

Other Businesses

- Revenues increased by 14% to HK\$1,117 million despite the impact of SARS
- External consulting and Octopus secure major overseas project
- Station renovations continue to enhance commercial facilities

The SARS outbreak had a negative impact on most of our non-fare businesses, but recovery was evident in the second half of the year, while high levels of growth were again recorded in overseas consulting.

Advertising

MTR is well recognised as a valuable resource for companies wishing to promote their products and services, and we seek to provide advertising opportunities without interfering with passenger comfort or convenience. Advertising in Hong Kong was severely impacted by the SARS outbreak and the soft economy, leading to advertising revenues for the MTR system falling by 3% to HK\$386 million. Nonetheless, MTR continued to expand and refine its advertising offerings in 2003, to capitalise further on the opportunity presented by its large passenger base.

In 2003, much effort was spent in revamping our products and enhancing the competitiveness of our trackside and concourse advertising. The programme to convert 4-sheet panels to larger 12-sheet panels in station concourses saw a total of 440 12-sheet panels in place by year end. During the second half of the year, we introduced our trackside plasmas, an exciting format which is expected to drive incremental revenue as more choices are provided to advertisers. These plasmas were joined by trackside scrolling units and trackside





Leveraging our expertise and assets at home and abroad

poster-on wall units. We also completed the project to revamp all our escalator crown panels to improve both panel size and presentation.

We stepped up our efforts to market our advertising infrastructure to advertisers and advertising agencies. In particular, we launched the "Best of the Best" campaign in early 2003 to reinforce perceptions of MTR as the leader in Hong Kong outdoor advertising.

The Company also seized the opportunity to enhance customer service and raise advertising revenues represented by increased interest in Internet usage, through providing free Internet access at stations. Two MTR Internet access centres, with advertising sponsorship, were opened in Central and Prince Edward stations, with more centres planned for 2004.

Telecommunications

The bulk of MTR's revenues from telecommunications services continues to come from mobile services. The competitive pricing by mobile network operators and the increasing mobile penetration accelerated growth in usage volumes during the year. This offset the negative impact of SARS, resulting in revenue increasing by 6.5% to HK\$198 million.

The Company continued to develop in the infrastructure to ensure we meet the expectations of customers and end-users, as well as to keep abreast of developments in technology. During the year, we began to put in place our first public wireless LAN network to enable wireless broadband services which will be launched early in 2004 on AEL. We also committed to upgrade the existing integrated radio system for mobile services so as to allow for the seamless use of 3G services within the railway system.

In the fixed line segment, our wholly-owned subsidiary, TraxComm Limited (TraxComm), secured a fixed telephone network services license in June, enabling it to begin to exploit the opportunities created by regulatory liberalisation as Hong Kong's only service provider focused exclusively on the wholesale market.

The MTR's existing fibre-optic network was enhanced for commercial use and the majority of data centres was connected. TraxComm also built and began to operate a DWDM-based (Dense Wavelength Division Multiplex) network to run alongside the existing fibre-optic network. This technology increases the capacity of the network and enables TraxComm to offer managed services that include traditional voice and data transmission as well as Internet protocol transmission on a single platform, contributing to cost efficiency.

Although revenues were recorded in TraxComm's first year of operation, these were lower than anticipated owing to the SARS outbreak and the resulting slower uptake of its services. The long-term contracts in place, however, represent a solid foundation for future expansion.

Station commercial facilities

Revenue from our station commercial facilities suffered during the SARS outbreak, which caused a slowing or freezing of expansion plans by retailers. However, the subsequent rebound together with further benefits derived from our programme to renovate stations more than mitigated the SARS impact. As a result, revenue from station commercial facilities increased by 16% to HK\$275 million.

The highly successful renovation programme commenced in 2001 following extensive passenger research and studies of other international railway systems. Its aim is to increase the



MTR is maximising the potential of commercial space

value and returns on station commercial facilities through improved trade mix, design and overall retail environment. As such, it leverages off MTR's ability to design station kiosk layouts that meet passenger, commercial, operational and statutory requirements in a cost-effective manner. The work completed during the year for the retail zones at Prince Edward, Wan Chai and Tsing Yi stations demonstrated clearly the gains to be made, increasing the combined retail floor area at these stations by 109% and rental income by 138%. At other stations a total of 45 new retail shops were added. These brought the total floor area devoted to commercial facilities in the MTR network to 18,449 square metres, an increase of 6% over 2002. Renovation work was also completed at Central and Kowloon Bay stations.

