Company as a result of him being beneficially interested in the entire issued share capital of Lasting Legend Ltd. which in turn holds approximately 10.26% of the issued share capital of the Company. Mr. Ho, Lawrence Yau Lung is also taken to be interested in 288,532,606 shares of the Company as a result of him being beneficially interested in 65% of the issued share capital of Better Joy Overseas Ltd. which in turn holds approximately 25.63% of the issued share capital of the Company.
- The personal interests of Mr. Ho, Lawrence Yau Lung consist of 5,432,612 ordinary shares and 1,800,000 share options.

Directors' Report

SUBSTANTIAL SHAREHOLDERS (continued)

(b) Convertible loan notes

Notes:

6. Ms. Sharen Lo is the spouse of Mr. Ho, Lawrence Yau Lung and is deemed to be interested in shares of the Company in which Mr. Ho, Lawrence Yau Lung is interested in under the SFO.
7. Pursuant to an agreement dated 11 May 2005 entered into between Great Respect, Melco PBL Entertainment and the Company, convertible loan notes of the Company in the total principal amount of HK\$1,175,000,000 were issued to Great Respect on 5 September 2005 on the terms set out in the agreement. Upon exercise in full of such convertible loan notes, a total of 117,912,694 shares, representing 9.48% of the enlarged issued share capital of the Company, will be issued by the Company. Great Respect is a company controlled by a discretionary family trust of Dr. Ho Hung Sun, Stanley, the beneficiaries of which are members of Dr. Stanley Ho's family including Dr. Ho Hung Sun, Stanley, Mr. Ho, Lawrence Yau Lung and Madam Lucina Laam King Ying. SG Trust (Asia) Ltd. is the trustee of the aforesaid discretionary family trust. The Shareholders have approved the issue of the convertible loan notes without the necessity for the making of an offer under Rule 26 of the Takeovers Code on conversion of the convertible loan notes. Hence, no offer under Rule 26 of the Takeovers Code would arise on full conversion.
8. Two convertible loan notes respectively for the principal amounts of HK\$100 million and HK\$56 million carrying the respectively rights to subscribe for shares at an initial conversion price of HK\$4.00 and HK\$8.2 respectively were issued by the Company to STDM on 9 November 2004 and 8 February 2005 respectively pursuant to two agreements disclosed in the announcements and the circulars of the Company respectively dated 13 September 2004, 11 October 2004, 23 November 2004 and 5 January 2005. As at 31 December 2005, the total outstanding principal amount of the said convertible notes is HK\$156 million. Due to the share subdivision on 19 May 2005, the said conversion prices of HK\$4.00 and HK\$8.2 have been adjusted to HK\$2.00 and HK\$4.1 respectively. If STDM exercises the conversion rights attached to the said convertible notes in full, a total of 63,658,536 shares of the Company will be issued to STDM. STDM's said conversion rights are subject to the Company's early redemption rights and can only be exercised if the Company does not exercise its rights to redeem the convertible loan notes before the conversion rights are exercised.

Save as disclosed above, the register of substantial shareholders maintained by the Company pursuant to section 336 of the SFO discloses no person as having a notifiable interest or short position of the issued share capital of the Company as at 31 December 2005.

ARRANGEMENTS TO PURCHASE SHARES OR DEBENTURES

Save as for the share option scheme disclosed in note 50 to the financial statements, at no time during the year was the Company, or any of its holding companies, subsidiaries or fellow subsidiaries, a party to any arrangements to enable the directors of the Company to acquire benefits by means of the acquisition of shares in, or debentures of, the Company or any other body corporate.

Directors' Report

DIRECTORS' INTERESTS IN CONTRACTS OF SIGNIFICANCE

Save as disclosed in note 57 to the financial statements, no contracts of significance to which the Company, or any of its holding companies, subsidiaries, or fellow subsidiaries, was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

CONNECTED TRANSACTIONS

During the year, the Group has entered into the following connected transactions which are required to be disclosed in accordance with Chapter 14A of the Listing Rules:

