

A young boy in a light blue shirt and dark pants holds a large, flowing blue banner. A young girl in a pink hoodie and plaid skirt holds a large, flowing yellow banner. They are standing on a reflective white surface against a bright blue sky with light clouds. The text "A New Era" is centered in the sky.

A New Era



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Looking to the Future

The Rail Merger places the Company in an excellent position to further promote the sustainable development of Hong Kong's economy and society. Leveraging on our enhanced expertise and resources, we are investing in exciting new expansion opportunities for the future. As one dynamic team, we are preparing for the future as an international enterprise while continuing to provide Hong Kong with a world-class railway infrastructure and good quality of life.



The Rail Merger

Key Rail Merger Events :



11 Apr 2006

Signing and announcement of the confidential

Memorandum of Understanding

between MTR and Government setting out the proposed structure and financial terms of the Rail Merger

24 Feb 2004

Government invited
MTR & KCRC

to commence discussions on a possible merger of the two companies

7 Jul 2006

The Legislative Council of HKSAR (LegCo) formed a

Bills Committee

to study the Rail Merger Bill in detail

8 Jun 2007

The Rail Merger Bill

was passed by LegCo

Key Rail Merger Integration Activities :

30 MTR and KCRC staff formed the

Merger Integration Office

to plan and manage the integration process, involving more than 11 taskforces with 300 members





9 Oct 2007

The Rail Merger was approved by MTR's

Independent Shareholders



2 December 2007

Appointed Day of the Rail Merger

9 Aug 2007

Transaction Documents

for the Rail Merger were signed

99 Cultural Integration Workshops

for over 12,000 staff to get to know each other

Replacement of

Over 150,000 Logos and Signs

for the new brand

Preparation of

Over 6,000 New Uniforms

for staff

Alignment of








Over 500 Procedures

with over 17,000 man-hours of training for staff to familiarise with new procedures, enabling a smooth transition in operations



Operating Network with Future Extensions



Legend

-  Station
-  Station with Depot
-  Interchange Station
-  Proposed Station
-  Proposed Interchange Station
-  Cable Car Ngong Ping 360
-  Shenzhen Metro Network
- * Racing days only

Existing Network

-  Airport Express
-  Disneyland Resort Line
-  East Rail Line
-  Island Line
-  Kwun Tong Line
-  Light Rail
-  Ma On Shan Line
-  Tseung Kwan O Line
-  Tsuen Wan Line
-  Tung Chung Line
-  West Rail Line





Projects in Progress

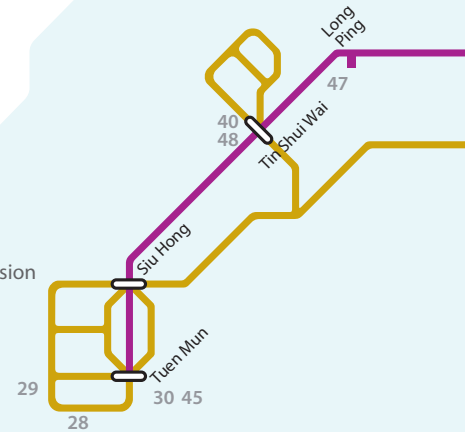
-  Kowloon Southern Link
-  Tseung Kwan O South

Extensions under Study

-  Guangzhou-Shenzhen-Hong Kong Express Rail Link
-  Kwun Tong Line Extension
-  Shatin-to-Central Link
-  South Island Line (East)
-  West Island Line

Future Extensions

-  North Island Line
-  Northern Link
-  South Island Line (West)
-  Tseung Kwan O Line Extension



Properties Owned / Developed / Managed by the Corporation

- 01 Telford Gardens / Telford Plaza I and II
- 02 World-wide House
- 03 Admiralty Centre
- 04 Argyle Centre
- 05 Luk Yeung Sun Chuen / Luk Yeung Galleria
- 06 New Kwai Fong Gardens
- 07 Sun Kwai Hing Gardens
- 08 Fairmont House
- 09 Kornhill / Kornhill Gardens
- 10 Fortress Metro Towers
- 11 Hongway Garden / Vicwood Plaza
- 12 Perfect Mount Gardens
- 13 New Jade Garden
- 14 Southorn Garden
- 15 Heng Fa Chuen / Heng Fa Villa / Paradise Mall
- 16 Park Towers
- 17 Felicity Garden
- 18 Tierra Verde / Maritime Square
- 19 Tung Chung Crescent / Citygate / Novotel Citygate / Seaview Crescent / Coastal Skyline / Caribbean Coast

- 20 Central Park / Island Harbourview / Park Avenue / Harbour Green / Bank of China Centre / HSBC Centre / Olympian City One / Olympian City Two
- 21 The Waterfront / Sorrento / The Harbourside / The Arch / Elements / The Cullinan / Harbourview Place / International Commerce Centre
- 22 One International Finance Centre / Two International Finance Centre / IFC Mall / Four Seasons Hotel / Four Seasons Place
- 23 Central Heights / The Grandiose / The Edge
- 24 Residence Oasis / The Lane
- 25 No 8 Clear Water Bay Road / Choi Hung Park & Ride
- 26 Metro Town
- 27 Royal Ascot / Plaza Ascot
- 28 Pierhead Garden / Ocean Walk
- 29 Sun Tuen Mun Centre / Sun Tuen Mun Shopping Centre
- 30 Hanford Garden / Hanford Plaza
- 31 Citylink Plaza
- 32 MTR Hung Hom Building / Hung Hom Station Carpark
- 33 Trackside Villas

Property Developments under Construction / Planning

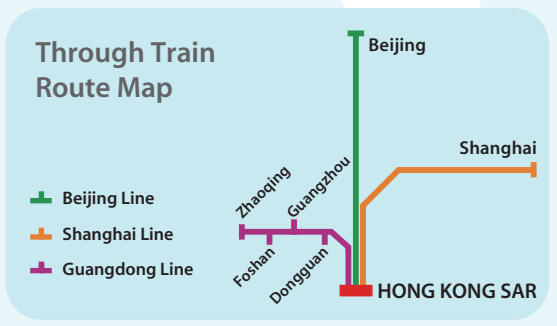
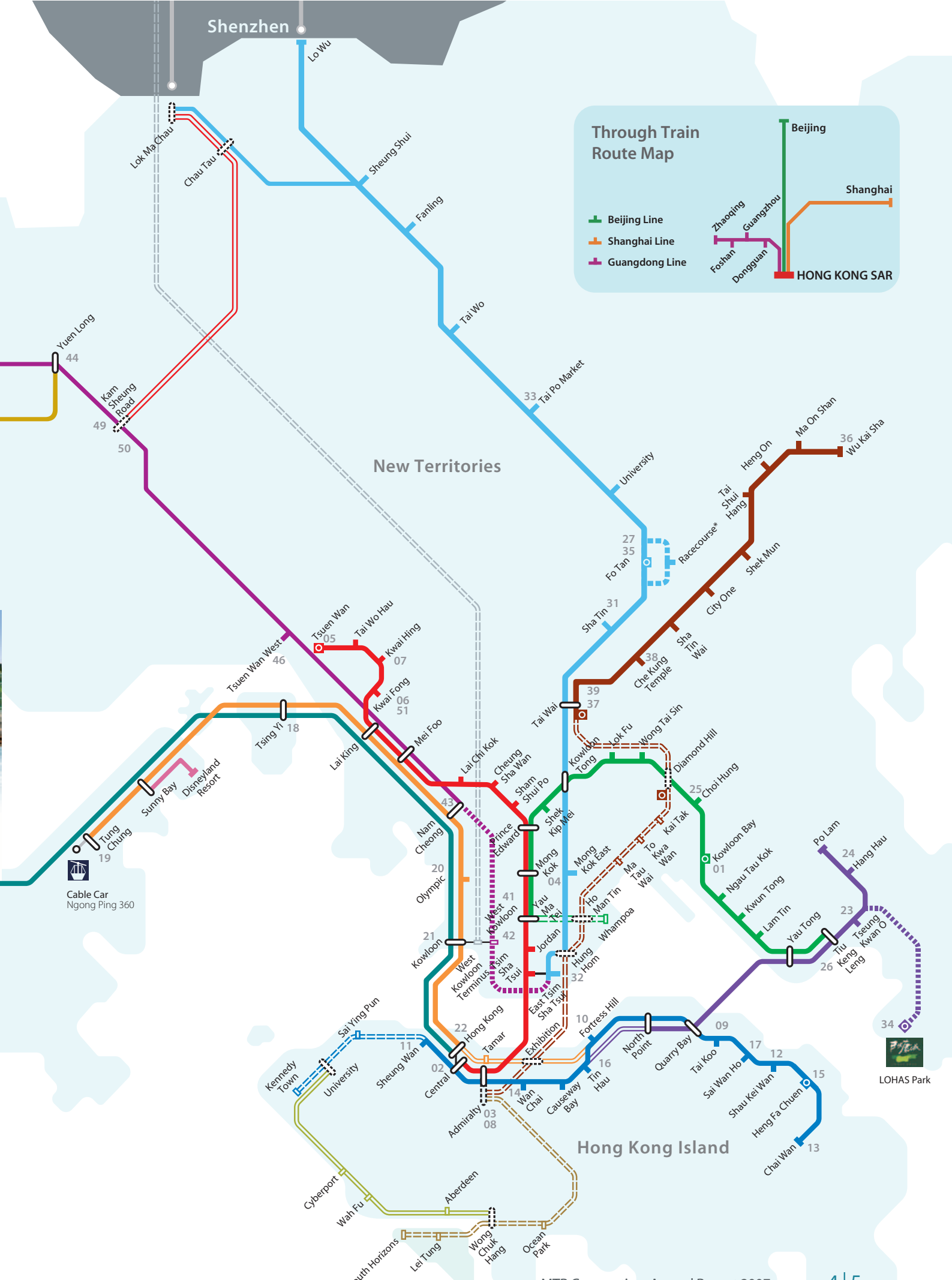
- 19 Tung Chung Station Package 3
- 21 Kowloon Station Package 5, 6 & 7
- 23 Tseung Kwan O Station Area 56
- 34 LOHAS Park
- 35 Ho Tung Lau Site A
- 36 Wu Kai Sha Station
- 37 Tai Wai Maintenance Centre
- 38 Che Kung Temple Station
- 39 Tai Wai Station
- 40 Tin Shui Wai Light Rail Terminus
- 41 Kowloon Southern Link Site C
- 42 Kowloon Southern Link Site D

West Rail Line Property Development (As Government Agent)

- 43 Nam Cheong Station
- 44 Yuen Long Station
- 45 Tuen Mun Station
- 46 Tsuen Wan West Station
- 47 Long Ping Station
- 48 Tin Shui Wai Station
- 49 Kam Sheung Road Station
- 50 Pat Heung Maintenance Centre
- 51 Kwai Fong Station



Lantau Island



MTR Corporation at a Glance

The size, scale and geographic coverage of the business activities of the Company have been significantly expanded as a result of the Rail Merger completed on 2 December 2007. Our share of the Hong Kong franchised public transport market has increased to 41.6% and our property land bank and rental portfolio have both been increased with the Rail Merger.



Railway Operations

Business Description

We operate a pre-dominantly rail based transportation system in Hong Kong, comprising Domestic and Cross-boundary services, a dedicated high-speed Airport Express and a light rail system, which in total stretches 211.6 kilometres with 82 stations and 68 stops. The Integrated MTR System is one of the most intensively used systems in the world, known for its reliability, safety and efficiency. We also provide intercity services to the Mainland of China as well as a bus operation in Hong Kong providing convenient feeder services.

Station Commercial and Rail Related Businesses

Business Description

We leverage our railway assets and expertise into additional businesses, including rental of station retail units (including Duty Free shops), advertising in trains and stations, telecommunications, rail consulting and freight services.

2007 Highlights

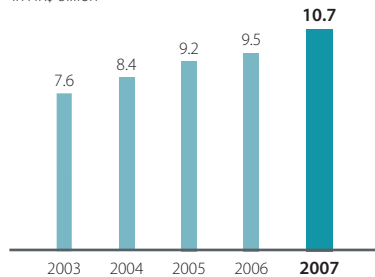
- Successfully completed the integration of two railway networks on the Appointed Day of 2 December, together with fare reductions with effect from that day
- Exceeded Performance Requirements under the pre-Rail Merger Operating Agreement and Customer Service Pledges and entered into a new post-Rail Merger Operating Agreement on Appointed Day
- Customer satisfaction levels for service quality and fares remained high
- Internationally received the Gold Asset Management Excellence Award and Steve Maxwell Leadership Award for outstanding railway asset management practices

2007 Highlights

- Renovations to commercial areas at nine stations were completed
- Replacement of seatback TV with new multimedia system in the Airport Express was completed
- New advertising formats including "Interactive Panel", "Shopping Guide Map" and "12-sheet Scrolling Units" were introduced to strengthen our market leadership position
- Advertising, station retail and telecommunications businesses included those of the KCR System after 2 December 2007, together with rental of space to Duty Free shops as well as freight services to Mainland China

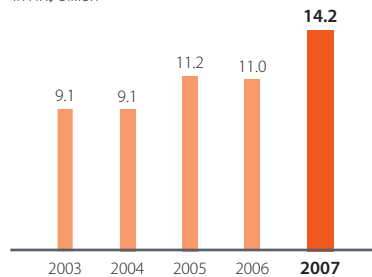
Turnover

in HK\$ billion



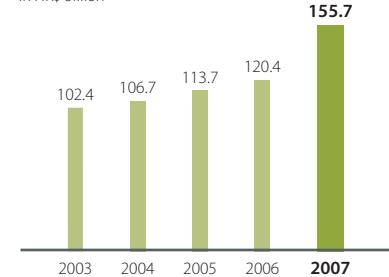
Operating Profit before Depreciation and Amortisation (after Property Development Profit)

in HK\$ billion



Total Assets

in HK\$ billion



Property and Other Businesses

Business Description

We develop mainly residential properties in conjunction with property developers. We own investment properties, principally shopping centres and offices, and manage our properties and others. Our investment portfolio includes 12 shopping centres and 18 floors of the Two International Finance Centre office tower.

Overseas Growth

Business Description

We continue our strategy to grow outside of Hong Kong by investing in urban rail networks in the Mainland of China, and pursuing "asset-light" operating concessions in European markets that are privatised or opening to new entrants.

2007 Highlights

- Tender of Area 56 of Tseung Kwan O awarded in February 2007 to a subsidiary of Sun Hung Kai Properties Limited
- Tender of Package Three of LOHAS Park awarded in November 2007 to a subsidiary of Cheung Kong (Holdings) Limited
- Elements Phase 1, our majority owned newest flagship shopping centre above Kowloon Station, opened on 1 October 2007
- Enlarged investment property portfolio with Elements and new intake of KCRC properties after the Rail Merger
- Opening of Ginza Mall in Beijing in January 2007

2007 Highlights

- Our joint venture with Laing Rail won the London Overground concession and successfully took it over on 11 November 2007
- Project progress and operational preparation of Beijing Metro Line 4 were satisfactory
- Training of 268 operations staff for Beijing Metro Line 4 commenced in September 2007 in cooperation with Beijing Communication School
- Preparatory work and expanded trial section work for Shenzhen Metro Line 4 continue while awaiting approval from the National Development and Reform Commission of Mainland China

Chairman's Letter



“The successful completion of the Rail Merger on 2 December 2007, the winning of the London Overground concession in the United Kingdom and the very successful opening of Elements shopping centre in Hong Kong were some of the highlights of the year”

Dear Stakeholders,

I am pleased to present to you the annual results of MTR Corporation for 2007, which continue to reflect the momentum of our core businesses and of our growth strategy at home and abroad. The successful completion of the Rail Merger on 2 December 2007, the winning of the London Overground concession in the United Kingdom and the very successful opening of Elements shopping centre in Hong Kong were some of the highlights of the year.

For the year, buoyant economic conditions led to continued growth in our businesses, which when combined with the effect of the Rail Merger since 2 December, enabled MTR Corporation to increase total revenue for 2007 to HK\$10,690 million, 12.0% higher than 2006. The operating profit from railway and related businesses before depreciation and amortisation also rose by 13.7% to HK\$5,912 million. Property development profit realised in the period was HK\$8,304 million, mainly from surplus proceeds at developments such as Le Point at Tiu Keng Leng Station. Excluding investment property revaluation and related deferred tax, profit from underlying businesses attributable to equity shareholders was HK\$8,571 million, 43.8% higher than 2006, largely due to the magnitude of property development profit as well as continued strong performance from our recurring businesses. Including investment property revaluation of HK\$8,011 million (HK\$6,609 million net of deferred tax), reported net profits for 2007 were HK\$15,182 million with earnings per share of HK\$2.72. With the strong financial results, your Board has recommended a final dividend of HK\$0.31, giving a full year dividend of HK\$0.45, which is an increase of 7.1% compared to 2006.

Rail Merger: A Milestone Achieved

2 December 2007 saw the completion of the Rail Merger between the Company and Kowloon-Canton Railway Corporation (KCRC), which followed the approval of the Rail Merger Bill by the Legislative Council of Hong Kong (LegCo) in June, and of independent shareholders at an Extraordinary General Meeting in October. In the Rail Merger, the Company has taken over KCRC's rail and related businesses under a concession arrangement and also acquired a property portfolio.

The Rail Merger increases significantly the scale and profitability of our rail and related businesses whilst at the same time enhances our property development land bank and rental property portfolio. Patronage on Domestic Service, which includes KCR Lines after the Rail Merger, grew from 2.6 million passengers per weekday before the Rail Merger, to 3.5 million passengers per weekday in December after the Rail Merger. Our property development land bank increased by 1.2 million square metres GFA while our investment property portfolio increased by 40,957 square metres lettable with the Rail Merger. The Rail Merger benefits all our stakeholders with fare reductions and improved network co-ordination for our passengers, increased opportunities for our staff and enhanced value for our shareholders. With the completion of the Rail Merger we are now working diligently on the further integration of the Company as well as the achievement of synergies, which when fully realised in three years' time are estimated at HK\$450 million per year.

Under the guiding principle of "One Company, One Team", the integration of staff from the Company and KCRC has progressed smoothly, for which I would like to thank management and all staff of the merged Company.

Growth Strategy

With the completion of the Rail Merger, our future growth strategy rests with the significant new rail development in Hong Kong and our continued expansion into the Mainland of China and Europe.

In Hong Kong, the year saw good progress being made on the Kowloon Southern Link, a KCRC project managed by the Company, and a new station at LOHAS Park (in Tseung Kwan O South), while planning and detailed design continued for the new 3-km West Island Line after approval was received from Government. In addition, the Chief Executive of Hong Kong SAR announced in his October Policy Address that the Government was pledging its support to a number of priority rail infrastructural developments, including the 7-km South Island Line (East), the 26-km Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link), and

“With the completion of the Rail Merger, our future growth strategy rests with the significant new rail development in Hong Kong and our continued expansion into the Mainland of China and Europe”

the Shatin-to-Central Link. Approval has already been obtained to proceed with preliminary planning and design for the South Island Line (East), Shatin-to-Central Link and the 3-km Kwun Tong Line extension whilst we are in active discussion with Government on the design and implementation proposal for the Express Rail Link.

In the Mainland of China, steady progress was made on the Beijing Metro Line 4 project, while we continued with preparations for the approval of the Shenzhen Metro Line 4 (SZL4) project. The approval process for SZL4 has taken a protracted length of time since it requires a breakthrough in certain policy areas. Under the current policy relating to property development in China, the public sector funding support to this project is likely to take other forms than the grant of property development rights. The Company will ensure that the project, if approved, will provide a satisfactory return to its shareholders. During the year, we also continued to pursue further investment opportunities in key cities such as Hangzhou, Suzhou, Tianjin and Wuhan, as well as in Beijing and Shenzhen.

In Europe, we continued with our “asset-light” approach to bid for new operating concessions in privatised markets. The highlight of the year was the winning of the London Overground concession by our UK joint venture, London Overground Rail Operations Ltd (LOROL). London Overground is an important rail network in the UK's capital serving West, North and East London and will be a vital link for the 2012 Olympic Games. Under the concession, LOROL will operate train services in Greater London for seven years.

Sustainability and Community

In our drive to achieve growth, an important priority for us is to ensure that our business and growth are sustainable. This has become even more crucial as the consequences of climate change, and social and environmental complacency

have become ever more apparent. As our new rail extensions reach out to a larger part of Hong Kong and our operations extend beyond Hong Kong into the Mainland of China and the UK, we remain determined to enhance the quality of life of our passengers, customers, tenants and employees. We aim to do this not only by providing the best possible railway infrastructure and services, but also by focusing on the needs of the community, by involving ourselves in its well-being, and above all by investing in resources to enhance efficiency and ecological sustainability.

The Company is in full support of the Government's clean-air initiatives and is committed to making a leading contribution to the Action Blue Sky Campaign launched by the Chief Executive of the Hong Kong SAR. As one of the largest electricity users in the Pearl River Delta, we are a signatory to and have been implementing the Clean Air Charter, which requires the Company to adopt energy-efficient measures in its operations and monitor its emissions of air pollutants.

In 2006, the Company adopted the MTR Corporation Climate Change Policy, which is modelled on the policy developed by the International Association of Public Transport (UITP), whose Sustainable Development Commission we currently chair.

The Company has undertaken a thorough assessment of the enterprise risk associated with exposure to climate change issues and concluded these are significant enough to require ongoing monitoring. We are in the process of reviewing how climate change can be taken into account in our design, construction, and asset management to prepare more definitively an adaptation-based scenario for future years. Our aim is to become one of the most resource efficient and ecologically responsible public transport companies in the world.

Our efforts in sustainability, corporate governance, service culture and management processes have continued to attract international recognition, both locally and internationally. We

have received the SAM (Sustainable Asset Management) Sector Leader award and Silver Class Award for recognising our ability to manage related risks and to seize associated opportunities. During the year, our Sustainability Report 2006, *Convergence*, was accredited the "Runner Up - Best Sustainability Report" by the Association of Chartered Certified Accountants (ACCA) Hong Kong. Our world-class professionalism, safety standards and cost efficiency are the backbone of our sustainability drives. The Company was honoured to receive the Gold Asset Management Excellence Award at the 2007 International Asset Management Conference in Melbourne for our results-driven and robust railway asset management system and focus on continuous improvement, which the panel of international judges considered the "best ever seen".

During the year, many of our employees took part in programmes and events to reach out to the less fortunate in our community.

There were 86 community volunteer initiatives involving more than 1,800 volunteers. Most of the volunteering services were for the elderly, the physically and mentally challenged, and underprivileged children and families. The MTR HONG KONG Race Walking 2007, which was co-organised with the Hong Kong Amateur Athletic Association, raised over HK\$1 million for the Hospital Authority's health education campaign. In 2007, we were once more nominated by eight social organisations for the Caring Company Logo 2007/08 in recognition of the Company's contributions to society through employee volunteering, community giving and providing a safe and family friendly environment for our staff.

To help the victims of the severe snowstorm in the Mainland of China, we donated HK\$1 million on 4 February 2008 to provide warm clothing and emergency supplies via the Hong Kong Red Cross. In addition, we set up donation counters at our twelve

shopping centres over Lunar New Year holidays. The funds received were donated through Oxfam Hong Kong to provide food supplies and warm clothing for the snowstorm victims.

Board Transitions

Mr David Gordon Eldon and Mr Lo Chung-hing will retire as independent non-executive Directors of the Company at our Annual General Meeting on 29 May 2008. I would like to thank Mr Eldon, who is also currently the chairman of our Nominations Committee, and Mr Lo for their long service and significant contributions to the Company.

I would like to welcome Ms Eva Cheng and Professor Chan Ka-keung, Ceajer, who both joined the Board in July 2007 on taking up the offices of Secretary for Transport and Housing, and Secretary for Financial Services and Treasury respectively. I would further welcome Mr Ng Leung-sing and the Honourable Abraham Shek Lai-him who joined the Board in December 2007 as independent non-executive Directors.

The successful performance of the Company is built on the excellence of our Board governance, management and staff, the trust of our customers, and our shareholders. As we enter a new era in the Company's history, I would like to extend my heartfelt thanks to my fellow Board Members, management and all staff for all their efforts in making 2007 a milestone year in advancing our vision of sustainable growth.



Dr. Raymond Ch'ien Kuo-fung, *Chairman*
Hong Kong, 11 March 2008

CEO's Review of Operations and Outlook



“2007 also saw strong financial results for MTR Corporation as we continued to make steady progress in all our businesses”

Dear Stakeholders,

2007 was a successful year for the Company. Firstly, on 2 December, we completed the merger of our rail operations with those of the Kowloon-Canton Railway Corporation (KCRC) and acquired from KCRC a portfolio of properties (Rail Merger). Secondly, in Hong Kong, a number of new rail lines saw progress. The West Island Line was gazetted by the Hong Kong SAR Government, and good construction progress was made on the Kowloon Southern Link, which is part of the Rail Merger. Hong Kong SAR's Chief Executive highlighted in his Policy Address three additional rail lines as infrastructural priority projects, these being the South Island Line (East), the Shatin-to-Central Link and the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link). We welcome Government's latest decision for the Company to proceed with the further planning and design of Shatin-to-Central Link and the Kwun Tong Line extension to Whampoa. Thirdly, outside of Hong Kong, we won the London Overground concession together with our UK joint venture partner, Laing Rail, whilst work progressed in Beijing on the construction of Beijing Metro Line 4.

2007 also saw strong financial results for MTR Corporation as we continued to make steady progress in all our businesses. For the year, our revenue increased by 12.0% to HK\$10,690 million, due to the continued growth in our recurring businesses and the effect of the Rail Merger. Operating profit from railway and related businesses before depreciation, amortisation and merger related expenses rose by 13.7% to HK\$5,912 million. Property development profit recognised in the period was HK\$8,304 million. Excluding investment property revaluation and the related deferred tax, net profit from underlying businesses attributable to equity shareholders was HK\$8,571 million, 43.8% higher than 2006. This significant increase in underlying profits was primarily the result of the very significant property development profits recognised in 2007, in particular from Le Point at Tiu Keng Leng Station. Earnings per share were HK\$1.54 before investment property revaluation and HK\$2.72 after such revaluation. With the strong financial results, your Board has recommended a final dividend of HK\$0.31,

which when combined with the interim dividend of HK\$0.14 per share, brings full year dividend to HK\$0.45, an increase of 7.1% over 2006.

The Rail Merger

Following the Memorandum of Understanding between the Company and the Hong Kong SAR Government on 11 April 2006, the Rail Merger Bill was approved by the Legislative Council of Hong Kong (LegCo) on 8 June 2007. Formal transaction documents were entered into between the Government, the Company and KCRC in August 2007, and independent shareholders of the Company approved the Rail Merger on 9 October. The completion of the Rail Merger on 2 December marked a new era not only for the Company but also for public transportation in Hong Kong.

For our customers, the Rail Merger brought fare reductions as well as better integration of the rail network in Hong Kong. For the Company and our shareholders, the Rail Merger represents a significant increase in the size and scale of our rail and property portfolio as well as growth opportunities in the form of new railway lines throughout Hong Kong and connecting to the Mainland of China. The expansion of our rail and rail related businesses together with the Rail Merger transaction structure increases our recurrent profitability and enhances the long term sustainability of the Company. This will benefit all stakeholders of the Company and will provide a platform for the sustainable development of Hong Kong's public transportation services.

Operational Review

Hong Kong Railway Operations

For the year, total patronage on the Integrated MTR System, including the effect of the Rail Merger since 2 December, increased by 8.2% to 948.3 million. For the period before the Rail Merger, total patronage increased by 2.9% as compared to the same period in 2006.

Average weekday patronage on pre-Merger MTR Lines increased by 3.3% to 2.6 million as compared to the same period last year. After the Rail Merger, our Domestic Service, which now

“... the Rail Merger represents a significant increase in the size and scale of our rail and property portfolio as well as growth opportunities in the form of new railway lines throughout Hong Kong and connecting to the Mainland of China”

also includes the KCR Lines (comprising the East Rail excluding Cross-boundary Service, West Rail, and Ma On Shan lines), saw average weekday patronage increasing significantly to 3.5 million.

Patronage on the Airport Express rose 6.3% to 10.2 million in 2007, as the number of air travellers using Hong Kong International Airport continued to rise, and the number of exhibitions and other events at AsiaWorld-Expo increased.

For Cross-boundary Service at Lo Wu and Lok Ma Chau, patronage for the full year recorded an increase of 4.7% to 92.1 million, of which 8.2 million was attributable to the Company from the Rail Merger for the period after 2 December. Light Rail, Bus and Intercity recorded patronage of 14.1 million for the period from 2 December to the end of 2007.

Our overall share of the franchised public transport market increased from 25.0% in 2006 to 25.3% in the period before the Rail Merger. After the Rail Merger including all rail and bus passenger services, our market share increased further to 41.6%.

In the period prior to the Rail Merger, average fare per passenger on the MTR Lines was HK\$6.83, which was similar to the comparable period in 2006. After the Rail Merger, average fare per passenger on Domestic Service was HK\$6.39 with the reduction in average fares being due to the fare reduction given as part of the Rail Merger and the lower average fares on KCR Lines as compared to the MTR Lines. Average fare per passenger for Airport Express was HK\$64.34 in 2007, an increase of 0.8% over 2006. Average fare per passenger on Cross-boundary Service was HK\$24.51 in 2007, similar to that of 2006. Total fare revenue from all passenger services for 2007 increased by 9.1% to HK\$7,115 million.

The successful integration of the two networks on 2 December 2007 reflected the very high level of integration planning, service and operational performance that was demonstrated throughout the year. Passenger journeys on time performance on the pre-Merger MTR System achieved a level of 99.9%. A new Operating Agreement came into effect on 2 December 2007 as a result of the Rail Merger that will govern the performance levels of the Integrated MTR System.

To meet the constantly rising expectations of our customers, we invested not only in the expansion of the network but also in service and efficiency improvements. To enhance accessibility, we opened new pedestrian links and entrances at various stations including a pedestrian link at Admiralty Station connecting to Three Pacific Place, and two new entrances at Kowloon Station linking up to Elements shopping centre.

The new Airport Express platform serving SkyPlaza in Hong Kong International Airport Terminal 2 was put into operation. The noise enclosure project in the Tung Chung area to reduce noise impact for residents was completed and some rail sections along north Lantau were replaced for the same purpose. To improve passenger comfort, five new trains are being procured for the Tsuen Wan, Kwun Tong, Island and Tseung Kwan O lines.

To promote customer service and to help attract new patronage, various marketing programmes were launched, including the selection of a lucky couple to participate in the first MTR Hello Kitty Dream Wedding in Hong Kong Station, the MTR Hello Kitty Heroes Redemption Programme and the Ride 5 Get Free Breakfast Promotion. A tailor-made shopping guide entitled “MTR Easy Ride to Hong Kong Shopping Festival” was developed

together with the Hong Kong Tourism Board for the use of overseas tourists in July and August.

On Airport Express, the popular "Ride to Rewards" programme was enhanced with new rewards. We also arranged same-day return trips on Airport Express as well as discounted prices for visitors travelling to private events or public concerts at AsiaWorld-Expo.

On the through train business to the Mainland of China, which we took on after the Rail Merger, the fare promotion on Intercity services to Beijing and Shanghai in non-peak periods continued. To promote the new Lok Ma Chau Station of the Cross-boundary Service, free ride promotions over the New Year and Lunar New Year holidays and weekly ticket promotions were provided to customers who used the new station.

Station Commercial and Rail Related Businesses

Revenue growth for our station commercial and rail related businesses benefited from a robust economy, rising patronage and the effect of the Rail Merger, resulting in revenue increasing 12.9% to HK\$1,741 million despite decreases in telecommunications and consultancy revenues. Excluding the Rail Merger effect from 2 December to the year end, such revenues would have increased by 4.8% to HK\$1,616 million.

Advertising revenue increased by 11.0% to HK\$593 million (9.6% to HK\$585 million excluding the Rail Merger effect), underpinned by higher passenger volumes, advertising innovations and station zone segmentation with the objectives of optimising revenue for the Company and advertising impact for our customers. Revenue also benefited from the replacement of seatback TV with the new multimedia system on the Airport Express, and the enhancement of the MTR Plasma TV network. With the Rail Merger, our advertising coverage now extends to an integrated network with larger patronage, including the cross-boundary market.

Station retail revenue rose 27.6% to HK\$499 million (9.7% to HK\$429 million excluding the Rail Merger effect). Renovations and new layouts were completed in the retail zones of nine stations in 2007 and altogether, 41 stations in the MTR System have been renovated since 2001. During the year, 31 new trades/brands were added to the station retail network in the MTR System to enhance customer satisfaction. With the Rail Merger, the number of shops at stations totaled 1,230 at the end

of the year, including nine Duty Free shops at Lo Wu, Lok Ma Chau and Hung Hom stations.

Revenue from telecommunications services decreased by 10.0% to HK\$233 million as compared to 2006 due to the cannibalisation of the 2G service by the less profitable 3G service. However, our fixed network services provider TraxComm Limited achieved higher revenue and by the end of the year had sold more than 220 Gbps of bandwidth services to carrier customers. With the Rail Merger, we took over the telecoms business of the KCR System, which is similar to MTR Corporation's own telecoms business, and our fibre network coverage expanded from 156 kilometres to 324 kilometres.

As part of the Rail Merger, we also gained KCRC's relatively small freight transportation business, which generated revenue of HK\$3 million from 2 December to the year end.

In external consultancy, we made progress on existing consultancy projects and the signing of new contracts. Project management consultancy work continued on Shanghai Metro Line 9 and Phase 1 (12 stations) opened on 29 December 2007. Overall, external consultancy activities generated a revenue of HK\$193 million in 2007, a decrease of 3.0% compared to 2006, which was mainly due to programme delays of some projects caused by the changing requirements of our customers.

Property and Other Businesses

The Hong Kong property market was very active in 2007. The office and retail rental markets continued to enjoy good growth with supply being limited in the office market, and strong retail market driven by consumer and tourist spending.

The development rights for eight property development sites totalling 1.2 million square metres GFA were acquired as part of the Rail Merger. The Company will act as the Government's agent for property developments at West Rail sites. The Merger also increased our investment property portfolio by 40,957 square metres lettable, particularly in the New Territories.

Profit for the year from property developments increased significantly to HK\$8,304 million. Amongst this, surplus proceeds contributed HK\$7,077 million, particularly from the sale of residential flats from Le Point at Tiu Keng Leng Station and to a lesser extent from Harbour Green at Olympic Station. Deferred

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income contributed HK\$1,224 million being profit recognition mainly from the newly opened Elements in Kowloon Station, and from Coastal Skyline and Caribbean Coast in Tung Chung.

In February 2007, the tender for Area 56 in Tseung Kwan O town centre was awarded to Lansmart Ltd, a subsidiary of Sun Hung Kai Properties Limited, with the plan to develop a hotel, residential, office and retail complex. In November, a subsidiary of Cheung Kong (Holdings) Limited, Wealth Pine Investment Limited, was awarded Tseung Kwan O Area 86 Package Three, a residential development with up to 1,648 units. Area 86 was formally named LOHAS Park in September.

Revenues from our property rental, management and other businesses benefited from additions to the portfolio, increasing by 24.3% to HK\$1,834 million as compared to 2006; the Rail Merger effect from 2 December to the end of 2007 contributed HK\$22 million to this total. Within this total, rental income rose by 25.2% over last year to HK\$1,581 million (23.5% to HK\$1,560 million excluding the Rail Merger effect), driven by positive rental renewals and new lettings, as well as contributions from Phase 1 of Elements with lettable area of 39,210 square metres and Ginza Mall in Beijing with lettable area of 19,307 square metres, both of which opened in 2007.

