# Financial review

## Review of 2004 financial results

### Profit and loss

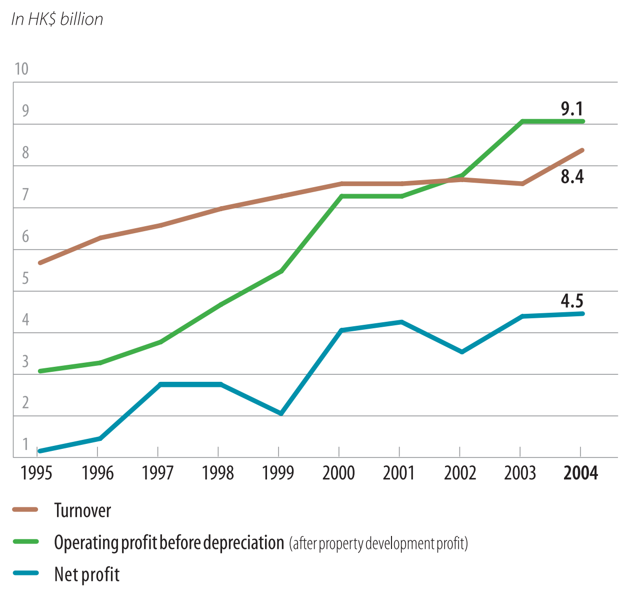
Total patronage for the MTR Lines, comprising the Urban Lines, the Tung Chung Line and the Tseung Kwan O Line, increased significantly from 770 million in 2003 to 834 million in 2004, following a recovery from the adverse effect of SARS in 2003 and an improved economic environment in 2004. Additional patronage also resulted from the opening of the West Rail Interchange and a strong increase in tourist arrivals from the Mainland. Average weekday patronage for the year improved to 2.40 million from 2.24 million in 2003. MTR's overall share of total franchised public transport rose to 24.8% from 24.3% in 2003, while the cross-harbour market share increased from 58.7% in 2003 to 59.6%.

Total fare revenue for the MTR Lines amounted to HK$5,417 million, which was a 7.0% increase from HK$5,064 million in 2003. With a higher proportion of passengers using concessionary tickets and an increase in free-ride tickets issued through the "Ride 10 Get 1 Free" promotion campaign, the average fare dropped slightly from HK$6.57 in 2003 to HK$6.50.

The average daily patronage on AEL rose by 16.6% to 21,800 from 18,700 in 2003, mainly due to the strong recovery of air passenger arrivals and departures at the Hong Kong International Airport. However, MTR's estimated market share of passengers travelling to and from the airport reduced from 23% in 2003 to 21% mainly as a result of a change in the mix of visitors. Total revenue from AEL increased by 21.2% to HK$515 million, with the average fare improving from HK$62.07 to HK$64.25 in 2004.

Non-fare revenue grew strongly by 14.9%, from HK$2,105 million in 2003 to HK$2,419 million, comprising HK$1,311 million from station commercial and other revenue and HK$1,108 million from property rental and management. Compared to 2003, a growth of 17.4% was achieved for station commercial and other revenue, mainly due to significant increases in advertising and


**Operating profit contributions**
The contribution to operating profit from railway operations increased.




**Net results**
Recovery from SARS, the economic rebound and continuous cost containment supported a very good overall performance.

telecommunication income resulting from the strong recovery in consumer spending. Property rental and management income increased by 12.1% compared with 2003, mainly attributable to a full year operation of Two IFC, an expanded portfolio of managed properties, higher rental renewal rates, and the removal of SARS rental concessions granted in 2003.

