

Report of the Members of the Board

The members of the Board have pleasure in submitting their Report and the audited statement of Accounts for the financial year ended 31 December 2002.

Principal Activities of the Group

The principal activities of the Company and its subsidiaries are:

- A** the operation of a mass transit railway system with lines from Central to Tsuen Wan (Tsuen Wan Line), from Yau Ma Tei to Tiu Keng Leng (Kwun Tong Line), from Po Lam to North Point (Tseung Kwan O Line), from Chai Wan to Sheung Wan (Island Line), from Hong Kong to Tung Chung (Tung Chung Line) and from Hong Kong to the Hong Kong International Airport at Chek Lap Kok (Airport Express Line);
- B** property development at locations relating to the railway system including the Tseung Kwan O Extension;
- C** related commercial activities, including the letting of advertising and retail space, bandwidth services on the railway system, property management and leasing management of investment properties, property agency and Octopus Card Building Access System services;
- D** the construction of the Tseung Kwan O Extension;
- E** the design and construction of the Penny's Bay Rail Link;
- F** the design, construction and operation of the Tung Chung Cable Car Project and related tourist development;
- G** the planning and construction of future extensions to the railway system and other related infrastructure projects;
- H** consultancy services covering all areas of expertise required in the project management, planning, construction, operation, maintenance and up-grading of railways plus fare collection, property integration/development advice including other property related services and advice on generation of non-fare revenues; and
- I** the operation of a smart card system by Octopus Cards Limited, a subsidiary of the Company, for the collection of payments for both transport and non-transport applications.

Dividend

The Directors have recommended a final dividend of HK\$0.28 per Ordinary Share to be payable to shareholders whose names appear on the Register of Members of the Company on 2 April 2003. Subject to the passing of the necessary resolution at the forthcoming Annual General Meeting, such dividend will be payable on or about 12 June 2003, in cash in Hong Kong dollars, with a scrip dividend alternative.

Members of the Board

Members of the Board who served during the year were Jack So Chak-kwong (Chairman and Chief Executive), Cheung Yau-kai, Raymond Ch'ien Kuo-fung, David Gordon Eldon, David Wylie Gairns (resigned on 31 August 2002), T Brian Stevenson (appointed on 1 October 2002), Edward Ho Sing-tin, Lo Chung-hing, the Commissioner for Transport (Robert Charles Law Footman), the Secretary for Transport (Nicholas Ng Wing-fui until retirement on 2 April 2002) and Denise Yue Chung-ye. Following the reorganisation within the Government and with effect from 1 July 2002, the Secretary for Transport (acting by Paul Tang Kwok-wai) and Denise Yue Chung-ye were replaced by the Secretary for the Environment, Transport and Works (Dr. Sarah Liao Sau-tung) and Frederick Ma Si-hang respectively.

The Chairman informed the Board on 12 February 2003 that he would not seek to renew his contract as Chairman and Chief Executive of the Company when his current contract expires in September 2003.

Raymond Ch'ien Kuo-fung and Lo Chung-hing retired by rotation at the Annual General Meeting on 16 May 2002 and were re-elected as members of the Board.

Cheung Yau-kai, Edward Ho Sing-tin, T Brian Stevenson and Frederick Ma Si-hang will retire by rotation at the forthcoming Annual General Meeting (in accordance with the Company's Articles of Association) and offer themselves for re-election.

Brief biographical details for Board Members are set out on page 56.

Alternate Directors

The Alternate Directors in office during the year were (i) Martin Mckenzie Glass (for Denise Yue Chung-ye), (ii) the Deputy Secretary for Transport (for the Secretary for Transport), (iii) Martin Mckenzie Glass and Alan Lai-nin (both for Frederick Ma Si-hang with effect from 24 July 2002), (iv) both the Permanent Secretary for the Environment, Transport & Works (Rita Lau Ng Wai-lan) with effect from 8 August 2002 and the Deputy Secretary for the Environment, Transport & Works (Paul Tang Kwok-wai, Arthur Ho Kin-wah and Margaret Fong Shun-man) on 1 July 2002 (for the Secretary for the Environment, Transport & Works), and (v) Dorothy Chan [replaced by the Deputy Commissioner for Transport/Transport Services and Management (Judy Li Wu Wai-lok) on 30 September 2002] (for the Commissioner for Transport).

Martin Mckenzie Glass and the Deputy Secretary for Transport ceased to be Alternate Directors to Denise Yue Chung-ye and the Secretary for Transport respectively following their cessation as Members of the Board.

Executive Directorate

The members of the Executive Directorate who served during the year were Jack So Chak-kwong (Chairman and Chief Executive), a member of the Board of Directors, and Russell John Black, William Chan Fu-keung, Philip Gaffney, Thomas Ho Hang-kwong, Lincoln Leong Kwok-kuen and Leonard Bryan Turk.

Lincoln Leong Kwok-kuen was appointed as the new Finance Director on 1 February 2002 following the resignation of Clement Kwok King-man who resigned as Finance Director on 31 January 2002.

Brief biographical details for members of the Executive Directorate during the year are set out on page 57.