Our latest up-market flagship shopping centre, Elements on top of Kowloon Station, was successfully opened in October 2007. It quickly became a unique attraction for premier shopping and recreation both for Hong Kong residents and for visitors. Commercially, Elements was equally successful with 100% of its shops leased at the time of the opening.

The investment properties portfolio acquired as part of the Rail Merger comprises five shopping centres in the New Territories totalling 36,487 square metres lettable, 20 residential units at Royal Ascot and an office at Hung Hom of 1,686 square metres lettable.

Property management income rose by 12.8% to HK\$168 million. During the year, 3,121 residential units were added to our property management portfolio at Coastal Skyline, Caribbean Coast and Harbour Green, which together with the 9,854 units under management acquired in the Rail Merger, brings the total number of residential units managed by the Company in Hong Kong to 71,851 units at the end of 2007.

Prior to the Rail Merger, total commercial properties managed by the Company increased by 81,457 square metres mainly due to the inclusion of Elements Phase 1. With the Rail Merger, an additional 93,026 square metres of commercial area was added to our property management portfolio to give a total of 756,556 square metres at year end.

Our managed property portfolio in the Mainland also increased in 2007, with a total new intake of 480,000 square metres. Altogether, total contracts in hand under management in the Mainland of China amounted to 820,254 square metres.

The Ngong Ping 360 cable car and associated theme village on Lantau Island, opened in September 2006. In June 2007, during the annual testing outside of operation hours, one of the gondolas dislodged from the cable. There were no injuries but operations were immediately suspended, followed by detailed investigations and a period of intensive testing of safety and operational procedures. In September, the Company took over the management and operation of the cable car system from the previous contractor through the acquisition of its Hong Kong subsidiary, with a senior management team of our experienced engineers and international cable car professionals. After extensive testing, the system was confirmed to be safe and reliable and the cable car service resumed on 31 December 2007. Patronage quickly returned to previous levels and we are optimistic about the future of this project. The revenue contributed for the year from Ngong Ping 360 was HK\$85 million.

The Company's share of Octopus' net profit for 2007 was HK\$97 million, a 42.6% increase over 2006. The increase was partly a result of an increase in average daily Octopus usage of 11.7% to HK\$81.9 million per day in 2007, brought about by a rise in the number of service providers and improvements in the general economy. Cards in circulation rose to 16.5 million and average daily transaction volume rose to 10.2 million. By the end of 2007, the total number of service providers had risen to 490 from 431.

Hong Kong Network Expansion

With the completion of the Rail Merger, our key focus will be directed to the construction of new rail lines over the next decade, which will significantly contribute to Hong Kong's future growth.

“In his Policy Address in October 2007, the Chief Executive of Hong Kong SAR identified a number of new rail lines as priority infrastructure projects. These include the South Island Line (East), the Shatin-to-Central Link and the Hong Kong Section of the Express Rail Link”

As the first of these new extension projects, the West Island Line (WIL) was gazetted under the Railways Ordinance in October 2007 followed by approval of design funding by Government in December 2007. WIL is a “community railway” that aims to rejuvenate the Western District of Hong Kong by enhancing connectivity for the community through rail service, station exits, lifts and escalators.

Works on the Kowloon Southern Link (KSL) connecting the existing East Rail Line’s East Tsim Sha Tsui Station with West Rail Line’s Nam Cheong Station, continued throughout the year. Completion is scheduled for late 2009. The Company took over the project management responsibility of KSL under the Rail Merger agreement. However, it will continue to be funded and owned by KCRC, and will form part of the Service Concession when it opens for service.

In his Policy Address in October 2007, the Chief Executive of Hong Kong SAR identified a number of new rail lines as priority infrastructure projects. These include the South Island Line (East), the Shatin-to-Central Link and the Hong Kong Section of the Express Rail Link.

A revised proposal for the South Island Line (East) with updated financial data and enhanced interchange arrangements at Admiralty Station was submitted to Government in June 2007. Government has since requested the Company to proceed with preliminary planning and design. In addition, feasibility studies were completed in 2007 for the Express Rail Link. The Express Rail Link will provide cross-boundary high speed train service connecting Hong Kong to the new high speed rail network in the Mainland of China.

The Government announced on 11 March 2008 its decision for the Company to proceed with the further planning and design of Shatin-to-Central Link and the Kwun Tong Line extension to Whampoa. The 17-km Shatin-to-Central Link, which will be based on the scheme proposed by the Company under the Rail Merger, will run from Tai Wai to Hong Kong Island connecting a number of rail lines to provide more convenient rail services to passengers. The section from Tai Wai to Hung Hom connecting Ma On Shan Line to West Rail Line is expected to be completed in 2015. The other section, which will extend the existing East Rail Line from Hung Hom across the harbour to Hong Kong Island, is expected to be completed in 2019. The Company will continue discussions with Government on the operation of Shatin-to-Central Link by way of a Service Concession. The 3-km Kwun Tong Line extension will run from the existing Yau Ma Tei Station via Ho Man Tin to Whampoa and is expected to be completed by 2015. The Company will discuss the implementation details of this project with Government based on the ownership approach and has proposed to use property development rights relating to a site at the former Valley Road Estate site to bridge the funding gap.

The funding model for these new rail projects will take different forms, each appropriately designed for the project. As always, the Company will seek to create a commercial return on its investments above its cost of capital and at rates commensurate with the risk of the projects. For the West Island Line, the Government has indicated that it would consider a capital grant model whereby Government grants to the Company a sum of money, currently estimated at HK\$6 billion, to establish the financial viability of the project. The South Island Line (East)

“Our overseas expansion took a step forward with the award of the London Overground concession to London Overground Rail Operations Ltd (LOROL), our 50:50 joint venture with UK's Laing Rail”

will likely follow the Company's traditional “Rail and Property” approach, whereby property development rights will be granted to us. A third model that could be used for future rail lines would be the Service Concession model used in the Rail Merger, whereby Government (or KCRC, which is wholly owned by the Government) pays for the initial capital costs of the rail line and the Company operates the line by paying an annual concession payment as well as being responsible for maintenance and upgrades; KSL has adopted this approach.

For the new station at LOHAS Park (in Tseung Kwan O South), civil and structural works were substantially completed in October 2007, and track installation was substantially completed in December 2007. Design of the railway electrical and mechanical systems has been completed, manufacturing of major plant and equipment is in progress, and installation works are on schedule for completion of the station in 2009.

Construction work for the pedestrian subway at Cheung Lai Street connecting Lai Chi Kok Station with the new developments to the south of Lai Chi Kok Road began in August 2007.

Overseas Expansion

Our overseas expansion took a step forward with the award of the London Overground concession to London Overground Rail Operations Ltd (LOROL), our 50:50 joint venture with UK's Laing Rail (now being acquired by Deutsche Bahn group). Works on the Beijing Metro Line 4 (BJL4) project made steady progress and the process to gain approval of the Shenzhen Metro Line 4 (SZL4) project continued.

In Beijing, tendering for the Electrical & Mechanical (E&M) Works Contracts of BJL4 was substantially completed. Design works and manufacturing for E&M equipment advanced smoothly. Testing and commissioning works of the first two trains commenced in December 2007.

In Shenzhen, we continued to support the Shenzhen Municipal Government in obtaining approval on the SZL4 project from the National Development and Reform Commission. Preparatory work and expanded trial section work continue with undertakings from the Shenzhen Municipal Government to reimburse certain of the costs incurred if the project is not approved. Under the current policy relating to property development in China, the public sector funding support to this project is likely to take other forms than the grant of property development rights. The Company will ensure that the project, if approved, will provide satisfactory returns to its shareholders. We continue to pursue other projects in the Mainland of China, such as the BJL4 Extension to Daxing District, as well as the development of new lines in Hangzhou, Suzhou, Tianjin and Wuhan.

In Europe, our joint venture with Laing Rail, LOROL, was awarded the London Overground concession on 19 June 2007. On 11 November, LOROL successfully took over the concession, which allows it to operate services on five existing lines in Greater London for seven years.

Financial Review

The Group achieved strong financial results in 2007. Total fare revenues increased by 9.1% from HK\$6,523 million to HK\$7,115 million with fare revenue from Domestic Service (including KCR Lines after the Rail Merger) increasing by 5.1% in 2007 to HK\$6,213 million. Fare revenues from Airport Express increased by 7.0% to HK\$655 million whilst Cross-boundary, Light Rail, Bus and Intercity services contributed total revenue of HK\$247 million for the period after the Rail Merger. Non-fare revenues increased by 18.5% in 2007 to HK\$3,575 million comprising HK\$1,741 million of station commercial and rail related business incomes and HK\$1,834 million of property rental, management and other incomes. Total revenues for 2007 therefore increased by 12.0% to HK\$10,690 million. Total

operating costs, excluding merger related expenses, increased by 10.1% in 2007 to HK\$4,778 million after accounting for the incremental operating costs following the Rail Merger in December. Operating profit from railway and related businesses before depreciation and amortisation therefore increased by 13.7% to HK\$5,912 million before accounting for merger related expenses. We estimate that the Rail Merger contributed approximately HK\$284 million to such operating profit from 2 December to the year end before merger related costs. Operating margin also increased from 54.5% in 2006 to 55.3%.

Property development profits for 2007 increased significantly from HK\$5,817 million to HK\$8,304 million mainly due to profit recognition from Le Point at Tiu Keng Leng Station. As noted in the 2006 Annual Report, costs relating to the Le Point property development had been accounted for in 2006 and hence profit recognition for Le Point in 2007 was based predominantly on our share of the revenue from sales of units at the development, leading to significant profit booking in 2007. Depreciation and amortisation charges for 2007 increased by 2.4% to HK\$2,739 million while interest and finance charges declined by 5.9% to HK\$1,316 million as a result of substantial cash inflows during the early part of the year. With the Rail Merger, merger related expenses charged to the 2007 profit and loss account were HK\$193 million. Acquisitions of assets in 2007 included investment property subsidiaries from KCRC as part of the Rail Merger and the Ngong Ping 360 operation management company from the previous contractor; fair market adjustments for such assets produced a net gain of HK\$187 million.

Excluding investment property revaluation, net profit attributable to shareholders of the Company from underlying businesses for 2007 increased by 43.8% to HK\$8,571 million, or HK\$1.54 per share as compared with HK\$1.08 in 2006. After accounting for the revaluation of investment properties, reported earnings attributable to shareholders of the Company were HK\$15,180 million with earnings per share of HK\$2.72.

The Company's balance sheet showed an 18.6% increase in net assets from HK\$76,786 million as at 31 December 2006 to HK\$91,037 million as at 31 December 2007. Total assets increased from HK\$120,421 million in 2006 to HK\$155,668 million as at 31 December 2007 mainly attributable to the addition of the Service Concession assets and property package acquired in the Rail Merger as well as the appreciation in market values of investment properties. Total liabilities increased from HK\$43,635 million in 2006 to HK\$64,631 million at 2007 year end mainly due to the additional borrowings, obligations under the Service Concession and other liabilities

arising from the Rail Merger. Including the obligations under the Service Concession of HK\$10,685 million as a component of debt, the Group's net debt-to-equity ratio increased from 36.3% at 2006 year end to 48.5% at 2007 year end.

Cash flow of the Company remained strong during the year with net cash inflow of HK\$5,965 million generated from railway and related activities and HK\$5,824 million of cash receipts from our property development business. After payments for capital projects, interest expense, working capital and dividends, a net cash inflow of HK\$6,122 million was generated before payments for the Rail Merger. Upfront payments of HK\$12,040 million were incurred while reimbursement of HK\$786 million was received in respect of the assumption of certain KCRC assets and liabilities for the Rail Merger, resulting in a cash deficit of HK\$5,132 million for the year, which was financed by an increase in debt of HK\$5,401 million.

In view of the strong financial performance in 2007, the Board has recommended a final dividend of HK\$0.31 per share which, when added to the interim dividend of HK\$0.14, will give a total dividend of HK\$0.45 per share for the year, representing an increase of HK\$0.03 or 7.1% as compared to last year. As in previous years, the Financial Secretary Incorporated 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 the Company's total dividend will be paid in cash.

Human Resources

The commitment, loyalty and professionalism of our staff have long been the foundation of our success. In the preparations for the Rail Merger, we consistently followed the principle of "One Company, One Team", and consulted our colleagues on all matters that affected their future. The Rail Merger was not simply a financial transaction involving physical assets and operational integration; it was a process that involved people. To help our colleagues to learn about the merger process, and to provide an opportunity for them to interact with each other, 99 Cultural Integration workshops were held. Every one of our colleagues attended at least one of these workshops. Their views were sought and they were kept abreast of developments through many different channels, including publications, newsletters and communication sessions. These programmes were designed to make the merger process more transparent and to reduce uncertainties.

Our numerous training and development programmes to enhance skills and maintain motivation continued throughout the year, with courses covering issues such as empathetic listening, empowerment and railway safety. In order to meet

CEO's Review of Operations and Outlook

the future requirements of the Company, several major initiatives were undertaken to develop management and leadership talents, including an Executive Associate Scheme and a graduate trainee programme with graduates from both Hong Kong SAR and the Mainland of China. We also continued to devote resources to developing and resourcing staff for our expanding overseas business and to create our culture at our operations offshore.

Outlook

Uncertainties in the global economy continued in the latter part of 2007 and into 2008, with the risk of a slowdown in the U.S.. However, with continued growth in the Mainland of China and barring any further major external shocks, we hold a positive view on the economic prospects of Hong Kong in 2008.

The Rail Merger will have a positive full-year impact on our businesses in 2008. We remain confident of achieving the HK\$450 million per year in merger synergies over three years. In 2008, we are of the view that approximately HK\$130 million of such synergies could be achieved through energy optimisation, combined procurements and revenue enhancements through the enlarged network.

However rail operating margin is expected to be lower in 2008 as a result of the fare reduction and also the lower margin of the KCR System. Station commercial and rail related businesses will benefit from economic growth in Hong Kong as well as the full year impact of the Duty Free shop tenancies in Hung Hom, Lo Wu and Lok Ma Chau. However, we will continue to see pressure on our telecommunications business with further cannibalisation of 2G service by 3G.

In our property and other businesses, our property investment and management business will benefit from the full year effect of Elements Phase 1 as well as the expected opening of Elements Phase 2 of around 7,609 square metres gross towards the end of 2008. We should also benefit from the full year effect of the re-opening of Ngong Ping 360 and the acquired investment property portfolio under the Rail Merger.

In our property development business, depending on the progress of constructions and pre-sale, we expect to recognise most of our remaining property deferred income balance (before deduction of related cost) of HK\$400 million in the next 18 months, which mainly relates to properties along the

Airport Railway, such as Elements in Kowloon Station, Coastal Skyline and Caribbean Coast in Tung Chung Station. In Tseung Kwan O, pre-sales have been successfully completed for The Capitol, LOHAS Park Package 1, and depending on the issuance of the Occupation Permit, we may be able to recognise surplus proceeds from this development in the second half of 2008. Pre-sales should also commence this year for Ho Tung Lau, one of the eight property development projects acquired in the Rail Merger. Once again depending on the progress of pre-sales and with the Occupation Permit expected to be received before the year end, there is a possibility of profit recognition from this development in 2008. From an accounting perspective, our acquisition costs for the property developments (such as Ho Tung Lau) acquired under the Rail Merger will have to be accounted for before profits can be recognised. Another of the eight projects acquired in the Rail Merger, Wu Kai Sha, will likely start pre-sales in 2008 but as the Occupation Permit is not expected until after 2008, it is unlikely that profits will be recognised on the project in 2008. The magnitude of property development profits in 2007 were mainly the result of the profit accounting of Le Point in Tiu Keng Leng, whereby the costs for that project were already accounted for in 2006. Hence, we do not expect the magnitude of development profits in 2007 to be repeated in 2008. In our property tender activities, we are likely to tender the Che Kung Temple site in 2008, for which the Expression of Interest was launched in early March 2008. Meanwhile, as the development agent for West Rail property developments, we will recommend the sites at Tsuen Wan West (TW5 and TW7) for tender invitation within the next 12 months, subject to market conditions. These three railway related property development sites are planned to provide a total of about 6,200 flats.

Finally, I would like to take this opportunity to thank my fellow directors and all my colleagues for their tremendous energy and dedication in a truly memorable year for the Company.



C K Chow, *Chief Executive Officer*
Hong Kong, 11 March 2008

Key Figures

	2007 [#]	2006	% Increase/ (Decrease)
Financial Highlights <i>in HK\$ million</i>			
Revenue			
– Fare	7,115	6,523	9.1
– Non-fare	3,575	3,018	18.5
Operating profit from railway and related businesses before depreciation and amortisation	5,912	5,201	13.7
Profit on property developments	8,304	5,817	42.8
Operating profit before depreciation and amortisation	14,216	11,018	29.0
Profit attributable to equity shareholders	15,180	7,759	95.6
Profit attributable to equity shareholders (excluding change in fair value of investment properties and related deferred tax)	8,571	5,962	43.8
Total assets	155,668	120,421	29.3
Loans, obligations under finance leases and bank overdrafts	34,050	28,152	21.0
Obligations under service concession	10,685	–	N/A
Total equity attributable to equity shareholders	91,014	76,767	18.6
Financial Ratios <i>in %</i>			
Operating margin	55.3	54.5	0.8% pt.
Net debt-to-equity ratio	48.5	36.3	12.2% pts.
Return on average equity attributable to equity shareholders	18.1	10.6	7.5% pts.
Return on average equity attributable to equity shareholders (excluding change in fair value of investment properties and related deferred tax)	10.2	8.1	2.1% pts.
Interest cover <i>in times</i>	9.0	6.7	2.3 times
Interest cover (excluding impact of change in fair value of derivative instruments) <i>in times</i>	9.3	6.7	2.6 times
Share Information			
Basic earnings per share <i>in HK\$</i>	2.72	1.41	92.9
Basic earnings per share (excluding change in fair value of investment properties and related deferred tax) <i>in HK\$</i>	1.54	1.08	42.6
Dividend per share <i>in HK\$</i>	0.45	0.42	7.1
Share price at 31 December <i>in HK\$</i>	28.70	19.56	46.7
Market capitalisation at 31 December <i>in HK\$ million</i>	161,037	108,531	48.4
Operations Highlights			
Total passenger boardings			
– Domestic Service <i>in millions</i>	915.8	866.8	5.7
– Cross-boundary Service <i>in thousands</i>	8,243	–	N/A
– Airport Express <i>in thousands</i>	10,175	9,576	6.3
– Light Rail <i>in thousands</i>	11,100	–	N/A
Average number of passengers <i>in thousands</i>			
– Domestic Service <i>weekday</i>			
– pre-merger	2,595	2,513 [^]	3.3
– post-merger	3,544	–	N/A
– Cross-boundary Service <i>daily</i>	274.8	–	N/A
– Airport Express <i>daily</i>	27.9	26.2	6.5
– Light Rail <i>weekday</i>	380.0	–	N/A
Fare revenue per passenger <i>in HK\$</i>			
– Domestic Service	6.78	6.82	(0.6)
– Cross-boundary Service	24.45	–	N/A
– Airport Express	64.34	63.85	0.8
– Light Rail	2.68	–	N/A
Proportion of franchised public transport boardings (December) [*] <i>in %</i>	41.6	25.7	15.9% pts.

* Proportions of franchised public transport boardings for the full year of 2007 and 2006 are 26.7% and 25.0% respectively.

[#] Before the Rail Merger on 2 December 2007, the Company's rail operations comprised MTR Lines and Airport Express. After the Rail Merger, our Domestic Service comprised MTR Lines and KCR Lines (East Rail Line excluding Cross-boundary, West Rail Line and Ma On Shan Line). Also after the Rail Merger we gained new passenger services for Cross-boundary Service, Light Rail, Bus and Intercity.

[^] The figure covered the period from 1 January 2006 to 1 December 2006 for like-with-like comparison.

Key Events in 2007

January



MTR Student Ambassadors Programme

The MTR Student Ambassadors Programme was launched on 11 January, whereby primary school students volunteered at MTR stations to advise passengers not to eat and drink in the MTR paid area, not to rush into trains when the doors were closing and to hold the handrail when using escalators.

Ginza Mall in Beijing, the first shopping centre in the Mainland of China managed and operated by our wholly owned MTR (Beijing) Commercial Facilities Management Co. Ltd. officially opened on 27 January.

February

Lansmart Limited, a subsidiary of Sun Hung Kai Properties Limited, won the tender for Tseung Kwan O Area 56 property development on 15 February.

Three Pacific Place Link connecting MTR Admiralty Station with Starstreet Precinct and Three Pacific Place complex was opened for service on 26 February.

A new platform at Airport Express Airport Station was opened for service on 28 February to serve passengers using Terminal 2 at Hong Kong International Airport.

March

The Company won "The Three Best Corporate Governance Practices in China" and "The Five Best Investor Relations Websites in Asia Pacific" awards in the Investor Relations (IR) Global Rankings and Awards 2007 Edition.

April



MTR HONG KONG Race Walking 2007

Over a thousand race walkers took part in "MTR HONG KONG Race Walking 2007" on 15 April. Top Asian race walkers also flew in from China, Malaysia, the Philippines, Singapore and Thailand to compete in the Elite competitions. The event raised over HK\$1 million for the Hospital Authority Health InfoWorld's health education campaign.

May

The Company won two awards (Gold Asset Management Excellence Award and Steve Maxwell Leadership Award) for its excellence in railway asset management at the 2007 International Asset Management Conference held in Melbourne, Australia between 23 and 25 May.

June

LegCo passed the Rail Merger Bill on 8 June and set up a subcommittee to study the draft subsidiary legislation.



London Overground

London Overground Rail Operations Ltd (LOROL), the 50:50 partnership between the Company and Laing Rail Ltd, won the concession to operate the new London Overground service in Greater London for seven years from 11 November 2007.

To celebrate the HKSAR's 10th anniversary, the Company issued a limited edition souvenir ticket set to mark the many infrastructure and tourism projects that were completed since 1997.

July

Two new multi-purpose "Self-Service Point" machines were put on trial use in Hong Kong Station on 22 July, providing customers with a more convenient and straightforward way of resolving ticket issues.



Escalator Safety Campaign

The Annual Escalator Safety Campaign was launched in July with the key message of "Stand clear, keep your toes away from the step edge". Escalator Safety Ambassadors were deployed to remind passengers about the safe use of escalators.

August

To celebrate the forthcoming Beijing 2008 Olympic Games, the Company joined hands with OMEGA and the Olympic Equestrian Company to launch a limited edition "Olympic 1 Year Countdown" MTR Souvenir Ticket Set and the OMEGA Olympic Countdown Vehicle.

The Government announced on 8 August the appointment of Dr Raymond Ch'ien Kuo-fung as Non-Executive Chairman and the selection of Mr C K Chow as the Chief Executive Officer of the Company after the Rail Merger with Kowloon-Canton Railway Corporation (KCRC).

The Company entered into formal agreements with Government and KCRC for the merger of the Company and KCRC operations and the acquisition of certain property interests on 9 August.

September

The Company announced on 18 September that a subsidiary company would manage and operate the Ngong Ping cable car system after an agreement with Skyrail-ITM to transfer management and operation of Ngong Ping 360 to the Company.

Tseung Kwan O Area 86 was formally named LOHAS Park by the Company.

October



Grand Opening

Elements Phase 1, our newest flagship shopping centre, opened on 1 October together with a grand opening ceremony held on 16 November.



Extraordinary General Meeting

Independent shareholders of the Company voted in favour of the proposed Rail Merger with KCRC at an Extraordinary General Meeting held on 9 October.



MTR West Island Line

The Executive Council requested the Company to proceed with further planning and detailed design of the West Island Line on 23 October. The decision marked an important milestone for the project, which will extend the existing MTR Island Line from Sheung Wan to Kennedy Town.

Our Safety Month was launched on 26 October with focus on escalator and train door safety.

December



Rail Merger

The Rail Merger with KCRC was completed on 2 December.

The Government announced on 19 December that the Company might proceed with preliminary planning and design for the South Island Line (East). The 7-km South Island Line (East) will run from South Horizons on Ap Lei Chau to Admiralty Station.

The Company's Sustainability Report 2006 received the Runner Up Prize in the Hong Kong Association of Chartered Certified Accountants' (ACCA) Awards for Sustainability Reporting 2007.

November

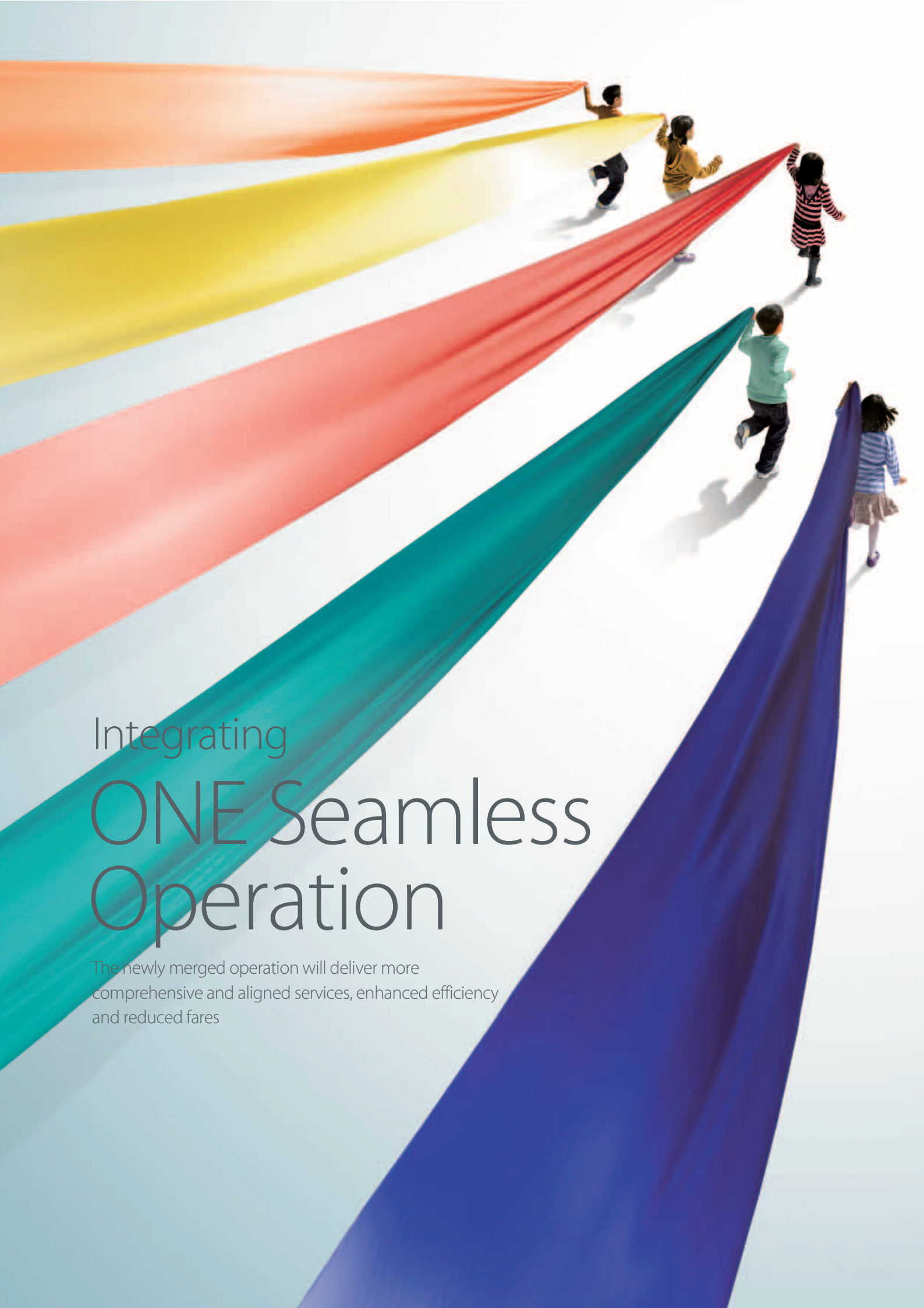


LOROL Launch

LOROL took over the operation of London Overground on 11 November.

Wealth Pine Investment Limited, a subsidiary of Cheung Kong (Holdings) Limited, won the tender for LOHAS Park Package Three property development on 28 November.





Integrating

ONE Seamless Operation

The newly merged operation will deliver more comprehensive and aligned services, enhanced efficiency and reduced fares

Executive Management's Report

Railway Operations



Patronage increased on the Domestic Service lines and Airport Express

Total fare revenue for the Company in 2007 increased by 9.1% to HK\$7,115 million as a result of increase in patronage from the economic growth in Hong Kong as well as the Rail Merger effect from 2 December to the end of 2007.

The Rail Merger

The Rail Merger was a very significant event for our railway operations. On the Appointed Day of 2 December, not only did we have to integrate two railway networks but we also had to provide a fare reduction with effect from that day. The many changeovers on the Appointed Day went smoothly due to the considerable amount of preparation prior to the Rail Merger with various integration committees and working groups at all levels of the two rail companies working together as one team.

Examples of some of these integration tasks include an integrated ticketing system which was developed to facilitate passengers using Octopus cards to enjoy fare reductions

throughout the integrated network from the Appointed Day. The integration also involved changes to 1,325 entrance and exit gates, 1,016 ticket issuing machines and 405 add value machines to take into account the new fare table with reduced fares. This was all completed in less than five non-traffic hours preceding 2 December. Over 150,000 logos and signs and a significant number of public address and passenger information display messages were also updated to ensure unified messages to passengers. The changeover of the ticketing system was successful with high level of ticket gate reliability maintained.

Common radio systems, joint operations procedures and contingency plans were in place for interchange stations at Nam Cheong, Mei Foo, Kowloon Tong and Tsim Sha Tsui/East Tsim Sha Tsui for day-to-day operations. A Communication Coordination Centre was established to monitor vital systems in different operations control centres and to ensure that train services information is disseminated to external parties in a

consistent and well-coordinated manner. Over 17,000 man hours of training and 17 drills and exercises were conducted at stations to enable a smooth transition in operations.

Patronage

For the year as a whole, total patronage on the Integrated MTR System increased by 8.2% to 948.3 million, after including the Rail Merger effect from 2 December to the end of 2007.

Our Domestic Service, which includes the MTR Lines (comprising the Kwun Tong, Tsuen Wan, Island, Tung Chung, Tseung Kwan O and Disneyland Resort lines) and after the Rail Merger, the KCR Lines (comprising the East Rail excluding Cross-boundary Service, West Rail and Ma On Shan lines), recorded total patronage of 915.8 million for 2007.

For the period before the Rail Merger, from the beginning of 2007 to 1 December, total patronage increased by 2.9% to 814.6 million compared to the equivalent period last year. For the remaining period after the Rail Merger from 2 December, total patronage on Domestic Service was 101.2 million, after adjusting for interchange passengers. With the Rail Merger, passengers who interchange between MTR and KCR lines are only counted as one passenger whereas before the Rail Merger, both the Company and KCRC would have counted that one passenger. Hence market share and total passenger numbers for the Company after the Rail Merger may seem lower than a simple addition of previous MTR Corporation and KCRC individual statistics would suggest.

Passengers using the Airport Express rose 6.3% to 10.2 million in 2007, as the number of air travellers using Hong Kong International Airport continued to rise, and the number of exhibitions and other events at AsiaWorld-Expo increased.

For the Cross-boundary Service at Lo Wu and Lok Ma Chau, patronage for the full year recorded an increase of 4.7% to 92.1 million as compared to 2006, of which 8.2 million was attributable to the Company for the period after the Rail Merger on 2 December.

Passenger volume on the other newly added post-Merger services of Light Rail, Bus and Intercity totalled 14.1 million for the period from 2 December to end of the 2007.

Average weekday patronage on the Domestic Service before the Rail Merger on 2 December 2007 increased by 3.3% to 2.6 million compared to the comparable period last year, and after the Rail Merger, average weekday patronage rose to 3.5 million. For the year as a whole, average weekday patronage on our Domestic Service was 2.7 million, an increase of 5.5% from 2006.

41.6% Share

of Franchised Public Transport Market in December 2007

3.5 Million Average Weekday Patronage

for Domestic Services in December 2007

HK\$7.50 Average Fare

Per Passenger for all Services in 2007

HK\$3.39 Operating Costs

Per Passenger for all Services in 2007

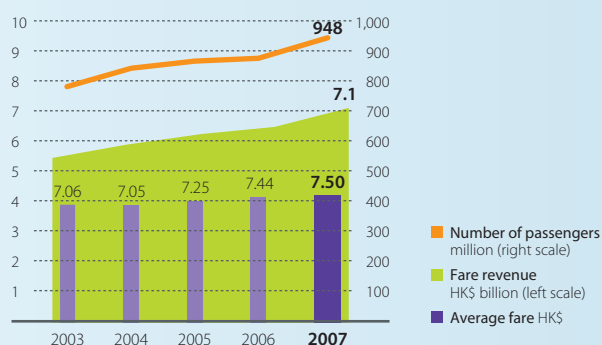
99.9% Passenger Journeys On Time

for MTR System (Pre-Merger)

Total fare revenue from Domestic Service rose to HK\$6,213 million, 5.1% higher than HK\$5,911 million reported in 2006

Passengers and Fares

MTR again achieved record patronage and average fares also rose, yielding a 9.1% increase in fare revenue.



The Rail Merger required careful and detailed planning at interchange stations such as Nam Cheong

Overall, after the Rail Merger, average weekday patronage from all rail and bus passenger services on the Integrated MTR System was 4.3 million.

Our overall share of the franchised public transport market increased from 25.0% in 2006 to 25.3% in the period before the Rail Merger. After the Rail Merger including all rail and bus passenger services, our market share increased further to 41.6%. Within this total, our estimated share of passengers travelling to and from the airport (excluding those travelling to and from the AsiaWorld-Expo Station) remained at 23% in 2007, while our share of cross-harbour traffic rose from 60.9% to 61.8%. The Cross-boundary Service market share decreased to 57.0% in 2007 from 58.3% in 2006.

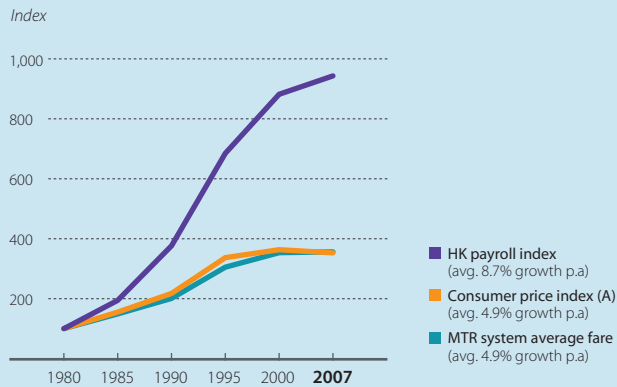
Fare Revenue

Total fare revenue in 2007 from the Domestic Service was HK\$6,213 million, an increase of 5.1% as compared to HK\$5,911 million reported in 2006. Fare revenue from the Airport Express in 2007 increased by 7.0% to HK\$655 million. Fare revenue contributions from Cross-boundary Service was HK\$201 million and HK\$46 million from Light Rail, Bus and Intercity services for the period from 2 December to the end of 2007. Overall, this gives a total fare revenue for the year from all passenger services of HK\$7,115 million, an increase of 9.1% from 2006.

Average fares per passenger on Domestic Service for the year was HK\$6.78, which represents a decrease of 0.6% over 2006. In the period prior to the Rail Merger, average fare per passenger on the MTR Lines was HK\$6.83, which was similar to

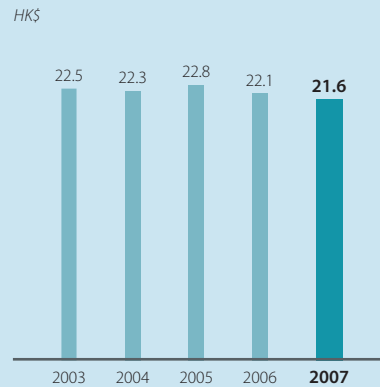
Fare Trend

In recent years, MTR fares have consistently lagged wage growth but were in line with the long-term changes in consumer prices in Hong Kong.