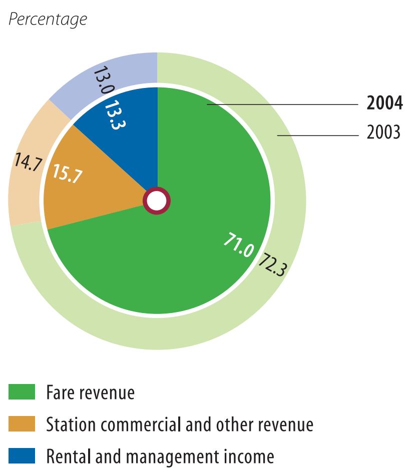
Despite a general increase in business activities during 2004, operating costs were well contained and there were continued gains in productivity. As a result, operating expenses before depreciation decreased 1.1% from HK$3,847 million in 2003 to HK$3,805 million. Apart from a reduction in staff costs from HK$1,643 million in 2003 to HK$1,542 million in 2004 mainly due to lower pension expenses, there was a HK$69 million write-back of property revaluation deficit on our head office building made in 2003, owing to a strong recovery in property prices. These were, however, partly offset by higher Government rent and rates, which increased from HK$21 million in 2003 to HK$70 million in 2004 due to a substantial rate refund in 2003, higher maintenance costs of HK$517 million resulting from the expiry of warranty periods in respect of most of the Tseung Kwan O Line assets, and higher project study and business development costs incurred during 2004 in line with the Company's strategy to expand our business development in the Mainland and in Europe.

Operating profit from railway and related operations before depreciation and interest amounted to HK$4,546 million, an increase of 21.3% from HK$3,747 million in 2003. Operating margin was 54.4% compared with 49.3% in 2003.

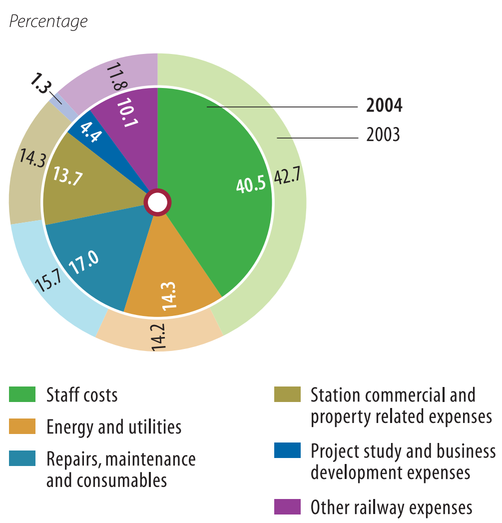
Profit on property development was HK$ 4,568 million as compared with HK$5,369 million in 2003, comprising mainly sharing in kind in respect of part of the Union Square retail shell structure at Kowloon Station, recognition of deferred income relating to Caribbean Coast and Coastal Skyline at Tung Chung Station and The Harbourside at Kowloon Station in line with construction progress, and surplus proceeds from The Harbourside at Kowloon Station and from Residence Oasis at Hang Hau Station in Tseung Kwan O.

Operating profit before depreciation was HK$9,114 million, almost the same as in 2003. Depreciation charges increased by 4.6% to HK$2,512 million from HK$2,402 million in 2003, mainly due to a full year's depreciation in respect of the West Rail Interchange facilities following its commissioning in December 2003, and depreciation on new railway assets including platform screen doors and station improvement works.

Net interest expenses decreased from HK$1,539 million in 2003 to HK$1,450 million as a result of the lower interest rate




**Turnover**
Proportion of fare revenue reduced following double-digit growth in non-fare revenues.




**Operating expenses**
Staff costs were lower, mainly due to lower pension expenses and gain in productivity.

environment and reduced borrowings. The average interest rate paid by the Company reduced from 5.1% in 2003 to 4.7% in 2004 whilst the interest cover increased to 6.1 times from 5.6 times in 2003 in line with the increase in operating profit.

The Company's share of Octopus Cards Limited's pre-tax earnings was HK$44 million for the year. Income tax expenses decreased by 6.4% from HK$748 million in 2003 to HK$700 million, mainly due to the prior year effect of a deferred tax adjustment of HK$300 million upon an increase in the Profits Tax rate in 2003, which was partly off-set by higher deferred tax expense on the 2004 property development profit. As a result, the Group's profit attributable to shareholders for the year was HK$4,496 million, an increase of 1.0% compared to HK$4,450 million in 2003. Earnings per share decreased slightly from HK$0.85 to HK$0.84 due to new shares issued during the year for scrip dividend and share options exercised.