1. On 17 March 2005, the Company entered into a conditional agreement ("Third Agreement") with STDM for acquiring the remaining 30% equity interests in a joint venture company, namely Great Wonders, Investments, Limited ("Great Wonders"), held by STDM for a consideration of HK\$400 million. The Company entered into an agreement with STDM on 8 September 2004 ("First Agreement") and another agreement on 11 November 2004 ("Second Agreement") whereby the Company acquired 50% equity interest in Great Wonders for a consideration of HK\$100 million under the First Agreement and then further acquired 20% equity interest in Great Wonders for a consideration of HK\$56 million under the Second Agreement. Details of the First Agreement had been disclosed in the announcement and circular of the Company dated 13 September 2004 and 11 October 2004 respectively. Details of the Second Agreement had been disclosed in the announcement and circular of the Company dated 23 November 2004 and 5 January 2005 respectively. With the completion of the First Agreement and the Second Agreement on 9 November 2004 and 8 February 2005, the Group's equity interest in Great Wonders increased to 70%. The consideration of HK\$400 million payable under the Third Agreement would be satisfied by the Company, as to HK\$200 million, by way of cash payment upon completion and as to the balance of HK\$200 million, by way of issue of 22,222,222 new shares of the Company at an issue price of HK\$9.00 per share ("Consideration Shares") to STDM upon completion or the actual date of the grant of the concession of a parcel of land with an area of 5,230 square meters located at Baixa da Taipa, Macau ("Land") by the Macau Government to Great Wonders, whichever was later. STDM was a connected person for the purpose of the Listing Rules by virtue of the fact that Dr. Stanley Ho, who was the Chairman and Executive Director of the Company prior to 15 March 2006, had an equity interest in, as well as being a director of, STDM. As a result, the Third Agreement and the issue of the Consideration Shares constituted a major and connected transaction for the Company. The Third Agreement and all transactions contemplated thereunder had been approved by the independent shareholders of the Company at an extraordinary general meeting held on 17 June 2005. Details of the Third Agreement and the transactions contemplated thereunder had been disclosed in the announcement and the circular of the Company dated 22 March 2005 and 2 June 2005 respectively. The Consideration Shares were issued by the Company to STDM on 1 March 2006, being the date of grant of the concession of the Land by the Macau Government to Great Wonders.

Directors' Report

CONNECTED TRANSACTIONS (continued)

2. Mocha Slot Management Limited ("Mocha Management"), a wholly-owned subsidiary of Mocha Slot Group Limited ("Mocha Slot") and a non-wholly owned subsidiary of the Company within the Melco PBL Joint Venture, had entered into the Slot Halls Service Arrangement comprising four separate service agreements in identical terms (dated 21 March 2005 in respect of the three slot halls located at Hotel Royal, Kingsway Commercial Centre and San Kin Yip Building and dated 22 March 2005 in respect of the slot hall located at Hotel Taipa Square) with Sociedade de Jogos de Macau, S.A. ("SJM"), being a subsidiary of STDM, for the provision of certain services in relation to the operation of certain slot halls of SJM in Macau for an initial period of five years commencing from the respective dates of the agreements. Subject to the approval of the Macau Government, after expiration of the initial five year period, the service period can be extended for equal periods of five years each. The Slot Halls Service Arrangement replaced the fixed ten year Equipment Lease Agreements (details of which had been disclosed in the announcements and circular of the Company dated 1 April 2004, 13 April 2004 and 23 April 2004 respectively). Subsequently in the second half of 2005, Mocha Management entered into two additional service agreements dated 6 September 2005 (in respect of slot hall located at Hotel Taipa) and 1 December 2005 (in respect of slot hall located at Hotel Sintra) respectively with identical terms of the previously executed service agreements with SJM for the provision of the same services to the said two additional slot halls. SJM was a connected person for the purpose of the Listing Rules by virtue of the fact that Dr. Stanley Ho, who was the Chairman and Executive Director of the Company before 15 March, 2006, had an equity interest in, as well as being a director of, SJM and STDM respectively.

As the services under the Slot Halls Service Arrangement are to be provided to SJM on a continuing basis, the Slot Halls Service Arrangement and all transactions contemplated thereunder constituted a continuing connected transaction for the Company under the Listing Rules. In consideration for the provision of the services, Mocha Management shall be entitled to receive a monthly service fee from SJM representing 31% of the aggregate gross income of all the electronic gaming machines installed in the sites in the relevant month. Gross income of each electronic gaming machines is defined as the net win from each such machine before deduction of any tax or levy as prescribed by the relevant legislations or rules in Macau. By taking into account various statistics available in relation to the gaming industry in Macau and assuming a daily net win of HK\$1,500 per electronic gaming machine installed in the sites, the 31% of the aggregate amount payable by SJM to Mocha Management will not exceed HK\$146.82 million, HK\$238.91 million and HK\$528.49 million for each of the three financial years ending 31 December 2007 respectively ("Annual Caps"). The Slot Halls Service Arrangement and the Annual Caps had been approved by the independent shareholders of the Company at an extraordinary general meeting of the Company held on 18 May 2005. Details of such continuing connected transaction had been disclosed in the announcement and circular of the Company dated 11 April 2005 and 29 April 2005 respectively.