Railway Operating Costs Per Car-km Operated

With the enlarged post-Merger network, operating cost per car kilometre decreased by 2.3% to HK\$ 21.6.



the comparable period in 2006. However, after the Rail Merger, average fare per passenger on Domestic Service decreased to HK\$6.39 as a result of the fare reduction given as part of the Rail Merger and the lower average fares on KCR Lines as compared to MTR Lines.

Average fare per passenger on Airport Express was HK\$64.34 in 2007, an increase of 0.8% over 2006. Average fare per passenger on Cross-boundary Service was HK\$24.51 in 2007, similar to that of 2006. No fare reduction was given for Airport Express and Cross-boundary services in the Rail Merger.

Service Promotions

One of the key contributors of our incremental patronage growth has been the effectiveness of the Company's service promotions, which also heightens the awareness of our brand and demonstrates our commitment to service excellence at all levels.

In 2007, we launched a number of highly effective station events and segment promotions including MTR Hello Kitty Dream Wedding on 14 February in the Central subway of Hong Kong Station, MTR Hello Kitty Heroes Redemption Programme and the Ride 5 Get Free Breakfast Promotion.

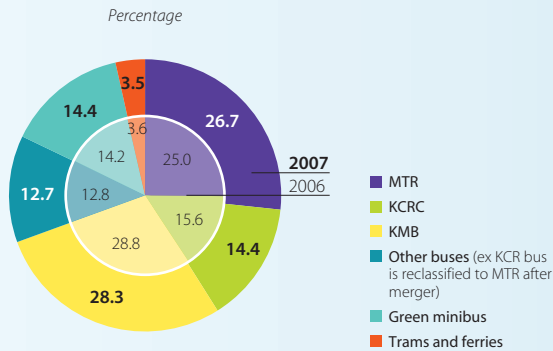
To improve the engagement and enthusiasm of MTR Club members, we launched the MTR Club Column in Metro Daily, inviting Club members to submit articles on special topics regarding the MTR and its services, as well as the MTR Club Customer Panel, to provide discussion groups and input on the Rail Merger.



Passenger volume for the Cross-boundary Service at Lo Wu and Lok Ma Chau continues to grow

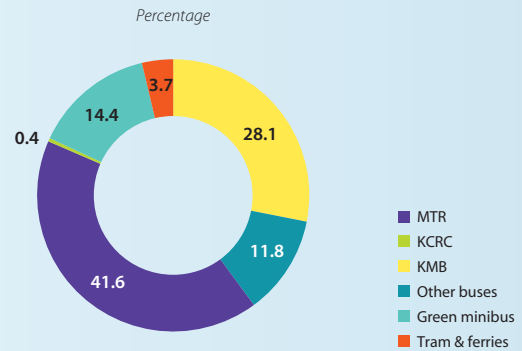
Market Shares of Major Transport Operators in Hong Kong

MTR's overall market share for 2007 increased to 26.7%, mainly as a result of the Rail Merger effect from 2 December to the end of 2007.



Market Shares of Major Transport Operators in Hong Kong (December 2007 only)

MTR's market share in December 2007 reached 41.6% as a result of the Rail Merger.



The Integrated MTR System is the backbone of Hong Kong's public transport

In a strategic partnership with the Hong Kong Tourism Board, a tailor-made shopping guide entitled "MTR Easy Ride to Hong Kong Shopping Festival" was developed and distributed to tourists who purchased a MTR 1-day Pass or Tourist Octopus during the promotion period in July and August 2007. This programme increased sales of these two products by 48% compared to the same period last year.

For Airport Express, discounts on tickets were offered to MTR shareholders from April onwards, accompanied by dining offers at SkyPlaza restaurants. The popular "Ride to Rewards" programme was enhanced with new rewards for registered

members that accumulated four journeys on Airport Express. For AsiaWorld-Expo, we joined with trade show organisers to arrange same-day return trips on Airport Express as well as discounted prices for visitors.

In 2007, the flourishing economy of the Pearl River Delta resulted in a higher demand for cross-boundary traffic, which continued to benefit the Cross-boundary and through train businesses that we took over from KCRC on the Appointed Day. For long-haul Intercity services to Beijing and Shanghai, a fare promotion for both single trip and round trip passengers during non-peak periods continued. To promote the new Lok Ma Chau Station of Cross-boundary Service, free ride promotions over the New Year and Lunar New Year holidays and weekly ticket promotions were provided to customers who used this new station.

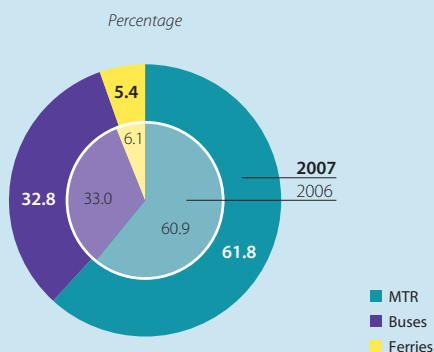
For East Rail Line, West Rail Line and Ma On Shan Line, most of the promotion activities which were in place before the Appointed Day continued, such as the Monthly Pass for the East Rail Line and West Rail Line and Day Pass for the West Rail Line.

Service Connectivity

Improved connectivity with other forms of transport remains an important driver of MTR patronage growth. Prior to the Rail Merger, two more feeder bus routes offering inter-modal fare discounts were added, bringing the number to 34. After the Rail Merger, the total number of feeder bus routes offering inter-modal fare discounts for the integrated network amounted to 61.

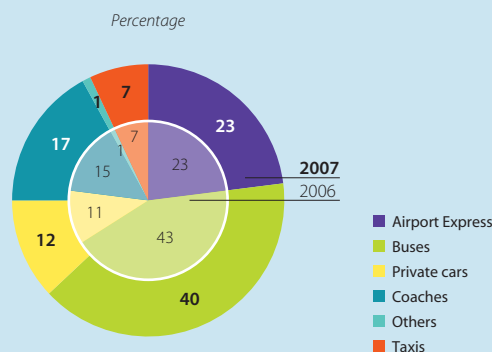
Market Shares of Major Transport Operators Crossing the Harbour

The Company's market share of cross-harbour traffic rose to 61.8%.



Market Shares of Major Transport Operators to/from the Airport

The proportion of people travelling to and from the Hong Kong International Airport on MTR remained stable.



We also gained 1,400 car park spaces from the Rail Merger (in Hung Hom and Kam Sheung Road stations), which increased our number of car park spaces at stations to 2,900 at the year end.

Market Recognition

Once more, our efforts in marketing, branding and increasing passenger awareness received widespread recognition in 2007. We won the "Sing Tao Excellent Services Brand 2006 – Category Award of Public Transportation" and our 2006 Train Door Safety TV Commercial received "The Top Ten Most Popular TV Commercials Award" in the 13th Annual Most Popular TV Commercial Awards hosted by ATV. Our print campaign on escalator safety was voted one of Hong Kong's Top Ten Most Creative Advertisements in the "Metro Creative Awards 2007" organised by Metropolis Daily.

Service Performance

Continuity of, and improvement in, performance is essential in an era of transformation. In 2007, we continued to enhance our customer services to provide the highest levels of customer satisfaction, passenger comfort, reliability and safety.

For the period before the Rail Merger, i.e. from 1 January 2007 to 1 December 2007, we exceeded all the minimum performance levels required by the Government and our own more stringent Customer Service Pledge targets for the MTR System. Passenger journeys on time were 99.9% (Airport Express 99.9%), supported by 99.9% reliability for train service delivery and 99.8% train punctuality (Airport Express 99.9%). With the Rail Merger, a new Operating Agreement was established with effect from

2 December 2007 to include the East Rail Line, West Rail Line, Ma On Shan Line and Light Rail. The performance levels in the post-Merger period from 2 December to end of 2007 will be incorporated into the next period for reporting purposes.

These results underpinned our "We serve from the heart" campaign, which was launched during the year to further enhance passenger service. This year-long campaign was supplemented by other monthly campaigns promoting train door and escalator safety, as well as general safety, and by a series of one-minute TV real-life stories on TVB Jade from April to May.

Training our staff and platform assistants to understand the needs and feelings of our passengers continued to be an ongoing priority in 2007, particularly with the Rail Merger in mind. In terms of safety, we set out to identify and minimise the Rail Merger transitional risks while adopting a common safety management framework to achieve a single Safety Management System. Railway Safety Rules for Operations personnel were rationalised and published to cope with the increasing complexity of operations. We also implemented a Human Factors programme to drive the application of human factors techniques to improve staff performance.

Customer satisfaction levels recorded during the year by our regular surveys remained high. In 2007, the Service Quality Index for the MTR Lines and Airport Express stood at 72 and 81 respectively, while the Fare Index, which indicates the level of satisfaction of customers with our fares, stood at 61 and 62 respectively. This performance also received international



We continued to enhance our customer services to provide the highest standards of customer satisfaction

recognition. In the benchmarking performed by the 11-member Community of Metros (CoMET) for 2006, we continued to hold a leading position in the areas of customer service, service reliability, business performance, and safety and security.

The sustained excellence of our service performance was again reflected in the winning of numerous awards. In Hong Kong, we won East Week magazine's "Hong Kong Service Awards" in the Public Transport category for the third consecutive year. We also won Next Magazine's "Top Service Award" – Public Transport Category for the ninth consecutive year. Mr Tony Tse, Station Officer of Tsing Yi Station won the "Best Staff Award" in the Top Service Awards 2007 among various industries. International recognition for our railway asset management came in the form of the Gold Asset Management Excellence Award, and the Steve Maxwell Leadership Award for our Operations Director, awarded jointly by the Asset Management Council and Maintenance Engineering Society of Australia at the 2007 International Asset Management Conference.

Service Improvements

To support the MTR network as the backbone of public transport in Hong Kong, we continued to enhance train services and network infrastructure.

The new platform serving SkyPlaza at Hong Kong International Airport Terminal 2 was opened and put into operation on 28 February 2007.

During the year, the opening of new pedestrian links at various stations further enhanced accessibility to the MTR System. Three Pacific Place Link was completed in February and provided a linkage between Admiralty Station and Three Pacific Place. Two new entrances at Kowloon Station were opened to link up with Elements shopping centre.

Also on the West Rail Line, Tuen Mun Station will enhance its linkage with the nearby passenger transport interchange and new residential development at Ho Pong Street by the construction of three new footbridges. One of the three footbridges will be completed in 2009 and the other two are scheduled for 2012.

Station improvement initiatives continued to upgrade the ambience and design of MTR stations to the levels expected by our ever more discerning customers. During 2007, 46 stations on the merged network underwent renovations and enhancements of various kinds to enrich station environment and provide more shopping outlets. These include an air-conditioning and ventilation system improvement at the Hung Hom Station Intercity Passenger Services departure and arrival halls which was completed in December 2007.

Two new "Self-Service Point" prototype machines were installed for trial use in Hong Kong Station starting from July and performance monitoring progressed well. The Self-Service Point machine is another new service channel for passengers, providing them with a more convenient and straightforward way of resolving ticketing issues. The machine is fitted with a call for assistance facility to speak directly to staff if passengers have any questions.

To improve passenger comfort on the existing network, five new trains are being procured for use on the Tsuen Wan, Kwun Tong, Island and Tseung Kwan O lines.

The noise enclosure project in the Tung Chung area was completed, which brought reduction in the level of train noise in the area. Improvement work was also in progress in the Tsing Yi area. A six-year programme to replace some sections of rail in north Lantau with rail of lower hardness was completed, which will significantly minimise the chances that surface cracks will develop on the rail head and will also help to reduce rail noise.

Access to the Network for the Disabled

The Company has a long track record of careful investment in facilities for the disabled, including ramps, portable ramps, wheelchair aids, stairlifts, passenger lifts etc.

Benchmarking Comparisons

MTR Corporation maintained its strong position, particularly in service reliability, against international benchmarks.

MTR performance vs. best performance

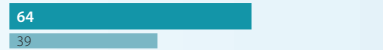
Service reliability passenger journeys on time



Punctuality percentage of trains on time



System utilisation passenger km per capacity km



Density number of passengers per track km



■ 2006
■ 2005

Best performance = 100

Staff Efficiency and Cost Efficiency

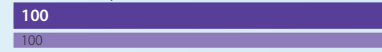
New initiatives will further be introduced to enhance operating efficiency.

MTR performance vs. best performance

Staff efficiency number of passengers per staff hour



Cost efficiency fare revenue per total cost



■ 2006
■ 2005

Best performance = 100



Our maintenance staff contribute to our very high standards of reliability and punctuality

During 2007, installation of internal passenger lifts was completed at Lai Chi Kok and Tai Wo Hau stations and works are in progress at Admiralty Station. Self-operated stairlifts were completed at Sham Shui Po, Cheung Sha Wan and Yau Ma Tei stations, while those in Diamond Hill, Jordon, Admiralty and Tsim Sha Tsui stations are scheduled to open for use in 2008.

Productivity

Improving efficiency and productivity remained a key priority for the Company in 2007. In March, we completed the replacement of 469 motor alternator sets on the 78 trains on the MTR Lines

with state-of-the-art static inverter units, thereby achieving energy savings of HK\$7.7 million per year, which is equivalent to a 1.5% reduction in energy costs for the year, whilst also reducing noise levels. The static inverter replacement work also started for trains on the East Rail Line with planned completion in 2010 and estimated energy cost savings of HK\$5.1 million per year. Operating costs per car kilometre for the MTR System were successfully maintained at similar levels to 2006. For the enlarged post-Merger network, operating cost per car kilometre decreased by 2.3% to HK\$21.6.

System and Market Information

Railway operation data	2007		2006	
Total route length <i>in km</i>	211.6		91	
Number of rail cars	1,871		1,074	
Number of "e-Instant Bonus" machines in stations	24		22	
Number of station kiosks and mini-banks in stations	1,230		552	
Number of advertising media in stations	20,564		15,206	
Number of advertising media in trains	27,011		9,036	
Daily hours of operation				
Island, Tsuen Wan, Kwun Tong, Tseung Kwan O, Tung Chung, Disneyland Resort & West Rail lines, Airport Express and Light Rail	19		19	
East Rail Line and Ma On Shan Line	19.5		N/A	
Minimum train headway in seconds	Morning peak	Evening peak	Morning peak	Evening peak
– Tsuen Wan Line	128	140	128	140
– Kwun Tong Line	128	144	128	144
– Island Line	124	156	124	156
– East Rail Line				
East Tsim Sha Tsui to Sheung Shui	180	210	N/A	N/A
East Tsim Sha Tsui to Lo Wu	327	327	N/A	N/A
East Tsim Sha Tsui to Lok Ma Chau	600	600	N/A	N/A
– Tseung Kwan O Line	160	180	160	180
– Tung Chung Line				
Hong Kong – Tung Chung	360	480	360	480
Hong Kong – Tsing Yi	240	240	240	240
– Airport Express	720	720	720	720
– West Rail Line	210	270	N/A	N/A
– Disneyland Resort Line	270	270	270	270
– Light Rail	270	300	N/A	N/A

Note: 2007 figures cover the Integrated MTR System

International Performance Comparisons: The 11-member Community of Metros (CoMET)

Metro system network data (2006)	MTR* Lines	Metro A	Metro B	Metro C	Metro D	Metro E	Metro F	Metro G	Metro H	Metro I	Metro J
Passenger journeys <i>in million</i>	867	466	1,014	1,417	657	2,476	1,499	1,410	452	630	564
Car kilometres <i>in million</i>	116	122	500	335	151	680	546	227	100	69	94
Route length <i>in km</i>	84	153	443	201	233	279	480	212	115	90	60
Number of stations	51	170	275	147	196	157	424	297	66	66	54

* For the data year 2006, MTR Lines included in the CoMET metro benchmarking programme are Kwun Tong Line, Tsuen Wan Line, Island Line, Tung Chung Line, Tseung Kwan O Line and Disneyland Resort Line. The Airport Express is excluded from the benchmarking.

Note: The other metros in the comparison are Berliner Verkehrsbetriebe, London Underground Limited, New York City Transit, Sistema de Transporte Colectivo, Régie Autonome des Transports Parisiens Metro, Régie Autonome des Transports Parisiens Réseau Express Régional, Metropolitano de São Paulo, Moscow Metro, Metro de Madrid and Shanghai Metro Operation Corporation. The benchmarking agreement prohibits specifically identifying the data by metro system.



Operations Control Centre at Tsing Yi

Operations Performance in 2007

Service performance item	Performance Requirement	Customer Service Pledge target	Actual performance in 2007 ^{**}
Train service delivery	98.5%	99.5%	99.9%
Passenger journeys on time			
– MTR Lines	98.5%	99.5%	99.9%
– Airport Express	98.0%	99.0%	99.9%
Train punctuality			
– MTR Lines	98.0%	99.0%	99.8%
– Airport Express	98.0%	99.0%	99.9%
Train reliability: train car-km per train failure causing delays \geq 5 minutes	N/A	500,000	1,762,621
Ticket reliability: magnetic ticket transactions per ticket failure	N/A	8,000	14,243
Add value machine reliability	98.0%	98.5%	99.5%
Ticket issuing machine reliability	97.0%	98.0%	99.4%
Ticket gate reliability	97.0%	99.0%	99.8%
Escalator reliability	98.0%	99.0%	99.9%
Passenger lift reliability	98.5%	99.0%	99.9%
Temperature and ventilation			
– Trains: to maintain a cool, pleasant and comfortable train environment generally at a temperature at or below 26°C	N/A	97.0%	99.9%
– Stations: to maintain a cool, pleasant and comfortable environment generally at or below 27°C for platforms and 29°C for station concourses, except on very hot days	N/A	90.0%	99.9%
Cleanliness			
– Train compartment: cleaned daily	N/A	98.5%	100.0%
– Train body: washed every 2 days	N/A	98.0%	99.9%
Passenger enquiry response time within 7 working days	N/A	99.0%	99.9%

^{**} The actual performance figures are for the operating period from 1st January to 1st December 2007 as per the pre-merger Operating Agreement.





Building
ONE Customer
Experience for All

During the year, we continued to focus on the enrichment of the customer journey through enlarged scale and value-added customer services

Executive Management's Report

Station Commercial and Rail Related Businesses



High impact advertising formats – an unrivalled choice of media platform in MTR stations

Our station commercial and rail related businesses continued to benefit from the strong economy and rising patronage in 2007. The increased scale following the Rail Merger not only enhanced revenue growth but also brought about new business opportunities for MTR in the form of Duty Free shops and freight transportation.

Revenue Performance

Revenue from our station commercial and rail related businesses increased by 12.9% in 2007 to HK\$1,741 million. The revenue increase was driven by a strong economy, rising patronage and the Rail Merger effect from 2 December to the end of 2007. Excluding the Rail Merger effect, such revenues would have increased by 4.8% in 2007 to HK\$1,616 million.

Advertising

Advertising revenue grew by 11.0% to HK\$593 million (a 9.6% increase to HK\$585 million excluding the Rail Merger effect), supported by higher passenger volumes, advertising

innovations and increased spending by retailers on beauty and slimming products. We continued to strengthen our market leadership position by introducing new formats such as “Interactive Panel”, “Shopping Guide Map” and “12-sheet Scrolling Units” for product display or poster advertising, as well as additional zone packaging at stations to maximise revenue for the Company and advertising impact for our customers.

The MTR Plasma TV network continued to be enhanced. We successfully replaced 68 units of trackside plasmas and their back-end system by the end of March 2007 for maintaining the best viewing quality for our passengers.

On Airport Express, the replacement of seatback TV with a new multimedia system was completed in May 2007.

With the Rail Merger, advertising coverage now extends to the enlarged network including the cross-boundary market. The scale of our advertising business also increased, with the number of advertising media in stations and trains totalling 20,564 and 27,011 respectively at the year end.

At the end of May, in addition to bill payment services for CLP Power HK Ltd, we launched rental payment services for Hong Kong Housing Authority tenants at Customer Service Centres in stations on the Kwun Tong Line, Island Line, Tsuen Wan Line, Tung Chung Line and Tseung Kwan O Line.

Station Retail

Station retail revenue increased by 27.6% to HK\$499 million (a 9.7% increase to HK\$429 million excluding the Rail Merger effect), due to growth in rental rates and retail sales volumes as well as the Rail Merger effect. To enhance customer satisfaction and increase revenue, renovations and new layouts were completed in the retail zones of nine stations in 2007: Hong Kong, Kowloon, Tung Chung, Kwun Tong, Wong Tai Sin, Lai Chi Kok, Quarry Bay, Sai Wan Ho and Po Lam. This brings to 41 the number of stations in the MTR System that have undergone renovation since 2001. In addition, five new cross-selling promotion campaigns were launched to enhance the MTR Shops brand and stimulate tenants' sales.

During the year, 31 new trades/brands were added to the station retail network in the MTR System to enhance customer satisfaction. With the Rail Merger, the number of shops at stations totaled 1,230 at the end of the year, including nine Duty Free shops at Lo Wu, Lok Ma Chau, and Hung Hom stations.



A huge banner ad in Kowloon Station

Over 47,000 Advertising Media

in Stations and Trains

HK\$12,464 Advertising Revenue

Per Advertising Medium

HK\$7.23 Million Advertising Revenue

Per Station

1,230 Kiosks

in Stations

31 New Trades/Brands Added

in Station Kiosks (MTR System)

20 Stations with Wi-Fi Access

Station Commercial and Rail Related Revenue Comprised

16.3% of Total Revenue

for the Year 2007



Innovative displays included projection ads in Central Station



MTR shops continued to add exciting new brands

Telecommunications

Revenue from telecommunications services decreased by 10.0% to HK\$233 million as compared to 2006 (a 11.2% decrease to HK\$230 million excluding the Rail Merger effect), partly due to a one-off recognition of income from a mobile operator network upgrade in 2006 that was not repeated in 2007. Intense price competition among operators and cannibalisation of call minutes by 3G mobile services continued to affect our telecommunications income. However, our fixed network services provider, TraxComm Limited, achieved higher revenue. By the end of 2007, TraxComm had sold more than 220 Gbps of bandwidth services to carrier customers, an increase of 40% from the end of 2006, and its overall network availability had achieved close to 100%.

With effect from the Rail Merger date on 2 December, we took over the telecoms business in the KCR System, which is similar to that of MTR Corporation including public payphones, mobile phone coverage in stations, tunnels and along railway tracksides, and also optical fibre leasing. The rental revenue of rooftop sites for mobile base stations of various mobile operators grew by 13.6% as compared to 2006 due to the Rail Merger, which increased the number of sites from 22 to 34. A telecoms operator requested for capacity expansion of its 3G network within MTR System in order to enhance data and voice capacity

for 3G mobile phone usage, which was completed by the end of 2007. The Company joined with a telecoms operator to enable passengers to access the internet through Wi-Fi at 16 of our Domestic Service stations and 4 Airport Express Line stations.

With the Rail Merger, our existing fibre network was integrated with the KCRC fibre network, expanding coverage from 156 kilometres to 324 kilometres and bringing about cross-boundary business potential.

Freight Services

With the Rail Merger, we have gained the right to operate KCRC's freight business into the Mainland of China. This small business comprises two main business segments: (i) ancillary services for warehouse and pier licensing, and (ii) core railway transport business of containers, general cargoes and livestock. Revenue from the freight business from 2 December to the end of 2007 was HK\$3 million.

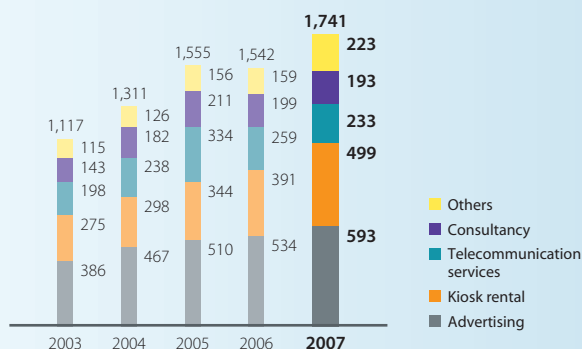
External Consultancy

During the year, in line with our strategy of focusing on consultancies that could lead to new investment opportunities, we made progress in existing consultancy projects and signed a number of new contracts. Overall, external consultancy activities generated a revenue of HK\$193 million in 2007, a decrease of

Revenue from Station Commercial and Rail Related Businesses

Growth in revenue from station commercial and other activities was led by advertising income and kiosk rental.

in HK\$ million



With the Rail Merger, our number of advertising media in stations and trains reached 20,564 and 27,011 respectively at the end of 2007

3.0% compared to 2006, which was mainly due to programme delays of some projects caused by the changing requirements of our customers.

In the Mainland of China, we were engaged by Asia Development Bank in a consultancy project to provide technical assistance to the Ministry of Finance for a study on Public Private Partnerships (PPP). The aim of the project is to develop PPP models that can be applied to urban rail projects in Mainland of China. In Chengdu, we secured a design review consultancy for Chengdu Metro.

In Thailand, the Company signed a consultancy project with Bangkok Mass Transit System Public Company Limited (BTS) to act as their technical advisor in BTS's re-signalling project. We also secured new projects in the UK, India and Australia, among other countries. To explore consultancy opportunities in the United Arab Emirates, we opened a branch office in Dubai.

During the year, the Company made significant progress and achieved several milestones in existing projects. Project management consultancy work continued on Shanghai Metro Line 9 and Phase 1 (12 stations) opened on 29 December 2007. Our existing consultancy works for Kaohsiung Rapid Transit Corporation in Taiwan and the works for the Roads and Transport Authority in Dubai also proceeded well. We

successfully delivered the power supply and signalling systems for the Automated People Mover extension at the Hong Kong International Airport, which was opened in February 2007. Phase 2 design work continued during the year and we will start the installation works once the Phase 2 site is ready for access, which is expected to be in May 2008.



Wi-Fi access is now available at 16 Domestic Service stations and 4 Airport Express Line stations



Offering the Community

ONE Access to Quality Living

Leveraging on our world-renowned "Rail and Property" model, we continue with our mission of providing refreshing and original property design, planning and management



Executive Management's Report

Property and Other Businesses



Area 86 at Tseung Kwan O was named LOHAS (Lifestyles of Health and Sustainability) Park

Our property business performed well in 2007 against a background of broad based growth in the Hong Kong property market. Expanding demand and limited supply meant that the office market enjoyed low vacancy rates and high rentals, while the strong retail market was driven by consumer and tourist spending. The total transaction volume and value in the “first hand” private residential market increased by 37% and 106% respectively as compared to 2006.

Profit from property development was HK\$8,304 million in 2007, while revenue from property rental, management and other businesses grew 24.3% to HK\$1,834 million. Although it has

no impact on our overall business, the strong office and retail markets resulted in revaluation gains of HK\$8,011 million for our rental portfolio in 2007 (HK\$6,609 million after deferred tax).

Property Development

Profit for the year from property development increased to HK\$8,304 million. The bulk of this profit was derived from surplus proceeds of HK\$7,077 million from developments along the Airport Express and Tseung Kwan O Line, particularly Le Point at Tiu Keng Leng Station and to a lesser extent Harbour Green at Olympic Station. Deferred income recognition of

HK\$1,224 million also contributed to profitability with profit recognition mainly from fit-out works at the newly opened Elements shopping centre in Kowloon Station, and at Coastal Skyline and Caribbean Coast in Tung Chung.

Pre-sale commenced at Crystal Cove in Tung Chung and was well received. Sales were re-launched at the Harbourside, Harbour Green, La Rossa of Coastal Skyline and Le Point to good response, whilst Occupation Permits were obtained for Phase One of International Commerce Centre, the two towers of The Cullinan at Kowloon Station, Phase 2 of Elements, Le Point at Tiu Keng Leng Station, and the last phase of the development in Coastal Skyline in Tung Chung.

In February 2007, the tender for Area 56 in Tseung Kwan O town centre was awarded to Lansmart Limited, a subsidiary of Sun Hung Kai Properties Limited, with plans to develop a hotel, residential, office and retail complex. In November, a subsidiary of Cheung Kong (Holdings) Limited, Wealth Pine Investment Limited, was awarded Package Three of LOHAS Park, a residential development of up to 1,648 units. A re-branding exercise was launched for Area 86, which was named LOHAS (Lifestyles of Health and Sustainability) Park in line with our commitment to the long term wellbeing of the communities we foster.

Following approval by the Town Planning Board, the land application procedure began for conversion of part of the lorry park and transport interchange adjacent to Tsing Yi Station to commercial use. With the Government's decision to proceed with preliminary planning and design for the South Island Line (East), the Company has procured consultancy to prepare the preliminary development scheme design for potential sites along this new line.

As part of the Rail Merger, the Company acquired a property package that comprised property development rights, investment properties and property management rights. The property development rights acquired comprise eight sites totalling 1.2 million square metres GFA of which three, namely Ho Tung Lau, Wu Kai Sha and Tai Wai Maintenance Centre, have already been tendered with the remaining five, totalling 0.6 million square metres GFA, yet to be tendered.

In early March 2008, we have invited expression of interest for Che Kung Temple site with a view to inviting tender in 2008.

Property Development

HK\$8.3 Billion

Property Development Profit

**8 Sites Totalling
1.2 Million sq.m. GFA**

Acquired in Rail Merger

**2 Property Tenders
Awarded**

with a Total GFA of 292,674 sq.m.

Property Rental

25.2% Increase

in Rental Income

Phase 1 of Elements

Opened on 1 October 2007

252,339 sq.m.

of Investment Properties in Hong Kong

Property Management Portfolio at End of 2007

71,851

HK Residential Units

756,556 sq.m.

of HK Commercial Properties

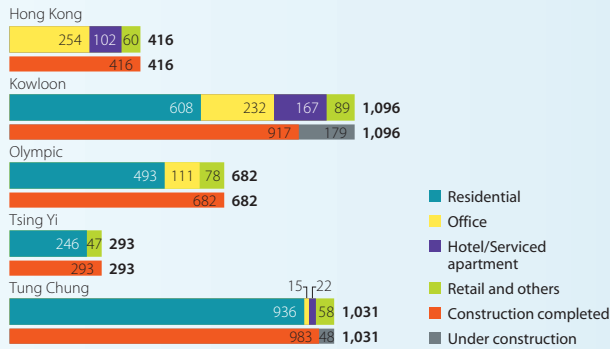
820,254 sq.m.

of Management Contracts in Mainland China

Airport Railway Property Development Plan and Progress

Phase One of International Commerce Centre and the two towers of the Cullinan at Kowloon Station were major projects completed in 2007.

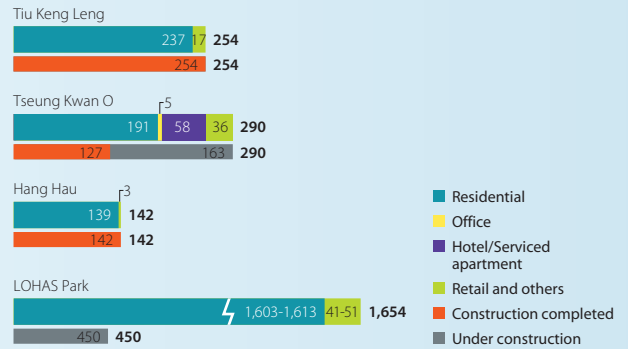
Gross floor area *Thousand sq. m.*



Tseung Kwan O Line Property Development Plan and Progress

The completion of Le Point contributed to the bulk of the property development profit in 2007.

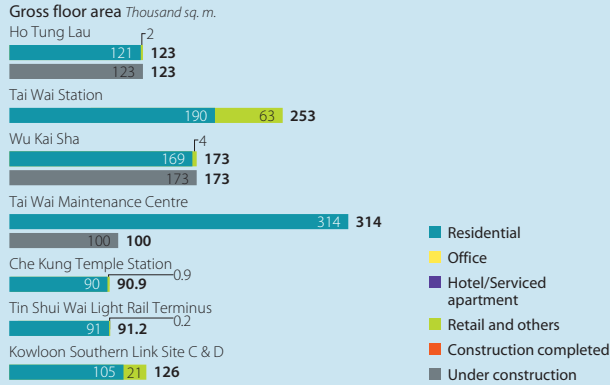
Gross floor area *Thousand sq. m.*



Elements shopping mall opened in October and quickly became 'talk-of-the-town'

East Rail Line, Ma On Shan Line, Kowloon Southern Link and Light Rail Property Development Plan and Progress

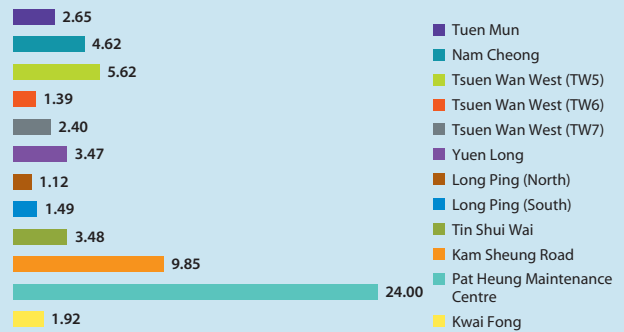
8 sites with a total GFA of 1.2 million sq.m. were acquired as part of the Rail Merger.



West Rail Property Development Plan

The Company acts as development agent for the West Rail property projects.

Site Area (in Hectare)



In addition, with the Rail Merger, the Company took on KCRC's role as development agent for Government in respect of a number of West Rail property projects, which have an estimated total gross floor area of 2.3 million square metres, for which the Company will receive a fee.

Property Rental, Management and Other Businesses

Revenue from our property rental, management and other businesses, benefiting from rental rate increases and further additions to the rental portfolio, increased by 24.3% to HK\$1,834 million as compared to 2006.

Property Rental

Property rental income rose by 25.2% over last year to HK\$1,581 million (a 23.5% increase to HK\$1,560 million excluding the Rail Merger effect from 2 December to the end of 2007), driven by positive rental renewals and new lettings, contributions from the opening of Phase 1 of Elements and Ginza Mall in Beijing as well as the approximate one month of contributions from rental properties acquired in the Rail Merger.

Our commitment to the continuous enhancement of our shopping centres and other investment properties, as well as our focus on providing "Premier" management services enabled



Shopping at our centres is exciting and pleasurable

us to capitalise on Hong Kong's strong consumer sentiment, improving job market and robust growth in visitor arrivals and overall tourism. The average rise in rental reversions for renewal of leases and re-letting was 21.7% in 2007 as compared to rentals achieved in the previous lettings.



Our "Premier" management services enabled us to capitalise on Hong Kong's strong consumer sentiment

Rising demand from retailers for high quality retail space increased rents for prime locations and enabled the Company to maintain 100% occupancy at all pre-Merger MTR Corporation shopping centres, except for retail spaces at Luk Yeung Galleria repossessed for renovation. The five KCRC shopping centres that we acquired had an average occupancy of 91%.

Elements Phase 1 with lettable floor area of 39,210 square metres, which opened on 1 October 2007, was very well received by the public and continued to be "talk-of-the-town", attracting local shoppers and tourists. Planned according to the Chinese five elements, large-scale artistic sculptures also brought a unique and exciting shopping experience to visitors. Many brands and services that are new to Hong Kong opened their flagship stores at Elements and the project received the MIPIM Marché International des Professionnels d'Immobilier

Asia 2007 award for the best shopping centre. New up-market tenants at Elements included Mikimoto, Cartier, Mulberry, Versace, Escada, Lanvin, Luella, Karen Millen, Onitsuka Tiger, Gucci, Dunhill, Kate Spade, Cerruti 1881, MontBlanc, Tiffany & Co., Megu, H&M and ZARA. Renovations were also completed in November 2007 at Luk Yeung Galleria, increasing the shopping centre's competitiveness and product offerings.

