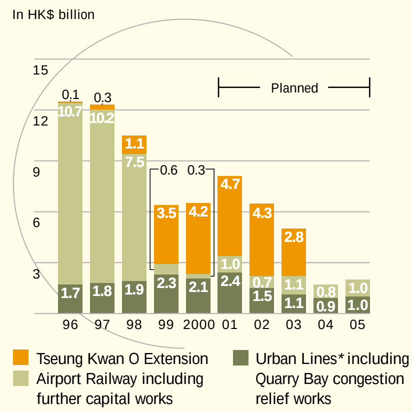
Partial privatisation

Government's partial privatisation of the Company was successfully concluded when shares of the Company commenced trading on The Stock Exchange of Hong Kong on 5 October 2000. With one billion existing shares, representing 20% of the Company being sold by Government, the initial public offering (IPO) was 17.5 times subscribed, attracting total demand of HK$164 billion for a HK$9.4 billion offering. With the subsequent exercise of the 3% over-allotment option, Government's shareholding in the Company was further reduced to 77%. The IPO was implemented with a number of unique features including the first ever e-IPO in Hong Kong. Some 79,000 applications were received electronically.

The Company's shares were listed at HK$9.38 per share, giving rise to a market capitalisation of HK$47 billion at the time of listing. Retail investors resident in Hong Kong were offered shares at a discount of 5% together with loyalty share bonuses for shareholders who retain their shares for one year and two years respectively. Since listing, the shares have outperformed the Hang Seng Index and closed the year at a high of HK$13.65. The Company's shareholder base at listing was 604,447, subsequently reduced to 528,049 as at 31 December 2000, the largest shareholder number of any Hong Kong listed enterprise.

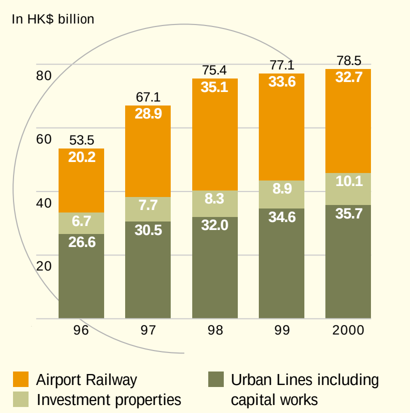
INVESTMENT IN NEW RAILWAYS AND EXISTING SYSTEM



**Urban Lines refer to the Kwun Tong, Tsuen Wan and Island lines.*

The Company continues to invest in new railways and the existing operating system, with total spending planned in the next five years amounting to over HK$23 billion.

ASSET GROWTH



Including the Airport Railway, a continuous upgrade of the urban lines and with the addition of investment properties, the MTR's fixed assets totalled HK$78.5 billion in 2000.

Listing reinforces commercial principles

Since its inception in 1975, MTR has always operated under prudent commercial principles, with strong emphasis on operational efficiency and sound financial management. Following the Stock Exchange listing, the Company's commercial foundations have been further strengthened. The regulatory framework provided in the new MTR Ordinance and Operating Agreement has preserved our fare setting autonomy. In addition, Government has acknowledged that the Company will require a commercial rate of return on its investments in new railway extensions, which typically would be expressed as a margin of 1 - 3% over the Company's estimated weighted average cost of capital. Government has further acknowledged that in order for the Company to achieve the required return on certain railway projects, it may be necessary for the Government to provide financial and other forms of support for those projects.

Financing achievements

With the proceeds from the IPO accruing to Government, the Company's funding requirement in 2000 was met by pursuing its established and well-planned financing strategy in accordance with our Preferred Financing Model. The Company successfully completed its planned funding programme of HK$12.8 billion in 2000, comprising a number of significant and cost-effective transactions involving different instruments and markets in line with its diversification strategy.