Corporate Governance

The Company has complied throughout the year ended 31 December 2002 with the Code of Best Practice as set out in Appendix 14 of the Listing Rules, except that non-executive Directors of the Company are not appointed for a specific term but are subject (save for those appointed pursuant to Section 8 of the MTR Ordinance) to retirement by rotation and re-election at the Company's annual general meetings in accordance with Articles 87 and 88 of the Company's Articles of Association. Details for corporate governance are set out on pages 42 to 43.

Internal Audit

The Company's Internal Audit Department provides independent, objective assurance and consulting services designed to add value and improve the Company's operations. Key responsibilities of the Department include:

- Assessments on the adequacy and effectiveness of the Company's system of internal control for controlling its activities and managing its risks.
- Identification of opportunities for improving management control, resources utilisation and profitability.
- Special reviews and/or investigations as commissioned by Company management.

The Company's Internal Auditor reports directly to the Chairman and has direct access to the Audit Committee.

Ethical Culture

Please refer to page 43.

Policies

The Board has adopted risk strategies on the following matters:

- A** Construction and insurance;
- B** Finance;
- C** Treasury risk management;
- D** Safety risk management;
- E** Security management;
- F** Environmental management.

No changes to such policies may be made without the approval of the Board of Directors.

Bank Overdrafts, Bank Loans and Other Borrowings

The total borrowing of the Group as at 31 December 2002 amounted to HK\$33,508 million (2001: HK\$31,385 million). Particulars of borrowings including bank overdrafts and bank loans are set out in Note 26 to the Accounts.

Accounts

The state of affairs of the Company and the Group as at 31 December 2002 and of the Group's results and cash flows for the year are set out in the Accounts on pages 71 to 120.

Ten-Year Statistics

A summary of the results and of the assets and liabilities of the Group together with some major operational statistics for the last ten years are set out on pages 54 to 55.

Fixed Assets and Railway Construction in Progress

Movements in fixed assets and railway construction in progress during the year are set out in Notes 14 and 15 to the Accounts respectively.

Movements in Reserves

Movements in reserves during the year are set out in Notes 32 and 33 to the Accounts.

Share Capital

As at 31 December 2001, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,055,229,742 of which were issued and credited as fully paid. During the year, the Company issued a total of 103,518,913 Ordinary Shares. Of this number:

- A** 4,362,000 Ordinary Shares were issued by the Company pursuant to the exercise of share options which had been granted under the Company's Share Option Scheme (as referred in note 41 to the Accounts). In respect of each Ordinary Share issued, the relevant exercising share option holder paid HK\$8.44 to the Company;
- B** 63,322,970 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the final dividend of the Company for the year ended 31 December 2001 (for which the cash dividend was HK\$0.28 per Ordinary Share); and
- C** 35,833,943 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the interim dividend of the Company for the six months ended 30 June 2002 (for which the cash dividend was HK\$0.14 per Ordinary Share).

As at 31 December 2002, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,158,748,655 of which were issued and credited as fully paid.

Redemption of Listed Securities

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of its listed securities during the financial year 2002.

Properties

Particulars of the principal investment properties and properties held for sale of the Company are shown on page 35.

Donations

During the year, a total of HK\$273,650 was donated, of which HK\$245,650 went to the Community Chest of Hong Kong.

To demonstrate our commitment to supporting charitable causes and promoting "Green" initiatives, the Company provided 30,000 free tickets for the Community Chest Green Day in 2002.

Internal Control

The Board of Directors is responsible for ensuring that there is in place a satisfactory system of internal control. The main objectives are to ensure adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

A function of the Audit Committee is to review the effectiveness of the system of internal control from information provided by the Executive Directorate and management of the Company and by the auditors.

Reporting and Monitoring

There is a comprehensive budgeting system for all operational and business activities, with an annual budget approved by the Board of Directors. Monthly results of the Company's operations, businesses and projects are reported against the budget to the Board of Directors and updated forecasts for the year are prepared regularly.

Treasury Management

The Company's Treasury Department operates within approved guidelines from the Board. It manages the Company's debt profile according to the Preferred Financing Model which defines the preferred mix of financing instruments, fixed and floating rate debts, maturities, interest rate risks, currency exposure and financing horizon. The model is reviewed and refined periodically to reflect changes in the Company's financing requirements and market environment. Derivative financial instruments such as interest rate swaps and cross currency swaps are used only as hedging tools to manage the Group's interest rate and currency risks. Prudent guidelines and procedures are in place to control the Company's derivatives activities, including a comprehensive credit risk management system for

monitoring counterparty credit exposure using the Value-at-Risk approach.

There is also appropriate segregation of duties within the Company's Treasury Department.

Major financing transactions and guidelines for derivatives transactions including credit risk management framework are approved at the Board level.

Capital and Revenue Expenditure

There are defined procedures for the appraisal, review and approval of major capital and revenue expenditures. All project expenditure over 0.2% of the net assets of the Company and the employment of consultancy services over 0.1% of the net assets of the Company require the approval of the Board.