Reference is made to the announcements made by the Company dated 9 March 2006 and 23 March 2006 respectively. In contemplation of the potential grant of a gaming subconcession in Macau to PBL Macau ("Subconcession") as disclosed in the Company's announcement dated 9 March 2006 and the continuation of the slot halls business under the Subconcession, the Company, Mocha Slot, Mocha Management and SJM entered into a legally binding Termination Agreement on 15 March 2006 pursuant to which both Mocha Management and SJM agree to amicably terminate the service agreements signed under the Slot Halls Service Arrangement in respect of all six slot halls upon the obtaining of the Subconcession by PBL Macau. Details of the termination of the Slot Halls Service Arrangement had been disclosed in the announcement of the Company dated 23 March 2006.

Directors' Report

CONNECTED TRANSACTIONS (continued)

3. On 13 April 2005, Elixir Group (Macau) Limited ("Elixir Macau") had conditionally entered into a service arrangement with SJM for the provision of system integration services and related maintenance services (the "Service Arrangement") for the respective amounts of approximately HK\$48.18 million and HK\$2.75 million. SJM was a connected person for the purpose of the Listing Rules by virtue of the fact that Dr. Stanley Ho, who was the Chairman and Executive Director of the Company prior to 15 March 2006, had an equity interest in, as well as being a director of, SJM and STDM respectively. Accordingly, the Service Arrangement and all transactions contemplated thereunder constituted connected transaction for the Company. The provision of the relevant system integration services and related maintenance services to SJM by Elixir Macau had been approved by the independent shareholders of the Company at an extraordinary general meeting of the Company held on 18 May 2005. Details of the Service Arrangement were set out in the announcement and circular of the Company dated 13 April 2005 and 29 April 2005 respectively.

4. On 20 December 2005, Elixir Macau had conditionally entered into service arrangements with each of SJM and Mocha Slot respectively, for the provision of system integration services and related maintenance services to SJM for an aggregate value of about HK\$69.02 million and about HK\$1.51 million respectively and for the provision of system integration services to Mocha Slot for an aggregate value of about HK\$142.58 million (the "Second Service Arrangements"). SJM was a connected person for the purpose of the Listing Rules by virtue of the fact that Dr. Stanley Ho, who was the Chairman and Executive Director of the Company prior to 15 March 2006, had an equity interest in, as well as being a director of, SJM and STDM respectively. Also, by reason of the fact that Dr. Stanley Ho has an equity interest in Mocha Slot, Mocha Slot is considered as a connected person of the Company under the Listing Rules. Accordingly, the Second Service Arrangements and all transactions contemplated thereunder constituted connected transactions for the Company. The Second Service Arrangements and transactions contemplated thereunder had been approved by the independent shareholders of the Company at an extraordinary general meeting of the Company held on 22 February 2006. Details of the Second Service Arrangements were set out in the announcement and the circular of the Company dated 20 December 2005 and 10 January 2006 respectively.

Directors' Report

CONNECTED TRANSACTIONS (continued)