In particular, the Company took advantage of a narrow market window in the beginning of November and successfully launched a 10-year 7.5% Global Bond issue. Based on a well-orchestrated marketing campaign supported by an informal roadshow, the transaction was executed within 48 hours and attracted a strong order book of over US$1.5 billion from a wide spectrum of high quality institutional investors across Asia, the U.S.A., and Europe. To meet this strong demand, the issue size was increased from US$500 million to US$600 million. The bonds were priced at a spread of 1.87% over 10-year US Treasuries, which was flat to the then prevailing secondary spread of the Company's outstanding 2009 Global Bond. The ability of the Company to price the bonds at zero new issue premium while extending the maturity by almost two years was a significant achievement in view of the volatile market conditions and the substantial new issue premium other comparable issuers had to pay at the time.

Other transactions included a number of bilateral bank loan facilities totalling HK$2.25 billion, club loan facilities of HK$2.27 billion equivalent, HK$700 million in medium-term notes issued to institutional investors in Hong Kong and a HK$500 million export credit facility arranged with the Export Finance and Insurance Corporation of Australia. The Company also took advantage of significantly improved conditions in the Hong Kong dollar loan market to restructure an existing syndicated loan facility to achieve better terms and pricing.

With the success of the IPO and its financing programme, the Company was honoured with a number of prestigious financing awards. The Global Bond issue was named Deal of the Year by *IFR Asia*, *Euroweek*, *Finance Asia* and *The Asset* magazines whilst the IPO was named Transport Sector Deal of the Year by *IFR Privatisation International* and Hong Kong Deal of the Year by *Asiamoney*. In addition the Company was named Borrower/Issuer of the Year by *IFR Asia*, *Euroweek*, *Asiamoney* and *The Asset* magazines.

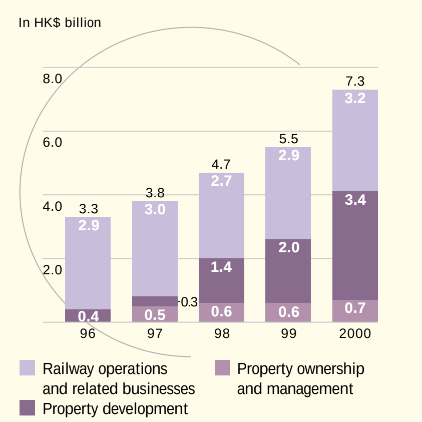
As at the year-end the Company had a total of HK$13.8 billion in undrawn committed facilities which will be sufficient to cover its anticipated funding needs up to the end of 2001. The average interest cost was 7.8% in 2000, which was only marginally higher than the 7.6% in 1999, reflecting the Company's continued success in controlling financing costs despite generally higher interest rates during the year.

Disciplined debt management

We have managed our debt portfolio over many years in accordance with the Preferred Financing Model, which diversifies risk through specifying the preferred mix of fixed and floating rate debt, the permitted currency exposure, a well-balanced spread of maturity, the use of different types of financing instruments and an adequate length of financing horizon. In accordance with this Model, the Company maintained a balanced debt profile with adequate risk diversification and forward coverage during the year.

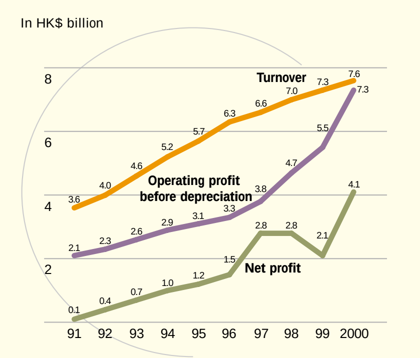
The Company actively uses derivative instruments to manage its interest rate and currency exposures to achieve the profile specified by the Preferred Financing Model. Transactions are conducted for hedging purposes only and no

OPERATING PROFIT CONTRIBUTIONS



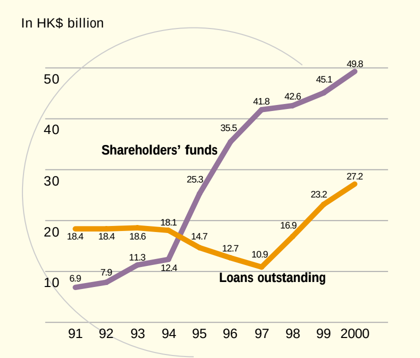
Operating profit before depreciation was HK$7,288 million, an increase of 32% from HK$5,523 million in 1999.