In addition to such major renovations, we again boosted rental income through enhancements in our network to make the shops better known and more appealing to customers. In total, we added 25 new trades or brands at all stations. These included the popular clothing retailer Giordano and additional food shops such as Rice Plus and Minamoto Kitchoan. These developments were accompanied by the introduction of an entirely new format of retail facility, the "sales cart", which offers more flexibility to tenants seeking smaller outlets and shorter leases.

In addition, we conducted a rebranding of our facilities to raise awareness among both retailers and end users of MTR shops. This included promotional activities within the shops themselves as well as an advertising campaign encouraging passengers to "Take a Short Break" on their MTR journey, highlighting the attraction of the enhanced retail environment and the expanded experience of being in MTR stations.

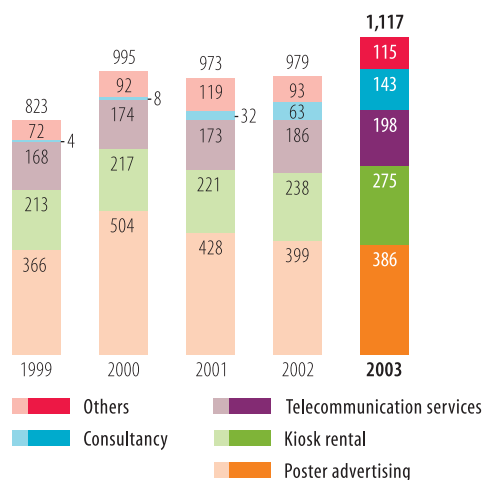
External consulting

Our consulting business continued to post strong growth in 2003 as our reputation for adding value to rail projects increased. Revenues from external consulting rose 127.0% in 2003 to HK\$143 million.

Revenues from other business activities

The strong growth in revenues from other businesses was led by external consulting and station commercial businesses.

In HK\$ million



A notable achievement was in Europe, where MTR and Octopus together secured a series of contracts with Thales e-Transactions CGA (Thales) to create an Automatic Fare Collection (AFC) system in the Netherlands. The two companies will work with the East-West Consortium, consisting of Thales, Accenture and Vialis Verkeer & Mobiliteit bv, to provide the Central Clearing House System Software as well as expertise in the operation of a new public transport e-ticketing system. The new system will be the first in the world to be implemented on a national scale and will offer integrated travel covering all modes of public transport including train, bus, tram, metro and ferry. The first phase for the Rotterdam area is planned for September 2004. MTR and Octopus also pre-qualified as supporting subcontractors to the East-West Consortium to bid for a similar national smartcard AFC system for Denmark.

In India, we were awarded our first rail consultancy contract to be funded by the International Bank for Reconstruction and Development. This is an important step in establishing a reputation with this body and its sister organisation the World Bank, which are both heavily involved in projects in developing countries. The Company will conduct a headway improvement study for the Mumbai Vikas Railway Corporation to examine the options to improve train frequencies on 33 commuter railway lines serving the city of Mumbai.

We also continued to make inroads in Mainland China, extending our consultancy involvement to eight cities: Beijing, Chengdu, Guangzhou, Hangzhou, Nanjing, Shanghai, Shenzhen and Tianjin. With contracts related to China's major metro systems, MTR is well positioned to bid for future projects covering construction, operations and investment.



e-Instant bonus machines show how MTR leverages technology in pursuit of new revenue streams

The rapid expansion of business in Mainland China has seen a greatly increased presence there. MTR now has an office in Shanghai, with over 100 employees, including 17 from Hong Kong. The Company's joint venture company in Shanghai, formed to pursue project management opportunities in China, was appointed to act as the owner's representative on the Phase I of the Shanghai Rail Transit Line No.9. The project consists of a 31 kilometre extension to the Shanghai Metro System, including 12 stations, a depot, 11 kilometres of bored tunnel, 18 kilometres of viaduct and two kilometres of at-grade railway. The planned opening date is the end of 2005 and the scope of work includes all aspects of project management from design, construction, commercial and programme management, to testing and commissioning.