Bonds and Notes Issued

The Group issued retail bonds during the year ended 31 December 2002, details of which are set out in Note 26D to the Accounts. Such bonds were issued in order to meet the Group's general corporate funding requirements, including the financing of new capital expenditure and the refinancing of maturing debts.

Computer Processing

There are defined procedures and regular quality reviews on the operation of computer systems to ensure the accuracy and completeness of financial records and efficiency of data processing. The Company's computer centre operation and support has been certified under ISO 9002.

Interests in Contracts of Members of the Board and the Executive Directorate

There was no contract of significance, to which the Company or any of its subsidiaries was a party and in which a member of the Board or a member of the Executive Directorate had a material interest (whether direct or indirect), subsisted at the end of the year or at any time during the year.

Board Members' and Executive Directorate's Interests in Shares

At 31 December 2002, the interests of the members of the Board of Directors and the Executive Directorate in the equity securities of the Company as recorded in the register required to be kept under section 29 of the SDI Ordinance or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:

Ordinary Shares

Member of the Board of Directors or Executive Directorate	Number of Ordinary Shares		
	Personal interests	Family interests	Total interests
Jack So Chak-kwong	80,358	–	80,358
T Brian Stevenson	4,102	–	4,102
Russell John Black	47,187	–	47,187
William Chan Fu-keung	46,233	–	46,233
Philip Gaffney	46,358	588	46,946
Thomas Ho Hang-kwong	48,226	2,358	50,584
Leonard Bryan Turk	46,554	2,329	48,883

Bond

Member of the Executive Directorate	Personal interests
William Chan Fu-keung	HK\$101,010 MTR 201 3.75 per cent. Notes due 2004
	HK\$50,740 MTR 301 4.50 per cent. Notes due 2005

Options to subscribe for Ordinary Shares granted under the Share Option Scheme, as referred to in Note 5B to the Accounts

Member of Board of Directors or Executive Directorate	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2002	Options vested during the year	Options lapsed during the year	Options exercised during the year	Price per share paid on exercise of options	Options outstanding as at 31 Dec 2002	Weighted average closing price of shares immediately before options were exercised
Jack So Chak-kwong	20/9/2000	1,599,000	5/4/01 – 11/9/10	1,599,000	533,000	–	–	–	1,599,000	–
Russell John Black	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	23,000	\$8.44	1,022,000	\$9.20
William Chan Fu-keung	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	23,000	\$8.44	1,022,000	\$9.15
Philip Gaffney	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	23,000	\$8.44	1,022,000	\$9.15
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,044,000	355,500	–	23,000	\$8.44	1,021,000	\$9.05
Leonard Bryan Turk	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	22,500	\$8.44	1,022,500	\$9.20
Other eligible employees	20/9/2000	40,343,000	5/4/01 – 11/9/10	36,324,500	12,341,000	2,104,500	4,165,000	\$8.44	30,055,000	\$10.36

Save as disclosed above:

A there were no interests held as at 31 December 2002 by any members of the Board of Directors or Executive Directorate of the Company in securities of the Company and its associated corporations (within the meaning of the SDI);

B during the year ended 31 December 2002, no member of the Board of Directors or Executive Directorate nor any of their spouses or children under 18 years of age held any rights to subscribe for equity or debt securities of the Company nor had there been any exercises of any such rights by any of them, as recorded in the register kept by the Company under section 29 of the SDI or otherwise notified to the Company and the HKSE pursuant to the Model Code for Securities Transactions by Directors of Listed Companies; and

C out of 1,066,000 options granted on 20 September 2000 to Clement Kwok King-man, Finance Director (resigned on 31 January 2002), 793,000 options remained outstanding as at 1 January 2002. During the year ended 31 December 2002, 82,500 options were exercised and 710,500 options lapsed. The weighted average closing price of shares immediately before those options were exercised was HK\$10.20 per share.

Directors' service contracts

No director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract which is not determinable by the company or any of its subsidiaries within one year without payment of compensation, other than statutory obligations.

Substantial Shareholders' Interests

Set out below is the name of the party which was interested in 10 per cent. or more of the nominal value of the share capital of the Company and the respective relevant numbers of shares in which it was interested as at 31 December 2002 as recorded in the register kept by the Company under Section 16(1) of the SDI:

Name	No. of Ordinary Shares
Financial Secretary Incorporated (in trust on behalf of the Government)	3,928,221,249

Loan Agreements with Covenant Relating to Specific Performance of the Controlling Shareholder

As at 31 December 2002, the Group had borrowings of HK\$32,866 million with maturities ranging 2003 to 2018 and undrawn committed and uncommitted banking and other facilities of HK\$13,866 million, which were subject to the Government, being the Company's controlling shareholder, to own more than half in nominal value of the voting share of the Company during the lives of the borrowings and the undrawn facilities. Otherwise, immediate repayment of borrowings may be demanded and cancellation of undrawn facilities may be resulted.

Major Suppliers and Customers

Less than 30% in value of supplies (which were not of a capital nature) purchased during the year ended 31 December 2002 was attributable to the Company's five largest suppliers. Less than 30% in value of the Company's turnover during the year ended 31 December 2002 was attributable to the Company's five largest customers combined by value.

