

MERCANTILE COMPANY LIMITED
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

Registered Number 37670



MERCANTILE COMPANY LIMITED

REPORT OF THE DIRECTORS

The Directors have pleasure in submitting their annual report together with the audited financial statements for the year ended 31 December 2006

PERFORMANCE AND DIVIDENDS

The results of the Company for the year ended 31 December 2006 and the state of the Company's affairs at that date are set out on pages 6 to 14

The Directors approved the payment of an interim dividend of GBP120,000 (2005 GBP120,000) in respect of the year ended 31 December 2006 on 26 April 2007. The Directors have not recommended a final dividend for the year ended 31 December 2006

PRINCIPAL ACTIVITIES, PRINCIPAL PLACE OF BUSINESS AND BUSINESS REVIEW

The Company is an investment company. It is a company incorporated and domiciled in the United Kingdom. Its registered office is 8 Canada Square, London, E14 5HQ, United Kingdom. Its principal place of business is 1 Queen's Road Central, Hong Kong. The Company does not hold any investment in recent years and deposits the surplus cash with a fellow subsidiary company to earn interest income.

FUTURE DEVELOPMENTS

No change in the Company's activities is anticipated.

RISK MANAGEMENT

The financial risk management objectives and policies of the Company together with an analysis of the exposure to such risks as required under the Companies Act are set out in Note 8 of these financial statements.

DIRECTORS

The Directors who served during the year were

E D Ancona (appointed on 15 June 2006)

V W De Alwis

S J Glass (resigned on 23 March 2006)

K S Y Ng

DIRECTORS' INTERESTS

According to the Register of Directors' Interests kept by the Company under Section 325 of the Companies Act 1985, the undernamed Directors of the Company had the following interests in HSBC Holdings plc (the Company's ultimate holding company)

Ordinary shares and share options

	Ordinary shares held at 1 January 2006	Ordinary shares held at 31 December 2006	Options held at 1 January 2006	Options granted during the year	Options exercised during the year	Options held at 31 December 2006
V W De Alwis	-	-	1,141	-	-	1,141
E D Ancona	# 217,567	217,567	# 515,288	-	-	515,288
K S Y Ng	35,802	** 27,312	-	-	-	-

Restricted Share Plan / The HSBC Share Plan

	Awards held at 1 January 2006	Awards made during the year	Awards held at 31 December 2006
V W De Alwis	1,561	3,454	5,171 ****
E D Ancona	# 67,231	-	68,369 *
K S Y Ng	73,501	15,513	74,639 ***

As at date of appointment

* Including scrip dividends received during the year

** Including shares released, disposal of shares and scrip dividends received during the year

*** Including scrip dividends received and shares released during the year

**** Including scrip dividends received during the year

SUPPLIER PAYMENT POLICY

The HSBC Group subscribes to the Better Payment Practice Code for all suppliers, the four principles of which are to agree payment terms at the outset and stick to them, to explain payment procedures to suppliers, to pay bills in accordance with any contract agreed with the supplier or as required by law, and to tell suppliers without delay when an invoice is contested and settle disputes quickly. Copies of, and information about, the Code are available from the Department of Trade and Industry, No 1 Victoria Street, London SW1H 0ET.

During the year the HSBC Group received certain goods and services from group undertakings. Part VI of Schedule 7 of the Companies Act 1985, setting out reporting requirements in relation to the policy and practice on payment of creditors is, therefore, not applicable.

DISCLOSURE OF INFORMATION TO AUDITORS

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware, and each Director has taken all the steps that they ought to have taken as a Director to make them self aware of any relevant audit information and to establish that the Company's auditors are aware of that information. This confirmation is given and should be interpreted in accordance with the provisions of Section 234ZA of the Companies Act 1985.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT TO FINANCIAL STATEMENTS

The following statement, which should be read in conjunction with the Auditors' statement of their responsibilities set out in their report on page 4, is made with a view to distinguishing for shareholders the respective responsibilities of the Directors and of the Auditors in relation to the financial statements

The Directors are responsible for preparing the Directors' Report and financial statements for the period ended 31 December 2006 in accordance with applicable law and regulations

Company law requires the Directors to prepare financial statements for each financial year. Under that law, they have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU).

The financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position of the Company and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing the financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent, and
- state whether they have been prepared in accordance with IFRSs as adopted by the EU.

The Directors are required to prepare the financial statements on the going concern basis unless it is not appropriate. Since the Directors are satisfied that the Company has the resources to continue in business for the foreseeable future, the financial statements continue to be prepared on the going concern basis.

The Directors have responsibility for ensuring that sufficient accounting records are kept that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its financial statements comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.



On behalf of the Board
Mimi Lam, Secretary

13 AUG 2007

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MERCANTILE COMPANY LIMITED

We have audited the financial statements of Mercantile Company Limited for the year ended 31 December 2006 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Changes in Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 3.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

BASIS OF AUDIT OPINION

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

OPINION

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the financial statements.



KPMG Audit Plc
Chartered Accountants
Registered Auditor, London

13 August 2007

MERCANTILE COMPANY LIMITED
Income Statement
for the year ended 31 December 2006

	<i>Note</i>	2006 £'000	2005 £'000
Interest income from bank deposits placed with fellow subsidiary company		134	135
Exchange gain/(loss)		<u>1</u>	<u>(1)</u>
Net operating income		135	134
General and administrative expenses	3	<u>(2)</u>	<u>(2)</u>
Profit before tax		133	132
Tax expense	4	<u>-</u>	<u>-</u>
Profit after tax		<u><u>133</u></u>	<u><u>132</u></u>

The notes on pages 10 to 14 form part of these financial statements


MERCANTILE COMPANY LIMITED

**Balance Sheet
as at 31 December 2006**

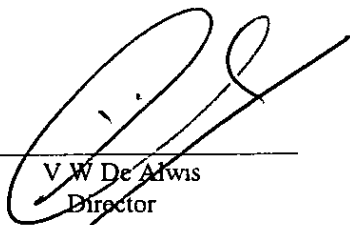
	<i>Note</i>	2006 £'000	2005 £'000
ASSETS			
Bank deposits placed with fellow subsidiary company		3,158	3,145
Interest receivable from bank deposits placed with fellow subsidiary company		<u>26</u>	<u>25</u>
Total assets		<u>3,184</u>	<u>3,170</u>
LIABILITIES			
Amount due to immediate holding company	6	10	9
Other liabilities		<u>2</u>	<u>2</u>
Total liabilities		<u>12</u>	<u>11</u>
EQUITY			
Called up share capital	7	3,000	3,000
Retained earnings		172	159
Total equity		<u>3,172</u>	<u>3,159</u>
Total equity and liabilities		<u>3,184</u>	<u>3,170</u>

Approved by the Board of Directors on **13 AUG 2007**

Signed on behalf of the Board



E D Ancona
Director



V W De Alwis
Director

The notes on pages 10 to 14 form part of these financial statements

MERCANTILE COMPANY LIMITED
Statement of Changes in Equity
for the year ended 31 December 2006

	<i>Note</i>	<u>Share Capital</u> £'000	<u>Retained Earnings</u> £'000	<u>Total Equity</u> £'000
At 1 January 2006		3,000	159	3,159
Profit for the year attributable to shareholders		-	133	133
Dividends paid in respect of the previous year	5	-	(120)	(120)
At 31 December 2006		<u>3,000</u>	<u>172</u>	<u>3,172</u>

		<u>Share Capital</u> £'000	<u>Retained Earnings</u> £'000	<u>Total Equity</u> £'000
At 1 January 2005				
- As previously reported		3,000	27	3,027
- Effect of adoption of IAS 10		-	110	110
- As restated		<u>3,000</u>	<u>137</u>	<u>3,137</u>
Profit for the year attributable to shareholders		-	132	132
Dividends paid in respect of the previous year	5	-	(110)	(110)
At 31 December 2005		<u>3,000</u>	<u>159</u>	<u>3,159</u>

MERCANTILE COMPANY LIMITED
Cash Flow Statement
for the year ended 31 December 2006