In the Mainland of China, following refurbishment and re-branding, Ginza Mall in Beijing opened in January and by the end of December was 95% let. This mall marked the first step in applying our experience and know-how of operating shopping centres to the Mainland. Ginza Mall introduced a number of new retailers to the Beijing market such as Ole Supermarket, Very, Bunka, I.S.O., Chitose and Think Pink.

Distinctive promotional programmes to raise the profile of MTR shopping centres continued throughout the year, further strengthening their competitiveness. Promotions included the "Elements Club", a television commercial campaign for Elements, an Octopus Rewards Scheme, an Astro Boy Campaign, a Terra Cotta Museum and the first Disney-Pixar themed Christmas Promotion Campaign for Telford Plaza, Maritime Square, Luk Yeung Galleria, Paradise Mall, The Lane, The Edge, Citylink Plaza and Ocean Walk.

Supported by strong demand for prime office space in Central and our "Premier" management services, the Company's 18 floors at Two International Finance Centre remained fully let throughout the year.

We acquired certain investment properties from KCRC as part of the Rail Merger, increasing our investment property portfolio by a lettable area of 40,957 square metres. The investment property portfolio acquired comprises five shopping centres in the New Territories totalling 36,487 square metres lettable, 20 residential units at Royal Ascot and an office at Hung Hom of 1,686 square metres lettable.

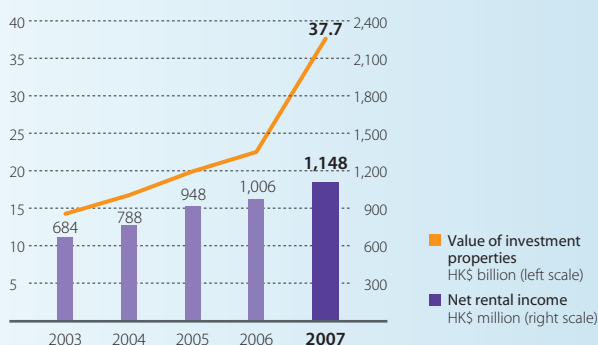
At the year end, the Company's attributable share of investment properties were 200,921 square metres of lettable floor area of retail properties, 41,215 square metres of lettable floor area of offices and 10,203 square metres for other usage.

Property Management

Our property management business, benefiting from additions to the portfolio, achieved revenue growth of 12.8% to HK\$168 million. During the year, 3,121 residential units were added to our property management portfolio at Coastal Skyline, Caribbean Coast and Harbour Green, which together

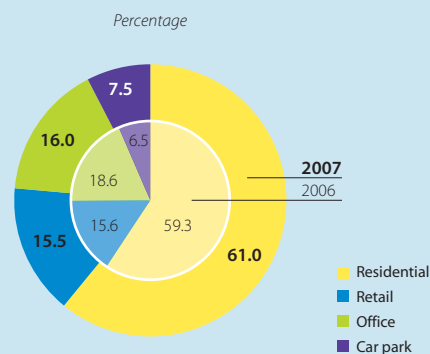
Investment Properties

Revenue from investment properties increased as rentals rose, together with contributions from the opening of Elements as well as additional investment properties acquired in the Rail Merger.



Distribution of Property Management Income

At the end of the year, the Company had 71,851 residential units and 756,556 sq.m. commercial properties under management in Hong Kong, and total management contracts in Mainland China amounted to 820,254 sq.m.



with the 9,854 units under agency management acquired in the Rail Merger, brings the total number of residential units in the property management portfolio of the Company in Hong Kong to 71,851 units at the end of 2007.

Prior to the Rail Merger, total commercial properties managed by the Company increased by 81,457 square metres mainly due to the inclusion of Elements Phase 1. With the Rail Merger, an additional 30,530 square metres of commercial area directly managed by the Company as well as 62,496 square metres of commercial area managed by agents were added to our property management portfolio to give a total of 756,556 square metres at the year end.

There was also a marked increase in the managed property portfolio in the Mainland of China in 2007, with a total new intake of 480,000 square metres, including Jian Wai SOHO Phase 7, SOHO Shangdu Phases 1 and 2, and Chao Wai SOHO all in Beijing, as well as Mei Li Shan Shui Phase 1 in Chongqing. A new consultancy project was undertaken in Shenyang for Shenyang Rich Gate. Altogether, total management contracts in hand in the Mainland amounted to 820,254 square metres.

Other Businesses

Ngong Ping 360

The Ngong Ping 360 cable car and associated theme village on Lantau Island opened on 18 September 2006. From its opening on 18 September 2006 to 11 June 2007, the tourist attraction carried some 1.5 million guests, which surpassed our

projections for the first full year of operations. In June 2007, during the annual testing outside of operation hours, one of the gondolas dislodged from the cable. There were no injuries and operations were immediately suspended, followed by detailed investigations and a period of intensive safety testing. In September, the Company took over the management and operation of the cable car system from the previous contractor through the acquisition of its Hong Kong subsidiary, with a senior management team of our experienced engineers and international cable car professionals. After many rigorous rounds of inspection, re-testing and re-certification, the system was confirmed to be safe and reliable and the cable car service resumed on 31 December 2007. The revenue contributed for the year was HK\$85 million.

Octopus Holdings Limited

The Company's share of Octopus' net profit for the year was HK\$97 million, a 42.6% increase over 2006. The increase was partly the result of an increase in average daily Octopus usage of 11.7% to HK\$81.9 million per day in 2007, brought about by a rise in the number of retail service providers and improvements in the general economy.

The "Portable Octopus Processor" (POP), which enables Octopus to extend its reach into the small to medium-sized market sector, was a driver of Octopus retail merchant expansion. By the end of 2007, the total number of service providers had risen to 490 from 431.

Other new products included the launch of the Mini Octopus, which has become a "hot" accessory in town, underscoring Octopus' innovation in product design. Octopus also introduced the Hello Kitty Octopus Key Ring Set, the first product offered by Octopus that comes in the form of a plush ring set.

Cards in circulation rose to 16.5 million and average daily transaction volume rose to 10.2 million. By the end of 2007, over 1.7 million cardholders had registered as members of the Octopus Rewards Programme with 14 participating Rewards merchants.

2007 was also a challenging year for Octopus in view of the Octopus EPS add-value incident whereby certain customers had incorrect amounts deducted from their bank accounts. With the help of EPS Company (Hong Kong) Limited and relevant

banks, virtually all unclaimed add-value funds using EPS were successfully returned to affected customers. To ensure customer protection, Octopus has permanently suspended the Octopus EPS add-value service, which accounted for only 1.5% of add-value transactions, since a detailed technical review by a special Task Force concluded that there can be no guarantee that the problem will not recur.

Octopus' unrelenting efforts to provide customer pleasure in using the Octopus service was duly recognised when it won the Excellent Creative Services Award in the Sing Tao Excellent Services Brand Award 2007. For the first time, the Company was also named a Caring Company by the Hong Kong Council of Social Service for its contribution to the community.

Airport Railway Property Developments (Packages Awarded)

Location	Developers	Type	Gross floor area (sq. m.)	No. of parking spaces	Actual or expected completion date
Hong Kong Station					
(International Finance Centre, IFC Mall, Four Seasons Hotel / Four Seasons Place)	Sun Hung Kai Properties Ltd. Henderson Land Development Co. Ltd. The Hong Kong & China Gas Co. Ltd.	Office Retail Hotel Car park	254,186 59,458 102,250	1,344	Completed by phases from 1998-2005
Sub-total			415,894		
Kowloon Station					
Package One (The Waterfront)	Wing Tai Holdings Ltd. Temasek Holdings (Pte) Ltd. Singapore Land Ltd. Keppel Land Ltd. Lai Sun Development Co. Ltd. Worldwide Investment Co. (Bermuda) Ltd.	Residential Car park	147,547	1,332	Completed in 2000
Package Two (Sorrento)	The Wharf (Holdings) Ltd. Wheelock and Company Ltd. Wheelock Properties Ltd. Realty Development Corporation Ltd. Harbour Centre Development Ltd.	Residential Car park	210,319	1,270	Completed by phases from 2002-2003
Package Three (The Arch)	Sun Hung Kai Properties Ltd.	Residential Cross border bus terminus Car park	100,000 5,113	412	Completed in 2005
Package Four (The Harbourside)	Hang Lung Properties Ltd.	Residential Car park	128,845	864	Completed in 2003
Packages Five, Six and Seven (Elements, International Commerce Centre, The Cullinan, Harbourview Place)	Sun Hung Kai Properties Ltd.	Retail Office Service apartment Hotel Residential Kindergarten Car park	82,750 231,778 72,472 95,000 21,300 1,045	1,743*	By phases from 2006-2010
Sub-total			1,096,169		

* The number of car parking spaces is subject to review

Airport Railway Property Developments (Packages Awarded) (Continued)

Location	Developers	Type	Gross floor area (sq. m.)	No. of parking spaces	Actual or expected completion date
Olympic Station					
Package One (Island Harbourview, HSBC Centre, Bank of China Centre and Olympian City One)	Sino Land Co. Ltd.	Office Retail Residential Indoor sports hall Car park	111,000 14,900 169,950 13,219	1,380	Completed in 2000
Package Two (Park Avenue, Central Park and Olympian City Two)	Sino Land Co. Ltd.	Retail Residential Market Car park	47,500 220,050 1,100	932	Completed in 2001
Package Three (Harbour Green)	Sun Hung Kai Properties Ltd.	Residential Kindergarten Car park	103,152 1,300	264	Completed in 2006
Sub-total			682,171		
Tsing Yi Station					
(Tierra Verde and Maritime Square)	Cheung Kong (Holdings) Ltd. Hutchison Whampoa Ltd. CITIC Pacific Ltd.	Retail Residential Kindergarten Car park	46,170 245,700 925	920	Completed in 1999
Sub-total			292,795		
Tung Chung Station					
Package One (Tung Chung Crescent, Citygate, Novotel Citygate and Seaview Crescent)	Hang Lung Group Ltd. Henderson Land Development Co. Ltd. New World Development Co. Ltd. Sun Hung Kai Properties Ltd. Swire Properties Ltd.	Office Retail Hotel Residential Kindergarten Car park	14,913 48,298 21,986 275,479 855	2,037	Completed by phases from 1999-2005
Package Two (Coastal Skyline)	HKR International Ltd. Hong Leong Holdings Ltd. Recosia Pte Ltd.	Retail Residential Kindergarten Car park	2,499 253,100 350	625	Completed by phases from 2002-2008
Package Three (Caribbean Coast)	Cheung Kong (Holdings) Ltd. Hutchison Whampoa Ltd.	Retail Residential Wet market Kindergarten Car park	4,996 407,300 508 350	1,185	By phases from 2002-2008
Sub-total			1,030,634		
Grand Total:			3,517,663	14,308	

Tseung Kwan O Line Property Developments (Packages Awarded)

Location	Developers	Type	Gross floor area (sq. m.)	No. of parking spaces	Status	Actual or expected completion date
Tseung Kwan O Station						
Area 57a (Central Heights)	Sun Hung Kai Properties Ltd. Nan Fung Development Ltd. Henderson Land Development Co. Ltd. Chime Corporation Ltd.	Residential Retail Car park	26,005 3,637	74	Awarded in July 2000	Completed in 2005
Area 55b (The Grandiose and The Edge)	New World Development Co. Ltd. Chow Tai Fook Enterprises Ltd. Wee Investments Pte. Ltd.	Residential Retail Car park	84,920 11,877	249	Awarded in January 2002	Completed in 2006
Area 56	Sun Hung Kai Properties Ltd.	Residential Hotel Retail Office Car park	80,000 58,130 20,000 5,000	363	Awarded in February 2007	2011
Hang Hau Station						
(Residence Oasis and The Lane)	Sino Land Co. Ltd. Kerry Properties Ltd.	Residential Retail Car park	138,652 3,500	369	Awarded in June 2002	Completed in 2004
Tiu Keng Leng Station						
(Metro Town)	Cheung Kong (Holdings) Ltd.	Residential Retail Car park	236,965 16,800	609	Awarded in October 2002	Completed by phases in 2006-2007
Area 86 (LOHAS Park)						
Package One	Cheung Kong (Holdings) Ltd.	Residential Retail Car park Residential Care Home for the Elderly	136,240 500 3,100	325	Awarded in January 2005	2008
Package Two	Cheung Kong (Holdings) Ltd.	Residential Kindergarten Car park	309,696 800	905	Awarded in January 2006	By phases from 2009-2010
Package Three	Cheung Kong (Holdings) Ltd.	Residential Kindergarten Car park	128,544 1,000	350	Awarded in November 2007	2012

East Rail Line, Ma On Shan Line and West Rail Line Property Developments (Packages Awarded)

Location	Developers	Type	Gross floor area (sq. m.)	No. of parking spaces	Status	Actual or expected completion date
Fo Tan Station						
Ho Tung Lau (Site A)	Sino Land Company Limited	Residential Retail Car park	120,900 2,000	239	Awarded in November 2002	2008
Wu Kai Sha Station						
	Sino Land Company Limited	Residential Retail Kindergarten Car park	168,650 3,000 1,000	308	Awarded in July 2005	2009
Tai Wai Maintenance Centre						
	Cheung Kong (Holdings) Limited	Residential Car park	313,955	711	Awarded in April 2006	By phases from 2009-2011
Tuen Mun Station*						
	Sun Hung Kai Properties Ltd	Residential Retail Car park	119,512 25,000	384	Awarded in August 2006	By phases from 2012-2013

* as development agent for the Government of HKSAR

Tseung Kwan O Line Property Developments (Packages to be Awarded)**

Location	No. of packages envisaged	Type	Gross floor area (sq. m.)	Expected No. of parking spaces	Period of package tenders	Expected completion date
LOHAS Park	6 – 10	Residential Retail Car park	1,025,220– 1,035,220 39,500 – 49,500	3,303 (max.)	2009-2015	2019

** Subject to review in accordance with planning approval, land grant conditions and completion of statutory processes

Ma On Shan Line/Light Rail/Kowloon Southern Link Property Developments (Packages to be Awarded)**

Location	No. of packages envisaged	Type	Gross floor area (sq. m.)	Expected No. of parking spaces	Period of package tenders	Expected completion date
Che Kung Temple Station	1	Residential Retail Kindergarten Car park	89,792 193 670	236	2008	2012
Tai Wai Station	1-2	Residential Retail Kindergarten Car park	190,480 62,000 1,100	713	Under review	Under review
Tin Shui Wai Light Rail Terminus	1	Residential Retail Car park	91,051 205	267	2012	2017
Site C & Site D West Kowloon Station, Tsim Sha Tsui	2	Residential Retail Car park	104,795 20,959	321	2009 - 2010	2013 - 2014

** Subject to review in accordance with planning approval, land grant conditions and completion of statutory processes

Choi Hung Park and Ride Development

Location	Developers	Type	Gross floor area (sq. m.)	No. of parking spaces	Status	Actual completion date
Choi Hung Station (No. 8 Clear Water Bay Road)	Chun Wo Holdings Ltd.	Residential Retail Car park Park & Ride	19,138 2,400	54 450	Awarded in July 2001	Completed in 2005

Investment Property Portfolio (as at 31 December 2007)

Location	Type	Lettable floor area (sq. m.)	No. of parking spaces	Company's ownership interest
Telford Plaza I, Kowloon Bay, Kowloon	Shopping centre	39,616	–	100%
	Car park	–	993	100%
Telford Plaza II, Kowloon Bay, Kowloon	Shopping centre	19,411	–	50%
	Car park	–	136	50%
Luk Yeung Galleria, Tsuen Wan, New Territories	Shopping centre	11,198	–	100%
	Car park	–	651	100%
Paradise Mall, Heng Fa Chuen, Hong Kong	Shopping centre	18,772	–	100%
	Wet Market	1,216	–	100%
	Car park	–	415	100%
Maritime Square, Tsing Yi	Shopping centre	28,931	–	100%
	Kindergarten	920	–	100%
	Car park	–	220	100%
	Motorcycle park	–	50	100%
The Lane, Hang Hau	Shopping centre	2,629	–	100%
	Car park	–	16	100%
	Motorcycle park	–	1	100%
The Edge, Tseung Kwan O	Shopping centre	7,683	–	70%
	Car park	–	50	70%
G/F, No. 308 Nathan Road, Kowloon	Shop unit	70	–	100%
G/F, No. 783 Nathan Road, Kowloon	Shop unit	36	–	100%
New Kwai Fong Gardens, Kwai Chung, New Territories	Kindergarten	540	–	100%
	Car park	–	126	100%
International Finance Centre (IFC), Central, Hong Kong				
– Two IFC	Office	39,529	–	100%
– One and Two IFC	Car park	–	1,308	51%
Phase I, Carpark Building, Kornhill, Quarry Bay, Hong Kong	Car park	–	292	100%
Roof Advertising Signboard, Admiralty Centre, No.18 Harcourt Road, Hong Kong	Advertising signboard	–	–	100%
Ten Shop Units, First Floor Podium, Admiralty Centre, No. 18 Harcourt Road, Hong Kong	Shops	286	–	50%
Olympian City One, Tai Kok Tsui, Kowloon	Indoor sports hall	13,219	–	100%
Olympian City Two, Tai Kok Tsui, Kowloon	Shop unit	1,252	–	100%
Caribbean Coast, Tung Chung, New Territories	Wet market	508	–	100%
Choi Hung Park & Ride Public Car Park, No. 8 Clear Water Bay Road, Choi Hung, Kowloon	Car park	–	54	51%
	Motorcycle park	–	10	51%
	Park & Ride	–	450	51%
Elements, No. 1 Austin Road West, Kowloon	Shopping centre	39,210	–	81%
	Car park	–	898	81%
Cross Border Coach Terminus, No. 1 Austin Road West, Kowloon	Coach terminus	5,113	–	100%
Kindergarten, No. 1 Austin Road West, Kowloon	Kindergarten	1,045	–	81%
Plaza Ascot, Sha Tin	Shopping Centre	7,381	–	100%
Royal Ascot, Sha Tin	Residential	2,784	–	100%
	Car park	–	20	100%
Ocean Walk, Tuen Mun	Shopping centre	6,086	–	100%
	Car park	–	32	100%
Sun Tuen Mun Shopping Centre, Tuen Mun	Shopping centre	9,039	–	100%
	Car park	–	421	100%
Hanford Plaza, Tuen Mun	Shopping centre	1,950	–	100%
	Car park	–	22	100%
Retail Floor and 1-6/F, Citylink Plaza, Sha Tin	Shopping Centre	12,031	–	100%
Portion of G/F and portion of 1/F, MTR Hung Hom Building, Hung Hom	Office	1,686	–	100%

All properties are held by the Company and its subsidiaries under Government Leases for over 50 years except for:

- Telford Plaza I and II, Luk Yeung Galleria, Maritime Square, New Kwai Fong Gardens, IFC, Olympian City, Caribbean Coast, Elements, Cross Border Coach Terminus and Kindergarten at No. 1 Austin Road West, Plaza Ascot, Royal Ascot, Ocean Walk, Sun Tuen Mun Shopping Centre and Hanford Plaza where the Government Leases expire on 30 June 2047

Investment Property Portfolio (as at 31 December 2007) (Continued)

- Choi Hung Park & Ride where the Government Lease expires on 11 November 2051
- The Lane where the Government Lease expires on 21 October 2052
- The Edge where the Government Lease expires on 27 March 2052
- Citylink Plaza and MTR Hung Hom Building where the grant of Government Leases to Kowloon-Canton Railway Corporation (KCRC) and the subsequent assignment of the properties by KCRC to the Company are underway

Properties Held for Sale (as at 31 December 2007)

Location	Type	Gross floor area (sq. m.)	No. of parking spaces	Company's ownership interest
Island Harbourview, No. 11 Hoi Fai Road, Kowloon	Car park	–	579	40%
Olympian City One, No. 11 Hoi Fai Road, Kowloon	Shopping centre Car park	6,042* –	– 330	40% 40%
Bank of China Centre, No. 11 Hoi Fai Road, Kowloon	Car park	–	117	40%
The Arch, No. 1 Austin Road West, Kowloon	Residential Car park	3,182 –	– 35	38.5% 38.5%
Residence Oasis, No. 15 Pui Shing Road, Hang Hau, Tseung Kwan O	Car park Motorcycle park	– –	191 18	71% 71%
The Grandiose, 9 Tong Chun Street, Tseung Kwan O	Car park Motorcycle park	– –	148 25	70% 70%
Metro Town, 8 King Ling Road, Tseung Kwan O	Car park Motorcycle park	– –	487 33	72% 72%
Central Heights, 9 Tong Tak Street, Tseung Kwan O	Car park Motorcycle park	– –	54 4	35% 35%
Harbour Green, No. 8 Sham Mong Road, Kowloon	Residential Car park Kindergarten	6,728 – 1,299	– 126 –	35% 35% 50%
Caribbean Coast, No. 1 Kin Tung Road, Tung Chung	Car park	–	285	20%

* Lettable floor area

Managed Properties (as at 31 December 2007)

Number of managed residential flats	71,851 units
Area of managed commercial and office space	756,556 sq.m.



Developing ONE Railway Network

With the merger, the combined existing network increased 132% from 91 to 211.6 kilometres. Committed and future railway projects will further increase the combined network length by 28% from 211.6 to 271.6 kilometres.



Executive Management's Report

Hong Kong Network Expansion



South Island Line (East) will connect Admiralty Station to Ap Lei Chau via Ocean Park, Wong Chuk Hang and Lei Tung

A combination of the Rail Merger, the Government's declared commitment to a number of priority rail infrastructure projects and our continuing programme of asset enhancement and replacement made 2007 a milestone year for new rail projects for the Company. These dynamic factors also set the scene for 2008 to be a particularly vibrant year for the design and planning of future rail lines.

Network Extensions

In his October 2007 Policy Address indicating long-term Government commitment to developing Hong Kong's rail system as the backbone of passenger transport system, Hong Kong's Chief Executive highlighted three priority rail infrastructure projects: the South Island Line (East), the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link) and the Shatin-to-Central Link. These are in addition to ongoing works for the West Island Line

and Kowloon Southern Link as well as proposals for the Kwun Tong Line extension, which we have previously submitted to Government. The result is that 2008 is set to be an especially active year both for the design of these new extension projects and the progress of works on existing extensions.

On-going Projects

West Island Line

As the first in the wave of extension projects for the future, the West Island Line made significant progress. This proposed extension of the Island Line consists of three underground stations at Sai Ying Pun, University and Kennedy Town. The scheme was gazetted under the Railways Ordinance in October 2007. We will continue to work closely with Government to address key technical and financial issues on the West Island Line in 2008.

The 3-km West Island Line is estimated to cost approximately HK\$8.9 billion for which Government will provide funding support estimated at approximately HK\$6.0 billion, by way of a capital grant in two stages. The first stage of HK\$400 million for design has already been approved. The second stage, which will be for the balance of the funding support, will require further approval by the Legislative Council of Hong Kong (LegCo). A preliminary project agreement was entered into with Government on 6 February 2008 for the detail design of the project. The line is expected to be completed in late 2013 or early 2014.

Kowloon Southern Link

The Kowloon Southern Link (KSL) is part of the Rail Merger and will connect the existing East Rail Line's East Tsim Sha Tsui Station with West Rail Line's Nam Cheong Station. This new 3.8-km long rail link, which is scheduled to open for service in late 2009, will provide direct access for passengers between West Rail and East Rail Lines and will have one intermediate station, at West Kowloon. All capital costs for KSL will be funded by KCRC and on commissioning this extension will fall within the Service Concession, under which KCRC will own the line but the Company will be responsible for operations and maintenance. Service Concession fees payable on commissioning will be annual variable payments in accordance with the structure stipulated in the Rail Merger with no adjustment to be made to the fixed annual payments or upfront payment. As part of the Rail Merger, we have a project management contract from KCRC to oversee the construction of KSL in return for a fee.



The proposed West Island Line is an extension of the Island Line

Kowloon Southern Link (KSL)

1.6 km (76%)

of Tunnels Bored

Tseung Kwan O South (TKS)

3.3km of New Track

Laid for Station at LOHAS Park

West Island Line (WIL)

ExCo Decision

to Proceed With Further Planning and Detailed Design – Oct 2007

Gazette of WIL Scheme

under the Railways Ordinance – Oct 2007

LegCo Finance Committee

Approved Funding
– Dec 2007

South Island Line (East) (SIL(E))

ExCo Decision

to Proceed With Preliminary Planning and Design – Dec 2007

Shatin-to-Central Link and Kwun Tong Line Extension

ExCo Decision

to Proceed With further Planning and Design – Mar 2008

New Projects

South Island Line (East)

South Island Line (East) is envisaged to be a medium capacity railway service connecting Admiralty Station to South Horizons on Ap Lei Chau via Ocean Park, Wong Chuk Hang and Lei Tung. A revised proposal with updated financial data and enhanced interchange arrangements at Admiralty Station to existing lines and the future Shatin-to-Central Link was submitted to Government in June 2007. The Government has since decided to proceed with preliminary planning and design for the 7-km South Island Line (East), construction of which is estimated to cost over HK\$7 billion. After representations from the Hong Kong Jockey Club, the Government has asked the Company to further review options for a Happy Valley Race Course Station. The Company will continue to discuss with Government on the detailed scope, implementation programme and financial arrangements for this line. It is intended that the "Rail and Property" approach will be used to bridge the funding gap for this line. Construction of the railway extension is expected to commence in 2011 for completion in 2015.

Shatin-to-Central Link

The Government announced on 11 March 2008 its decision for the Company to proceed with the further planning and design of Shatin-to-Central Link. The 17-km Shatin-to-Central Link, which will be based on the scheme proposed by the Company under the Rail Merger, will run from Tai Wai to Hong Kong Island connecting a number of rail lines to provide more convenient rail services to passengers. The section from Tai Wai to Hung Hom connecting Ma On Shan Line to West Rail Line is expected to be completed in 2015. The other section which will extend the existing East Rail Line from Hung Hom across the harbour to Hong Kong Island is expected to be completed in 2019. The Company will continue discussions with Government on the operation of Shatin-to-Central Link by way of a Service Concession.

Kwun Tong Line Extension

The Government announced its decision for the Company to proceed with the further planning and design of the Kwun Tong Line extension on 11 March 2008. The 3-km Kwun Tong Line extension will run from the existing Yau Ma Tei Station via Ho Man Tin to Whampoa and is expected to be completed by 2015. The Company will discuss the implementation details of this project with Government based on the ownership approach and has proposed to use property development rights relating to a site at the former Valley Road Estate site to bridge the funding gap.



Construction works on the Kowloon Southern Link

Express Rail Link

In February 2006, the Government invited KCRC to proceed with planning for the Northern Link and the Express Rail Link as a combined project. Feasibility studies were completed in 2007 under an integrated study team jointly managed by the Company and KCRC. The 26-km Express Rail Link will provide cross-boundary high speed rail service connecting Hong Kong to Shenzhen, Guangzhou and the Mainland of China's new high speed national intercity rail network. The West Kowloon terminus is planned to become one of the main gateways to the Mainland, with good connectivity to neighbouring developments such as the West Kowloon Cultural District and developments above both the Kowloon and West Kowloon stations.

The Northern Link will provide a cross-boundary link for the West Rail Line. By joining the northern sections of West Rail and East Rail, it will also create a new railway corridor between the northeast and the northwest New Territories. Further planning for the Northern Link will be subject to the reviews by Government of the proposed new development areas in the North West New Territories and the opening up of the Frontier Closed Area.

In 2007, the Company continued discussions with Government with the aim of completing the preliminary design for the Express Rail Link by the end of 2008 in order that this railway scheme can be gazetted as soon as possible.

Funding Models for New Projects

The funding model for new rail projects will take different forms, each appropriately designed for the project. As always, the Company will seek to create a commercial return on its investments above its cost of capital and at rates commensurate with the risk of the projects. For the West Island Line, the Government has indicated that they would consider a capital grant model whereby Government grants to the Company a sum of money, currently estimated at HK\$6 billion, to establish the financial viability of the project. The Company will bear the balance of the capital cost and all of the operation, maintenance and asset replacement costs. The South Island Line (East) will likely follow the Company's traditional "Rail and Property" approach whereby property development rights will be granted to us. A third model that could be used for future rail lines would be the Service Concession model used in the Rail Merger, whereby Government (or KCRC, which is wholly owned by the Government) pays for the initial capital costs of the rail line and the Company operates the line by paying an annual concession payment as well as being responsible for maintenance and upgrades; KSL has adopted this approach. We are still in discussion with Government on which of these funding models will be used for the Express Rail Link.

Completion of Projects

The civil and structural works for the new station at LOHAS Park (in Tseung Kwan O South) were substantially completed in October 2007, track installation was close to completion in December 2007. Design of the new station's electrical and mechanical systems has been finalised and installation works are on schedule for completion of the station in 2009.

Subways and Pedestrian Links

Subways and pedestrian links increase the Company's catchment areas and extend rail benefits and customer services to more members of the community.

Construction works for the two underground entrances linking the Tsim Sha Tsui concourse with the basement of the adjacent redevelopment of 63 Nathan Road are expected to commence in April 2008.

Works for the pedestrian subway at Cheung Lai Street connecting Lai Chi Kok Station with the new developments to the south of Lai Chi Kok Road began in August 2007 for completion by end of 2009, while the developers started construction of the link from Jordan Valley to Kowloon Bay Station in early 2007 for completion by end of 2008. A further pedestrian link at Prince Edward Station has been planned, while design for Kwai Hing, Olympic and Choi Hung stations is well underway.



Computer graphic of the station at Hung Hom on the proposed Shatin-to-Central Link

Wuhan

Beijing

Shenzhen

Hangzhou

London

Becoming
**ONE International
Enterprise**

Leveraging on our enhanced expertise and resources,
we are investing in exciting new growth opportunities for the future



Tianjin

Suzhou



Executive Management's Report Overseas Growth



14 stations have been handed over to the B JL4 PPP company to start E&M installation

2007 saw progress in our international business. The winning of the London Overground concession by our 50:50 joint venture MTR Laing Metro Limited (now renamed as London Overground Rail Operations Ltd (LOROL)) was a major highlight of the year. Steady progress was made on the Beijing Metro Line 4 (BJL4) project, while we continued with discussions to seek approval for the Shenzhen Metro Line 4 (SZL4) project.

Mainland of China

In Beijing, the Public-Private Partnership (PPP) company comprising the Company (49%), Beijing Infrastructure Investment Co. Ltd. (2%) and Beijing Capital Group (49%) made steady progress on the B JL4 project.

Tendering for the Electrical & Mechanical (E&M) Works contracts was substantially completed. Design works and manufacturing for E&M equipment including the automatic fare collection, station communications, radio, transmission, fire alarm system, passenger information display system and building automation system, advanced smoothly. We made good progress on the internal fitting out and equipment assembly works for the first two trains for which testing and commissioning works commenced in December 2007. Progress of the tunnel works, which are the responsibility of Beijing Municipal Government, was satisfactory with 85% of the works completed by the construction company related to the Beijing Municipal Government. All tunnelling works should be completed by May 2008. 14 stations have been handed over to the BJL4 PPP company to start E&M installation.

Due to land resumption issues at Majialou depot, the civil construction programme of the depot, which is the responsibility of the Beijing Municipal Government, is behind schedule. Measures have been taken to minimise the possible impact on the scheduled line opening date in October 2009.

As a reflection of the high standards reached, the quality management system of the PPP company was granted ISO9001 certification in April 2007.



The Company's Projects Director Russell Black and CEO Chow Chung-kong discuss finer points of the BJL4 project

Beijing Metro Line 4

Tendering for E&M

Works Contracts Substantially Completed

Started

Rolling Stock and Locomotive Manufacturing

268 Operations Staff

Commenced Training in September 2007

London Overground

Won London Overground Concession

Concession Successfully Started on

11 November 2007

107.2 Kilometres

Total Route Network



Steady progress was made on the Beijing Metro Line 4 (BJL4) project

A senior operations team was established during the year and pre-operation planning is well underway. The PPP company joined hands with the Beijing Communication School to co-organise operations training classes with the aim of training qualified operations staff. 268 station controllers, train drivers and maintenance personnel started the one-and-a-half years' training in September 2007. A detailed operations plan highlighting the operations model for train services, station services, customer services, maintenance strategies and staff training is being formulated.

In Shenzhen, we continued to support the Shenzhen Municipal Government in obtaining final approval for the SZL4 project from the National Development and Reform Commission. In the meantime, preparatory work and expanded trial section work continue with undertakings from the Shenzhen Municipal Government to reimburse certain of the costs incurred if the project is not approved. Under the current policy relating to property development in China, the public sector funding

support to this project is likely to take other forms than the grant of property development rights. The Company will ensure that the project, if approved, will provide satisfactory returns to our shareholders.

We continue to seek further investment opportunities in the Mainland of China. During the year, we pursued projects in Beijing such as the BJL4 Extension to Daxing District, as well as the development of new metro lines in Hangzhou, Suzhou, Tianjin and Wuhan. In January 2007, we signed a Memorandum of Understanding with Suzhou Municipal Government for feasibility studies and the development of a business model for Suzhou Metro Line 1 and 2.

Europe

Our strategy in Europe remains "asset light", focusing on operating concessions in the railway and metro markets. In line with this, our 50:50 joint venture with the UK's Laing Rail (now being acquired by Deutsche Bahn group), LOROL, won the London Overground concession on 19 June 2007 and we took over the concession on 11 November 2007.

Under this concession, LOROL operates train services on five existing lines in Greater London for seven years, with an option for a two-year extension at the discretion of Transport for London (TfL). The cost-based operating concession, which is overseen by TfL, will receive an amount of about £700 million over the lifetime of the contract, which should cover operating costs and include an expected profit margin for LOROL.



The winning of the London Overground concession was a major highlight of the year



Many service improvements are planned for London Overground

London Overground is a semi-orbital route serving West, North and East London and will be a vital link for the 2012 Olympic Games. The total route network measures 107.2 kilometres and under the concession, LOROL will eventually manage 55 of the 78 stations on the network. Among the five lines, the East London line is currently undergoing an extensive renovation and upgrade programme and is scheduled to re-open in 2010.

Some of the service improvements planned for London Overground include the introduction of a more comprehensive ticketing system, a phased programme of station upgrades to improve comfort and security for passengers, as well as the introduction of a fleet of new trains from 2009. The cost of these improvements will be paid by TfL, although for station upgrades certain cost overrun risks will be borne by LOROL.





Fostering
**ONE Company
One Team**

In 2007, our priority was to integrate our people as "One Company One Team" while ensuring a stable workforce with harmonious staff relations

Executive Management's Report

Human Resources



Our staff exemplified trust and a mutually supporting working culture in team building

The Company's success has been built on the commitment, caring service and professionalism of our staff. We have always regarded people as our most important asset, driving our business expansion and enabling the Company to adapt to changes. The Rail Merger created a significant opportunity for us to integrate as "One Company, One Team" thereby making the Company stronger, more energetic, more competitive and more united as we aspire to be the finest railway company in the world.

Merger Planning and Communication

Merger is about people. One of the key challenges of the year was the need to maintain a stable workforce during the time leading up to the Appointed Day, while also ensuring that staff resourcing for our growth business remained uninterrupted.

As a caring employer, the Company took the interests of staff into account in the merger process while ensuring fairness and equity in formulating policies that affect our staff. Staff were consulted through various channels and great efforts were made to maintain close communications with them. An internal newsletter, Merger Update, was published regularly to give information on major milestones and merger issues, and staff were kept abreast of progress through letters from the CEO and Human Resources Director, briefings, a merger hotline and e-mail. As a result, harmonious staff relations were maintained throughout the merger process.