Going Concern

The financial statements on pages 71 to 120 have been prepared on a going concern basis. The Board of Directors has reviewed the Company's budget for 2003, together with the longer-term forecast for the following five years and is satisfied that the Company has sufficient resources to continue as a going concern for the foreseeable future.

Connected Transactions

During the year under review the following transactions and arrangements described below have been entered into (or were ongoing) with persons who are "connected persons" for the purposes of the Listing Rules:

Entrustment Agreements

A The Company has entered into the following entrustment agreements with Government in relation to the Tseung Kwan O Extension/Lantau Airport Railway under which Government agreed to carry out works on behalf of the Company in return for monthly payments based on the work completed:

- (1) Agreement dated 12 January 1999, for Government to carry out works relating to construction of diaphragm walls crossing underneath Road P1 in Tseung Kwan O Town Centre, with a total value of HK\$19,034,200.
- (2) Agreement dated 6 March 1995, for Government to carry out construction and part design of railway tunnels and railway formation works within West Kowloon Expressway Corridor, with a total value of HK\$302,992,941.

(3) Agreement dated 6 March 1995, for Government to carry out design and construction of railway drainage and subballast and all bridges between Tsing Chau Tsai and Chek Lap Kok, with a total value of HK\$684,176,963.

Government is a substantial shareholder in the Company.

B The Company has entered into the following entrustment agreements with Government in relation to the Tseung Kwan O Extension/Lantau Airport Railway under which the Company agreed to carry out works on behalf of Government in return for monthly payments based on the work completed:

- (1) Agreement dated 26 May 1999, for the Company to carry out construction works relating to infrastructure adjacent to Areas 45, 55, 56 and 57 in Tseung Kwan O Town Centre, with a total value of HK\$47,750,000.
- (2) Agreement dated 19 November 1999, for the Company to carry out construction works at Road D4 in Tseung Kwan O Town Centre, with a total value of HK\$19,397,685.
- (3) Agreement dated 28 February 2000, for the Company to carry out design and construction of landscape bund and footbridge link to Area 24 to Po Lam, with a total value of HK\$20,850,000.
- (4) Agreement dated 28 February 2001, for the Company to carry out design and construction of noise mitigation measures adjacent to Housing Sites No. 6 and 10 in the northern part of West Kowloon reclamation, with a total value of HK\$210,500,000.
- (5) Agreement dated 4 June 2001, for the Company to carry out substructure work relating to the Kowloon Regional Education Resource Centre cum Public Transport Interchange at Kowloon Tong, with a total value of HK\$78,900,000.
- (6) Agreement dated 14 May 2002, for the Company to carry out design and construction of modification and extension works to the southern concourse of Tsim Sha Tsui Station, the link to the Middle Road subway and the fitting out to the Mody Road subway, with a total value of HK\$270,000,000.

Government is a substantial shareholder in the Company.

C The Company has entered into the following entrustment agreements with the Housing Authority in relation to the Tseung Kwan O Extension, under which the Company agreed to carry out works on behalf of the Housing Authority in return for monthly payments based on the work completed:

- (1) Agreement dated 10 April 1999, for the Company to carry out site formation works and part foundations of housing blocks at Eastern Harbour Crossing and shopping spine above Yau Tong Station, with a total value of HK\$397,600,000.
- (2) Agreement dated 11 December 1998, for the Company to carry out construction work relating to Yau Tong Phase 4 Public Transport Interchange, with a total value of HK\$46,278,514.

The Housing Authority is a Governmental statutory body and Government is a substantial shareholder in the Company.

D The Company has entered into an entrustment agreement with the Airport Authority, dated 15 December 1995, for the Airport Authority to carry out construction work for the Company relating to the Airport Station at Chek Lap Kok, with a total value of HK\$854,000,000.

The Company entered into an Airport Automated People Mover Maintenance Agreement with the Airport Authority on 18 March 2002, for the Company to carry out preventive and corrective maintenance of the Airport Automated People Mover, with a total value of HK\$48,540,000.

The Airport Authority is a Governmental statutory body and Government is a substantial shareholder in the Company.

E The Company has entered into an entrustment agreement with Kowloon-Canton Railway Corporation ("KCRC"), dated 18 January 2000, for KCRC to carry out design and construction work for the Company, at the cost of KCRC, relating to the Airport Railway element of Nam Cheong Station.

KCRC is wholly-owned by Government, which is a substantial shareholder in the Company.

F The Company has entered into an agreement with Territory Development Department dated 1 February 2002, under which the Company was entrusted to do certain works in relation to or adjacent to the Hong Kong Station Development at a total consideration of HK\$30,417,764.48. The scope of works include Footbridge FB4 including removal of Footbridge FB4A, the promenade works in between Pier 1 & Pier 3 including removal of existing barge loading facility and Road D1. The actual works are carried out by the Hong Kong Station Developer.

Territory Development Department is a department of Government. Government is a substantial shareholder in the Company.