	2006 £'000	2005 £'000
Cash flows from operating activities		
Profit before taxation	133	132
Adjustment for Interest income	<u>(134)</u>	<u>(135)</u>
Cash used in operations	(1)	(3)
Interest received	<u>133</u>	<u>137</u>
Net cash from operating activities	<u>132</u>	<u>134</u>
Cash flows from financing activities		
Increase in amount due to immediate holding company	1	3
Ordinary dividends paid	<u>(120)</u>	<u>(110)</u>
Net cash used in financing activities	<u>(119)</u>	<u>(107)</u>
Net increase in cash and cash equivalents	13	27
Cash and cash equivalents at 1 January	<u>3,145</u>	<u>3,118</u>
Cash and cash equivalents at 31 December	<u><u>3,158</u></u>	<u><u>3,145</u></u>

MERCANTILE COMPANY LIMITED
Notes on the Financial Statements

1. SIGNIFICANT ACCOUNTING POLICIES

(a) Statement of compliance

Mercantile Company Limited (the Company) has prepared its financial statements in accordance with International Financial Reporting Standards (IFRSs) as endorsed by the European Union (EU). EU-endorsed IFRSs may differ from IFRSs as published by the International Accounting Standards Board (IASB) if, at any point in time, new or amended IFRSs have not been endorsed by the EU. At 31 December 2006, there were no unendorsed standards effective for the year ended 31 December 2006 affecting the financial statements, and there was no difference in application to the Company between IFRSs endorsed by the EU and IFRSs issued by the IASB.

IFRSs comprise accounting standards issued by the IASB and its predecessor body as well as interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and its predecessor body. A summary of the significant accounting policies adopted by the Company is set out below.

(b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is the historical cost basis.

The preparation of financial statements in conformity with IFRSs as endorsed by the EU requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

(c) Payables

Payables are initially recognised at fair value and subsequently stated at amortised cost unless the effect of discounting would be immaterial, in which case they are stated at cost.

(d) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

(e) Interest income

Interest on bank deposits is recognised as it accrues using the effective interest method.

(f) Translation of foreign currencies

Foreign currency transactions during the year are translated at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies and non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated at the foreign exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in profit or loss.

1. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(g) Related parties

For the purposes of these financial statements, a party is considered to be related to the Company if

- (i) the party has the ability, directly or indirectly through one or more intermediaries, to control the Company or exercise significant influence over the Company in making financial and operating policy decisions, or has joint control over the Company,
- (ii) the Company and the party are subject to common control,
- (iii) the party is a subsidiary, an associate of the Company or a joint venture in which the Company is a venturer,
- (iv) the party is a member of key management personnel of the Company or the Company's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals,
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals, or
- (vi) the party is a post-employment benefit plan which is for the benefit of employees of the Company or of any entity that is a related party of the Company

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity

2. EMOLUMENTS OF DIRECTORS AND EMPLOYEES

No directors' emoluments were incurred during the year (2005 nil) No staff were employed during the year (2005 nil), and consequently no employee costs were incurred

3. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses include a charge of £2K (2005 £2K) audit fees payable to the auditor for the Company's audit

4. TAX CHARGE ON PROFIT ON ORDINARY ACTIVITIES

The Company is not resident in the United Kingdom for taxation purposes and accordingly no provision for United Kingdom taxation has been made

5. DIVIDENDS

(a) Dividends payable to equity shareholders of the Company attributable to the year:

	2006 £'000	2005 £'000
Interim dividend proposed after the balance sheet date	<u>120</u>	<u>120</u>

The interim dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date

(b) Dividends payable to equity shareholders of the Company attributable to the previous financial year, approved and paid during the year:

	2006 £'000	2005 £'000
Interim dividend in respect of the previous financial year, approved and paid during the year	<u>120</u>	<u>110</u>

6. AMOUNT DUE TO IMMEDIATE HOLDING COMPANY

The amount due to the immediate holding company, The Hongkong and Shanghai Banking Corporation Limited, is unsecured, non-interest bearing and repayable on demand