One Company, One Team

To provide a platform for staff to learn about the merger process, reinforce staff's positive mindset and provide an opportunity for staff from different backgrounds to interact and get to know each other, a series of Cultural Integration Programmes were launched for over 12,000 staff. The three main themes of "Embracing Change as Opportunity", "One Company, One Team" and "Taking Care of Our Customers" were successfully communicated to all staff. These programmes were designed to make the merger process more transparent and to reduce uncertainties.

To realise the vision of "One Company, One Team", we have communicated to staff before the Appointed Day the alignment of the employment terms and conditions and the introduction of one common grading structure. During the integration, we took the interest of staff as a major consideration and strived to maintain market competitiveness and to ensure equity and fairness among various functions and job categories for over 12,000 staff. Extensive staff communication and consultation, including staff briefings and publication of printed materials, were arranged to ensure staff understanding of the arrangements.

We have also developed comprehensive staffing plans to retain talents and qualified human resources to meet our business requirements. We have ensured a fair, effective and equitable staff selection and appointment process. A Voluntary Separation Scheme has been launched, which is a win-win approach that provides an additional option for staff while increasing flexibility in staffing arrangements so as to minimise the impact on staff.

Caring for the Community

As a caring and responsible organisation, the Company takes its commitment to the community seriously.

In 2007, staff continued to volunteer in community projects through the "More Time Reaching Community" Scheme. The Scheme provides corporate support for staff to initiate and participate in community projects. During the year, 86 activities were organised involving the elderly, the physically and mentally challenged, underprivileged children and families, and environmental protection.

In recognition of the Company's contributions to society through employee volunteering, community giving and providing a safe and family friendly workplace for our staff, we were again awarded the Caring Company Logo 2007/08 following nomination by eight social service organisations.

One Common Grading Structure and Employment Terms and Conditions

aligned for 14,134 Staff

452 Staff Communication Sessions for Merger

99 Cultural Integration Workshops

for Over 12,000 Staff

Training for Appointed Day Integrated Operation

Completed

36,225/7,637 Man Days for Operations/Management Training respectively

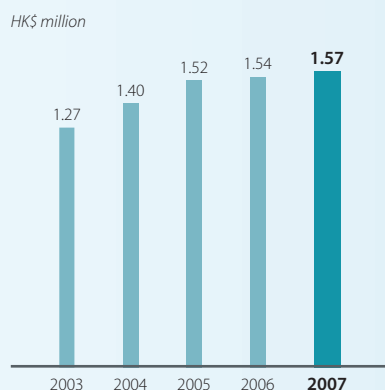
86 More Time Reaching Community Projects

Completed and Involved 1,800 Volunteers

Free Flu Vaccination for All Staff to Safeguard Staff Health

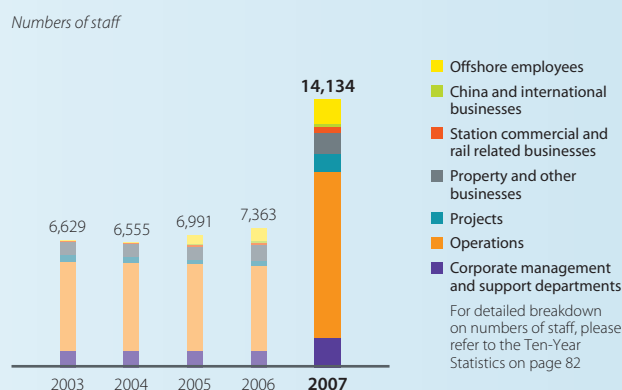
Staff Productivity – Turnover Per Operating Railway Employee

Productivity has shown continuous improvement.



Total Staff Strength

The Company had a greater pool of skilled employees after the Rail Merger to pursue its business expansion.



Progressive integration activities such as cookery competition were held to foster team spirit

Training and Development

2007 was a particularly intensive year for the provision of training to ensure that staff members have the skills and expertise they need for the challenges of the merger and the new era. Timely and comprehensive operations and safety training provided the requisite knowledge and skills to ensure staff were competent for the Appointed Day integrated operation. A series of internal customer service training courses was organised to cultivate a mutually supportive working culture. In addition, customer service training focusing on empathy was launched to all station operators, train staff and station maintenance staff.

In order to meet the future requirements of the Company, several major initiatives were undertaken to develop management talents. We trained 2,000 senior and junior supervisors in "Coaching through Empathetic Listening" and conducted a series of important seminars on "Doing Business in China" for senior supervisors. The leadership skills of station supervisors were also tested in a new programme entitled "Being a Service Leader".

Leadership Development

Developing capable staff with high potential at various levels of the organisation continued to be a priority for creating a pipeline of management prospects. All 11 young managers in the three-year Executive Associate Scheme started their new placements in 2007. In addition, a Mentoring Scheme was launched in which each Executive Associate was assigned a senior manager as



Train Simulator in Kowloon Bay Training Centre to ensure staff competency

his/her mentor. This served the dual purpose of developing the Associate as well as our high potential senior managers.

In 2007, a Graduate Trainee Development Task Force comprising representatives from all key functions was formed to take care of the Graduate Trainees' job placement and development. Ten Graduate Trainees from the Mainland of China joined the Company during the year, along with six from Hong Kong SAR.

Other development programmes were undertaken to support managers with strong career potential. Four senior managers attended overseas executive development programmes and three middle managers attended the Ivey Consortium Executive Programme organised by the Richard Ivey School of Business. Training programmes were also held in Hong Kong for Mainland operations managers from our Beijing and Shenzhen investment projects, along with training for key Mainland staff from our Shanghai project.

In the CoMET Staff Exchange Programme, two senior supervisory staff were selected for a six-month secondment to London Underground. The key objectives of the programme were for secondees to acquire experience of working in a country with

a different culture and to benchmark best practices in their respective functional areas.

Support for Growth Business

With the rapid expansion of our activities outside Hong Kong, we continued to provide proactive training support to offshore projects such as Shenzhen Metro Line 4, Beijing Metro Line 4 and external consultancy. We also stepped up resourcing efforts for the timely mobilisation of manpower to support the new franchise of London Underground.

The China Graduate Trainee Scheme was launched to groom local talents for our growth business in China. During the year, ten Graduate Trainees were recruited from leading universities in China. They started their 12-month intensive training and placements in Hong Kong in July 2007.

In addition, to develop local metro industry talents in the Mainland of China, the Company signed cooperation agreements with Beijing Communication School in December 2007 to co-run a Training Centre to train quality personnel for the metro industry.

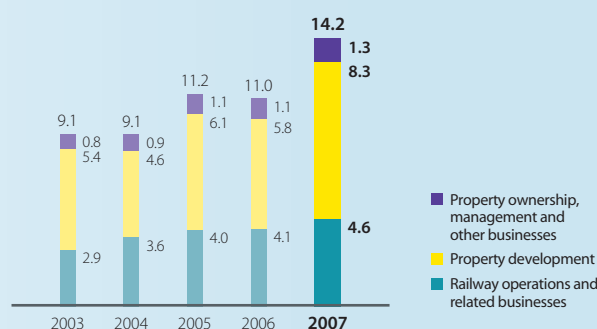
Financial Review

The Company's 2007 financial statements have incorporated the operating results of the Rail Merger with effect from 2 December 2007

Operating Profit Contributions

Steady growths were maintained in all segments with significant profit increase from property development.

in HK\$ billion



Review of 2007 Financial Results

The Company's 2007 financial statements have recognised the Rail Merger which became effective on the Appointed Day of 2 December 2007, together with the post-merger operating results from 2 December to the year end (Rail Merger effect). In the profit and loss account, the impacts were primarily reflected as increases in operating profits, amortisation charge, interest charge and provision for merger related expenses. On the balance sheet, the Rail Merger increased total assets mainly from the recognition of the Service Concession, which includes the capitalised amount of total annual fixed concession payments of HK\$750 million per year, and the property package acquired, as well as increased total liabilities by the additional borrowings, obligations under the Service Concession and other liabilities arising from the transaction. Payment for the Rail Merger was mainly financed by additional borrowings. Details of the Rail Merger impacts to the 2007 financial results are included in the following discussion.

Profit and Loss

Total revenues for 2007 increased by 12.0% to HK\$10,690 million driven by the strong Hong Kong economy, continued expansion of our businesses and the Rail Merger effect.

Fare revenue from Domestic Service (including KCR Lines after the Rail Merger) increased by 5.1% in 2007 to HK\$6,213 million as a result of a 5.7% growth in patronage to 915.8 million and

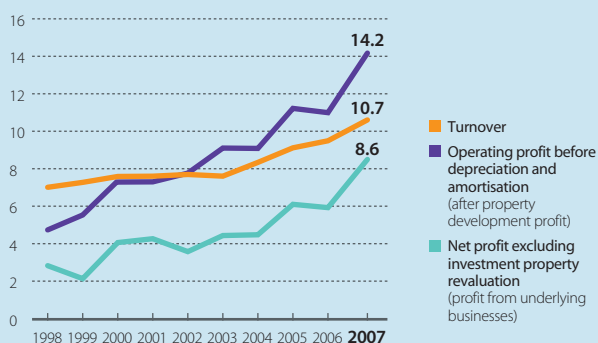
0.6% decrease in average fare to HK\$6.78, which was mainly due to the fare reduction implemented on the Appointed Day as well as the lower average fare on KCR Lines. Fare revenue from Airport Express increased by 7.0% to HK\$655 million with patronage growth of 6.3% to 10.2 million and average fare increasing 0.8% to HK\$64.34. The Cross-boundary, Light Rail, Intercity and Bus services, which were part of the Rail Merger, contributed total revenue of HK\$247 million and patronage of 22.4 million. Total fare revenues for the Company therefore increased by 9.1% to HK\$7,115 million.

Revenues from station commercial and rail related businesses increased by 12.9% in 2007 to HK\$1,741 million. With the Rail Merger and riding on the growing economy and increased patronage, revenues from advertising and station retail rose by 11.0% to HK\$593 million and 27.6% to HK\$499 million respectively. However, income from telecommunications decreased by 10.0% to HK\$233 million mainly due to the one-off mobile network upgrade income recognised in 2006, which was not repeated in 2007, and the decrease in the Company's revenue sharing as a result of intense price competition and cannibalisation by 3G mobile services. Consultancy income decreased slightly by 3.0% to HK\$193 million mainly due to programme delays of some projects caused by the changing requirements of our customers. Excluding the Rail Merger effect, which contributed HK\$125 million, revenues from station commercial and rail related businesses would have increased by 4.8% in 2007.

Net Results from Underlying Businesses

The increase in net profit was brought by sustained rise in turnover and significant increase in development profit.

in HK\$ billion



Rental, management and other revenues increased by 24.3% in 2007 to HK\$1,834 million, comprising HK\$1,749 million of property rental and management income and HK\$85 million of revenues from Ngong Ping 360. With the continued increase in rental rates, the opening of Phase 1 of Elements at Kowloon Station and Ginza Mall in Beijing, the expansion of our property management portfolio and the Rail Merger effect, property rental and management income recorded strong growth of 23.9%. Excluding the Rail Merger effect, the growth in property rental and management income would have been 22.3%.

Total operating costs, excluding merger related expenses, increased by 10.1% in 2007 to HK\$4,778 million after accounting for the incremental operating costs following the Rail Merger in December. Excluding the Rail Merger effect, total operating costs would have increased by 4.4%. Costs relating to staff, energy and utilities and stores and spares increased by 9.0%, 6.9% and 8.3% respectively mainly due to the Rail Merger. Operational rent and rates increased by 52.3% mainly as a result of the Rail Merger and a one-off income in 2006 from settlement with the Government on rateable value assessment related to the Tseung Kwan O Line. Expenses relating to property ownership, management and other businesses increased by 56.5% mainly due to business expansion, additional costs for the opening of new shopping malls, the cable car operation at Ngong Ping 360 and the Rail Merger effect.

Profit from Underlying Businesses Increased
43.8% to **HK\$8,571 Million**

Strong Property Development Profit at
HK\$8,304 Million

Net Profit of
HK\$15,182 Million

Turnover Increased 12% to
HK\$10,690 Million

Net Cash Inflow of
HK\$6,122 Million

before Rail Merger Payments

Net Assets Increased 18.6% to
HK\$91,037 Million

HK\$10 Billion

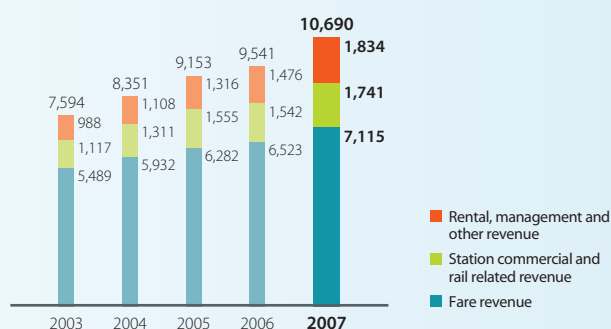
Syndicated Loan Facility Arranged
on Favourable Terms

Credit Ratings Affirmed
after Rail Merger Bill
and Upgraded
along with Hong Kong SAR

Turnover

Revenue increased across the board due to the Rail Merger, the expanding operations and a strong economy.

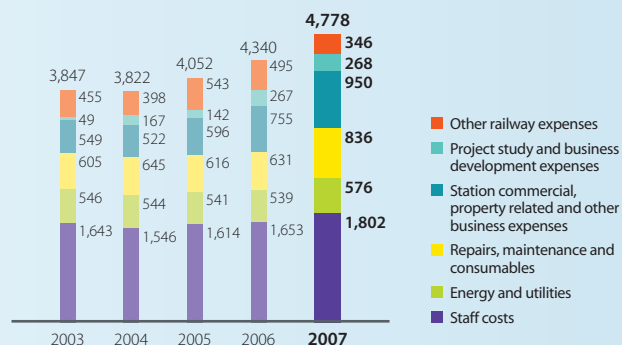
in HK\$ million



Operating Expenses

The cost increases were in line with business expansions including the Rail Merger effect.

in HK\$ million



Operating profit from railway and related businesses before depreciation, amortisation and merger related expenses therefore increased by 13.7% to HK\$5,912 million. It is estimated that the Rail Merger effect contributed approximately HK\$284 million to such operating profit. Operating margin increased from 54.5% in 2006 to 55.3%.

With the continued rise in property prices, the number of property projects completed in the year and profit recognition for Le Point (where costs relating to that project were recognised in 2006), property development profit for 2007 increased significantly to HK\$8,304 million from HK\$5,817 million in 2006. Income from surplus proceeds amounted to HK\$7,077 million mainly relating to Le Point at Tiu Keng Leng Station and to a lesser extent, Harbour Green at Olympic Station and Caribbean Coast at Tung Chung Station. Deferred income recognised amounted to HK\$1,224 million mainly from Coastal Skyline and Caribbean Coast at Tung Chung Station and the fit-out works for Elements at Kowloon Station.

Operating profit before depreciation and amortisation therefore increased 29.0% to HK\$14,216 million. Depreciation and amortisation charges for 2007 increased by 2.4% to HK\$2,739 million due to the additional amortisation charge on Service Concession assets related to the Rail Merger as well as the full year depreciation charge on Ngong Ping 360 and other assets added to the network. After deducting merger related expenses of HK\$193 million, operating profit before interest and finance charges increased by 35.2% to HK\$11,284 million.

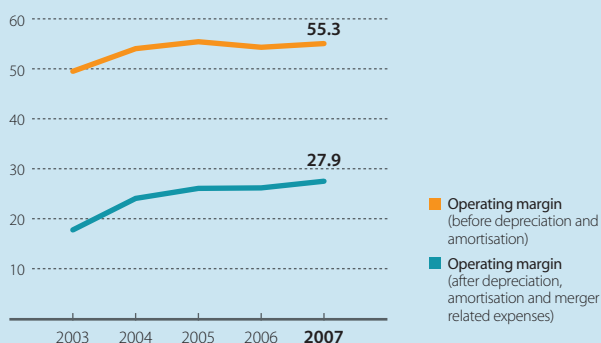
Due to substantial cash inflows during the early part of the year, interest and finance charges for 2007 declined by 5.9% to HK\$1,316 million despite an increase in borrowings to fund the Rail Merger in December 2007 and an increase in average borrowing cost to 5.6% as compared to 5.5% in 2006. The gain from the increase in market value of investment properties amounted to HK\$8,011 million before tax, which included HK\$311 million of value appreciation on the investment properties acquired in the Rail Merger. The post-tax valuation gain on investment properties was HK\$6,609 million.

As part of the Rail Merger, the Company acquired certain property holding and other subsidiaries from KCRC. This combined with the takeover of operations of Ngong Ping 360 resulted in a net gain of HK\$187 million, mainly due to increases in market value, as at the Appointed Day, of investment properties held by those subsidiaries in excess of their purchase considerations. The Company's share of net profit of associates amounted to HK\$99 million, including HK\$97 million from Octopus Holdings Limited and HK\$2 million from London Overground Rail Operations Ltd. Tax expenses, comprising mainly non-cash deferred tax provision, amounted to HK\$3,083 million based on the current standard Hong Kong Profits Tax rate of 17.5%. Net profit for the Group in 2007 increased by 95.7% to HK\$15,182 million, of which HK\$15,180 million was attributable to equity shareholders. Earnings per share correspondingly increased from HK\$1.41 in 2006 to HK\$2.72 in 2007.

Operating Margin

Operating margin has improved steadily over the years.

Percentage



Fixed Assets Growth

Significant surplus on property revaluation and additions of Service Concession assets and investment properties after the Rail Merger accounted for the growth in fixed assets.

in HK\$ billion



Excluding investment property revaluation and the related deferred tax provision, the underlying profit for the Group increased by 43.8% from HK\$5,962 million in 2006 to HK\$8,571 million. Earnings per share based on underlying profit increased by 42.6% from HK\$1.08 in 2006 to HK\$1.54 in 2007.

In view of the good financial performance in 2007, the Board has recommended a final dividend of HK\$0.31 per share which, when added to the interim dividend of HK\$0.14, will give a total dividend of HK\$0.45 per share for 2007, representing an increase of HK\$0.03 or 7.1% compared to 2006. The final dividend, amounting to HK\$1,740 million in total, offers a scrip dividend option to all shareholders except those with registered addresses in the United States of America or any of its territories or possessions. As in previous years, The Financial Secretary Incorporated ("FSI") 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 the Company's total dividend will be paid in cash.

Balance Sheet

The Group's balance sheet strengthened further in 2007 with an 18.6% increase in net assets from HK\$76,786 million as at 31 December 2006 to HK\$91,037 million as at 31 December 2007.

Total fixed assets increased from HK\$106,943 million in 2006 to HK\$132,417 million as at 31 December 2007 mainly attributable

to the addition of Service Concession assets and investment properties from the Rail Merger together with the surplus from investment property revaluation. Stores and spares increased from HK\$272 million in 2006 to HK\$642 million as at 31 December 2007 again mainly due to the acquisition of inventories from KCRC in the Rail Merger.

Railway construction in progress increased from HK\$232 million in 2006 to HK\$424 million as at 31 December 2007 as a result of the additional construction works for the new station at LOHAS Park project, partly offset by the transfer-out of the project costs on the SkyPlaza Platform at Airport Terminal Two upon its completion in February 2007.

Property development in progress increased significantly from HK\$3,297 million in 2006 to HK\$9,066 million as at 31 December 2007, mainly due to the acquisition costs of property development rights in the Rail Merger. Properties held for sale as at 31 December 2007 amounted to HK\$756 million, comprising mainly unsold residential units at Harbour Green in Olympic Station and The Arch at Kowloon Station.

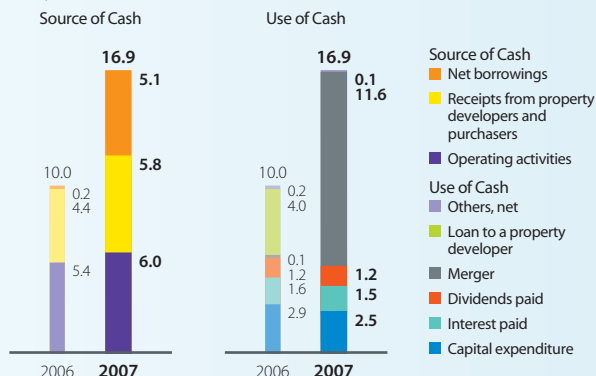
Property management rights acquired in the Rail Merger amounted to HK\$40 million, which was carried as an asset on the balance sheet subject to amortisation charge over the duration of the management contracts acquired.

Derivative financial assets and liabilities, representing the fair value of derivative financial instruments, were recorded

Cash Utilisation

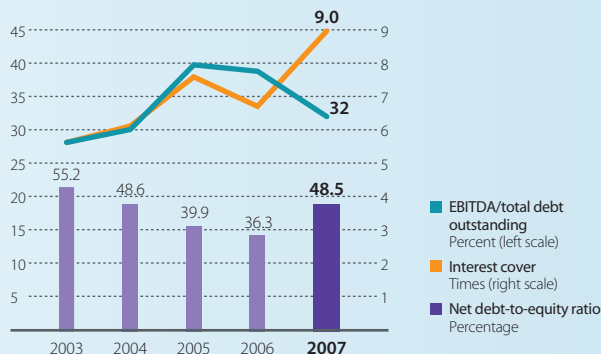
Cash outflows for Rail Merger in 2007 was met by surplus from operations and additional borrowings.

in HK\$ billion



Debt Servicing Capability

Total debt outstanding including obligations under Service Concession increased in 2007 due to the Rail Merger with a corresponding increase in gearing.



at HK\$273 million and HK\$192 million respectively as at 31 December 2007 as compared to HK\$195 million and HK\$515 million respectively in 2006. The movements were mainly due to lower US interest rates and the weaker Hong Kong dollar forward exchange rates during the period, resulting in an increase in "mark-to-market" value of the Group's interest rate and currency fair value hedges.

Debtors, deposits and payments in advance increased significantly from HK\$1,894 million in 2006 to HK\$5,167 million as at 31 December 2007 primarily due to the increase in amounts receivable from pre-sale of residential units in Le Point at Tiu Keng Leng Station.

Total loans outstanding increased from HK\$28,152 million in 2006 to HK\$34,050 million as at 31 December 2007 mainly due to increased borrowing to fund the initial payments for the Rail Merger.

As at 31 December 2007, the amount due to KCRC was HK\$975 million mainly in connection with the cost of property enabling works for KCRC property development sites that have not been tendered as well as a small amount of provision for the HK\$750 million fixed annual payment for the Service Concession accrued for 2007. Reimbursement for such property enabling works will be received from developers on tender and will be paid to KCRC. In recognising the discounted present value of the total fixed annual payments as a Service Concession asset, an equivalent amount has been taken into account as obligations

under the Service Concession, the balance of which at the year end was HK\$10,685 million.

Creditors, accrued charges and provisions as at the end of 2007 amounted to HK\$5,412 million as compared to HK\$3,639 million in 2006. The increase was mainly attributable to the transfer of deposits on leases and certain other liabilities from KCRC in accordance with the Rail Merger agreements.

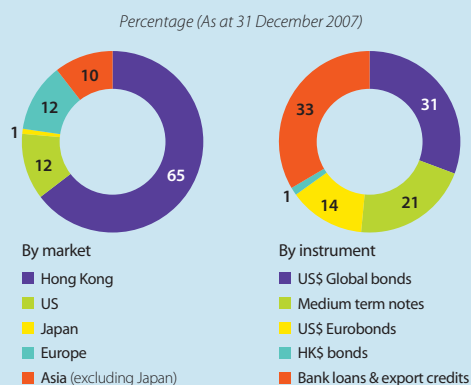
Deferred income decreased from HK\$1,682 million in 2006 to HK\$515 million as at 31 December 2007, which relates primarily to profit to be recognised from Tung Chung and Kowloon station development packages in accordance with the progress of property construction and pre-sales, as well as income to be recognised in connection with the lease out and lease back transaction on certain passenger cars.

With the recognition of tax on the profit for the year, including deferred tax provision for property revaluation, deferred tax liabilities increased from HK\$9,453 million to HK\$12,574 million.

Share capital, share premium and capital reserve increased by HK\$1,189 million to HK\$39,828 million at the end of 2007 as a result of shares issued for scrip dividend and share options exercised. Together with increases in fixed asset revaluation and other reserves of HK\$214 million and retained earnings net of dividends of HK\$12,844 million, total equity attributable to equity shareholders increased from HK\$76,767 million in 2006 to HK\$91,014 million as at 31 December 2007. Including the

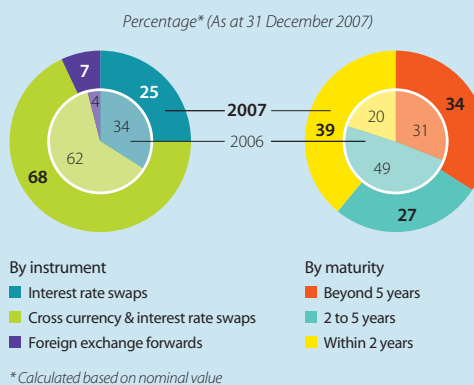
Sources of Borrowing

Although Hong Kong is our main market, our strategy is to diversify our funding sources and maintain ready access to other important international markets.



Use of Interest Rate and Currency Risk Hedging Products

The Company is an active user of derivative financial instruments, and has a strict policy of limiting their use for hedging purposes only.



obligations under the Service Concession as a component of debt, the Group's net debt-to-equity ratio increased from 36.3% at 2006 year end to 48.5% at 2007 year end.

Cash Flow

Net cash inflow generated from railway and related activities increased from HK\$5,387 million in 2006 to HK\$5,965 million for the year, while cash receipts from developers and purchasers in respect of property development projects also increased from HK\$4,400 million in the previous year to HK\$5,824 million. Outflows for capital project payments, interest expenses, working capital and dividend payments amounted to HK\$5,667 million, as compared to HK\$5,925 million for the previous year. Hence, before upfront payments for the Rail Merger, the Company had recorded a net cash inflow of HK\$6,122 million compared to HK\$3,862 million in 2006. After including the upfront payments of HK\$12,040 million for the Rail Merger, and receipts of HK\$786 million in respect of net cash for the assumption of certain KCRC assets and liabilities on the Appointed Day, there was a cash deficit of HK\$5,132 million, which was financed by an increase in debt of HK\$5,401 million. Cash balances at the year end increased by HK\$269 million.

Financing Activities

New Financings

In 2007, Hong Kong continued to benefit from robust economic growth and a buoyant stock market, and saw continued significant capital flows into the local banking system. In the first eight months of the year, the U.S. Federal Reserve (the Fed)

maintained the Fed Funds target rate at 5.25%, but throughout this period Hong Kong interest rates gradually rose on the back of significant funding demand for financing IPO activities, narrowing the differential with U.S. rates. However, the Fed began to aggressively cut the Fed Funds rate in September due to the potential impact of the subprime mortgage crisis. These actions, comprising rate cuts both at and in-between Federal Open Market Committee meetings, brought the Fed funds rate down from 5.25% to 2.25% as of 18 March 2008. These aggressive cuts, together with a slowdown in IPO activities and lacklustre stock market performance closer to the year end, caused Hong Kong rates to decline after reaching their peaks in October.

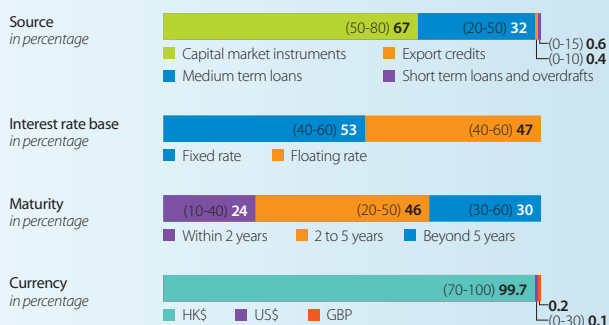
The Group's main financing activity was a HK\$10 billion syndicated loan facility signed in October 2007 with a group of 19 major banks from Hong Kong, Mainland of China, Japan, Europe and the U.S., to meet our general corporate funding requirements, including partial settlement of the upfront payment to KCRC for the Rail Merger. This dual-tranche facility comprised a HK\$3 billion 3-year term loan facility and a HK\$7 billion 5-year revolving/term loan facility. The pricing and terms of the loan facility were amongst the most favourable in the Hong Kong dollar syndicated loan market, reflecting the strong financial position of the Group and the banking community's confidence in the Group's prospects.

As at the end of 2007, the Group had total undrawn committed facilities of HK\$6.3 billion. With strong positive operating cash

Preferred Financing Model and Debt Profile

The Preferred Financing Model exemplifies the Company's prudent approach to debt management and helps ensure a well balanced debt portfolio.

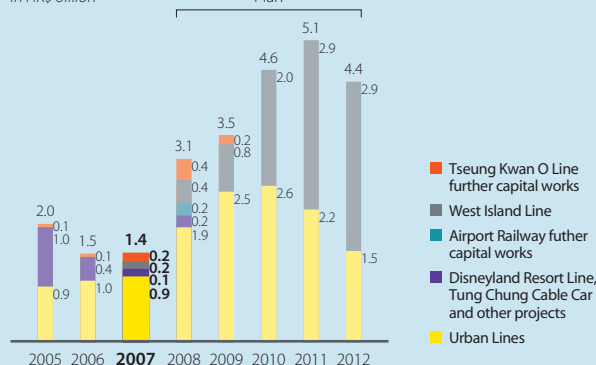
(Preferred Financing Model) vs. Actual debt profile As at 31 December 2007



Investment in New Railway Lines and Existing Network in Hong Kong

Projected capital expenditures between 2008-2010, based on existing network and committed projects, are estimated at HK\$11.2 billion.

in HK\$ billion



flows projected for 2008 and 2009, these undrawn facilities would be used mainly for contingency purposes or to meet unexpected demands, if any.

Cost of Borrowing

Despite higher interest rates in the first half of the year, average borrowing cost in 2007 rose only slightly to 5.6% from 5.5% in 2006 due to the Group's prudent use of fixed and floating rate debt, as well as lower interest rates towards the year end. However, gross interest and finance charges (before interest income and impact from derivative financial instruments) decreased to HK\$1,580 million in 2007 from HK\$1,685 million in 2006; the amount in 2007 also includes HK\$60 million of notional interest relating to the capitalisation of the total fixed annual payments from the Rail Merger.

Risk Management

The cornerstone of our financing and risk management practices is our well-established Preferred Financing Model, which guides our financing and hedging activities by specifying the preferred mix of fixed and floating rate debt, the permitted level of currency exposure, a well-balanced spread of maturities, the use of different types of financing instruments, and an adequate length of financing horizon. With this disciplined and systematic approach, the Group was able to maintain a well diversified debt portfolio with adequate forward coverage of our future funding requirements.

The Group remains an active corporate user of derivative financial instruments to manage our debt portfolio based on the policy that such instruments can only be used for hedging purposes to reduce exposure to interest rate and currency risks, and not for speculation or trading purposes. To monitor and control counterparty risk exposure, Company policy requires all counterparties to have a minimum credit rating of A-/A3, and that exposure limits be assigned to these counterparties in accordance with their credit ratings. In addition, the Company adopts a risk monitoring framework based on the widely accepted "value-at-risk" methodology, and an "expected loss" concept to further quantify and monitor those exposures.

Credit Ratings

The Company was the first Hong Kong corporate entity to obtain internationally recognised credit ratings and has since maintained strong ratings on a par with the Hong Kong SAR Government based on our strong credit fundamentals, prudent financial management and continuous Government support.

In May, our foreign currency issuer and senior unsecured debt ratings of Aa3 were placed on review for possible upgrade by Moody's following its decision to place the Hong Kong SAR Government's Aa3 rating on review for possible upgrade. Following the passage of the primary legislation for the Rail Merger Bill by LegCo on 8 June 2007, Moody's on 16 July

2007 affirmed the Company's current ratings of Aa3 whilst continuing with the upgrade review process opining that the Company's sound credit standing would remain after the merger. The Company's ratings were subsequently upgraded to Aa2 with a stable outlook on 26 July 2007, following the rating agency's decision to upgrade the ratings of the Hong Kong SAR Government to Aa2.

Also on 16 July 2007, Standard & Poor's affirmed the Company's local and foreign currency long-term credit ratings at AA with a stable outlook and its A-1+ short-term corporate credit rating after considering the terms of the merger transaction and the strong support from the Government. Subsequently on 26 July 2007, the rating agency revised the outlook of the Company's AA ratings to positive from stable, in line with its revision of the outlook on the Hong Kong SAR's sovereign rating.

Credit ratings	Short-term ratings*	Long-term ratings*
Standard & Poor's	A-1+/A-1+	AA/AA
Moody's	~/P-1	Aa2/Aa2
Rating and Investment Information, Inc.	a • 1+/-	AA/AA

* Ratings for Hong Kong dollar/foreign currency denominated debts respectively

On 2 July 2007, Rating & Investment Information, Inc. of Japan affirmed the Company's foreign currency and Hong Kong dollar issuer ratings at AA with a stable outlook and short-term rating at a • 1+, citing the content of the Rail Merger as being reasonable to the Company. Subsequently, on 10 October 2007, the rating agency announced it had revised the Company's ratings outlook to positive whilst affirming its foreign currency and Hong Kong dollar issuer ratings at AA and short-term rating at a • 1+.

Financial Planning

We continued to use our comprehensive long-term financial planning model, which is based on well-established methodologies, to plan our railway operations and to evaluate new projects and investments. The model subjects all investment proposals to rigorous evaluations that take into

account our weighted average cost of capital and required rate of return. To ensure our assumptions are realistic and robust, we also carefully review all key assumptions used in the model regularly and conduct sensitivity analyses taking into account present business and economic conditions as well as different scenarios in the future. To manage our cost of capital effectively, detailed assessment of our funding requirements and capital structure is conducted on a regular basis.

Financing Capacity

The Group's current projected capital expenditure programme comprises three parts – railway projects in Hong Kong, property projects in Hong Kong, and overseas investments. Capital expenditure for railway projects in Hong Kong consists mainly of investment in new railway projects, such as the West Island Line and the new station at LOHAS Park, and capital outlays for sustaining and upgrading the existing railway. For property projects, it comprises mainly the remaining fit-out works for Elements, fit-out works for the Tseung Kwan O Area 56 retail shells, and common infrastructure works for Area 86 development sites. For overseas investments, it consists mainly of capital expenditure for Shenzhen Metro Line 4 and further equity injections into Beijing Metro Line 4 public-private-partnership in the Mainland of China. Based on the current programmes, total capital expenditures for the next three years between 2008 and 2010 are estimated at HK\$11.2 billion for railway projects in Hong Kong, HK\$1.1 billion for property investment in Hong Kong, and HK\$5.9 billion for overseas investments, the bulk of the latter relates to Shenzhen Metro Line 4 if and when it is approved. These estimates, however, have not included the project costs of South Island Line (East) and the Kwun Tong Line extension in Hong Kong, where the bulk of such costs will be incurred after 2010.

With our strong financial position and robust cash flows, we are of the view that we will have sufficient financing capacity to fund the projected capital expenditure and to capture other potential investment opportunities.