NET RESULTS



The MTR earned net profit of HK$4,055 million for 2000, a significant increase of 91.6% over 1999's net profit of HK$2,116 million.

DEBT/EQUITY PROFILE



Due to borrowings required for the Company's ongoing capital expenditure programme including the TKE project, the Company's debt to equity ratio increased from 51.4% in 1999 to 54.6% in 2000.

speculative positions are permitted. The Company generally only deals with counterparties with credit ratings of single A or better and has developed a framework for counterparty risk monitoring using the "expected loss" concept and "value-at-risk" methodology.

Credit ratings reaffirmed

The Company was the first Hong Kong corporate borrower to obtain international credit ratings and has since maintained its ratings from Moody's, Standard & Poor's and R&I on par with Hong Kong's sovereign level. Following the finalisation of the Operating Agreement in June 2000, Standard & Poor's revised the Company's outlook from "developing" to "stable" and reaffirmed its short-term and domestic/foreign currency ratings at A-1 and A+/A respectively. These long-term domestic/foreign currency ratings were further upgraded to AA-/A+ in February 2001 in line with the upgrade in Hong Kong's sovereign rating. Moody's upgraded the Company's P-2 short-term foreign currency rating and A-1 long-term domestic currency rating to P-1 and Aa3 respectively in August 2000 and re-affirmed its long-term foreign currency rating at A3 following similar changes to Hong Kong's sovereign rating. The outlook on the Company's A3 foreign currency rating was further revised in February 2001 from stable to positive.

CREDIT RATINGS

	Commercial paper	Long-term ratings *
Standard & Poor's	A-1	AA-/A+
Moody's	P-1	Aa3/A3
Japan Rating and Investment Information Inc. (R & I)	–	AA/AA-

* Long-term ratings for Hong Kong dollar denominated debt and foreign currency denominated debt respectively.

Investors' relations

The success of the IPO and our financing programme have clearly demonstrated the benefits of our long-held strategy of cultivating strong investor relations and maintaining a high level of transparency and information disclosure. During the year, the Company continued to strengthen its investor relations efforts and, in line with its transformation into a publicly listed company, established a dedicated corporate finance team to cover the needs of institutional equity investors and stock analysts. Senior management continued to meet and maintain regular dialogue with debt and equity investors and analysts and were encouraged by the extensive research coverage produced by the financial community.

Over the years the Company has consistently provided quality and timely disclosure of information on its operations and finances to the capital markets and the financial community. Our efforts in transparency, corporate governance and disclosure have consistently been recognised. The Company's 1999 annual report was named the Best Annual Report by the Hong Kong Management Association for the third consecutive year, marking the seventh time that the Company has won this prestigious award. In 2000 the Company was also awarded a Diamond Award for Best Corporate Governance by the Hong Kong Society of Accountants.

Prudent financial planning

Railway projects are by nature highly capital intensive and involve long payback periods. During the initial years of operation of a new railway, our profits are usually significantly affected by depreciation and interest charges related to that new railway. This was experienced with the commencement of service of the Airport Railway in 1998.

A similar effect is expected to occur with the Tseung Kwan O Extension (TKE), which is scheduled for opening in late 2002. However, earnings from new projects are expected to grow steadily as patronage along the new railway line builds up over time, eventually providing sufficient cash flows to repay interest and borrowings as well as to earn a reasonable return to shareholders.