Land Agreements

A The Company has entered into the following land grants with Government in relation to the Airport Railway, which provides for the Company to develop certain sites adjacent to the Airport Express and Tung Chung Lines. Upon payment of the relevant land premium, the Company may develop the relevant site within the building covenant period. All agreements except in respect of item (9) specified below, provide for the sites (once developed) to have a lease term up to 30 June 2047.

(1) Grant No. 12459, dated 21 May 1997, for Private Treaty Grant of IL No. 8898 for development at Hong Kong Station (building covenant period expiry date 30 September 2005) with a total consideration or value of HK\$5,834,000,000.

(2) Modification of Grant No. 12459, dated 1 February 2000, for development at Hong Kong Station (building covenant period expiry date 1 February 2006) with a total consideration or value of HK\$5,500,000,000.

(3) Grant of KIL No. 11080 to the Company, dated 8 July 1996, for development at Kowloon Station (building covenant period expiry date 30 March 2009) with a total consideration or value of: Site A – HK\$3,377,230,000; Sites B, C, D, E, F and G – to be assessed.

The total consideration or value for Sites B and D was subsequently assessed on 31 March 1999 and 24 March 1999 at HK\$4,725,500,000. The total consideration or value for Sites C, E, F and G are set out in the Modification Letters in paragraphs (4) and (5) immediately below.

(4) Modification, dated 15 May 2000, to amend and allow the Company to develop Site C at Kowloon Station under new user and gross floor area restrictions (building covenant period expiry date 14 June 2006) with a total consideration or value of HK\$2,400,000,000.

(5) Modification, dated 12 December 2000, to amend and allow the Company to develop Sites E, F and G at Kowloon Station under new user and gross floor area restrictions (building covenant period expiry dates 31 March 2007 for Sites E and F and 31 March 2009 for Site G) with a total consideration or value of HK\$5,562,710,000.

(6) Grant No. 12349 for Private Treaty Grant of KIL No. 11068, dated 8 May 1995, for development at Olympic Station (building covenant period expiry dated 7 November 1999) with a total consideration or value of HK\$1,530,000,000.

(7) Grant No. 12375 for Private Treaty Grant of KIL No. 11074, dated 31 January 1996, for development at Olympic Station (building covenant period expiry date 30 January 2002) with a total consideration or value of HK\$3,777,860,000.

(8) Grant No. 12434 for Private Treaty Grant of KIL No. 11090, dated 10 January 1997, for development at Olympic Station (building covenant period expiry date 9 January 2003) with a total consideration or value of HK\$6,118,000,000.

(9) Conditions of Exchange No. 12620 dated 4 March 2002 in respect of Kowloon Inland Lot No. 11151 for development at Olympic Station (building covenant period expiry date 31 March 2007) with a total consideration or value of HK\$815,050,000 and a lease term of 50 years from date of grant.

(10) New Grant No. 6993 for Private Treaty Grant of TYTL No. 132, dated 7 March 1996, for development at Tsing Yi Station (building covenant period expiry date 30 September 2001) with a total consideration or value of HK\$4,343,500,000.

(11) New Grant No. 7973 for Private Treaty Grant of Tung Chung Town Lot No. 1, dated 16 August 1995, for development at Tung Chung Station (building covenant period expiry date 30 September 2000) with a total consideration or value of HK\$1,730,550,000.

(12) New Grant No. 7984 for Private Treaty Grant of Tung Chung Town Lot No. 2, dated 27 September 1995, for development at Tung Chung Station (building covenant period expiry date 30 September 2003) with a total consideration or value of HK\$724,010,000.

(13) New Grant No. 8015 for Private Treaty Grant of Tung Chung Town Lot No. 3, dated 1 May 1996, for development at Tung Chung Station (building covenant period expiry date 31 March 2001) with a total consideration or value of HK\$873,030,000.

(14) Modification of New Grant No. 8015, dated 29 August 2001, for additional gross floor area at Tung Chung Station (building covenant expiry date 31 March 2003) with a total consideration or value of HK\$116,000,000.

(15) Modification for New Grant No. 8082, dated 3 May 2000, for additional gross floor area and some other amendments at Tung Chung Station (building covenant period expiry date 31 March 2005) with a total consideration or value of HK\$493,570,000.

(16) New Grant No. 8102 for Private Treaty Grant, dated 26 June 1997, of Tung Chung Town Lot No. 5 for development at Tung Chung Station (building covenant period expiry date 30 June 2003) with a total consideration or value of HK\$4,150,000,000.

(17) Modification for New Grant No. 8102, dated 16 August 1999, for additional gross floor area and some other amendments for development at Tung Chung Station (building covenant period expiry date 30 June 2005) with a total consideration or value of HK\$660,000,000.

(18) New Grant No. 8082, dated 26 March 1997, of Tung Chung Town Lot No. 4 for development at Tung Chung Station (building covenant period expiry date 31 March 2002) with a total consideration or value of HK\$2,510,000,000. The building covenant period was extended to 31 December 2002 by a letter from Lands Department dated 30 November 2001.