Ten-Year Statistics

	2007*	2006*	2005*	2004*	2003*	2002*	2001*	2000*	1999	1998
Financial										
Profit and loss account <i>in HK\$ million</i>										
Turnover	10,690	9,541	9,153	8,351	7,594	7,686	7,592	7,577	7,252	6,981
Operating profit before depreciation and amortisation	14,216	11,018	11,246	9,097	9,116	7,769	7,301	7,290	5,523	4,720
Depreciation and amortisation	2,739	2,674	2,682	2,499	2,402	2,470	2,178	2,091	2,039	1,426
Interest and finance charges	1,316	1,398	1,361	1,450	1,539	1,125	874	1,143	1,104	475
Increase in fair value (net of deferred tax) on investment properties [†]	6,609	1,797	2,310	2,051	–	–	–	–	–	–
Profit	15,182	7,758	8,463	6,543	4,450	3,579	4,278	4,069	2,116	2,819
Dividend proposed and declared	2,522	2,328	2,299	2,259	2,215	2,161	2,118	500	–	–
Earnings per share <i>in HK\$</i>	2.72	1.41	1.55	1.23	0.85	0.70	0.85	0.81	0.42	–
Balance sheet <i>in HK\$ million</i>										
Total assets	155,668	120,421	113,666	106,674	102,366	101,119	98,126	92,565	87,250	82,104
Loans, obligations under finance leases and bank overdrafts	34,050	28,152	28,264	30,378	32,025	33,508	31,385	27,203	23,177	16,897
Obligations under service concession	10,685	–	–	–	–	–	–	–	–	–
Deferred income	515	1,682	3,584	4,638	5,061	6,226	8,411	10,403	13,776	15,970
Total equity attributable to equity shareholders	91,014	76,767	69,785	61,892	57,292	53,574	53,893	50,355	45,115	42,601
Financial ratios <i>in percentage</i>										
Operating margin	55.3	54.5	55.7	54.2	49.3	52.2	53.4	51.7	48.2	47.3
Non-fare revenue as a percentage of turnover	33.4	31.6	31.4	29.0	27.7	25.6	24.6	24.6	22.2	22.1
Net debt-to-equity ratio	48.5	36.3	39.9	48.6	55.2	59.3	57.8	53.7	51.2	37.8
Net debt-to-equity ratio (excluding revaluation reserves)	49.2	36.7	40.3	48.9	62.6	67.4	66.0	61.8	58.3	42.9
Interest cover <i>in times</i>	9.0	6.7	7.6	6.1	5.6	4.5	3.8	3.8	3.7	5.1
Employees										
Corporate management and support departments	1,530	823	810	792	793	824	870	911	967	1,203
Station commercial and rail related businesses	305	82	82	67	61	62	60	55	64	114
Operations	8,770	4,521	4,600	4,669	4,730	4,836	4,756	4,943	5,132	5,890
Projects	942	260	242	362	398	546	973	898	912	1,105
Property and other businesses	1,141	832	688	660	642	618	567	519	456	468
China and international businesses	135	112	83	–	–	–	–	–	–	–
Offshore employees	1,311	733	486	5	5	5	5	6	6	6
Total	14,134	7,363	6,991	6,555	6,629	6,891	7,231	7,332	7,537	8,786

* Consolidated results

† New accounting standard requirement

	#2007*	2006*	2005*	2004*	2003*	2002*	2001*	2000*	1999	1998
Railway Operations										
Revenue car km operated <i>in thousands</i>										
Domestic and Cross-boundary	128,041	115,784	114,449	114,364	112,823	103,318	96,751	92,199	94,704	94,260
Airport Express	19,956	20,077	17,122	16,081	15,227	19,467	19,458	19,557	19,394	9,011
Light Rail	755	-	-	-	-	-	-	-	-	-
Total number of passengers <i>in thousands</i>										
Domestic Service	915,755	866,754	857,954	833,550	770,419	777,210	758,421	767,416	779,309	793,602
Cross-boundary Service	8,243	-	-	-	-	-	-	-	-	-
Airport Express	10,175	9,576	8,493	8,015	6,849	8,457	9,022	10,349	10,396	3,928
Light Rail	11,100	-	-	-	-	-	-	-	-	-
Bus	2,757	-	-	-	-	-	-	-	-	-
Intercity	285	-	-	-	-	-	-	-	-	-
Average number of passengers <i>in thousands</i>										
Domestic Service – weekday average										
– pre-merger	2,595**	2,523	2,497	2,403	2,240	2,261	2,231	2,240	2,284	2,326
– post-merger	3,544	-	-	-	-	-	-	-	-	-
Cross-boundary Service – daily average	275	-	-	-	-	-	-	-	-	-
Airport Express – daily average	28	26	23	22	19	23	25	28	29	22
Light Rail – weekday average	380	-	-	-	-	-	-	-	-	-
Bus – weekday average	98	-	-	-	-	-	-	-	-	-
Intercity – daily average	10	-	-	-	-	-	-	-	-	-
Average passenger km travelled										
Domestic and Cross-boundary	7.9	7.7	7.6	7.7	7.7	7.6	7.4	7.3	7.4	7.4
Airport Express	29.5	29.7	30.4	30.2	29.7	29.9	29.8	29.7	29.9	31.2
Light Rail	3.0	-	-	-	-	-	-	-	-	-
Bus	4.6	-	-	-	-	-	-	-	-	-
Average car occupancy <i>number of passengers</i>										
Domestic and Cross-boundary	58	58	57	56	53	57	58	61	61	62
Airport Express	15	14	15	15	13	13	14	16	16	14
Light Rail	45	-	-	-	-	-	-	-	-	-
Proportion of franchised public transport boardings <i>in percentage</i>										
	41.6 ^{^^}	25.0	25.2	24.8	24.3	23.5	23.5	24.1	25.2	25.7
HK\$ per car km operated (all services)										
Fare revenue	47.8	48.0	47.7	45.5	42.9	46.6	49.3	51.1	49.4	52.7
Railway operating costs	21.6	22.1	22.8	22.3	22.5	22.8	24.6	26.8	27.3	29.2
Railway operating profit	26.2	25.9	24.9	23.2	20.4	23.8	24.7	24.3	22.1	23.5
HK\$ per passenger carried (all services)										
Fare revenue	7.50	7.44	7.25	7.05	7.06	7.28	7.46	7.35	7.14	6.82
Railway operating costs	3.39	3.43	3.47	3.45	3.70	3.57	3.72	3.85	3.94	3.78
Railway operating profit	4.11	4.01	3.78	3.60	3.36	3.71	3.74	3.50	3.20	3.04
Safety Performance										
Domestic, Cross-boundary and Airport Express										
Number of reportable events [^]	989	826	748	701	641	690	686	748	859	842
Reportable events per million passengers carried [^]	1.05	0.94	0.86	0.83	0.82	0.88	0.89	0.96	1.09	1.05
Number of staff and contractors' staff accidents	26	23	31	25	33	24	39	36	49	65
Light Rail										
Number of reportable events [^]	6	-	-	-	-	-	-	-	-	-
Reportable events per million passengers carried [^]	0.54	-	-	-	-	-	-	-	-	-
Number of staff and contractors' staff accidents	0	-	-	-	-	-	-	-	-	-

** The figure covers the pre-merger MTR Lines up to 1 December 2007.

^{^^} The figure is for December 2007. Proportion of franchised public transport boardings for the full year of 2007 is 26.7%.

[^] Reportable events are occurrences affecting railway premises, plant and equipment, or directly affecting persons (with or without injuries), that are reportable to the Secretary for Transport and Housing, Government of the Hong Kong SAR under the Mass Transit Railway Regulations, ranging from suicides/attempted suicides, trespassing onto tracks, to accidents on escalators, lifts and moving paths.

[#] Before the Rail Merger on 2 December 2007, the Company's rail operations comprised MTR Lines and Airport Express. After the Rail Merger, our Domestic Service comprised MTR Lines and KCR Lines (East Rail Line excluding Cross-boundary, West Rail Line and Ma On Shan Line). Also after the Rail Merger we gained new passenger services for Cross-boundary Service, Light Rail, Bus and Intercity.

* Consolidated results

Investor Relations

Investors and MTR Corporation

The Company is committed to maintaining good relations with its wide base of institutional and retail investors. We believe that shareholder value can be enhanced by clearly communicating the Company's corporate strategies, business development and future outlook through a continuous and active dialogue with existing and potential investors.

To communicate clearly and effectively, the Company aims to provide regular, full and timely information on corporate developments that may affect the interests of shareholders, lenders and bondholders.

As a result of this commitment, for over two decades in the international capital markets, the Company has demonstrated a high standard of corporate governance and disclosure, becoming recognised as a leader in investor relations practices in Asia.

Extraordinary General Meeting ("EGM") for the Rail Merger

An EGM was held on 9 October 2007 to vote on the Rail Merger with KCRC. Only shareholders independent of the Hong Kong Government were eligible to vote at the EGM. Those independent shareholders who voted, voted overwhelmingly by 82.3% in support of the Rail Merger.

Communications were enhanced during the period through different channels to provide transparent and comprehensive information on the Rail Merger to shareholders. In addition to the issuance of the EGM Circular, a dedicated hotline, a website and public notices were also made available to our shareholders.

Communicating with Institutional Investors

Our pro-active approach to investor relations has made the Company one of the most widely covered companies in Hong Kong. A number of local and international research houses currently publish reports on the Company on a regular basis and we are also followed by analysts from a wide range of buy-side institutions.

Management remains dedicated to maintaining an open dialogue with the investment community to ensure a thorough understanding of the Company and its business strategies. The Company participates in a number of major investor conferences and pro-actively organises other non-deal investor roadshows to maintain good communications with our investors. In total, over 270 meetings were held with institutional investors and research analysts in Hong Kong and overseas in 2007.

Retail Shareholder Programmes

The Company greatly values the long-standing shareholder support from our many individual shareholders. Following

success with shareholder programmes in previous years, in 2007 shareholders were able to enjoy various exclusive benefits, such as ticket discounts on Airport Express, discount coupons for SkyPlaza at the Hong Kong International Airport, a promotion for the opening of Elements shopping centre, and rights to purchase an exclusive MTR Crystal Train Set.

Access to Information

To ensure all shareholders have equal and timely access to important company information, the Company makes extensive use of the company website to deliver up-to-date information. English and Chinese versions are available for both annual and interim reports. Full and summary versions are also available for annual reports only. These reports, together with other stock exchange filings, are also accessible on the corporate website.

The Company's dedicated hotline to answer individual shareholders' enquiries handled more than 28,000 such calls in 2007.

Index Recognition

The Company's position in the Hong Kong market as a blue chip stock with a sizeable market capitalisation and a high degree of liquidity is affirmed through the continued inclusion of our stock in some of the most important benchmark indices. The stock is currently a constituent member of the Hang Seng Index, MSCI Index and FTSE Index series.

Since 2002, our achievements in the areas of corporate social responsibility and sustainability have been recognised by both the Dow Jones Sustainability Index and the FTSE4Good Index. The Company remains one of the few companies in Hong Kong that is able to meet and maintain the globally recognised standards required for inclusion in these indices.

Market Recognition

For the 19th consecutive year the Company's 2006 Annual Report achieved recognition in the Hong Kong Management Association (HKMA) Annual Report Awards, with the report winning the Bronze Award in the "General Category". The Company also won a citation for Achievement for Design in the "General Category". Our Sustainability Report 2006, named Convergence, received the Runner Up prize in the Hong Kong Association of Chartered Certified Accountants' (ACCA) Awards for Sustainability Reporting 2007. The Company is being recognised as a Sustainability Leader in the global "travel and tourism" industry sector, with the winning of the Silver Class Award from SAM (Sustainable Asset Management). During the year, the Company was also awarded "Highly Commended – Grand Prix for overall investor relations at a Hong Kong Company – large cap" and "Best investor relations officer" from *IR Magazine*.

Key Shareholder Information

Financial Calendar 2008

Announcement of 2007 results	11 March
Last day to register for 2007 final dividend	7 April
Book closure period	8 to 15 April (both dates inclusive)
Annual General Meeting	29 May
2007 final dividend payment date	On or about 18 June
Announcement of 2008 interim results	August
2008 interim dividend payment date	October
Financial year end	31 December

Principal Place of Business and Registered Office

MTR Corporation Limited, incorporated and domiciled in Hong Kong
MTR Headquarters Building, Telford Plaza, Kowloon Bay, Kowloon, Hong Kong

Telephone: (852) 2993 2111
Facsimile: (852) 2798 8822

Share Information

Listing

MTR Corporation Limited's shares are listed on the Stock Exchange of Hong Kong. In addition, shares are traded in United States through an American Depositary Receipt (ADR) Level 1 Programme sponsored by JP Morgan Depositary Receipts.

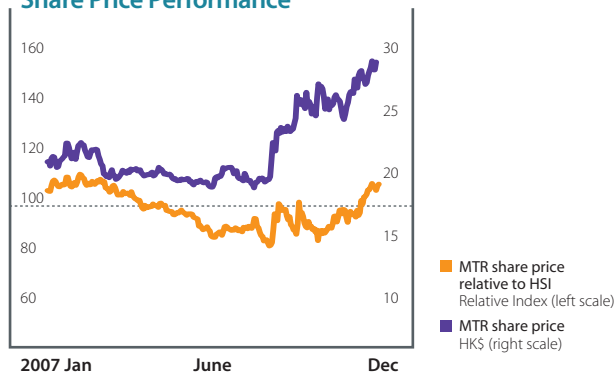
Ordinary Shares (as at 31 December 2007):

Shares outstanding	5,611,057,035 shares
Hong Kong SAR Government Shareholding:	4,301,750,382 shares (76.67%)
Free float:	1,309,306,653 shares (23.33%)

Nominal Value HK\$1 per share

Market Capitalisation (as at 31 December 2007) HK\$161,037 million

Share Price Performance



Dividend Policy

Subject to the financial performance of the Company, we expect to pay two dividends each financial year with interim and final dividends payable around October and June respectively.

Dividend per share (in HK\$)

2006 Final Dividend	0.28
2007 Interim Dividend	0.14
2007 Final Dividend	0.31

ADR Level 1 Programme

Ordinary share to ADR ratio	10:1
Depositary Bank	JP Morgan Depositary Receipts 4 New York Plaza, 13th Fl. New York, NY 10004

Stock Codes

Ordinary Shares

The Stock Exchange of Hong Kong	66
Reuters	0066.HK
Bloomberg	66 HK

ADR Level 1 Programme MTRJY

Annual Report 2007

Shareholders can obtain copies of our annual report by writing to:

Computershare Hong Kong Investor Services Limited,
Rooms 1806-1807, 18th Floor, Hopewell Centre,
183 Queen's Road East, Wan Chai, Hong Kong

If you are not a shareholder, please write to:

Corporate Relations Department, MTR Corporation Limited
MTR Headquarters Building, Telford Plaza, Kowloon Bay,
Kowloon, Hong Kong

Our annual/interim reports and accounts are also available online at our corporate website at <http://www.mtr.com.hk>

Shareholder Services

Any matters relating to your shareholding, such as transfer of shares, change of name or address, and loss of share certificates should be addressed in writing to the Registrar:

Computershare Hong Kong Investor Services Limited
Shops 1712-1716, 17th Floor, Hopewell Centre
183 Queen's Road East, Wan Chai, Hong Kong

Telephone: (852) 2862 8628

Facsimile: (852) 2529 6087

Shareholder Enquiries

Our enquiry hotline is operational during normal office hours:

Telephone: (852) 2881 8888

Investor Relations

For enquiries from institutional investors and securities analysts, please contact:

Investor Relations Department, MTR Corporation Limited
MTR Headquarters Building, Telford Plaza, Kowloon Bay,
Kowloon, Hong Kong
Email: investor@mtr.com.hk

Sustainability

As a leader among Asian corporations and rail companies worldwide in implementing sustainable development, the Company continues to enhance the business case for sustainability and reinforce our reputation for best practice. Our objective remains to create value for stakeholders through sustainable competitive advantage. We aim to achieve this by means of a dynamic interaction between focused strategy, cost leadership and value-added services. In 2007, we continued to apply these principles to drive our business and the merger.

Sustainability as Business Vision

The framework in which we guided the Company's business focused on our Diamond Vision for embedding sustainability and corporate social responsibility (CSR) programmes into all of our operations: people, process, strategy and community. This allowed us to continue stewarding the community asset, creating value for our stakeholders, and delivering safe and reliable transport to Hong Kong and beyond while transforming communities along the rail network into modern, thriving urban centres and economic hubs. The rail-to-people, people-to-rail philosophy behind this strategy demonstrates our integrated approach to how we plan, design and deliver our services.

Sustainability Report 2006/07

The seventh Sustainability Report, published by the Company in 2006, presented a progress chart of our sustainability journey from 2001 to 2006. For continuous improvement in 2007 and beyond, building capability and creating value have been the focus of our sustainability and CSR activities. Building capability was addressed through the development and implementation of common directions, recognising and rewarding sustainable actions, and encouraging continuous learning. Specific initiatives and achievements during the year can be found in our Sustainability Report 2007 and our sustainability website www.mtr.com.hk/sustainability.

The Company was recognised as a Sustainability Leader within the global "travel and tourism" industry sector, with its winning of the Silver Class Award from SAM (Sustainable Asset Management) for our ability to manage related risks and seize associated opportunities. Our Sustainability Report 2006 was also accredited the "Runner Up - Best Sustainability Report" by the Association of Chartered Certified Accountants (ACCA) Hong Kong. This award is the fifth consecutive year our reporting has won awards from the ACCA.

Global Benchmarks

As a prominent listed company, it is important for us to proactively maintain membership of international benchmarks that promote and measure sustainability such as the DJSI, FTSE4Good and Ethibel indices. We also participate each year in major best practice reporting exercises under the Global Reporting Initiative (GRI), CoMET (Community of Metros), and The World Economic Forum.

Climate Change

The Company is in full support of the Government's clean-air initiatives and is committed to making a leading contribution to the Action Blue Sky Campaign launched by the Chief Executive of the Hong Kong SAR. As one of the largest electricity users in the Pearl River Delta, the Company accepts the need for leading a response to climate change. In 2006 we signed and in 2007 we implemented the Clean Air Charter sponsored by the Hong Kong General Chamber of Commerce, the Greater Pearl River Delta Business Council, the China Council for the Promotion of International Trade - Guangdong Sub-Council and Guangdong Association of Environmental Protection. The charter requires the Company to undertake a number of energy conservation measures including adopting energy-efficient measures in its operations and the monitoring of air pollutant emissions. The Company has also become a Gold Star Business Member of the Hong Kong Climate Change Business Forum.

In 2006, the Company adopted the MTR Corporation Climate Change Policy, which is modelled on the policy developed by the International Association of Public Transport (UITP), whose Sustainable Development Commission we currently chair.

The Company has undertaken a thorough assessment of the enterprise risk associated with exposure to climate change issues and concluded these are significant enough to require ongoing monitoring. We are in the process of reviewing how climate change can be taken into account in our design, construction, and asset management to prepare more definitively an

adaptation-based scenario for future years. Our aim is to become one of the most resource efficient and ecologically responsible public transport companies in the world.

Underpinning our sustainability achievements are a large number of CSR activities. In 2007 the Company delivered a wide spectrum of initiatives within the areas of Community Investment, Employment and Social Affairs, and Sustainability and Environmental Issues. A brief summary is presented below with a more detailed discussion in our Sustainability Report 2007.

Community Investment

- More Time Reaching Community: 86 community projects with participation of 1,800 volunteers and 12,000 recipients
- Race Walking completed, Step to Health campaign ongoing
- Live performance every Friday, Roving art every other month
- Railway Extension: 18 events, UITP participation and dissemination
- Art included into Area 86 property development

Employment and Social Affairs

- 17 talks on work-life balance and 8 talks on value creation
- 8 articles on environmental issues published in MTR's internal magazine
- Workstation ergonomics, staff stretching video and activities and gala night held
- Internal staff training of 51.5 hrs/staff
- Slogan campaign "Sustainability – My Responsibility" launched

Sustainability and Environmental Issues

- 14,258 MWh electricity saved for MTR System
- 4 screenings of "An Inconvenient Truth"
- Water consumption 3% under budget even with new cooling tower at Admiralty Station
- All waste metals and oil recycled
- Mandatory use of HK-BEAM standards

Recognition

- 34 Awards: Caring Company, Service, Waste Separation, Investor Relations and SAM and ACCA awards
- Listings on FTSE4Good and DJSI maintained

Corporate Governance Report

Corporate Governance Practices

The Company is committed to ensuring high standards of corporate governance in the interests of shareholders and devotes considerable effort to identifying and formalising best practices. This Report describes how the Company has applied the principles of the Code on Corporate Governance Practices (the "Code") contained in Appendix 14 of the Listing Rules.

The Company has complied throughout the year ended 31 December 2007 with the Code Provisions except that, with respect to Code Provision A.4.1, 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. As there are currently 11 Directors subject to the requirement to retire by rotation, and one-third of them shall retire at each annual general meeting of the Company (subject to re-election by the shareholders), each of these Directors is effectively appointed for a term of approximately three years.

The Board of Directors

The overall management of the Company's business is vested in the Board. Pursuant to the Articles of Association and the Protocol adopted by the Board, the Board has delegated the day-to-day management of the Company's business to the Executive Directorate, and focuses its attention on matters affecting the Company's overall strategic policies, finances and shareholders. These include financial statements, dividend policy, significant changes in accounting policy, annual operating budget, certain material contracts, strategies for future growth, major financing arrangements and major investments, risk management strategies, treasury policies and fare structures.

The Board comprises 13 members, consisting of one executive Director (the Chief Executive Officer) and 12 non-executive Directors, of whom eight are independent non-executive Directors. In this regard, the Company well exceeds the requirement of the Listing Rules which requires every board of directors of a listed issuer to have at least three independent non-executive directors.

On 8 August 2007, the Government appointed Dr. Raymond Ch'ien Kuo-fung as the non-executive Chairman of the Company for a term of 24 months with effect from the Rail Merger. The Rail Merger took effect from 2 December 2007. Dr. Ch'ien, a Member of the Board since 1998, was first appointed as the non-executive Chairman of the Company with effect from 21 July 2003 for a

term of three years, which was renewed in 2006 for a further term up to 31 July 2007. In July 2007, Dr. Ch'ien was re-appointed as the non-executive Chairman of the Company with effect from 1 August 2007 for a term up to 31 December 2007 or the day to be appointed by the Secretary for Transport and Housing by notice published in the Gazette under the Rail Merger Ordinance, whichever was the earlier. The Rail Merger Ordinance relates to the Rail Merger between the Company and KCRC.

On 8 August 2007, the Government selected Mr. Chow Chung-kong as the Chief Executive Officer of the Company after the Rail Merger. Mr. Chow was appointed as the Chief Executive Officer of the Company with effect from 1 December 2003 for a term of three years. He was also appointed as a Member of the Board on the same date. His contract as the Chief Executive Officer of the Company was renewed for a further term of three years with effect from 1 December 2006.

Two of the other non-executive Directors (being the Secretary for Transport and Housing and the Commissioner for Transport) are appointed by the Chief Executive of the HKSAR. The office of the Secretary for Transport and Housing has replaced the office of the Secretary for the Environment, Transport and Works to become a non-executive Director of the Company with effect from 1 July 2007. Another non-executive Director, Professor Chan Ka-keung, Ceajer who took over the post of the Secretary for Financial Services and the Treasury of the Government from Mr. Frederick Ma Si-hang with effect from 1 July 2007, has been appointed as a non-executive Director of the Company in place of Mr. Ma with effect from 10 July 2007. The Government through FSI, holds approximately 76% of the issued share capital of the Company.

Coming from diverse business and professional backgrounds, the non-executive Directors actively bring their valuable experience to the Board for promoting the best interests of the Company and its shareholders. On the other hand, the independent non-executive Directors contribute to ensuring that the interests of all shareholders of the Company are taken into account by the Board and that relevant issues are subjected to objective and dispassionate consideration by the Board. The Company has received confirmation from each independent non-executive Director about his/her independence under the Listing Rules, and continues to consider each of them to be independent.

Each Director ensures that he/she can give sufficient time and attention to the affairs of the Company. They are requested to disclose the number and nature of offices held in public companies or organisations and other significant commitments as well as their identity to the Company twice a year.

Biographies of the Members of the Board and the Executive Directorate are set out on pages 101 to 106. None of the Members of the Board and the Executive Directorate has any relationship (including financial, business, family or other material or relevant relationships) between each other, although the Secretary for Transport and Housing (Ms. Eva Cheng) and Commissioner for Transport (Mr. Alan Wong Chi-kong) were appointed by the Chief Executive of the HKSAR, and Professor Chan Ka-keung, Ceajer was appointed by FSI, and Ms. Christine Fang Meng-sang sits on various government advisory committees.

As permitted under its Articles of Association, the Company has arranged Directors' and Officers' Liability Insurance for which Members of the Board and officers of the Company do not have to bear any excess.

Chairman and Chief Executive Officer

The posts of Chairman and Chief Executive Officer are distinct and separate (please refer to the respective appointment of Dr. Raymond Ch'ien Kuo-fung as the non-executive Chairman of the Company, and Mr. Chow Chung-kong as the Chief Executive Officer of the Company and a Member of the Board on page 88). The non-executive Chairman is responsible for chairing and managing the operations of the Board, as well as monitoring the performance of the Chief Executive Officer and Members of the Executive Directorate. Apart from ensuring that adequate information about the Company's business is provided to the Board on a timely basis, the Chairman also ensures that the non-executive Directors make an effective contribution at Board meetings. As head of the Executive Directorate, the Chief Executive Officer is responsible to the Board for managing the business of the Company.

The Chairman held a meeting on 13 March 2007 with a majority of the non-executive Directors (or their alternates) without the presence of Members of the Executive Directorate (including the Chief Executive Officer) to discuss a new share option scheme proposed by the Remuneration Committee to the Board, succession plan of Members of the Executive Directorate, and impact of the extended legislative process of the then Rail Merger Bill and other related Regulations and By-laws that might have on staff morale.

Another meeting has been scheduled to be held by the Chairman in April 2008.

Board Proceedings

The Board meets in person regularly, and all Members of the Board have full and timely access to relevant information and may take independent professional advice at the Company's

expense, if necessary, in accordance with the approved procedures. The draft agenda for regular Board meetings is prepared by the Legal Director & Secretary and approved by the Chairman of the Company. Members of the Board are advised to inform the Chairman or the Legal Director & Secretary not less than one week before the relevant Board meeting if they wish to include a matter in the agenda of the meeting. The date of the Board meetings for the following year is usually fixed by the Legal Director & Secretary and agreed by the Chairman some time in the third quarter of each year.

At each regular Board meeting, Members of the Executive Directorate together with senior managers report to the Board on their business, including the operations, project progress, financial performance, corporate governance and outlook. The Chief Executive Officer also submits his Executive Summary, which focuses on the overall strategies and principal issues of the Company, to the Board. These reports, together with the discussions at Board meetings, provide information to enable all Members of the Board to make informed decisions for the benefit of the Company. The agenda together with board papers is sent in full at least 3 days before the intended date of the Board Meeting.

All Members of the Board have access to the advice and services of the Legal Director & Secretary, who is responsible for ensuring that the correct Board procedures are followed and advises the Board on all corporate governance matters. The Members of the Board also have full access to all Members of the Executive Directorate as and when they consider necessary.

Unless specifically permitted by the Articles of Association, a Director cannot cast a vote on any contract, transaction, arrangement or any other kind of proposal in which he has an interest and which he knows is material. For this purpose, interests of a person who is connected with a Director (including any of his associates) are treated as the interests of the director himself. Interests purely as a result of an interest in the Company's shares, debentures or other securities are disregarded. A Director may not be included in the quorum for such part of a meeting that relates to a resolution he is not allowed to vote on but he shall be included in the quorum for all other parts of that meeting. This reduces potential conflicts which might otherwise arise between the Company's business and an individual Director's other interests or appointments.

In 2007, the Board held eight meetings. The then proposed Rail Merger was discussed at six of the Board meetings. At these six meetings, updates on matters such as Day One readiness, Legislative Council's Bills Committee meetings, staff selection

Corporate Governance Report

and voluntary separation scheme design, Rail Merger Circular and other Rail Merger related documents, and financing were provided by relevant Members of the Executive Directorate. When matters which might result in conflicts of interest between the Company and Government were discussed at Board meetings, the Government-nominated Members of the Board, who during the course of 2007 consisted of the then Secretary for the Environment, Transport and Works, the Secretary for Transport and Housing, Mr. Frederick Ma Si-hang (the then Secretary for Financial Services and the Treasury), Professor Chan Ka-keung, Ceajer, the Secretary for Financial Services and the Treasury, and the Commissioner for Transport (or their respective alternates) either did not attend the relevant Board meetings, or where they did attend, they declared their interests and did not vote in any relevant motion and were not included in the calculation of the relevant quorum.

The attendance record of each Member of the Board is set out below:

Directors	Attendance of Board meetings in 2007
Non-executive Directors	
Dr. Raymond Ch'ien Kuo-fung (Chairman)	8/8
Commissioner for Transport (Alan Wong Chi-kong) 2 meetings were attended by his alternate director	8/8
Secretary for the Environment, Transport and Works (Dr. Sarah Liao Sau-tung) (Note 1) 3 meetings were attended by her alternate directors	4/4
Secretary for Transport and Housing (Eva Cheng) (Note 2) 1 meeting was attended by her alternate director	4/4
Frederick Ma Si-hang (Note 3) 1 meeting was attended by his alternate director	4/4
Professor Chan Ka-keung, Ceajer (Note 4) 2 meetings were attended by his alternate director	4/4
Independent Non-executive Directors	
Professor Cheung Yau-kai	7/8
David Gordon Eldon	7/8
Christine Fang Meng-sang	6/8
Edward Ho Sing-tin	8/8
Lo Chung-hing	7/8
T. Brian Stevenson	7/8
Ng Leung-sing (Note 5)	1/1
Abraham Shek Lai-him (Note 5)	1/1
Executive Director	
Chow Chung-Kong (Chief Executive Officer)	8/8

Notes

- Secretary for the Environment, Transport and Works (Dr. Sarah Liao Sau-tung) ceased to be non-executive Director with effect from 1 July 2007.
- Secretary for Transport and Housing (Ms. Eva Cheng) has been appointed as non-executive Director with effect from 1 July 2007.
- Mr. Ma ceased to be non-executive Director with effect from 10 July 2007.
- Professor Chan has been appointed as non-executive Director with effect from 10 July 2007.
- Messrs Ng and Shek have been appointed as independent non-executive Directors with effect from 18 December 2007.

The minutes of Board meetings are prepared by the Secretary of the meeting with details of the matters considered by the Board and decisions reached, including any concerns raised by the Members of the Board or dissenting views expressed. The draft minutes are circulated to all Members of the Board for their comment within a reasonable time after the meeting. The approved procedure is that the Board formally adopts the draft minutes at the subsequent meeting. If Members of the Board have any comment on the draft minutes, they will discuss it at that meeting, followed by a report on what has been agreed in the minutes of that meeting. Minutes of Board Meetings are kept by the Legal Director & Secretary and open for inspection by all Members of the Board at the Company's registered office.

Material Interests and Voting

All Directors are required to comply with their common law duty to act in the best interests of the Company and have particular regard to the interest of the shareholders as a whole. The Government is a substantial shareholder of the Company and the Chief Executive of the HKSAR, may, pursuant to Section 8 of the MTR Ordinance, appoint up to three persons as "additional directors". Each Director appointed by the Chief Executive of the HKSAR pursuant to Section 8 of the MTR Ordinance or by the Government through its shareholding must, like any other Director, act in the best interests of the Company.

Directors are required to declare their interests, if any, in any transaction, arrangement or other proposal to be considered by the Board at Board Meetings and to abstain from voting on any related resolutions. As a result, if a conflict arises between the interests of the Company and those of the Government, a Director appointed by the Chief Executive of the HKSAR pursuant to Section 8 of the MTR Ordinance or by the Government, would not be included in the quorum of part of a meeting that relates to the transaction, arrangement or other proposal being considered by the Board and would not be allowed to vote on the related resolution.

There are a number of contractual arrangements that have been entered into between the Company and the Government (and its related entities), some of which are continuing in nature. As the Government is a substantial shareholder of the Company, such contractual arrangements are connected transactions (and in some cases continuing connected transactions) for the purposes of the Listing Rules. The section headed "Connected Transactions" explains how, in accordance with the Listing Rules, these transactions are treated.

Appointment, Re-election and Removal of Members of the Board

A person may be appointed as a Member of the Board at any time either by the shareholders in general meeting or by the Board upon recommendation by the Nominations Committee of the Company. Directors who are appointed by the Board must retire at the first annual general meeting after their appointment. A Director who retires in this way is eligible for election at that annual general meeting, but is not taken into account when deciding which and how many Directors should retire by rotation. In either case, the Directors so elected and appointed are eligible for re-election and re-appointment. At each annual general meeting of the Company, one third of the Directors (or, if the number of Directors is not divisible by three, such number as is nearest to and less than one third) must retire as Directors by rotation.

The Chief Executive of the HKSAR may, pursuant to Section 8 of the MTR Ordinance, appoint up to three persons as "additional directors". Directors appointed in this way may not be removed from office except by the Chief Executive of the HKSAR. These Directors are not subject to any requirement to retire by rotation nor will they be counted in the calculation of the number of Directors who must retire by rotation. In all other respects, the "additional directors" are treated for all purposes in the same way as other Directors and are, therefore, subject to the normal common law duties of directors, including to act in the best interests of the Company. The Chief Executive of the HKSAR has appointed the office of the Secretary for Transport and Housing and the office of Commissioner for Transport as "additional directors". As there are currently 11 Directors subject to the requirement to retire by rotation, and one-third of them shall retire at each annual general meeting of the Company (subject to re-election by the shareholders), each of these Directors is effectively appointed for a term of approximately three years.

Each of the Directors, on appointment to the Board, is given a comprehensive induction programme on key areas of business operations and practices of the Company, as well as a Directors' Manual. Amongst other things, the Manual not only sets out

the general and specific duties of the Directors under general law (common law and legislation) and the Listing Rules, but also includes the Terms of Reference of the Board Committees. The Directors' Manual is updated from time to time to reflect developments in those areas.

To assist their continuous professional development, the Legal Director & Secretary recommends Directors to attend relevant seminars and courses. The costs for such training are borne by the Company.

Accountability

The Members of the Board are responsible for preparing the accounts of the Company and of the Group. The accounts are prepared on a going concern basis and give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2007, and of the Group's profit and cash flow for the year then ended. In preparing the accounts for the year ended 31 December 2007, the Members of the Board have selected appropriate accounting policies and, apart from those new and amended accounting policies as disclosed in the notes to the accounts for the year ended 31 December 2007, have applied them consistently with previous financial periods. Judgments and estimates have been made that are prudent and reasonable. The reporting responsibilities of the External Auditor are set out on page 126.

In support of the above, the accounts presented to the Board have been reviewed by the Members of the Executive Directorate. For both the annual and interim reports and accounts, the Finance Division is responsible for clearing them with the External Auditor and then the Audit Committee. In addition, all new and amended accounting standards and requirements, as well as changes in accounting policies adopted by the Company have been discussed and approved at the Audit Committee before adoption by the Company.

Board Committees

As an integral part of good corporate governance, the Board has established the following Board Committees to oversee particular aspects of the Company's affairs. Each of these Committees comprises non-executive Directors who have been invited to serve as members. Each of the Audit, Remuneration and Nominations Committee is governed by its respective Terms of Reference, which are available on the Company's website: www.mtr.com.hk.

In respect of the Rail Merger between the Company and KCRC, and for the purpose of looking after the interest of independent shareholders and ensuring good corporate governance, the

Corporate Governance Report

Board has established an Independent Committee of the Board ("IBC"). Governed by its Terms of Reference, the IBC comprises six independent non-executive Directors of the Company and has set out its advice to the independent shareholders regarding the Rail Merger in the Rail Merger Circular.

All Committees are provided with sufficient resources to discharge their duties.

Audit Committee

The Audit Committee consists of four non-executive Directors, three of whom are independent non-executive Directors. The Members of the Committee are T. Brian Stevenson (chairman), Professor Cheung Yau-kai, the Commissioner for Transport (Alan Wong Chi-kong), and Ng Leung-sing who has been appointed as a member of the Audit Committee with effect from 18 December 2007. None of the Committee Members is a partner or former partner of KPMG, the Company's External Auditor. The Finance Director, the Head of Internal Audit and representatives of the External Auditor of the Company are expected to attend meetings of the Committee. At the discretion of the Committee, others may also be invited to attend meetings. The Committee normally meets four times a year, and the External Auditor or the Finance Director may request a meeting if they consider it necessary.