Overseas investment

Feasibility studies and the negotiation of an in-principle agreement were completed for MTR's involvement in the Shenzhen Line 4 project. In January 2004, MTR signed an in-principle agreement with the Shenzhen Municipal Government for the construction of Phase 2 of the Line 4 of the proposed Shenzhen Metro System and the operation of the whole of Line 4 for 30 years under a build-operate-transfer arrangement. Line 4 will form part of the Shenzhen Metro

network and would run north from the Lok Ma Chau boundary crossing to the existing Longhua Town, passing through the new business district of Shenzhen. The formal concession agreement is expected to be signed later in 2004 following further design, planning and approval from the Central Government in Beijing. Based on the in-principle agreement, the Company will form a project company in Shenzhen to construct and operate this project, as well as acquire property development rights directly from the Shenzhen Municipal Government at stations and the depot along the new line. The total gross floor area to be developed from these rights amounts to 2.9 million square metres of commercial and residential property and this will provide MTR with an opportunity to expand its property portfolio outside Hong Kong.

In Beijing, feasibility studies are underway to evaluate business potentials of two metro projects, one being the Beijing airport link and the other a metro line that runs through the western part of the capital city.

The Company is working together with Mitsubishi Corporation of Japan in pursuit of modest investment opportunities in the light rail sector in the United Kingdom. Projects in the Portsmouth area (South Hampshire Rapid Transit) and in

Liverpool (Merseytram) are under investigation. In Vancouver, Canada, we are working within a consortium towards the development and operation of a light rail line between Richmond, Vancouver Airport and the City.

Such opportunities align with MTR's strategy of:

- Expanding the Company's existing businesses
- Investing in businesses synergistic with existing operations
- Investing in businesses which leverage off the Company's existing assets, skills and know-how

These opportunities have developed through ongoing relationships between MTR and other business partners. The projects are in light rail, of which all aspects of the methodology and technology, planning, business analysis, construction, operation and maintenance are familiar to the Company through its core business.

Octopus Cards Limited (Octopus)

The effect of SARS on travel and retail activity in Hong Kong caused a temporary halt to the rapid rise of Octopus card usage, with revenues falling sharply at the height of the crisis from 2002 levels. Although monthly transaction revenues and operating profit subsequently recovered in the final quarter to higher than pre-SARS levels, boosted in part by tourism from Mainland China, this was not enough to offset the earlier decline.

For the year, the number of cards in circulation rose from 9.3 million at the end of 2002 to 10.4 million as at 31 December 2003 and the number of service providers from 182 to 253. Profit contribution to the Company from Octopus nonetheless decreased by 40.4% over 2002 to HK\$23.1 million.

A major target for 2003 was to diversify from the company's core Hong Kong payment business into international AFC consultancy. This was achieved during the year when the company together with MTR's consulting arm and an international consortium prevailed over strong competition to win contracts for a nationwide AFC system in the Netherlands.

In Hong Kong, Octopus succeeded in expanding its use in the transport sector through a number of areas. The roll out of the system to off-road parking units saw Festival Walk and Pacific Place becoming "cashless" parking places and the number of car parks covered rose to over 130 by year end. On-road parking units accepting Octopus also increased and the number of red mini-buses accepting the card rose to 19 by year end. Octopus' acceptance by Hong Kong's retail network also continued to gain ground, taking in major chains such as Wellcome, Daily Stop, Pricerite and Ocean Empire.

The market share of our Octopus Access Control System for buildings also expanded. The system was successfully deployed as a one-card solution for schools, in addition to its existing applications in carparks, clubhouses, building access control and time attendance recording. The system for schools intelligently incorporates into one Octopus Card a time attendance record application with an SMS function for parent notification, building and room access control, tuck shop purchases, as well as library management systems.

The increasing popularity of the card resulted in more financial services groups joining the Automatic Add-Value Service in 2003, led by Standard Chartered, Bank of China and AEON, three large credit card issuers in Hong Kong.

Octopus' continued success secured a number of awards during the year that testify to the high regard in which the brand and the product are held. These include the Brand Leader Award in the Business Equipment and Services Category Award in Superbrands Hong Kong 2003, given by Superbrands, the Best Practice Award for Simplicity 2003 given by Best Practice Management, the Enterprise Award in the DHL/SCMP Hong Kong Business Awards 2003 and the Hong Kong Top Ten Brandnames Award 2003 presented by The Chinese Manufacturers' Association of Hong Kong.