- On 10 May 2005, Melco Hotels and Resorts (Macau) Limited ("Melco Hotels"), a wholly-owned subsidiary of the Company as at 10 May 2005, accepted in principle an offer from the Macau Government to grant to Melco Hotels a long term lease in respect of a plot of land with an area of approximately 113,325 square metres in Taipa, Macau on the Cotai Strip, for the construction and development of an integrated entertainment resort, now known as "The City of Dreams". Melco Entertainment Limited (now known as "Melco PBL Entertainment (Greater China) Limited") ("Melco Entertainment") is a company which is indirectly owned as to 80% by Melco PBL Holdings Limited and as to the balance of 20% by Melco Leisure and Entertainment Group Limited ("Melco Leisure"). Melco Leisure is a wholly-owned subsidiary of the Company while Melco PBL Holdings Limited is a 50/50 joint venture between the Company and Publishing and Broadcasting Limited ("PBL"). On 11 May 2005, Melco Entertainment entered into a conditional agreement ("1st Agreement") with Great Respect Limited ("Great Respect") and the Company, pursuant to which Melco Entertainment agreed to purchase 49.2% interest in the joint venture established under the Memorandum of Agreement dated 28 October 2004 between Melco Leisure and Great Respect ("Joint Venture") for a cash consideration of HK\$1,175 million and Great Respect had undertaken to immediately subscribe the entire amount of the consideration to be received by it on completion of the 1st Agreement for convertible loan notes ("Convertible Loan Notes") due 2010 to be issued by the Company and subscribed by Great Respect under the 1st Agreement and conferring the right to subscribe for new shares at an initial conversion price of HK\$9.965 per new shares, subject to adjustment in accordance with the terms and conditions of the Convertible Loan Notes. On 11 May 2005, Melco Entertainment also entered into another conditional agreement ("2nd Agreement") with Melco Leisure pursuant to which Melco Leisure will transfer its 50.8% interest in the Joint Venture and its interest in Melco Hotels to Melco Entertainment, in accordance with the requirements of the Shareholders Agreement dated 8 March 2005 ("Shareholders Agreement") between the Company and PBL and the Declaration Agreement dated 9 March 2005 between Melco Leisure and Melco Entertainment and in consideration of the mutual benefits to be derived by, and reciprocal covenants of, the Company and PBL under the Shareholders Agreement. Completion of the 1st Agreement and the 2nd Agreement were not inter-conditional. Since Great Respect was a company controlled by a discretionary family trust of Dr. Stanley Ho, who was the Chairman and Executive Director (prior to 15 March 2006), and a connected person of the Company, accordingly the 1st Agreement constituted a connected transaction of the Company under Chapter 14A of the Listing Rules which is also a very substantial acquisition for the Company under Chapter 14 of the Listing Rules. The 1st Agreement and the 2nd Agreement and the transactions contemplated thereunder had been approved by the independent shareholders of the Company at an extraordinary general meeting of the Company held on 10 August 2005. Details of the 1st Agreement and the 2nd Agreement were set out in the announcement and the circular of the Company dated 13 May 2005 and 22 July 2005 respectively. Completions of the 1st Agreement and the 2nd Agreement took place on 5 September 2005. Melco Hotels became a wholly-owned subsidiary of Melco Entertainment as of 3 November 2005.

Directors' Report

CONNECTED TRANSACTIONS (continued)

6. On 30 August 2005, Melco Investment Holdings Limited ("Melco Investment"), a wholly-owned subsidiary of the Company, acquired the title to units C, D, E of Ground Floor of Kingsway at Rua de Luis Gonzaga Gomes No.176-230, Rua De Nagasaki No.64A to 82 and Rua de Xiamen No.37A to 59, Macau ("Macau Property") from the registered owner, namely San Pong Investment Company Limited ("San Pong"), an independent third party which engages in the business of property development in Macau pursuant to a sale and purchase agreement dated 29 July 2005 for a consideration of HK\$45,000,000. The Macau Property was acquired by the Company for investment purpose. Prior to the acquisition, the Macau Property had been leased by San Pong to Mocha Slot under a lease dated 28 December 2003 ("Lease"), which in turn sub-leased such property on identical terms of the Lease to SJM for operation of an electronic gaming machines lounge in September 2004 ("Sub-Lease"). Since the Lease and the Sub-Lease remain valid and effective and binding on Melco Investment after its acquisition of the Macau Property and both Mocha Slot and SJM were connected persons of the Company for the purpose of the Listing Rules by virtue of the fact that Dr. Stanley Ho, who was the Chairman and Executive Director of the Company before 15 March 2006, had 20% equity interests in Mocha Slot and an equity interest in, as well as being a director of, SJM and STDM respectively, the Lease constituted a continuing connected transaction for the Company of the Listing Rules but was exempt from the independent shareholders' requirement under the Listing Rules by virtue of the fact that each of the relevant percentage ratios is on an annual basis equal to or more than 2.5% but less than 25% and the annual consideration is less than HK\$10,000,000 and the Sub-Lease constituted an exempt continuing connected transaction for the Company by reason of the fact that SJM is not required to pay any rentals under the Sub-Lease to Mocha Slot (as the rentals of the Macau Property are to be borne by Mocha Management under the Slot Halls Service Arrangement as detailed in paragraph 2 above). The rentals, receivable by Melco Investment from Mocha Slot under the Lease, are subject to the annual caps of HK\$640,000 for the year ending 31 December 2005, HK\$2,112,000 for the respective years ending 31 December 2006 and 31 December 2007, HK\$2,323,200 for the respective years ending 31 December 2008 and 31 December 2009, HK\$2,555,520 for the respective years ending 31 December 2010 and 31 December 2011 and HK\$2,811,120 for the respective years ending 31 December 2012 and 31 December 2013. Details of this continuing connected transaction were set out in the announcement of the Company dated 9 September 2005.