The Terms of Reference of the Audit Committee have been revised and approved by the Board in December 2007. Under its Terms of Reference, the duties of the Audit Committee include financial and efficiency aspects as described below. Amongst other things, the Committee is required to oversee the relationship with the Company's External Auditor, to review the financial information of the Company, and to oversee the Company's financial reporting system and internal procedures. The Committee discusses with the External Auditor the nature and scope of audit and reporting obligations before the audit commences. Apart from giving pre-approval of all audit services, the Committee also pre-approves any non-audit services for complying with relevant legal requirements. The Committee is primarily responsible for making recommendations to the Board on the appointment and removal of the External Auditor, and approving the remuneration and terms of such engagement. With respect to financial information of the Company, the Committee monitors the integrity of financial statements, annual and interim reports and accounts, together with the preliminary announcement of results and other announcements regarding the Company's financial information to be made public. In dealing with the financial information, the Committee liaises with the Board and the Executive Directorate (including the Finance Director), and the Chairman of the Committee further meets on an ad hoc basis with the Head of Internal Audit,

representatives of the External Auditor, and Management. Apart from considering issues arising from the audit, the Committee discusses any matters that auditor(s) may wish to raise either privately or together with executive director and any other person. The Committee is required to review, at least annually, the effectiveness of the Company's financial controls, internal control and risk management systems and to report to the Board that such a review has been carried out. These controls and systems allow the Board to monitor the Company's overall financial position and to protect its assets. The Committee reviews and approves the annual Internal Audit Plan which includes audits on the efficiency of chosen activities or operations of the Company. In addition, the Committee reviews periodic reports from the Head of Internal Audit and the follow-up of major action plans recommended, and puts forward recommendations to the Board where appropriate.

The Chairman of the Committee summarises activities of the Committee and highlights issues arising therefrom by a report to the Board after each Audit Committee meeting.

The minutes of the Audit Committee meetings are prepared by the secretary of the meeting with details of the matters considered by the Committee Members and decisions reached, including any concerns raised by the Committee Members and dissenting views expressed. The draft minutes are circulated to the Committee Members for comments and the final version of the minutes is sent to the Committee Members for their records within a reasonable time after the meeting and the minutes are open for inspection by the Committee Members at the Company's registered office. A framework of the agenda items for the meetings for the following year is set out for the Committee Members' reference and comment in the last quarter of each year. The chairman of the Committee makes the final determination on the agenda for the regular Committee meetings.

In 2007, the Audit Committee held four meetings. The major work performed by the Committee in 2007 included:

- Reviewed and recommended for the Board's approval the draft 2006 Annual Report and Accounts and 2007 Interim Report and Accounts;
- Reviewed the Company's internal control systems;
- Approved the 2007 Audit Plan and reviewed the periodic report prepared by the Internal Audit Department; and
- Pre-approved the audit and non-audit services provided by KPMG, External Auditor, for 2007.

The attendance record of each Audit Committee Member is set out below. Representatives of the External Auditor, the Finance Director and the Head of Internal Audit attended all

those meetings for reporting and answering questions about their work. Further to that and by invitation, the Operations Director, the Property Director, the China & International Business Director and the Legal Director & Secretary (or their representatives) had respectively provided an overview of the Company's railway operations, property business, the Mainland of China and international businesses as well as outstanding litigation, compliance and enterprise risk management matters to the Members at the meetings.

Directors	Attendance of Audit Committee meetings in 2007
T. Brian Stevenson (Chairman)	4/4
Professor Cheung Yau-kai	4/4
Commissioner for Transport (Alan Wong Chi-kong) 2 meetings were attended by his alternate director	3/4
Ng Leung-sing (Note)	–

Note: Mr. Ng Leung-sing has been appointed as a member of the Audit Committee with effect from 18 December 2007. There was no Committee meeting held in 2007 after his appointment.

Remuneration Committee

The Remuneration Committee consists of three non-executive Directors, two of whom are independent non-executive Directors. The Members of the Remuneration Committee are Edward Ho Sing-tin (chairman), T. Brian Stevenson and Professor Chan Ka-keung, Ceajer. Professor Chan took over the post of the Secretary for Financial Services and the Treasury from Mr. Frederick Ma Si-hang with effect from 1 July 2007 and was appointed as a non-executive Director of the Company and a Member of the Remuneration Committee in place of Mr. Ma with effect from 10 July 2007. Mr. Ho and Mr. Stevenson are independent non-executive Directors.

The principal responsibilities of the Remuneration Committee include formulating a remuneration policy and practices that facilitate the employment of top quality personnel, recommending to the Board the remuneration of the Members of the Board who are non-executive Directors, determining the remuneration packages of the Members of the Board who are executive Directors and other Members of the Executive Directorate, and reviewing and approving performance-based remuneration by reference to the Company's goals and objectives.

In 2007, the Remuneration Committee held three meetings. In accordance with its Terms of Reference, the Committee performed the following work during the year:

- Approved the 2006 Remuneration Report as incorporated in the 2006 Annual Report;
- Reviewed and approved payouts under the Company's performance-based variable incentive scheme for the 2006 performance period;
- Approved the 2007 Share Option Scheme following the expiry of the New Joiners Share Option Scheme, which was subsequently approved and adopted by shareholders at the Annual General Meeting held on 7 June 2007;
- Conducted an annual review of the remuneration packages for the Chief Executive Officer and other Members of the Executive Directorate which took effect in 2007;
- Reviewed the remuneration for the Chief Executive Officer and other Members of the Executive Directorate upon their appointment following the Rail Merger;
- Reviewed the remuneration for non-executive Directors following the Rail Merger;
- Reviewed and amended the Variable Incentive Scheme to take effect in 2008, reflecting changes to the Company's scope, objectives and performance expectations following the Rail Merger; and
- Reviewed and approved share options and discretionary awards for Members of the Executive Directorate.

The attendance record of each Committee Member is set out below:

Directors	Attendance of Remuneration Committee meetings in 2007 (Note 2)
Edward Ho Sing-tin (Chairman)	3/3
T. Brian Stevenson	3/3
Frederick Ma Si-hang The meeting was attended by his alternate director	1/1
Professor Chan Ka-keung, Ceajer (Note 1)	1/1

Notes

- 1 Professor Chan was appointed as a non-executive Director of the Company and a Member of the Remuneration Committee in place of Mr. Ma with effect from 10 July 2007.
- 2 Only two Committee Members attended the July Remuneration Committee meeting due to the transition of Mr. Ma.

The Remuneration Committee also met on 3 March 2008 to approve the 2007 Remuneration Report, which is set out on pages 98 to 100 and includes a description of the remuneration policy of the Company.

Nominations Committee

The Terms of Reference of the Nominations Committee have been revised and approved by the Board in December 2007. The Committee consists of seven non-executive Directors, four of whom are independent non-executive Directors. The Members of the Nominations Committee are David Gordon Eldon (chairman), Dr. Raymond Ch'ien Kuo-fung, Christine Fang Meng-sang, Lo Chung-hing, Abraham Shek Lai-him, Professor Chan Ka-keung, Ceajer and the Secretary for Transport and Housing (Eva Cheng). Dr. Ch'ien, Ms. Fang, Mr. Shek and Professor Chan were appointed as Members of the Nominations Committee on 18 December 2007.

The Nominations Committee nominates and recommends to the Board candidates for filling vacancies on the Board, and the positions of Chief Executive Officer ("CEO"), Finance Director ("FD") and Chief Operating Officer ("COO") (provided that the COO position exists). For the positions of FD and COO, the Committee may consider candidates recommended by the CEO, or any other candidates (provided that the CEO shall have the right to first agree to such other candidates).

In 2007, the Nominations Committee held two meetings. The major work performed by the Committee in 2007 included:

- 1 Nomination and recommendation to the Board the appointment of Professor Chan Ka-keung, Ceajer, the Secretary for Financial Services and the Treasury to succeed Mr. Frederick Ma Si-hang as a non-executive Director; and
- 2 Nomination and recommendation to the Board the appointment of Messrs Ng Leung-sing and Abraham Shek Lai-him as independent non-executive Directors.

The attendance record of each Committee Member is set out below:

Directors	Attendance of Nominations Committee meetings in 2007
David Gordon Eldon (Chairman)	2/2
Dr. Raymond Ch'ien Kuo-fung (Notes 1 and 2)	-
Secretary for Transport and Housing (Eva Cheng)	2/2
Lo Chung-hing	1/2
Professor Chan Ka-keung, Ceajer (Note 1)	-
Christine Fang Meng-sang (Note 1)	-
Abraham Shek Lai-him (Note 1)	-

Notes

- 1 Dr. Ch'ien, Professor Chan, Ms. Fang and Mr. Shek were appointed as Members of the Nominations Committee on 18 December 2007. There was no Committee meeting held in 2007 after their appointment.
- 2 Dr. Ch'ien attended both meetings in 2007 in the capacity of Chairman of the Company pursuant to the then Terms of Reference of the Committee.

Independent Committee

The IBC consists of six independent non-executive Directors. Chaired by Edward Ho Sing-tin, the other Members are Professor Cheung Yau-kai, David Gordon Eldon, Christine Fang Meng-sang, Lo Chung-hing and T. Brian Stevenson.

The principal responsibilities of the IBC include advising the Company's independent shareholders as to whether the terms of the Rail Merger are fair and reasonable, whether the Rail Merger is in the interests of the Company and its shareholders as a whole, and on how to vote after taking into account the recommendations of the independent financial adviser ("IFA") required to be appointed by the Company under the Listing Rules. The extraordinary general meeting held on 9 October 2007 approving the Rail Merger was completed.

In 2007, the IBC held five meetings to discuss, among others, the letter from the IFA and the IBC letter to the independent shareholders in relation to the Rail Merger.

Internal Controls

The Board is responsible for the system of internal controls of the Company and its subsidiaries, setting appropriate policies and reviewing the effectiveness of such controls. Internal control is defined as a process effected by the Board, Management and other personnel, designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute assurance of the following:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with applicable laws and regulations
- effectiveness of risk management functions

Pursuant to the Protocol adopted by the Board, the Board has delegated the day-to-day management of the Company's business to the Executive Committee, and focuses its attention on matters affecting the Company's overall strategic policies, finances and shareholders.

Supported by the Members of the Executive Committee, the Chief Executive Officer who chairs the Executive Committee is responsible to the Board for the conduct of the business of the Company. The Executive Committee is responsible for

implementing the Board's policies on risk and control. In fulfilling its responsibilities, the Executive Committee identifies and evaluates the risks faced by the Company for consideration by the Board and designs, operates and monitors a suitable system of internal controls which implements the policies adopted by the Board. The Executive Committee is accountable to the Board for monitoring the system of internal controls and providing assurance to the Board that it has done so. Additionally, all employees have responsibility for internal controls within their areas of accountability.

Various risk management strategies have been established by the Board as advised by the Executive Committee to identify, assess and reduce risks, including construction, business operations, finance, treasury, safety and enterprise risks as well as to ensure appropriate insurance coverage.

The Company has established an Enterprise Risk Management ("ERM") framework for the strategic management of business risks. The framework covers all key business areas of the Company and provides a useful forum for communicating risk issues at different levels of the organization and thereby improves visibility on risk. The framework has been in operation since early 2006 and its application at divisional level has been further refined in 2007. Structured cross-discipline processes and organizations have been put in place at corporate and divisional levels for risk identification, mitigation and monitoring. A standard rating system is employed to establish a consistent set of risk measurement criteria across the Company and to prioritise risks for effective monitoring and reporting to the Executive Committee and the Board. A manual that governs the working of the ERM framework has been issued, and regular briefing sessions are conducted, to promulgate the application and ensure consistent understanding of ERM.

The operation of the ERM framework, which is overseen by the Enterprise Risk Committee, is underpinned by line management taking direct risk management responsibilities as risk owners. Changes to existing risks and the emergence of new risks are regularly reviewed by line management. Risks associated with major changes and new businesses such as the merger and local and overseas railway construction and investment projects have been assessed in 2007. The Enterprise Risk Management Department plays a central role in facilitating the risk workshops and reviewing existing and emerging business risks. The Enterprise Risk Committee reviews the operation of the ERM framework and key risks every three months.

The Executive Committee reviews significant risks half-yearly and the Board annually to ensure that such risks are under satisfactory control.

The Board also periodically reviews the implementation and the ERM organization and processes that have been put in place.

To ensure the efficient and effective operation of business units and functions, and safety of operating railway and construction works in railway projects, Corporate General Instructions ("CGIs"), divisional/departmental procedures and manuals, committees, working groups and quality assurance units are established to achieve, monitor and enforce internal controls and evaluate their effectiveness.

CGIs and various departmental procedures and manuals are established for preventing or detecting unauthorized expenditures/payments, safeguarding the Company's assets, ensuring the accuracy and completeness of accounting records and timely preparation of reliable financial information.

All Department Heads, including Business and Project Managers for overseas projects, are responsible for ensuring the compliance with statutes and regulations applicable to their own functional units. They are required to identify any new or updated statutes, to assess their impact on the Company's operations, and to review at least once a year that relevant statutes/regulations are complied with.

Members of the Board and the Executive Committee, and other nominated managers who have access to price-sensitive and/or specific information are bound by the Model Code for Securities Transactions by Directors of Listed Issuers. In addition, every employee is also bound by the Code of Conduct issued by the Company, amongst other things, to keep unpublished price-sensitive information in strict confidence.

The Internal Audit Department plays a major role, independent of the Company's management, in assessing and monitoring the internal controls of the Company. The Head of Internal Audit reports to the Chief Executive Officer and has direct access to the Audit Committee. The Department has unrestricted access to information that allows it to review all aspects of the Company's risk management, control and governance processes. On a regular basis, it conducts audits on financial, operational and compliance controls, and effectiveness of risk management functions of all business and functional units as well as subsidiaries. Management is responsible for ensuring that control deficiencies highlighted in internal audits are rectified within a reasonable period. The Department produces an annual internal audit plan derived from risk assessment for the Audit Committee's approval. On a half-yearly basis, the Head of Internal Audit reports to the Audit Committee his audit findings and his opinion on the system of internal controls.

Corporate Governance Report

On behalf of the Board, the Audit Committee evaluates annually the effectiveness of the Company's system of internal controls, including the reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws and regulations and effectiveness of risk management functions. This is achieved primarily through approving the annual internal audit plan and reviewing the findings of internal audit work, in addition to reviewing the annual and interim financial statements, and the nature, scope of work, and report of the external auditors, and consideration of the following:

- the changes in the nature and extent of significant risks since the previous review and the Company's ability to respond to changes in its business and external environment;
- the scope and quality of management's ongoing monitoring of risks and the system of internal controls, the work of the Internal Audit Department, and the assurance provided by the Executive Committee;
- the extent and frequency with which the results of monitoring are communicated, enabling the Audit Committee to build up a cumulative assessment of the state of control in the Company and the effectiveness with which risk is being managed;
- the incidence of any significant control failings or weaknesses that have been identified at any time during the period and the extent to which they have resulted in unforeseen outcomes or contingencies that have had, could have had, or may in the future have, a material impact on the Company's financial performance or condition; and
- the effectiveness of the Company's processes in relation to financial reporting and statutory and regulatory compliance.

The processes in assessing internal controls by the Audit Committee have included: regular interviews with Members of the Executive Committee in relation to key business operations, internal control and compliance issues, both financial and non-financial; review of significant issues arising from internal audit reports and external audit report, and private sessions with internal and external auditors. The Audit Committee has also reviewed the papers prepared by the Executive Committee and Internal Audit Department covering: 2006 Annual Report and Accounts, Preview of 2007 Interim and Year End Accounting issues, 2007 Interim Accounts, 2007 Internal Audit Plan, Internal Audit's Half-yearly Reports, Annual Report on Staff Complaints, Reporting of Internal Control Systems, Reporting of Outstanding Litigation and Compliance Issues, Annual Insurance Programme, Compliance audit on mandatory and statutory filings and

registration for Beijing MTR Corporation Limited and Evaluation of Effectiveness of Internal Audit Department. The Chairman of the Committee meets on an ad hoc basis with the Head of Internal Audit, representatives of the External Auditor and Management of the Company as appropriate. He summarizes activities of the Committee and highlights issues arising therefrom by a report to the Board after each Audit Committee meeting.

The Board has, through the Audit Committee, conducted the review of the effectiveness of the Company's system of internal controls for the year ended 31 December 2007, covering all material financial, operational and compliance controls, and risk management function, and concluded that adequate and effective internal controls are maintained to safeguard the shareholders' investment and the Company's assets. There were no significant control failings, weaknesses or significant areas of concern identified during the year which might affect shareholders.

Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code")

The Company has adopted the Model Code and, having made specific enquiry, confirms that Members of the Board and the Executive Directorate complied throughout the year with the Model Code set out in Appendix 10 to the Listing Rules. Senior managers who, because of their office in the Company, are likely to be in possession of unpublished price sensitive information, have been requested to comply with the provisions of the Model Code.

Business Ethics

The Company is committed to a high standard of business ethics and integrity. The contents of the Company's Code of Conduct and the Corporate Guidebook for All Staff are reviewed every two years by Human Resources to ensure appropriateness and compliance with legislation. Commitment to our Code of Conduct and Guidebook is reinforced by biennial certification programme, which requires all staff to acknowledge their understanding of and agreement to abide by the Code. In November 2007, the Code of Conduct and Guidebook were issued to all pre-merger KCRC staff and they have completed the certification.

To uphold the ethical culture of our subsidiaries in Mainland of China, briefing on the Company's Code of Conduct and Guidebook is included in the Induction Programme. For other joint venture companies, guidelines on business ethics have also been published for staff's observation and compliance.

US Sarbanes-Oxley Act 2002

The Company terminated its reporting obligation under the U.S. Securities Exchange Act of 1934, as amended, in September 2007, and is generally no longer subject to the provisions of the Sarbanes-Oxley Act of 2002.

External Auditor

The Company engages KPMG as its External Auditor. In order to maintain KPMG's independence and objectivity and the effectiveness of the audit process in accordance with applicable standards, the Audit Committee, under its Terms of Reference, pre-approves all audit services to be provided by KPMG and discusses with KPMG the nature and scope of their audit and reporting obligations before the audit commences.

The Audit Committee also reviews and pre-approves the engagement of KPMG to provide any non-audit services for complying with relevant legal requirements and seeks to balance the maintenance of objectivity with value for money.

The nature of audit and non-audit services provided by KPMG and fees paid to KPMG (including any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally) are set out in note 6D to the accounts on page 147.

Communication with Shareholders

Annual General Meeting ("AGM")

The Company's AGM is one of the principal channels of communication with its shareholders. It provides an opportunity for shareholders to question Directors about the Company's performance. The Chairman of the Company and the Chairmen of the Board Committees were present at the 2007 AGM.

At the 2007 AGM, the Chairman started the formal business by outlining the categories of persons who were entitled to demand a poll in accordance with Article 67 of the Company's Articles of Association on any resolution to be proposed at the AGM. Separate resolutions were proposed for each substantially separate issue at the AGM. Before the resolutions were considered, the Chairman exercised his right as the Chairman of the Meeting under Article 67 of the Company's Articles

of Association to call a poll on all resolutions. The Company conducted the poll voting electronically at the AGM, the first time in Hong Kong. The poll results were published in an English and a Chinese newspaper and posted on the websites of the Company and HKSE on the day after the AGM. The webcast of the AGM was posted on the Company's website on the following day after the AGM.

Extraordinary General Meeting ("EGM")

The Company may also communicate with its shareholders through EGMs if and when appropriate. For example, an EGM was held on 9 October 2007 to consider approving the Rail Merger.

If shareholders want to convene an EGM of the Company, those shareholders may requisition the Directors of the Company to do so, provided that at the date of requisition they hold, in aggregate, not less than one-twentieth of the paid-up capital of the Company. The shareholders' requisition must state the objects of the meeting requested and must be deposited at the registered office of the Company. The requisition may consist of several documents in like form, each signed by one or more of the shareholders concerned.

If, within 21 days from the date of the deposit of the requisition, the Directors of the Company do not proceed duly to convene an EGM for a day not more than 28 days after the date on which the notice convening the EGM is given, the relevant shareholders, or any of them representing more than one-half of the total voting rights of all of them, may themselves convene an EGM, provided that any EGM so convened is held within 3 months from the date of the original requisition.

Enquiries from Shareholders

Details of other means of communication with shareholders are set out in the section of Investor Relations on pages 84 and 85.

Remuneration Report

This Remuneration Report has been reviewed and approved by the Remuneration Committee of the Company.

Remuneration Policy

It is the Company's policy to ensure that remuneration is appropriate and aligns with the Company's goals, objectives and performance. To this end, the Company considers a number of relevant factors including salaries paid by comparable companies, job responsibilities, duties and scope, employment conditions elsewhere in the Company and its subsidiaries, market practices, financial and non-financial performance, and desirability of performance-based remuneration.

The Company is committed to effective corporate governance and employing and motivating top quality personnel, and recognises the importance of a formal and transparent remuneration policy covering its Board and Executive Directorate.

The Board has established a Remuneration Committee consisting of three non-executive Directors, two of whom are independent non-executive Directors. It considers and recommends to the Board the Company's remuneration policy and has a delegated authority to review and determine the remuneration packages of the Chief Executive Officer and other Members of the Executive Directorate.

As necessary and with the agreement of the Chairman, the Remuneration Committee is authorised to obtain outside independent professional advice to support the Committee on relevant issues.

A summary of the work performed by the Remuneration Committee during 2007 is set out in the "Corporate Governance Report" on pages 88 to 97.

The Remuneration Committee also ensures that no individual Director or any of his associates is involved in deciding his own remuneration.

Non-Executive Directors, Chief Executive Officer and the Executive Directorate

The Remuneration Committee makes recommendations to the Board from time to time on the remuneration of the Members of the Board who are non-executive Directors. To ensure that non-executive Directors are appropriately paid for their time and responsibilities devoted to the Company, the Committee considers factors such as fees paid by comparable companies, time commitment, responsibilities of the non-executive Directors, and employment conditions elsewhere in the Company.

The Remuneration Committee is responsible for establishing policies, and reviewing and determining the remuneration of the Members of the Board who are executive Directors (namely, the Chief Executive Officer) and the Executive Directorate in accordance with the Company's remuneration policy. In the case of the Chief Executive Officer, the Committee will consult with the Chairman and in the case of other Members of the Executive Directorate, the Committee will consult with both the Chairman and the Chief Executive Officer in respect of their recommendations.

Remuneration Structure for Employees

The Company's remuneration structure for its employees, including Members of the Board who are executive Directors and Members of the Executive Directorate, comprises fixed compensation, variable incentives, discretionary awards, long-term incentives, and retirement schemes. The specifics of these components are described below.

Fixed Compensation

Fixed compensation comprises base salary, allowances and benefits-in-kind (e.g. medical). Base salary and allowances are set and reviewed annually for each position taking into consideration the Company's remuneration policy, competitive market positioning, market practice, as well as the Company's and individuals' performance. Benefits-in-kind are reviewed regularly taking into consideration market practices.

Variable Incentives

The Chief Executive Officer, other Members of the Executive Directorate and selected management of the Company are eligible to receive an annual cash incentive under the Company's Variable Incentive Scheme, the rules of which are regularly reviewed by the Remuneration Committee.

Under the current scheme rules, the payouts are based on the performance of the Company and individual performance. The Company's performance is measured by the return on fixed assets and operating profit on an annual and rolling three-year basis.

A portion of the target incentive levels under the scheme was originally funded by participants by foregoing their 13th month pay and portions of their fixed allowances. Target incentive levels for the Chief Executive Officer and other Members of the Executive Directorate represent approximately 15-30% of base pay. If performance exceeds pre-defined threshold standards, then payouts under the scheme are made annually.

The scheme rules have been reviewed and amended for implementation in 2008 to reflect changes to the Company's scope, objectives and performance expectations following the Rail Merger.

In addition, the Company operates other sales and business-related incentive schemes to motivate the staff concerned to reach specific business targets of the Company.

Discretionary Awards

In 2007, special discretionary awards were provided to staff with competent or above performance as a recognition of their contribution to the Company's good performance in the past year and to motivate staff to strive for continuous business growth.

Long-Term Incentives

The Company operates three share option schemes, namely the Pre-Global Offering Share Option Scheme (the "Pre-IPO Scheme"), the New Joiners Share Option Scheme (the "New Option Scheme") and the 2007 Share Option Scheme (the "2007 Scheme").

The 2007 Scheme was approved and adopted by shareholders at the Company's Annual General Meeting on 7 June 2007. The 2007 Scheme is intended to provide employees of the Company and of its subsidiaries the opportunity to participate in the growth and success of the Company. Awards under this Scheme were granted to the Chief Executive Officer, other Members of the Executive Directorate and selected employees of the Company in December 2007.

Options exercised and outstanding in respect of each Member of the Executive Directorate as at 31 December 2007 under the three Schemes are set out under the paragraph "Board Members and Executive Directorate's Interest in Shares" of the Report of the Members of the Board.

Details of the three Schemes and options granted to Members of the Executive Directorate and selected employees of the Company under the Schemes are set out in notes 7 & 47 to the accounts.

The Chief Executive Officer does not participate in the Pre-IPO and New Option Schemes. He is entitled to receive an equivalent value in cash of 418,017 Shares on completion of his three-year contract on 30 November 2009.

Retirement Schemes

The Company operates five retirement schemes, the MTR Corporation Limited Retirement Scheme (the "MTR Retirement

Scheme"), the MTR Corporation Limited Retention Bonus Scheme (the "MTR RBS"), the Kowloon-Canton Railway Corporation Retirement Benefit Scheme (the "KCRC Retirement Benefit Scheme") and two Mandatory Provident Fund Schemes (the "MTR MPF Scheme" and the "KCRC MPF Scheme"). Employees who are eligible to join the MTR Retirement Scheme can choose between the MTR Retirement Scheme and the MTR MPF Scheme, while other employees are required to join the MTR MPF Scheme. The MTR RBS is a top-up scheme to supplement the MTR Retirement Scheme for employees who are classified by the Company as staff working on designated projects and who are not on gratuity terms. Former KCRC employees who were eligible to join the KCRC Retirement Benefit Scheme can choose between the KCRC Retirement Benefit Scheme and the KCRC MPF Scheme.

(a) MTR Retirement Scheme

The MTR Retirement Scheme contains a hybrid benefit section and a defined contribution section. It is a registered scheme under the Occupational Retirement Schemes Ordinance (Cap. 426) and has been granted an MPF Exemption so that it can be offered to employees as an alternative to the MTR MPF Scheme. The hybrid benefit section provides benefits based on the greater of a multiple of final salary times service or the accumulated contributions with investment returns. Members' contributions to the hybrid benefit section are based on fixed percentages of base salary. The Company's contributions are determined by reference to an annual actuarial valuation carried out by an independent actuarial consulting firm.

The hybrid benefit section has been closed to new employees since 31 March 1999. All employees joining the Company on or after 1 April 1999 who would have been eligible to join the MTR Retirement Scheme can choose to join either the defined contribution section or, commencing 1 December 2000, the MTR MPF Scheme.

The defined contribution benefit section is a member investment choice plan which provides benefits based on accumulated contributions and investment returns. Both members' and the Company's contributions to the defined contribution section are based on fixed percentages of members' base salary.

(b) MTR RBS

The MTR RBS is a registered scheme under the Occupational Retirement Schemes Ordinance. It provides benefits only in the event of redundancy for service accrued up to 31 December 2002, offset by any benefits payable from the MTR Retirement Scheme. Members are not required to contribute while the

Remuneration Report

Company's contributions are determined by reference to an annual actuarial valuation carried out by an independent actuarial consulting firm.

(c) KCRC Retirement Benefit Scheme

The KCRC Retirement Benefit Scheme is a registered scheme under the Occupational Retirement Schemes Ordinance and has been granted an MPF Exemption so that it can be offered to former employees of KCRC as an alternative to the KCRC MPF Scheme. All benefits payable under the KCRC Retirement Benefit Scheme are calculated by reference to the Company's contributions and members' own contributions, together with investment returns on these contributions. Both members' and the Company's contributions are based on fixed percentages of members' base salary.

(d) MTR MPF Scheme

The MTR MPF Scheme which has been registered with the Mandatory Provident Fund Schemes Authority, covers those employees who did not opt for or who are not eligible to join the MTR Retirement Scheme. Both members and the Company each contribute to the MTR MPF Scheme at the mandatory levels as required by the Mandatory Provident Fund Schemes Ordinance ("the MPF Ordinance"). Additional contributions above the mandatory level may be provided subject to individual terms of employment.

(e) KCRC MPF Scheme

The KCRC MPF Scheme, which has been registered with the Mandatory Provident Fund Schemes Authority, covers those former KCRC employees who did not opt for or who were not eligible to join the KCRC Retirement Benefit Scheme. Both members and the Company each contribute to the KCRC MPF Scheme at the mandatory levels as required by the MPF Ordinance.

The executive Directors who have been employed by the Company before 1 April 1999 are eligible to join the hybrid benefit section of the MTR Retirement Scheme.

The executive Directors who are hired on or after 1 April 1999 are eligible to join the defined contribution benefit section of the MTR Retirement Scheme.

The Chief Executive Officer participates in the MTR MPF Scheme. Both the Company and the Chief Executive Officer each contribute to the MTR MPF Scheme at the mandatory levels as required by the MPF Ordinance.

Remuneration of Non-Executive and Executive Directors

(i) The total remuneration of the Members of the Board and the Executive Directorate (excluding share-based payments) is shown below and the remuneration details are set out in note 7 to the accounts.

<i>in HK\$ million</i>	2007	2006
Fees	3	3
Base Salaries, allowances and other benefits-in-kind	32	31
Variable remuneration related to performance	16	11
Retirement scheme contributions	1	2
	52	47

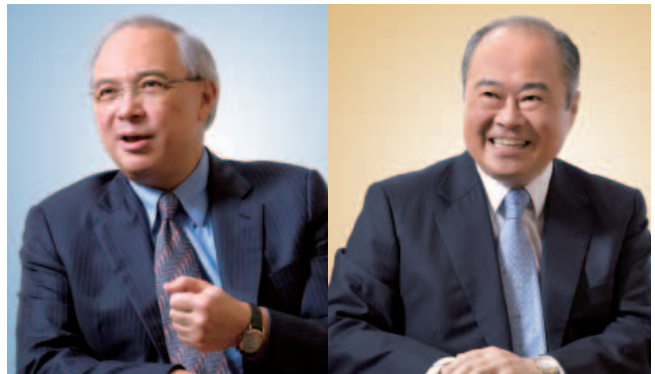
(ii) The gross remuneration of non-executive and executive Directors (excluding share-based payments) were within the following bands:

<i>Remuneration</i>	2007 Number	2006 Number
HK\$0 – HK\$500,000	13	9
HK\$500,001 – HK\$1,000,000	–	1
HK\$1,000,001 – HK\$1,500,000	1	–
HK\$4,500,001 – HK\$5,000,000	1	7
HK\$5,000,001 – HK\$5,500,000	3	–
HK\$5,500,001 – HK\$6,000,000	2	–
HK\$6,000,001 – HK\$6,500,000	1	–
HK\$10,000,001 – HK\$10,500,000	–	1
HK\$10,500,001 – HK\$11,000,000	1	–
	22	18

The information shown in the above table includes the five highest paid employees. The independent non-executive Directors' emoluments are included in the first remuneration band except the non-executive Chairman, whose emolument is included in the third remuneration band.

Edward Ho Sing-tin, *Chairman, Remuneration Committee*
MTR Corporation Limited
Hong Kong, 3 March 2008

Board and Executive Directorate



*Dr. Raymond Ch'ien Kuo-fung
(Chairman)*

*Chow Chung-kong
(Chief Executive Officer)*



Professor Cheung Yau-kai

David Gordon Eldon

Christine Fang Meng-sang

Edward Ho Sing-tin



Lo Chung-hing

Ng Leung-sing

Abraham Shek Lai-him

T. Brian Stevenson



*Alan Wong Chi-kong
(Commissioner for Transport)*

*Eva Cheng
(Secretary for Transport and Housing)*

*Professor Chan Ka-keung, Cejjer
(Secretary for Financial Services and
the Treasury)*

Board and Executive Directorate

Members of the Board

Dr. Raymond Ch'ien Kuo-fung 56, was appointed Non-Executive Chairman in July 2003. He has been a member of the Board since 1998. Dr. Ch'ien is chairman of CDC Corporation and its subsidiary, China.com Inc. He is also chairman and independent non-executive director of Hang Seng Bank Limited, as well as non-executive chairman of HSBC Private Equity (Asia) Limited. He serves on the boards of The Hongkong and Shanghai Banking Corporation Limited, Inchcape plc, Convenience Retail Asia Limited, VTech Holdings Limited and The Wharf (Holdings) Limited. Dr. Ch'ien is chairman of the Hong Kong/European Union Business Cooperation Committee, a Hong Kong member of the APEC Business Advisory Council, and a member of the Standing Committee of the Tianjin Municipal Committee of the Chinese People's Political Consultative Conference. In addition, Dr. Ch'ien is the honorary president and past chairman of the Federation of Hong Kong Industries. He was a member of the Executive Council of Hong Kong, then under British Administration, from 1992 to 1997, a member of the Executive Council of the Hong Kong SAR from 1 July 1997 to June 2002 and chairman of the Advisory Committee on Corruption of the Independent Commission Against Corruption from 1 January 1998 to 31 December 2006. Dr. Ch'ien was appointed a Justice of the Peace in 1993. He was made a Commander in the Most Excellent Order of the British Empire in 1994 and awarded the Gold Bauhinia Star medal in 1999. Dr. Ch'ien received a doctoral degree in economics from the University of Pennsylvania in 1978 and became a Trustee of the University in 2006.

Chow Chung-kong 57, was appointed Chief Executive Officer on 1 December 2003. He was formerly chief executive officer of Brambles Industries Ltd, a global support services company. From 1997 to 2001, Mr. Chow was chief executive of GKN PLC, a leading engineering company based in the United Kingdom. Mr. Chow is a chartered engineer. He holds Bachelor of Science and Master of Science degrees in Chemical Engineering from The University of Wisconsin and The University of California respectively. He also holds a Master of Business Administration degree from The Chinese University of Hong Kong and was a graduate of the Advanced Management Program of Harvard Business School. He was awarded an Honorary Doctor of Engineering degree by The University of Bath. Mr. Chow was knighted in the United Kingdom in 2000 for his contribution to industry. He is currently a member of the Hong Kong Tourism Board and the Council of The Chinese University of Hong Kong. He is also a member of the General Committee of The Hong

Kong General Chamber of Commerce, a member of both the Commission on Strategic Development and the Standing Committee on Directorate Salaries and Conditions of Service of the HKSAR Government, and a member of the Standing Committee of the Shenzhen Municipal Committee of the Chinese People's Political Consultative Conference. Mr. Chow is a non-executive director of Standard Chartered PLC and the non-executive chairman of Standard Chartered Bank (Hong Kong) Limited.

Professor Cheung Yau-kai 73, is an independent non-executive Director and has been a member of the Board since 1999. Professor Cheung is Honorary Professor of Engineering and Special Adviser to the Vice-Chancellor of The University of Hong Kong. He was Taikoo Professor of Engineering and Acting Deputy Vice-Chancellor of The University of Hong Kong until 30 June 2000. Professor Cheung began his academic research career at the University College of Swansea, Wales. He was appointed Professor of Civil Engineering at Calgary in 1970 and moved to the University of Adelaide in 1974 as Professor and Chairman of the Department of Civil Engineering. In 1977, he took up the Chair and Headship of the Department of Civil Engineering in The University of Hong Kong. In addition to his academic appointments, Professor Cheung was the former first Senior Vice-President of the Hong Kong Institution of Engineers and the Ex-Chairman of its Accreditation Board. He has been awarded several honorary degrees at educational institutions, including, an honorary Doctor of Science by The University of Hong Kong and an honorary Doctor of Laws by the University of Wales. He has also been elected a member of the Chinese Academy of Sciences, and is a fellow of the Royal Academy of Engineering, a fellow of the Royal Society of Canada and immediate past President of the Hong Kong Academy of Engineering Sciences.