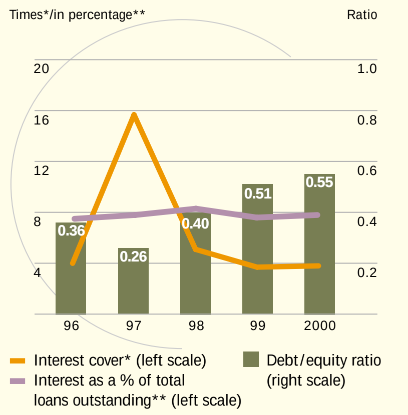
As an integral part of our railway development activities, property developments are undertaken at the sites of our railway stations in order to supplement the returns from the railway investment. In the case of the Airport Railway, property development earnings will continue to counteract the effect of increased depreciation and interest charges during the early years of operations.

Over the years, the Company has developed a sophisticated long-term financial planning model and a clear methodology for evaluating new projects and investments. All investment proposals are subject to a rigorous evaluation process taking into account the Company's weighted average cost of capital. Each year, the key financial planning assumptions are carefully reviewed as part of our budgeting exercise and sensitivity analyses are conducted on key variables. The Company's capital structure, as well as key financial ratios and interest, dividend and cashflow covers, are carefully monitored on a regular basis.

Our longer term financial plan has factored in the significant programme of committed capital expenditure to maintain and upgrade the existing lines and to further expand the MTR system. In addition to the TKE project, our committed programme includes the modernisation of passenger trains, improvement of station facilities, installation of platform screen doors, the congestion relief works at Quarry Bay and construction of the Penny's Bay Link railway. This committed programme is forecast to require total funding of HK$13 billion (excluding debt refinancing) in the three years from 2001 to 2003, including the planned capital expenditure and dividend payments. As currently planned, the Company has sufficient financial resources to fund this programme through debt, whilst maintaining acceptable gearing and financial coverage ratios.

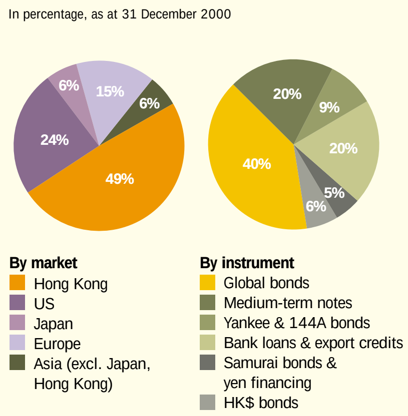
Other projects beyond this committed programme are currently being evaluated, including the North Island Line, the West Island Line and the Shatin to Central Link. The funding requirements for these projects are not expected to arise until after 2003 and the Company will further examine the appropriate capital structure and method of funding for these projects.

DEBT SERVICING CAPABILITY



The Company carefully manages its debt/equity ratio and its interest cover in establishing its financial plans.

SOURCES OF BORROWING



The Company has a well-established funding programme which utilises innovative financing instruments sourced from the major capital markets of the U.S.A., Europe and Japan.

Review of financial results

Profit and loss

The Company achieved a significant improvement in operating results in 2000, with an improving patronage trend during the year and the benefits of its cost reduction measures over the past two years coming through. Total patronage for the MTR Lines, which comprises the Urban Lines and the Tung Chung Line, declined by 1.5% from 779 million in 1999 to 767 million in 2000. The average weekday patronage for the first half and second half of 2000 were 2.218 million and 2.262 million respectively, representing a decline from 1999 of 3.2% and 0.7% respectively, thus reflecting an improving trend in the latter part of the year. Our overall market share declined from 25.2% in 1999 to 24.1 and our cross-harbour market share declined from 60.3% to 57.9% in 2000.

Total fare revenue for the MTR Lines amounted to HK$5,166 million, a decline of 0.5% from HK$5,194 million in 1999. The average fare increased from HK$6.67 in 1999 to HK$6.73, mainly as a result of the additional 10 cents per ride charged since July 2000 due to the platform screen doors project.