B The Company has entered into a land grant relating to NKIL No. 6179 for development rights near Choi Hung Station in order for the Company to develop the lot in accordance with the terms and conditions stipulated in the Conditions of Grant No. 12611 dated 12 November 2001 (building covenant period expiry date 30 June 2006), with a total value of HK\$207,000,000 and a lease term of 50 years from date of grant.

C The Company has entered into the following land grants with Government in relation to the Tseung Kwan O Line, which provides for the Company to develop certain sites above or adjacent to the Tseung Kwan O Line. Upon payment of the relevant land premium, the Company may develop the relevant site within the building covenant period. All land grants provide for the sites to have a lease term of 50 years from the date of the land grant.

(1) New Grant No. 9687 for Private Treaty Grant, dated 28 March 2002, of TKOTL No. 75 for development at Area 55b Tseung Kwan O (building covenant period expiry date 31 March 2007) with a total consideration or value of HK\$600,000,000 subject to a Deed of Surrender dated 28 December 2002 for surrender of a stratum of the lot.

(2) New Grant No. 9686 for Private Treaty Grant, dated 28 March 2002, of TKOTL No. 74 for development at 57a Tseung Kwan O (building covenant period expiry date 31 March 2007) with a total consideration or value of HK\$202,800,000 subject to a Deed of Surrender dated 28 December 2002 for surrender of a stratum of the lot.

(3) New Grant No. 9689 for Private Treaty Grant, dated 16 May 2002, of TKOTL No. 70 for development at Area 86 Tseung Kwan O (building covenant period expiry date 31 December 2015 or 60 months from the due date for payment of land premium of Site O, whichever is the later) with a consideration or value of HK\$150,000,000 for Site M1 and the consideration or value for the other sites to be assessed.

(4) New Grant No. 9694 for Private Treaty Grant, dated 22 October 2002, of TKOTL No. 24 for development at Area 38b Tseung Kwan O (building covenant period expiry date 31 December 2007) with a total consideration or value of HK\$1,276,000,000.

(5) New Grant for Private Treaty Grant of TKOTL No. 73, entered into in February 2003, for development at Area 73b Tseung Kwan O (building covenant period expiry date 31 March 2008 for Site A and 31 March 2009 or 60 months from the due date for payment of the land premium, whichever is the later, for Site B) with a consideration or value of HK\$1,028,000,000 for Site A and the consideration or value for Site B to be assessed.

D The Company has entered into an assignment on 9 March 2001 for the public transport terminus on ground floor of the development at KIL No. 11090 in compliance with Special Condition No. 25(a)(i) of the Conditions of Grant No. 12434, with a total value of HK\$18,770,000.

E The Company has entered into an agreement for sale and purchase on 5 October 2001 with The Financial Secretary Incorporated for the sale of levels 55, 56 and 77 to 88 of the office building on Site R of Hong Kong Station Development (IL No. 8898) for a total value of HK\$3,699,000,000.

F In respect of the Remaining Portion of Mass Transit Railway Lot No. 1:

A Supplemental Lease was signed on the 11 February 2002 between Government and the Company in which the Government leased to the Company land occupied by the Quarry Bay Congestion Relief Works or the Quarry Bay Relief Works connecting Quarry Bay Station to North Point Station at an annual rent of 3% of the rateable value of the leased area for a term commencing 1 October 2001 to 29 June 2050 on terms and conditions substantially similar to the lease for the Mass Transit Railway Lot No. 1.

By a Modification Letter dated 13 May 2002 entered into between Government and the Company, the lease for the Remaining Portion of Mass Transit Railway Lot No. 1 was modified in areas indicated in the lease plans attached to the Modification Letter.

Transactions between the Company and Octopus Cards

The Company has entered into the following transactions with its subsidiary, Octopus Cards, to enable Octopus Cards to meet the requirements of a deposit-taking company under the Banking Ordinance (Cap.155 of the laws of Hong Kong).

(1) Subscription by the Company on 18 April 2000 of 28,475,322 additional shares in Octopus Cards, for a total consideration of HK\$28,475,322.

(2) Subordinated loan agreement, dated 18 April 2000, under which the Company made a loan of HK\$18,984,000 to Octopus Cards ("Subordinated Loan"), with interest payable at prime lending rate, which is subordinate to all other claims against Octopus Cards and will not be repaid by Octopus Cards without the consent of the Hong Kong Monetary Authority.

During the year ended 31 December 2002, the Company paid Octopus Cards a total amount of HK\$44.9 million in respect of central clearing services provided by Octopus Cards. During the same period, load agent fees amounting to HK\$10.7 million were received by the Company from Octopus Cards in respect of services and facilities provided by the Company at various MTR stations to enable customers to add value to Octopus cards.

In connection with the listing of the Company's shares on the HKSE in October 2000, the HKSE granted the Company a waiver from strict compliance with Chapter 14 of the Listing Rules insofar as it relates to connected transactions, subject to compliance with certain requirements. As required by one of these requirements, the Company now confirms that those of the central clearing services provided by Octopus Cards and load agent fees paid to the Company which occurred following completion of the Global Offering (as defined in the prospectus issued by the Company in relation to the MTR Privatisation Share Offer and dated 25 September 2000) were: (i) transactions entered into by the Company in the ordinary and usual course of its business; (ii) entered into on normal commercial terms (by reference to transactions of a similar nature made by similar entities within Hong Kong); and (iii) entered into on terms no less favourable than terms available to the other shareholders of Octopus Cards.