7 SHARE CAPITAL

	2006 Number of shares in thousands	2005 Number of shares in thousands	2006 £'000	2005 £'000
Authorised				
Ordinary shares of £1 each, at 1 January and 31 December	5,509	5,509	5,509	5,509
Deferred ordinary shares of £1 each, at 1 January and 31 December	<u>1,991</u>	<u>1,991</u>	<u>1,991</u>	<u>1,991</u>
	<u>7,500</u>	<u>7,500</u>	<u>7,500</u>	<u>7,500</u>
Allotted, called-up and fully paid				
Ordinary shares of £1 each, at 1 January and 31 December	1,009	1,009	1,009	1,009
Deferred ordinary shares of £1 each, at 1 January and 31 December	<u>1,991</u>	<u>1,991</u>	<u>1,991</u>	<u>1,991</u>
	<u>3,000</u>	<u>3,000</u>	<u>3,000</u>	<u>3,000</u>

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All ordinary shares rank equally with regard to the Company's residual assets and are subject to the rights of the holders of Deferred shares on distribution of assets upon winding up as described below.

The holders of Deferred shares are entitled to a fixed non-cumulative dividend at the rate of 5 per cent per annum for any financial year of the Company in respect of which the net profits of the Company available for dividend (as certified by the auditors of the Company whose decision shall be final and binding) exceed £100,000,000.

7. SHARE CAPITAL (CONT'D)

On a winding up, the holders of the Deferred shares shall be entitled out of the surplus assets of the Company to a return of the capital paid up on the Deferred shares held by them respectively after a total sum of £1,000,000 has been distributed in such winding up in respect of each of the Ordinary shares of £1 each of the Company

The holders of the Deferred shares shall not be entitled to any participation in the profits or assets of the Company

The Deferred shares shall not entitle the holders thereof to attend or vote at any General Meeting of the Company by virtue or in respect of their holdings of such Deferred shares

8. FINANCIAL INSTRUMENTS

Exposure to credit, liquidity, interest rate and foreign currency risks arises in the normal course of the Company's business. These risks are limited by the Company's financial management policies and practice described below

(a) Credit risk

Credit risk represents the potential loss that the Company would incur if counterparties fail to perform pursuant to the terms of their obligations to the Company. The Company limits its credit risk by carrying out transactions through established reputable institutions. At the balance sheet date, there was no significant credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet.

(b) Liquidity risk

The Company's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash to meet its liquidity requirements in the short and longer term.

(c) Interest rate risk

Cash and cash equivalents of the Company are subject to short term interest rate repricing and are not subject to significant interest rate risk. Other financial assets are non-interest bearing.

(d) Foreign currency risk

The Company is not subject to significant foreign currency risk.

(e) Fair values

All financial instruments are carried at amounts not materially different from their fair value as at 31 December 2006 and 2005.

9. MATERIAL RELATED PARTY TRANSACTIONS

Other than the transactions and balances disclosed elsewhere in these financial statements, the Company did not enter into any material related party transactions during the year.

10. IMMEDIATE AND ULTIMATE CONTROLLING PARTY

At 31 December 2006, the directors consider the immediate parent of the Company to be The Hongkong and Shanghai Banking Corporation Limited, which is incorporated in Hong Kong and the ultimate controlling party of the Company to be HSBC Holdings plc, which is incorporated in England. Both entities produce consolidated financial statements available for public use.

11 POSSIBLE IMPACT OF AMENDMENTS, NEW STANDARDS AND INTERPRETATIONS ISSUED BUT NOT YET EFFECTIVE FOR THE PERIOD ENDED 31 DECEMBER 2006

Up to the date of issue of these financial statements, a number of amendments, new standards and interpretations have been issued which are not yet effective for the accounting period ended 31 December 2006 and which have not been adopted in these financial statements

The Company is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that while the adoption of them is unlikely to have a significant impact on the Company's results of the operations and financial position, the following developments may result in new or amended disclosures in the financial statements

<i>Effective for accounting periods beginning on or after</i>		
IFRS 7	Financial instruments disclosures	1 January 2007
Amendment to IAS 1	Presentation of financial statements capital disclosures	1 January 2007