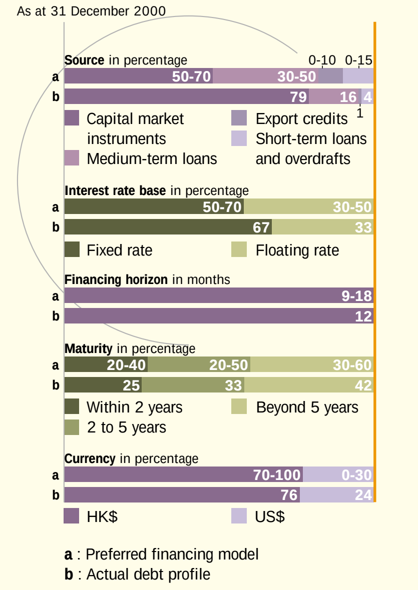
The average daily patronage on the Airport Express Line (AEL) declined marginally from 28,500 in 1999 to 28,300, following the reduction in fare discount from 30% to 10% effective from July 2000. Our estimated market share of passengers travelling to and from the airport fell from 32% in 1999 to 28%. Despite the reduction in patronage, total revenue from the AEL grew strongly by 23% to HK$549 million, with the average fare increasing from HK$42.8 to HK$53.1.

Non-fare revenues increased by 15.2% from HK$1,613 million in 1999 to HK$1,858 million, comprising HK$867 million from rental and management and HK$991 million from station commercial and other revenue. The increase in rental and management income was attributable to the first full year's operations of Maritime Square together with new residential and commercial properties coming on stream in our Airport Railway property developments. Strong growth was seen in our advertising business with the expansion of advertising space utilisation and the launch of a number of special advertising programmes, as well as increased advertising spending in certain sectors of the economy.

Operating expenses before depreciation decreased by 2.6% from 1999 to HK$3,661 million. A substantial reduction in staff costs was achieved in 2000, from HK$1,851 million in 1999 to HK$1,688 million, reflecting significant gains in productivity and efficiency with effective redeployment of staff following the voluntary separation scheme launched in the last quarter of 1999. Other operating costs increased by 3.4% from 1999 as a result of the higher maintenance costs for the Airport Railway following the expiry of the defects liability period for most contracts in early 2000, and the provision of additional costs related to the Company's listing.

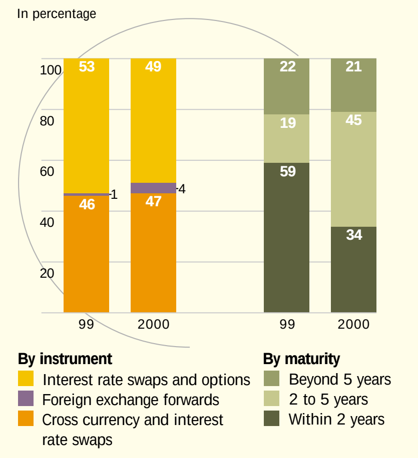
The operating profit from railway and related operations before depreciation amounted to HK$3,912 million, an increase of 12.0% from HK$3,493 million in 1999. This represented a margin of 51.7% on total revenue, the first year since the opening of the Airport Railway in which the Company has regained a margin of over 50%.

PREFERRED FINANCING MODEL AND DEBT PROFILE



The Company maintained a well-diversified debt portfolio with adequate forward coverage of future funding consistent with the Preferred Financing Model.

USE OF INTEREST RATE AND CURRENCY RISK HEDGING PRODUCTS



A variety of hedging instruments are used to manage the debt portfolio and foreign currency exposures. Derivatives are used only for hedging purposes and no speculative positions are taken.

Profit on property developments amounted to HK$3,376 million, compared with HK$2,030 million for the previous year, due to the recognition of deferred income in respect of certain Airport Railway developments in line with the progress of those development towards completion. The amounts recognised during the year related to Tung Chung and Kowloon stations due largely to construction progress and Olympic station due largely to pre-sales.

The operating profit before depreciation rose by 32% to HK$7,288 million. Depreciation and amortisation charges increased by a modest 2.6% to HK$2,091 million as no major new assets were commissioned during the year. As a result of the above, the operating profit after depreciation increased by 49.2% from HK$3,484 million in 1999 to HK$5,197 million.