Transactions between the Company and KCRC in relation to Octopus Cards

The Company entered into the following agreements with KCRC, The Kowloon Motor Bus Company (1933) Limited, Citybus Limited and The Hongkong and Yaumati Ferry Company, Limited.

(1) Shareholders' agreement, dated 9 June 1994, under which the parties agreed to incorporate a company, Octopus Cards, in order to undertake the development and operation of a contactless smart card ticketing system (now known as Octopus). The Company held 67.8% of the equity capital in Octopus Cards but the voting rights at board meetings of the director appointed by the Company to the board of directors of Octopus Cards were

limited to 49% only. The parties paid HK\$1,000 in aggregate (in proportion to their respective shareholdings) for shares in Octopus Cards and undertook to make available loans to Octopus Cards (in proportion to their respective shareholdings) up to a total amount of not more than HK\$195.7 million (which has been fully repaid).

(2) Supplemental shareholders' agreement, dated 13 August 1999, which revised the terms of the shareholders' agreement dated 9 June 1994 to address, inter alia, certain issues arising from the application by Octopus Cards for authorisation under the Banking Ordinance (Cap.155 of the laws of Hong Kong) to carry on business as a deposit-taking company. The parties made a commitment to provide funds to Octopus Cards and give guarantees and indemnities as required under the Banking Ordinance (Cap.155 of the laws of Hong Kong).

(3) On 17 January 2001, the then shareholders in Octopus Cards (New World First Bus Services Limited and New World First Ferry Services Limited having replaced The Hongkong and Yaumati Ferry Company, Limited as a shareholder) entered into a replacement shareholders' agreement in respect of Octopus Cards, under which, inter alia, Octopus Cards was converted to profit making status. In connection with this agreement, the Company's shareholding in Octopus Cards was reduced to 57.4% and KCRC's shareholding was reduced to 22.1%. Further details of the replacement shareholders' agreement are set out in Note 18 to the Accounts.

(4) On 17 January 2001, the Company entered into an Octopus Card Services Agreement (the "MTR Octopus Services Agreement") with its subsidiary, Octopus Cards, in order to formalise the arrangements that already existed between them as to services provided to each other relating to Octopus cards. Under the terms of the MTR Octopus Services Agreement, the Company will accept use of Octopus cards as payment for its fares and will provide add-value services, refund handling and other services to Octopus Cards for an indefinite period terminable on six months' notice (not to be given before 1 July 2010).

(5) On 17 January 2001, KCRC entered into an Octopus Card Services Agreement (the "KCRC Octopus Services Agreement") with Octopus Cards in order to formalise the arrangements that already existed between them as to services provided to each other relating to Octopus cards. Under the terms of the KCRC Octopus Services Agreement, KCRC will accept use of Octopus cards as payment for its fares and will provide add-value services, refund handling and other services to Octopus Cards for an indefinite period terminable on six months' notice (not to be given before 1 July 2010).

During the year ended 31 December 2002, KCRC paid Octopus Cards a total amount of HK\$30.1 million in respect of transaction and interchange fees for the handling of Octopus tickets. During the same period, load agent fees amounting to HK\$5.7 million were received by KCRC from Octopus Cards in respect of services and facilities provided by KCRC at various KCR stations to enable customers to add value to Octopus cards.

As at 31 December 2002, the Company held 57.4% of the issued share capital in Octopus Cards and KCRC held 22.1%. Octopus Cards is a subsidiary of the Company and KCRC is a substantial shareholder in Octopus Cards.

Furthermore, Government is a substantial shareholder in the Company and KCRC is wholly owned by Government.

As required by the waiver referred to above granted to the Company by the HKSE in relation to connected transactions, the Company confirms that the MTR Octopus Services Agreement was: (i) a transaction entered into by the Company in the ordinary and usual course of its business; (ii) entered into on normal commercial terms (by reference to transactions of a similar nature made by similar entities within Hong Kong); and (iii) entered into on terms no less favourable than terms available to the other shareholders of Octopus Cards.

Octopus Cards - Updated Information

Octopus Cards repaid 50% and the remaining balance of the Subordinated Loan with the consent of the Hong Kong Monetary Authority on 17 October 2001 and 17 January 2002 respectively.

On 2 January 2002 Creative Star Limited changed its name to "Octopus Cards Limited".

Project Agreements

The Company and the Secretary for Transport, for and on behalf of Government, entered into an Amendment and Restatement Agreement on 30 June 2000 which, in the light of the partial privatisation of the Company, provides for the amendment and restatement of, inter alia, the TKE Project Agreement as defined below (which was ongoing during 2002). Government is a substantial shareholder in the Company.