Pursuant to Rule 14A.38 of the Rules Governing the Listing Securities on The Stock Exchange of Hong Kong Limited ("Listing Rules"), the board of directors engaged the auditors of the Company to perform certain agreed upon procedures in respect of the continuing connected transactions mentioned in paragraphs (2) and (6) above as required under the aforesaid Listing Rules. The auditors have reported their factual findings on these procedures to the board of directors. The independent non-executive directors have reviewed the continuing connected transactions and the report of the auditors and have confirmed that the transactions have been entered into by the Company in the ordinary course of its business, on normal commercial terms, and in accordance with the terms of the agreement governing such transactions that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

Disclosure of the abovementioned continuing connected transaction and connected transactions of the Group have been made in compliance with the disclosure requirements under Chapter 14A of the Listing Rules.

Directors' Report

CONNECTED TRANSACTIONS (continued)

Apart from the foregoing, none of the related party transactions set out in note 57 to the financial statements fall under the definition of "connected transaction" or "continuing connected transaction" in Chapter 14A of the Listing Rules.

POST BALANCE SHEET EVENTS

Details of the significant post balance sheet events of the Group are set out in note 58 to the financial statements.

DIRECTORS' INTERESTS IN COMPETING BUSINESSES

Dr. Stanley Ho and Madam Lucina Laam King Ying, have direct or indirect beneficial interests in Shun Tak Holdings Limited, its subsidiaries and associates (the "Shun Tak Group") as shareholders. In addition, Dr. Stanley Ho has beneficial interests in STDM, its subsidiaries and associates (the "STDM Group") as shareholders. Further, Dr. Stanley Ho is a director of the Shun Tak Group and the STDM Group.

During the year and up to the date of this report, the businesses of property investment and hospitality (which includes restaurant operations) carried out by the Shun Tak Group and the STDM Group were considered to compete or are likely to compete, either directly or indirectly, with the businesses of the Group.

Dr. Stanley Ho is actively involved in the management of the Shun Tak Group.

Dr. Stanley Ho is also actively involved in the management of the STDM Group which operates principally outside Hong Kong.

As the board of directors of the Company is independent of the boards of the Shun Tak Group and the STDM Group, the Group is therefore capable of carrying on such businesses independently of, and at an arm's length from the businesses of these companies.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

There was no purchase, sales or redemption by the Company or any of its subsidiaries, of the Company's listed securities during the year ended 31 December 2005.

EMOLUMENT POLICY

The employees of the Group are selected, remunerated and promoted on the basis of their merit, qualifications and competence.

The emoluments of the directors of the Company are decided by the Remuneration Committee, having regard to the Company's operating results, individual performance and comparable market standards.

The Company has adopted a share option scheme as an incentive to directors and eligible employees, details of the scheme are set out in note 50 to the financial statements.

INDEPENDENT NON-EXECUTIVE DIRECTORS

Confirmation of independence has been received from each of the Independent Non-executive Directors of the Company and the Company considers all existing independent non-executive directors to be independent.

Directors' Report

AUDIT COMMITTEE

The Company has an audit committee which was established for the purposes of reviewing and providing supervision over the Group's financial reporting process and internal controls.

The audit committee, comprising a non-executive and two independent non-executive directors, met two times during the financial year. During the meetings, the audit committee reviewed the accounting principles and practices adopted by the Group, the interim and annual reports of the Group, connected transactions and discussed with management the auditing, internal control and financial reporting matters.

SUFFICIENCY OF PUBLIC FLOAT

The Company has maintained a sufficient public float throughout the year ended 31 December 2005.

DONATIONS

During the year, the Group made charitable and other donations amounting to approximately HK\$726,000.

AUDITORS

Messrs. Deloitte Touche Tohmatsu have been appointed as auditors of the Company since the retirement of Messrs. PricewaterhouseCooper at the 2005 annual general meeting of the Company held on 18 May 2005. A resolution will be submitted to the forthcoming Annual General Meeting to re-appoint Messrs. Deloitte Touche Tohmatsu as auditors of the Company.

On behalf of the Board

Ho, Lawrence Yau Lung

Chairman & Chief Executive Officer

Hong Kong

31 March 2006