The net interest expense increased from HK$1,104 million in 1999 to HK$1,142 million. Despite volatile market conditions, we were able to maintain the average interest rate paid on our borrowings at 7.8% compared to 7.6% for 1999.

The net profit for the year increased from HK$2,116 million in 1999 to a record level of HK$4,055 million, comfortably above the profit forecast of HK$3,600 million set out in the IPO prospectus. Both the basic and diluted earnings per share were HK$0.81.

In line with the indication given in the IPO prospectus, the Board has recommended a dividend of 10 cents per share, amounting in total to HK$500 million, with a scrip dividend option offered to all shareholders. This equates to an annualised dividend yield of approximately 4.5 per cent on the IPO price, taking into account the period for which the Company was listed in 2000. Government has agreed that it will elect to receive all or part of its entitlement to dividends in the form of shares to the extent necessary to ensure that a maximum of 50% of the total dividend paid by the Company in respect of the year will be in cash. We believe that Government's agreement to receive dividends in scrip demonstrates its strong support for the Company and confidence in its future.

Balance sheet

The Company's balance sheet continued to be well-capitalised, with the bulk of its assets being invested in the railway system. Total fixed assets increased marginally from HK$77,105 million last year to HK$78,475 million as at 31 December 2000. There were no significant increases in the railway fixed assets and the increase was mainly due to the year-end revaluation of our investment properties.

Construction of the TKE project has progressed according to programme. The total costs incurred during the year amounted to HK$4,198 million, bringing the total expenditure for the project to HK$9,194 million by the year-end. As a result of the lower prices obtained for the contracts awarded and the continued cost reduction measures, the estimate of total project cost has been further revised from HK$24,000 million to HK$21,000 million. The latest estimate represents a saving of over 31% from the original budget of HK$30,500 million.

Property development in progress represents the costs incurred in the preparation of sites for property developments along the Airport Railway line and the TKE, less amounts already received from developers. In accordance with our accounting policies, the payment received from the developer appointed during the year for Kowloon Packages Five, Six and Seven was credited against the amounts in property development in progress attributable to that development. The balance of property development in progress at the year-end amounted to HK$2,699 million, a decrease of 9% from last year's balance of HK$2,968 million. Of the outstanding balance, HK$2,013 million relates to TKE project foundation works where the amounts will be recovered when the packages are tendered to developers in due course.

The total loans outstanding at the end of the year amounted to HK$27,023 million, an increase of HK$4,026 million from last year. Loan drawdowns from existing and new facilities during the year were mainly used to finance the construction of the TKE project and capital works for the MTR system. As a result of this, the debt-to-equity ratio increased from 51.4% a year ago to 54.6% at year-end in line with our longer term financial plan. The interest cover remained at a satisfactory level of 3.8 times, as compared to 3.7 times last year.

Deferred income decreased from HK$13,776 million in 1999 to HK$10,403 million as amounts were recognised as income in accordance with the progress of construction and pre-sales of the property development projects at Kowloon, Olympic and Tung Chung stations.

The total share capital of HK$32,188 million remained unchanged from 1999. However, in the process of incorporating the new company for the purpose of listing, the capital structure was revised from 327,000 authorised and 321,881 issued shares of HK$100,000 each to 6.5 billion authorised and 5 billion issued shares of HK$1.00 each, together with a capital reserve balance of HK$27,188 million.

As at 31 December 2000, total shareholders' funds stood at HK$49,828 million, an increase of HK$4,713 million from HK$45,115 million as at 31 December 1999. The increase was mainly attributable to the current year's retained profit of HK$3,555 million and the increase in revaluation reserves in respect of the Company's investment properties.

Cash flow

The net cash inflow from operating activities increased to HK$3,732 million from HK$3,311 million last year due to higher revenues from AEL fares and advertising and rental income, together with lower operating expenses. The main cash outflow was related to the TKE project and other capital works projects which together with interest and financing charges paid amounted to HK$7,828 million. The net loan drawndown for the year was reduced from last year's figure of HK$6,445 million to HK$4,125 million.