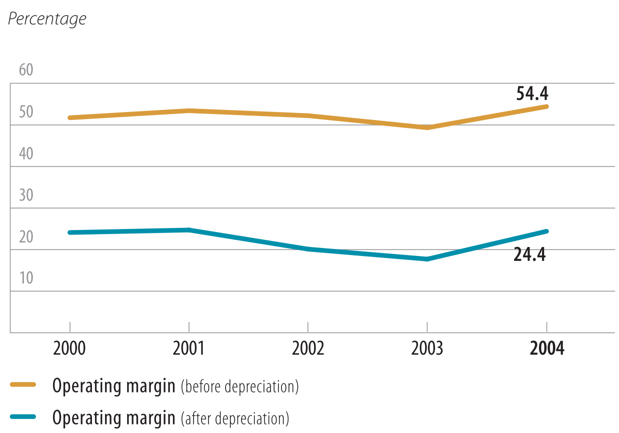
The Board has recommended a final dividend of HK$0.28 per share, amounting in total to HK$1,509 million, with a scrip dividend option offered to all shareholders with Hong Kong addresses. As in previous years, the Government has agreed to receive its entitlement to dividends in the form of shares to the extent necessary to ensure that a maximum of 50% of MTR's total dividend will be paid in cash.

**Balance sheet**

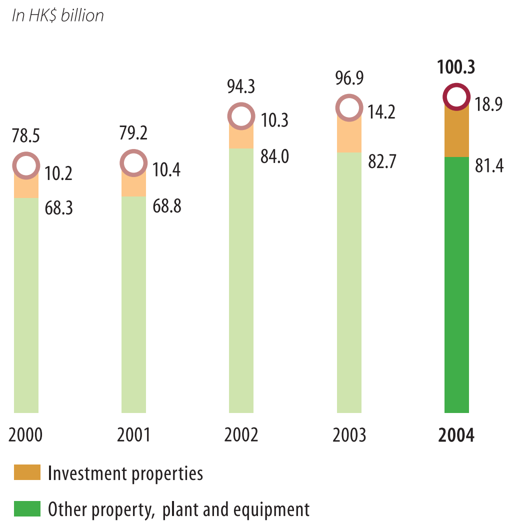
The Group's balance sheet remained strong, with the bulk of our assets invested in the railway system. Total fixed assets increased from HK$96,921 million in 2003 to HK$100,313 million as at 31 December 2004, mainly attributable to receipt of the shell of a retail centre and surpluses in investment property revaluation.

Railway construction in progress increased from HK$181 million in 2003 to HK$962 million as at 31 December 2004, comprising additional capital expenditures on the Disneyland Resort Line, Tung Chung Cable Car and AsiaWorld-Expo Station projects.

Property development in progress represents the costs incurred in preparation of sites for property development less reimbursement already received from developers. Property development in progress at the year end amounted to HK$2,088 million, a decrease of 9.6% from the previous year's HK$2,309 million, mainly due to transfer out of the account of development costs in respect of Hang Hau property development project upon its completion.




## Operating margin
Improved productivity and higher revenues lifted operating margin.




## Fixed assets growth
Total fixed assets rose, following receipt of a retail shell and surpluses in property revaluation.

Cash and cash equivalents decreased to HK$269 million as at 31 December 2004 from HK$376 million as at 2003 year end.

Total loans outstanding at year-end were HK$30,378 million, a decrease of HK$1,647 million compared with 2003 due to loan repayments. Loans drawn down during the year amounted to HK$7,194 million which were primarily for refinancing purposes.