The Company and the Secretary for Transport, for and on behalf of Government, had entered into a Project Agreement for the Design, Construction, Financing and Operating of the Tseung Kwan O Extension ("TKE") (the "TKE Project Agreement") on 4 November 1998. Under the TKE Project Agreement, the capital cost of work undertaken by the Company to complete the TKE and other costs are borne by the Company and there are provisions relating to the design, construction and operation of the TKE by the Company, and provisions relating to works to be carried out by the Company on behalf of Government (in respect of which, Government will reimburse the Company). The TKE Project Agreement provides for the grant of land to the Company for the operation of the railway (subject, inter alia, to the payment by the Company to Government of nominal land premium only), land for the construction of a depot and land for property development (subject, in each case, to the payment by the Company to Government of an amount to be assessed). The TKE Project Agreement also provides for the future grant to the Company of the ownership and operating rights in respect of the TKE.

The Company and the Deputy Secretary for the Environment, Transport and Works, for and on behalf of Government, entered into a Project Agreement for the Penny's Bay Rail Link project on 24 July 2002. This agreement sets out the

obligations of the Company in respect of design, construction and operation of the Penny's Bay Rail Link, including the need for compliance with relevant terms of the agreement between the Government and the Walt Disney Company. The Agreement also sets out the obligations of Government in respect of making land and access available. It provides remedies to the Company for delay or failure by Government in making land available or in completing the Disney Theme Park. In order to provide financial support in respect of the Penny's Bay Rail Link project, provision is made for the waiver (as against the Company) of any entitlement to dividends representing Government's beneficial entitlement to cash dividends for the financial year 2002 and (to the extent necessary) 2003 and for subsequent financial years, as it is equivalent to a net present value amount (as at the end of 2001) of HK\$798 million as at the relevant date (as more particularly described in the Project Agreement).

Government is a substantial shareholder in the Company.

Following a competitive bid, the Company and the Commissioner for Tourism on behalf of Government entered into a Provisional Agreement for the Tung Chung to Ngong Ping Cable Car Franchise on 31 July 2002. The Agreement sets out the obligations of the Company to develop the design, obtain requisite approvals for and carry out consultation in respect of the design and alignment of the Cable Car System and to negotiate a Project Agreement with Government for the construction, operation and transfer of the System. Following completion of land acquisition, the passing of enabling legislation and completion of the statutory process and public consultation required under various ordinances and subject to agreement on terms, a formal Project Agreement is expected to be signed in mid 2003. The franchise period will extend for 30 years from the date of signing the Project Agreement following which the System will be transferred to the Government. The Company has in parallel entered into negotiation with Government on the terms of a Private Treaty Grant for the land upon which the associated Ngong Ping tourism facilities will be constructed.

Government is a substantial shareholder in the Company.

Land Comfort Letter

The Company has received a letter from Government, dated 14 July 2000, pursuant to which Government agreed to extend the period of certain of the Company's land interests so that they are coterminous with the Company's initial 50-year franchise and, for certain other interests, Government has agreed to render assistance to the Company to facilitate the smooth operation of the railway during the Company's franchise period. If the Company's initial 50-year franchise is extended, Government has agreed that, subject to certain conditions (including the prevailing land policy at the time of extension of the franchise), Government will amend certain documents, including the Running Lines Leases, to make them coterminous with the extended franchise period.

Government is a substantial shareholder in the Company.

Eastern Harbour Crossing Agreement

The Company and the Secretary for the Treasury, for and on behalf of Government, entered into an agreement on 30 June 2000 in respect of the vesting of certain assets comprised in the Eastern Harbour Crossing by Government into the Company in 2008 for nominal consideration (the "EHC Agreement"). Under the EHC Agreement, the Company agreed to indemnify Government for certain amounts which are expected to be nominal.

Government is a substantial shareholder in the Company.

Transactions in connection with the Privatisation Share Offer of the Company

(1) The Company entered into a deed of indemnity dated 22 September 2000, with the members of the Board and members of the Executive Directorate and the FSI, under which, inter alia, the FSI agreed to indemnify the Company, the members of the Board and members of the Executive Directorate in certain circumstances and in respect of certain liabilities in respect of the global offering of the shares in the Company by the FSI. The FSI is a substantial shareholder in the Company and the members of the Board and members of the Executive Directorate are also connected persons of the Company.

(2) The Company, the FSI, Goldman Sachs (Asia) L.L.C., HSBC Investment Bank Asia Limited and UBS AG entered into the following underwriting agreements in relation to the underwriting of the Privatisation Share Offer of the Company, details of which were disclosed in the prospectus issued by the Company in connection with the Privatisation Share Offer of the Company dated 25 September 2000:

(i) the Hong Kong Underwriting Agreement, with the Hong Kong Underwriters (as defined therein), dated 22 September 2000; and

(ii) the International Underwriting Agreement, with the International Underwriters (as defined therein), dated 1 October 2000.

The FSI is a substantial shareholder in the Company.

Auditors

The retiring auditors, KPMG, have signified their willingness to continue in office. A resolution will be proposed at the Annual General Meeting to reappoint them and to authorise the Directors to fix their remuneration.

By order of the Board

Leonard Bryan Turk
Secretary to the Board
Hong Kong, 6 March 2003