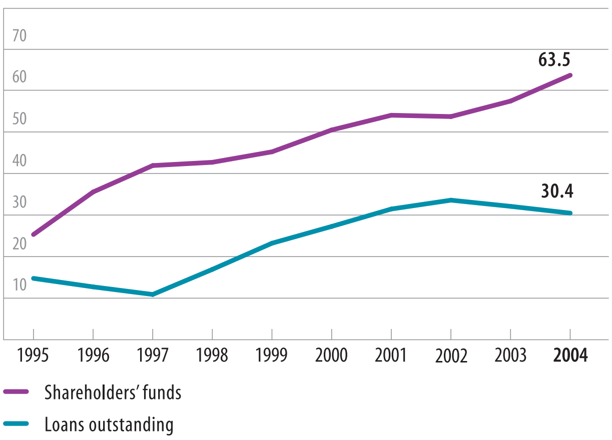
Deferred income decreased from HK$5,061 million in 2003 to HK$4,638 million following profit recognition at Tung Chung and Kowloon station developments in accordance with the progress of property construction and pre-sales programmes. This was partly offset by an increase in the transfer-in of deferred income in respect of the retail shell structure at Kowloon Station.

Our share capital, share premium and capital reserve of HK$36,269 million at year end was HK$1,183 million higher than in 2003, as a result of shares issued for scrip dividend and share options exercised. Together with increases in property revaluation reserves of HK$2,759 million and retained earnings net of dividend of HK$2,265 million, total shareholders' funds increased to HK$63,499 million from HK$57,292 million as at 31 December 2003. As a result, the Group's gross debt-to-equity ratio improved from 55.9% to 47.8% at 2004 year-end and net debt-to-equity ratio from 55.2% to 47.4%.

**Cash flow**

Net cash inflow generated from railway and related activities increased from HK$3,837 million in 2003 to HK$4,486 million for the year, while cash receipts from developers for property development projects also increased from HK$855 million for the previous year to HK$2,576 million. Outflows for capital project payments and interest expenses amounted to HK$2,889 million and HK$1,301 million respectively, as compared to HK$2,670 million and HK$1,643 million for the previous year. Together with other minor movements, net cash flow before dividends and loan repayments were HK$2,566 million, being HK$2,109 million higher than the previous year. After dividend payments of HK$1,079 million and net loan repayment of HK$1,593 million, there were net cash outflows of HK$106 million compared to net outflows of HK$1,320 million in 2003.

*In HK$ billion*




**Debt/equity profile**

Reduced borrowings and increase in shareholders' funds improved the debt/equity profile.

**Revised accounting standards in 2005**

Following the convergence of the Hong Kong Accounting Standards with the International Accounting Standards from 1 January 2005, the accounting standards in Hong Kong have been substantially revised and the Company's future financial statements and results will be affected by a number of accounting changes in the coming year, notably those relating to valuation of investment properties and financial instruments. Previously, changes in the fair value of investment properties arising from revaluation had been generally recognised through the reserve account on a portfolio basis without impacting the Profit and Loss Account (P&L). However, after 1 January 2005, these revaluation gains or losses are required to be brought through the P&L. With the volatility of property prices being a characteristic of the Hong Kong market, this new accounting standard could have a significant impact on the level and consistency of our reported profit.

The new accounting standard relating to financial instruments requires that after 1 January 2005 all financial instruments which the Company is using to hedge the interest rate and currency risks of our borrowings must be marked to market, with any change in their fair values recognised in the P&L directly. However, the standard allows the application of hedge accounting, that is, to use the change in fair value of the underlying hedged items to offset this impact so that only inefficiency in the hedging relationship resulting in net residual impact will be reported in the P&L. Given that hedge efficiency is affected by a number of factors including the nature of the hedging relationship, direction of interest rates and changes in foreign exchange rates, it is difficult to forecast and control this residual impact.

It should be stressed, however, that both of these items are non-cash items and hence do not affect cash flow. Apart from these, the revised standards introduced a number of other minor changes mainly on alignment of disclosure with the international standards which will be reflected in the 2005 accounts.