David Gordon Eldon 62, is an independent non-executive Director and has been a member of the Board since 1999. He is based in Hong Kong and is Senior Advisor to PricewaterhouseCoopers. He is Chairman of both the Dubai International Financial Centre Authority and the Noble Group Ltd. He retired as Chairman of The Hongkong and Shanghai Banking Corporation Limited in May 2005, after 37 years with the HSBC Group. He was an Executive Director of HSBC Holdings plc, non-executive Chairman of Hang Seng Bank Limited, and a board member of Swire Pacific Limited. Mr. Eldon is a Vice Patron of The Community Chest of Hong Kong, having previously been Chairman of the Executive Committee. He is an Honorary Steward of the Hong Kong Jockey Club from 10 March 2008 (formerly Deputy Chairman), a member of the Advisory Board

of Unisys and an independent non-executive director of Eagle Asset Management (CP) Limited and China Central Properties Limited. Mr. Eldon was appointed a member of the Capital Adequacy Review Tribunal in 2007 and holds a number of other public and private community service appointments. Mr. Eldon is a fellow of the Chartered Institute of Bankers and a fellow of the Hong Kong Institute of Bankers. He is a Justice of the Peace.

Christine Fang Meng-sang 49, is an independent non-executive Director and has been a member of the Board since 2004. Ms. Fang has been the chief executive of the Hong Kong Council of Social Service since 2001. Prior to joining the Hong Kong Council of Social Service, she worked for the Hong Kong Red Cross from 1989 to 2001 and held the position of Secretary General from 1993 to 2001. By training, Ms. Fang is a social worker and has a strong background in community service. She sits on various government advisory committees, including the Social Welfare Advisory Committee (until 30 November 2007), the Manpower Development Committee, the Sustainable Development Council and the Digital 21 Strategy Advisory Committee. She is also a member of the Commission on Strategic Development.

Edward Ho Sing-tin 69, is an independent non-executive Director and has been a member of the Board since 1991. He is an architect and the deputy chairman and managing director of Wong Tung & Partners Limited. Mr. Ho was an elected member of the Legislative Council of Hong Kong from 1991 to 2000, representing the architectural, surveying and planning functional constituency. He was president of the Hong Kong Institute of Architects in 1983 and 1984 and was chairman of the Hong Kong Industrial Estates Corporation from 1992 to 2001. Mr. Ho serves on a number of statutory boards and advisory committees including the Board of Hong Kong Hospital Authority. He is also chairman of the Board of Governors of the Hong Kong Philharmonic Society Ltd. and chairman of the Antiquities Advisory Board.

Lo Chung-hing 56, is an independent non-executive Director and has been a member of the Board since 1995. Mr. Lo began his banking career in 1969 and he is general manager of Bank of China (Hong Kong) Limited since October 2001. He is a director of the Urban Renewal Authority. Mr. Lo was appointed as a board member of the Provisional Airport Authority in 1994 and served as vice chairman of the Airport Authority from 1996 to May 1999. He was also a board member of the Hospital Authority from December 1997 to November 2005. Mr. Lo was awarded the Silver Bauhinia Star medal in 1998.

Ng Leung-sing 58, joined the Board as an independent non-executive Director on 18 December 2007. Mr. Ng is vice chairman of Chiyu Banking Corporation, general manager, Bank-wide Operation Department of Bank of China (HK) Ltd and an independent non-executive director of Smartone Telephone Holdings Ltd. He is a director of the Bank of China (Hong Kong) Charitable Foundation and a Member of the Court of Lingnan University. Mr. Ng is also a Hong Kong Deputy to the 10th and 11th National People's Congress, People's Republic of China. Mr. Ng is a graduate of University of East Asia, Graduate College, Macau and holds a diploma in Chinese Law.

Abraham Shek Lai-him 62, joined the Board as an independent non-executive Director on 18 December 2007. Mr. Shek is an independent non-executive director and an audit committee member of each of Midas International Holdings Limited, Paliburg Holdings Limited, Lifestyle International Holdings Limited, Chuang's Consortium International Limited, NWS Holdings Limited, See Corporation Limited, Regal Portfolio Management Limited, Titan Petrochemicals Group Limited, Eagle Asset Management (CP) Limited, ITC Corporation Limited, Country Garden Holdings Company Limited and is also an independent non-executive director of each of Hop Hing Holdings Limited, SJM Holdings Limited and Hsin Chong Construction Group Ltd (with effect from 23 January 2008). Mr. Shek was appointed as Justice of the Peace in 1995 and was awarded the Silver Bauhinia Star in 2007. He is a Member of the Council of The Hong Kong University of Science & Technology and the Court of the University of Hong Kong. Mr. Shek is a graduate of the University of Sydney and holds a Bachelor of Arts degree and a Diploma in Education.

T. Brian Stevenson 63, is an independent non-executive Director and has been a member of the Board since October 2002. He is a non-executive director of The Hongkong and Shanghai Banking Corporation Limited, a member of the Asia Pacific Advisory Board of BT and a member of the Public Service Commission. He is Deputy Chairman of the Hong Kong Jockey Club with effect from 10 March 2008. Mr. Stevenson was previously the Senior Partner of Ernst & Young, Hong Kong from 1981 to 1999. He served on the Council of the Hong Kong Society of Accountants from 1991 to 1997 and was president of the Society in 1996. Mr. Stevenson is a chartered accountant and holds law degrees from Glasgow and Hong Kong Universities. He was awarded the Silver Bauhinia Star medal in 1998. He is also a Justice of the Peace.

Board and Executive Directorate



Front: Chow Chung-kong

From left to right: Lincoln Leong Kwok-ken, William Chan Fu-keung, Russell John Black, Francois Lung Ka-kui, Andrew McCusker, Leonard Bryan Turk, Thomas Ho Hang-kwong

Commissioner for Transport (Alan Wong Chi-kong 52, joined the Board as a non-executive Director appointed as an “additional director” under section 8 of the MTR Ordinance by virtue of his appointment to the post of the Commissioner for Transport of the Government of the Hong Kong SAR on 18 June 2005. Prior to that, Mr. Wong has served in various bureaux and departments of the Government of the Hong Kong SAR including the Home Affairs Bureau, Civil Service Bureau, the former Urban Services Department, the former City and New Territories Administration, the former Health and Welfare Branch, the former Recreation and Culture Branch, the former Secretariat of the University and Polytechnic Grants Committee, the former Trade and Industry Branch, the Office of the Commissioner of Insurance from August 1996 to January 2000, the Mandatory Provident Fund Schemes Authority from January 2000 to June 2001, the former Information Technology

Services Department from July 2001 to July 2004, and the Office of the Government Chief Information Officer from July 2004 to January 2005. As Commissioner for Transport, Mr. Wong is also a director of several transport-related companies, including The Kowloon Motor Bus Company (1933) Limited, Long Win Bus Company Limited, New World First Bus Services Limited, New Lantao Bus Company (1973) Limited, Citybus Limited, The Star Ferry Company Limited, The New Hong Kong Tunnel Company Limited, Western Harbour Tunnel Company Limited, Tate’s Cairn Tunnel Company Limited and Route 3 (CPS) Company Limited.)

Secretary for Transport and Housing (Eva Cheng 47, joined the Board as a non-executive Director appointed as an “additional director” under section 8 of the MTR Ordinance on 1 July 2007 upon her appointment as the Secretary for Transport and Housing of the Government of the

Hong Kong SAR. Ms. Cheng has served in various bureaux and departments of the Government of the HKSAR since 1983. Before joining the Transport and Housing Bureau, Ms. Cheng was the Permanent Secretary for Economic Development. She is a graduate of the University of Hong Kong and holds a Bachelor of Social Science degree.)

Professor Chan Ka-keung, Ceajer 51, joined the Board as a non-executive Director on 10 July 2007 after his appointment as the Secretary for Financial Services and the Treasury of the Government of the Hong Kong SAR with effect from 1 July 2007. He received his bachelor's degree in economics from Wesleyan University in the US and both his M.B.A. and Ph.D. in finance from the University of Chicago. Professor Chan sits on the boards of several public bodies including the Mandatory Provident Fund Schemes Authority and The Hong Kong Mortgage Corporation Limited and is the Chairman of the Kowloon-Canton Railway Corporation in his official capacity. Before joining the Government, Professor Chan was Dean of Business and Management of the Hong Kong University of Science and Technology from 1 July 2002. He was also an independent non-executive Director of Shui On Construction and Materials Limited from 1 June 2005 to 30 June 2007.

Members of the Executive Directorate

Chow Chung-kong Biographical details are set out on page 102.

Russell John Black 61, has been the Projects Director of the Company since 1992. He is responsible for the planning and implementation of all major railway extension and upgrade projects, which have included the Airport Railway project and the Tseung Kwan O Extension project. Currently under construction is the Kowloon Southern Link, and under planning and design are the West Island Line, the South Island Line, the Guangzhou-Shenzhen-Hong Kong Express Rail Link and the Shatin to Central Line. He also provides project management expertise to the Company's railway projects in the Mainland of China. Mr. Black initially worked for the Company from 1976 to 1984 and, prior to rejoining the Company in 1992, he was the Project Director of London Underground's Jubilee Line Extension project. He also worked on Singapore's underground railway and on the Eastern Harbour Crossing. Mr. Black served on the Vocational Training Council from 1998 to 2002, the Construction Advisory Board from 1993 to 1999, the Provisional Construction Industry Coordination Board from 2001 to January 2007 and the Construction Industry Council since February

2007. Mr. Black holds an honours degree in civil engineering from the University of Canterbury in New Zealand. In 2006, he was elected an International Fellow of The Royal Academy of Engineering. He is also a Fellow of the Hong Kong Academy of Engineering Sciences, the Hong Kong Institution of Engineers and the Institution of Professional Engineers, New Zealand. He was awarded the Public Service medal (PBM) in Singapore in 1986 and the Bronze Bauhinia Star medal in 1999.

William Chan Fu-keung 59, has been the Human Resources Director since August 1998. He joined the Company as Human Resources Manager in 1989. He is responsible for human resource management, people development, operations and management training, administration and security management. Prior to joining the Company, Mr. Chan held senior managerial positions both in the commerce and in the utility sectors in Hong Kong, including the Government, the Hong Kong Productivity Council, Hutchison Whampoa Limited and Hong Kong Telecommunications Limited. He is a fellow member of the Hong Kong Institute of Human Resource Management since 1985 and is also the Vice President of the Institute. He is a Council member of Employers' Federation of Hong Kong, a member of the Remuneration Committee of the Hong Kong Housing Society, the Standing Committee on Disciplined Services Salaries and Conditions of Service and the Career Development and Advisory Board for a number of universities. Mr. Chan received a Bachelor of Social Science degree from The University of Hong Kong in 1971, majoring in economics.

Thomas Ho Hang-kwong 57, has served as the Property Director since joining the Company in 1991. He is responsible for the development and management of all properties above and adjacent to MTR stations and depots. He leads a multi-disciplinary team of managers involved in the planning, design, construction and management of large-scale property developments. Between 1971 and 1990, Mr. Ho worked for the Hong Kong Government specialising in land administration and latterly held a directorate post in the Lands Department, responsible for formulating policies and procedures to make land available for the airport and the Airport Railway project. Mr. Ho was qualified in 1974 as a chartered surveyor in Hong Kong. He is serving The Community Chest of Hong Kong as a Member of the Campaign Organising Committee and a Co-Chairman of the Corporate and Employee Contribution Programme.

Board and Executive Directorate

Lincoln Leong Kwok-kuen 47, has served as the Finance Director since February 2002. He is responsible for the financial management of all of the Company's affairs, including financial planning and control, budgeting, accounting and reporting and the treasury function. In addition, he has responsibility for the Company's information technology function and serves as chairman of both Octopus Holdings Limited and the board of trustees of the Company's retirement schemes. Mr. Leong graduated from Cambridge University in 1982 and later qualified as a chartered accountant in England in 1985 and Canada in 1986. Prior to joining the Company as Finance Director, he worked in both the accountancy and investment banking industries. Mr. Leong has also worked as an accountant in London and Vancouver, Canada and for a number of years as an investment banker in Hong Kong. Mr. Leong is the chairman of the executive committee of the Hong Kong Society for the Protection of Children, a member of the supervisory board of the Hong Kong Housing Society, a board member of the Community Chest and a non-official member of the Family Council. He also serves on the Board of Governor of the Chinese International School and is a trustee of the Hospital Authority Pension Fund Scheme. Mr. Leong is also a non-executive director of both Hong Kong Aircraft Engineering Company Limited and Tai Ping Carpets International Limited.

Francois Lung Ka-kui 49, has served as the China & International Business Director since September 2005. He heads the Company's growth-business efforts, including investments in Mainland of China, operating franchises in Europe and international consultancy. Dr. Lung has held various positions in a number of Royal Dutch Shell affiliates since 1997 and joined the Company from Shell Eastern Petroleum (Pte) Ltd. He was the General Manager, China, with responsibility for strategy development, governance and business performance of Shell's gas and power business in China. From 1994 to 1997, he held positions at Duke Energy Asia Limited, an affiliate of Duke Energy International, becoming Vice-President in 1996. Prior to this, Dr. Lung spent approximately five years at PowerGen plc, a major generator, distributor and retailer of electricity in the United Kingdom, and three years at the Central Electricity Generating Board before the privatisation of the electricity industry in the

United Kingdom. Dr. Lung holds a Bachelor of Science degree in Mechanical Engineering from the University of Hong Kong, a PhD in Combustion from the University of Leeds in the United Kingdom, a Master of Science degree in Management from the University of Southampton in the United Kingdom and a Bachelor of Law degree from the University of London. Dr. Lung was admitted to the Bar of the United Kingdom in 1992.

Andrew McCusker 62, has served as the Operations Director since December 2005. Mr. McCusker has more than 40 years of experience in the operating, engineering and projects fields in Defence, Power, Water and Rail Industries. He joined the Company as Operations Engineering Manager in 1987, and since then has been posted to other responsible positions, including Operations Engineering Design Manager, Project Manager (Operations) and General Manager (Operations). He was appointed Deputy Operations Director in March 2004 and Acting Operations Director in October 2005. Mr. McCusker holds a degree in Mechanical Engineering from the Kensington University in the United States and is a chartered member of both the Institution of Mechanical Engineers of the United Kingdom and the Chartered Institute of Personnel and Development (U.K.). In 2007, he was awarded the prestigious Steve Maxwell Leadership Award from the Australian Asset Management Council.

Leonard Bryan Turk 58, is a solicitor admitted to practise both in England and Wales and in Hong Kong. He joined the Company in 1981 and has been Legal Director & Secretary to the Board since 1988. Mr. Turk is responsible for legal advice, corporate secretarial services, insurance, procurement and enterprise risk management functions within the Company. His responsibilities include matters of corporate governance as well as construction contracts, contract administration and dispute resolution. Before joining the Company, Mr. Turk worked in England, concentrating particularly on commercial property development and the financing of large projects.

Key Corporate Management

Chow Chung-kong
Chief Executive Officer

Operations

Andrew McCusker
Operations Director

Li Yun-tai
Deputy Operations Director

Wilfred Lau Cheuk-man
Head of Operations

Tony Yeung Sau-on
General Manager – Operations Development

Jacob Kam Chak-pui
Head of Operations Engineering

Franco Fabbian
General Manager – Technical Engineering Services & International Consultancy

David Leung Chuen-choi
General Manager – Infrastructure

Yuen Wah-hi
Rolling Stock Workshop Manager

Tony Lee Kar-yun
Rolling Stock Fleet Manager

George Lee Kai-wing
General Manager – Safety & Quality

Ho Chun-wing
Planning & Development Manager

Carmen Li Wai-ching
General Manager – Intercity & Freight

Leung Kwok-yiu
Operations Manager – EAL & MOL

Choi Tak-tsan
Operations Manager – ISL & TKL

Paul Chin Kam-wah
Operations Manager – KTL & TWL

Lai Dor-fuk
Operations Manager – AEL, TCL & DRL

Selwyn Lai Sau-heem
Operations Manager – WRL & LRL

China & International Business

Francois Lung Ka-kui
China & International Business Director

David Tang Chi-fai
General Manager – Central & Southern China

Richard Wong Shiu-ki
General Manager – Beijing & Tianjin

Adi Lau Tin-shing
General Manager – Shenzhen Line 4

Antonio Choi Fung-chung
Chief Project Manager – Shenzhen Line 4

Alvin Luk Wing-kwok
Chief Project Manager – Shanghai

Lee Tze-man
Deputy General Manager – Project

Jeremy Long
Chief Executive Officer – European Business

Richard Drake
Finance Director – European Business

Jonathan Dring
Commercial Manager – European Business

Kelson Chan Chi-kun
Strategy & Planning Manager

Projects

Russell Black
Projects Director

Lee Kang-kuen
Deputy Projects Director

Henry Lam Hing-cheung
General Manager – KSL

David Sorton
Project Manager – Civil

Paul Lo Po-hing
General Manager – XRL/MP

Roderic Hockin
General Manager – WIL/SIL

Barry Hill
Project Manager – WIL/SIL E&M

Joseph Choi Kin-hung
General Manager – SCL

Malcolm Gibson
Head of Project Engineering

Wilfred Yeung Sze-wai
Chief Architect

Stephen Chik Wai-keung
Chief Civil & Planning Engineer

Leung Chi-lap
Chief E&M Engineer

William Leung Hon-wai
Head of Merger Integration

Ringo Lo Tze-shut
Head of Corporate Efficiency

Glenn Frommer
Head of Sustainability Development

Property

Thomas Ho Hang-kwong
Property Director

Victor Chan Hin-fu
General Manager – Property Development

Terence Chan Pak-hang
General Manager – Property Project

Angus Cheng Siu-chuen
General Manager – Investment Properties & Management

Steve Yiu Chin
General Manager – Town Planning

James Hor Wai-hong
Chief Development Manager

Emily Chan Sau-ching
Chief Development Manager

Andy Tong Sze-hang
Chief Project Manager-Property

Edward Wong Koon-pong
Chief Project Manager-Property

Betty Leong Sin-ling
Chief Retail Development Manager

Candy Ng Chui-lok
Chief Shopping Centre Manager

Gary Lau Wai-keung
Chief Property Manager

Sammy Yu Ka-yin
Chief Property Manager

Maria S. Sze Mang-kwan
Chief Property Manager

Matthew Wong Siu-wing
Chief Technical Manager

Finance

Lincoln Leong Kwok-kuen
Finance Director

Jimmy Lau Chiu-chung
General Manager – Financial Control & Treasury

Herbert Hui Leung-wah
General Manager – Corporate Finance

Jeff Kwan Wai-hung
Treasurer

Daniel Lai Sik-cheung
Head of Information Technology

Denise Ng Kee Wing-man
Head of Investors Relations and Retirement Benefits

Leung Chi-choi
Stores Manager

Sunny Lui Siu-sun
Financial Controller-Railway Operations & Property

Raymond Chan Wai-man
Financial Controller-Corporate Services

Lisa Seto Siu-wah
Financial Controller-Projects

Legal & Procurement

Leonard Turk
Legal Director & Secretary

David Fleming
Deputy Legal Director

Martin Dunn
General Manager – Procurement & Contracts

Teresa Tang Sui-ching
Procurement & Contracts Manager – Operations

Lila Fong Man-lee
Legal Manager – Company Secretarial

Linda Li Sau-lin
Legal Manager – Property

Gillian Meller
Legal Manager – General

Ivan Lai Ching-kai
Enterprise Risk Manager

Human Resources & Administration

William Chan Fu-keung
Human Resources Director

Vincent Luk Kin-ping
General Manager – Human Resources

Alison Wong Yuen-fan
Human Resources Manager – China & International Business

Chester Tsang Wing-cheong
Management Training & Development Manager

Steven Cho Yan-ming
Training Manager – Operations

Lok Ka-sui
Administration & Security Manager

Amy Kong Ming-chu
People Development Manager

Katy Lam Kwun-yi
Organisation Development Manager

Marketing

Jeny Yeung Mei-chun
General Manager – Marketing & Station Commercial

Eddie So Chung-tat
Senior Manager – Fare & Business Planning

Stella Kwan Mun-ye
Senior Manager – Media Business

Paul Ho Nai-man
Senior Manager – Business Development

Victor Leung Wai-keung
Senior Manager – Service Planning & Branding

Corporate Relations

Miranda Leung Chan Che-ming
General Manager – Corporate Relations

May Wong May-kay
Senior Manager – Corporate Relations

Maggie So Man-kit
Senior Manager – Projects & Property Communications

Ida Leung Pik-fu
Senior Manager – External Affairs

Internal Audit

Stanley Woo Kam-ming
Head of Internal Audit

Nelson Hung Yat-keung
Senior Internal Audit Manager

Octopus Holdings Limited

Prudence Chan
Chief Executive Officer

TraxComm Limited

Paul Ho Nai-man
Chief Executive Officer

Ngong Ping 360 Limited

Morris Cheung Siu-wa
Managing Director

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 2007.

Principal Activities of the Group

The principal activities of the Company and its subsidiaries are:

A the operation of a modern 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), from Hong Kong to the Hong Kong International Airport and then AsiaWorld-Expo both at Chek Lap Kok (Airport Express Line), from Sunny Bay to Disneyland Resort (Disneyland Resort Line), from East Tsim Sha Tsui to the boundary at Lo Wu and Lok Ma Chau (East Rail Line), from Tai Wai to Wu Kai Sha (Ma On Shan Line), from Nam Cheong to Tuen Mun (West Rail Line), the North-west Railway (commonly known as Light Rail) in the North-West New Territories of Tuen Mun, Tin Shui Wai and Yuen Long, an intercity railway system between Hong Kong and some major cities in the Mainland of China, and a freight railway system along East Rail Line from the boundary at Lo Wu to Sheung Shui Abattoir and Hung Hom;

B property development, either as owner or as agent for KCRC, at locations relating to the railway system including the Tseung Kwan O Line, the Ma On Shan Line, the East Rail Line, the Light Rail and the West Rail Line;

C related commercial activities, including the letting of advertising and retail space, bandwidth services on the railway telecommunication system, property management and leasing management of investment properties (including shopping centres and offices), and Octopus Card Building Access System services;

D the operation of the 7-year London Overground Concession, in which the Company has a 50% equity share, consisting of 107.2 route kilometres of commuter railway lines connecting London's suburbs into the London Underground network;

E the design and construction of a station at LOHAS Park (in Tseung Kwan O South) as an extension of the Tseung Kwan O Line;

F project management for the Kowloon Southern Link as an extension of the West Rail Line;

G the planning and construction of future extensions to the railway system and other related infrastructure projects, in particular the West Island Line and the South Island Line for which Government has confirmed policy support;

H the operation of the Tung Chung to Ngong Ping Cable Car System and the Theme Village in Ngong Ping, Lantau Island, Hong Kong;

I 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;

J investment in Octopus Holdings Limited, a subsidiary of the Company, which has business activities both in Hong Kong and overseas including the operation of a smart card system by its subsidiary Octopus Cards Limited for the collection of payments for both transport and non-transport applications in Hong Kong;

K equity investments and long term operation and maintenance contracts outside of Hong Kong;

L property management, shopping centre investment and railway related property development business in the Mainland of China; and

M the investment in, and construction of, Beijing Metro Line 4, in which the Company has a 49% equity interest, for future operations under a 30 year concession agreement with the Beijing Municipal Government.

In addition to the above, a Feasibility Study Report for Shenzhen Line 4 has been submitted to National Development and Reform Commission for approval. The Company continues the discussion of the Report with Shenzhen Municipal Government.

Dividend

The Directors have recommended a final dividend of HK\$0.31 per Ordinary Share to be payable to shareholders whose names appear on the Register of Members of the Company on 15 April 2008. Subject to the passing of the necessary resolutions at the forthcoming Annual General Meeting, such dividend will be payable on or about 18 June 2008, in cash in Hong Kong dollars, with a scrip dividend alternative. The Company's majority shareholder, The Financial Secretary Incorporated, has agreed to elect to receive all or part of its entitlement to dividends in the form of scrip to the extent necessary to ensure that a maximum of 50% of the total dividend paid by the Company will be in the form of cash.

Members of the Board

Members of the Board who served during the year were Raymond Ch'ien Kuo-fung (non-executive Chairman), Chow

Chung-kong (Chief Executive Officer), Cheung Yau-kai, David Gordon Eldon, Christine Fang Meng-sang, Edward Ho Sing-tin, Lo Chung-hing, Ng Leung-sing and Abraham Shek Lai-him [both appointed with effect from 18 December 2007], T. Brian Stevenson, Frederick Ma Si-hang [resigned with effect from 10 July 2007], Chan Ka-keung, Ceajer [appointed with effect from 10 July 2007], the Secretary for the Environment, Transport and Works (Sarah Liao Sau-tung) [ceased to be a Member of the Board with effect from 1 July 2007], the Secretary for Transport and Housing (Eva Cheng) [appointed by the Chief Executive of the HKSAR with effect from 1 July 2007] and the Commissioner for Transport (Alan Wong Chi-kong).

In July 2007, Raymond Ch'ien Kuo-fung was re-appointed as the non-executive Chairman of the Company with effect from 1 August 2007 for a term up to 31 December 2007 or the day to be appointed by the Secretary for Transport and Housing by notice published in the Gazette under the Rail Merger Ordinance, whichever was the earlier. The Rail Merger Ordinance relates to the Rail Merger between the Company and KCRC. On 8 August 2007, the Government of HKSAR appointed Raymond Ch'ien Kuo-fung as the non-executive Chairman for a term of 24 months and selected Chow Chung-kong as the Chief Executive Officer of the Company, with effect from the Rail Merger. The Rail Merger took effect on 2 December 2007.

At the Annual General Meeting on 7 June 2007 and pursuant to the Articles of Association, Chow Chung-kong, David Gordon Eldon and Christine Fang Meng-sang retired under the Articles of Association and were re-elected as Members of the Board.

At the forthcoming Annual General Meeting and in accordance with the Articles of Association, Edward Ho Sing-tin and Lo Chung-hing will retire by rotation. Chan Ka-keung, Ceajer, Ng Leung-sing and Abraham Shek Lai-him, who were appointed by the Board after the 2007 Annual General Meeting, will retire under Article 85 of the Articles of Association.

Biographical details for Board Members are set out on pages 101 to 105.

Alternate Directors

The Alternate Directors in office during the year were:

- for Frederick Ma Si-hang (until he resigned as a Member of the Board on 10 July 2007): Alan Lai Nin, Martin McKenzie Glass [ceased on 19 April 2007] and Leung Cheuk-man [with effect from 19 April 2007];

- for Chan Ka-keung, Ceajer (who became a Member of the Board with effect from 10 July 2007): Alan Lai Nin [ceased on 5 November 2007], Ying Yiu-hong [with effect from 5 November 2007] and Leung Cheuk-man;
- for the office of the Secretary for the Environment, Transport and Works (until the office ceased to be a Member of the Board on 1 July 2007): (i) the Permanent Secretary for the Environment, Transport and Works (Joshua Law Chi-kong) and (ii) the Deputy Secretary for the Environment, Transport and Works (Patrick Ho Chung-kei, Chu Man-ling, Annie Choi Suk-han [who ceased to be the Deputy Secretary for the Environment, Transport and Works and accordingly ceased to be an alternate director to the office of the Secretary for the Environment, Transport and Works], Yung Wai-hung and Lee Lai-yee [with effect from 2 May 2007]);
- for the office of the Secretary for Transport and Housing (the office became a Member of the Board with effect from 1 July 2007): (i) the Permanent Secretary for Transport and Housing (Transport) (Joshua Law Chi-kong [who ceased to be the Permanent Secretary for Transport and Housing (Transport) and accordingly ceased to be an alternate director to the office of the Secretary for Transport and Housing] and Ho Suen-wai [with effect from 15 August 2007]) and (ii) the Deputy Secretary for Transport and Housing (Transport) (Patrick Ho Chung-kei [who ceased to be the Deputy Secretary for Transport and Housing (Transport) and accordingly ceased to be an alternate director to the office of the Secretary for Transport and Housing], Chu Man-ling, Yung Wai-hung and Lee Lai-yee); and
- for the Commissioner for Transport: the Deputy Commissioner for Transport/Transport Services and Management (Carolina Yip Lai-ching).

Executive Directorate

The Members of the Executive Directorate who served during the year were Chow Chung-kong (Chief Executive Officer and a Member of the Board), Russell John Black, William Chan Fu-keung, Thomas Ho Hang-kwong, Lincoln Leong Kwok-kuen, Francois Lung Ka-kui, Andrew McCusker and Leonard Bryan Turk.

Biographical details for Members of the Executive Directorate during the year are set out on pages 105 and 106.

Internal Audit

The Company's Internal Audit Department provides independent, objective assurance and consulting services

Report of the Members of the Board

designed to add value and improve the Company's operations. Key responsibilities of the Department include:

- Assessment of the adequacy and effectiveness of the Company's system of internal controls over its activities and risk management.
- Identification of opportunities for improving management control, resources utilisation and profitability.
- Special reviews and/or investigations as commissioned by Company management or the Audit Committee.

The Head of Internal Audit reports directly to the Chief Executive Officer and has direct access to the Audit Committee.

Business Ethics

Please refer to page 96.

Policies

The Board has adopted the following risk management strategies and policies:

- A** Construction and Insurance Risk Management Strategy;
- B** Finance Risk Management Strategy;
- C** Treasury Risk Management Strategy;
- D** Safety Risk Management Strategy;
- E** Enterprise Risk Management Strategy;
- F** Security Risk Management Policy; and
- G** Environmental Risk Management Policy.

Public Float

The Stock Exchange granted to the Company, at the time of its listing on the Main Board of the Stock Exchange in 2000, a waiver from strict compliance with Rule 8.08(1) of the Listing Rules ("Public Float Waiver"). Pursuant to the Public Float Waiver, the Company's prescribed minimum percentage of shares which must be in the hands of the public must not be less than 10% of the total issued share capital of the Company. Based on the information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained the prescribed amount of public float during the year and up to the date of this report as required by the Public Float Waiver.

Bank Overdrafts, Bank Loans and Other Borrowings

The total borrowings of the Group as at 31 December 2007 amounted to HK\$34,050 million (2006: HK\$28,152 million). Particulars of borrowings including bank overdrafts and bank loans are set out in note 38 to the accounts.

Accounts

The state of affairs of the Company and the Group as at 31 December 2007 and of the Group's results, changes in equity and cash flows for the year are set out in the accounts on pages 127 to 214.

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 82 to 83.

Fixed Assets and Railway Construction in Progress

Movements in fixed assets and railway construction in progress during the year are set out in notes 18 to 20 and 22 to the accounts respectively.

Movements in Reserves

Movements in reserves during the year are set out in notes 45 and 46 to the accounts.

Share Capital

As at 31 December 2006, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,548,613,951 of which were issued and credited as fully paid. During the year, the Company issued a total of 62,443,084 Ordinary Shares. Of this number:

- A** 2,562,500 Ordinary Shares were issued by the Company pursuant to the exercise of share options which had been granted under the Company's Pre-Global Offering Share Option Scheme (as referred in note 45 to the accounts). In respect of each Ordinary Share issued, the relevant exercise price per share of options is HK\$8.44 to the Company;
- B** 129,000 Ordinary Shares were issued by the Company pursuant to the exercise of share options which had been granted under the Company's New Joiners Share Option Scheme (as referred in note 45 to the accounts). In respect of each Ordinary Share issued, the relevant exercise price per share of options are HK\$9.75, HK\$15.45 and HK\$19.104 to the Company;
- C** 39,183,554 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 2006 (for which the cash dividend was HK\$0.28 per Ordinary Share); and
- D** 20,568,030 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 2007 (for which the cash dividend was HK\$0.14 per Ordinary Share).

As at 31 December 2007, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,611,057,035 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 2007.

Properties

Particulars of the principal investment properties and properties held for sale of the Company are shown on pages 54 to 55.

Donations

During the year, the Company donated a total of HK\$193,000 to charitable organisations.

The MTR HONG KONG Race Walking 2007 raised over HK\$1 million for the Hospital Authority Health InfoWorld health education campaign.

The Company helped raise funds for the Community Chest with a total cash donation of over HK\$1 million through different activities such as CARE Scheme, Skip Lunch Day and Dress Special Day.

In early 2008, the Company donated HK\$1 million to the Hong Kong Red Cross and HK\$1 million to the All-China Federation of Railway Trade Unions for the relief work in relation to the snowstorms on the Mainland. Charity counters were set up at its shopping malls to help raise funds for this cause.

Reporting and Monitoring

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

Syndicated Loan Raised

In October 2007, the Group signed a HK\$10 billion syndicated loan facility with a group of 19 major banks from Hong Kong, Mainland China, Japan, Europe and the US to meet the Group's general corporate funding requirements, including partial payment of the HK\$12.04 billion upfront payment to KCRC on the Appointed Day for the Rail Merger.

Computer Processing

There are defined procedures, controls 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, help desk operation and support services, and also software development and maintenance, have been certified under ISO 9001:2000. Disaster recovery rehearsal on critical applications is conducted annually.

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), which subsisted at the end of the year or at any time during the year.

Report of the Members of the Board

Board Members' and Executive Directorate's Interests in Shares

As at 31 December 2007, the interests or short positions of the Members of the Board and the Executive Directorate in the shares, underlying shares and debentures of the Company (within the meaning of Part XV of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code were as follows:

Long Positions in Shares and Underlying Shares of the Company

Member of the Board or Executive Directorate	Number of Ordinary Shares held			Derivatives		Total interests	Percentage of aggregate interests to total issued share capital
	Personal* interests	Family† interests	Corporate interests	Share Options	Other		
Raymond Ch'ien Kuo-fung	50,369	–	–	–	–	50,369	0.00090
Chow Chung-kong	–	–	–	720,000 (Note 1)	418,017 (Note 2)	1,138,017	0.02028
T. Brian Stevenson	4,790	–	–	–	–	4,790	0.00009
Christine Fang Meng-sang	1,712	–	–	–	–	1,712	0.00003
Russell John Black	55,152	–	–	170,000 (Note 1)	–	225,152	0.00401
William Chan Fu-keung	46,960	–	–	(i) 217,500 (Note 3) (ii) 170,000 (Note 1)	–	434,460	0.00774
Thomas Ho Hang-kwong	55,037	2,541	–	(i) 321,000 (Note 3) (ii) 170,000 (Note 1)	–	548,578	0.00978
Lincoln Leong Kwok-kuen	23,000	–	23,000 (Note 4)	(i) 1,043,000 (Note 5) (ii) 170,000 (Note 1)	160,000 (Note 6)	1,419,000	0.02529
Francois Lung Ka-kui	46,000	2,500	–	(i) 1,066,000 (Note 5) (ii) 130,000 (Note 1)	–	1,244,500	0.02218
Andrew McCusker	–	–	–	170,000 (Note 1)	–	170,000	0.00303
Leonard Bryan Turk	–	–	–	170,000 (Note 1)	–	170,000	0.00303
Ho Suen-wai (Note 7)	681	1,371	–	–	–	2,052	0.00004

Notes

- Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the 2007 Share Option Scheme.
 - Chow Chung-kong has a derivative interest in respect of 418,017 shares in the Company within the meaning of Part XV of the SFO. That derivative interest represents Mr. Chow's entitlement to receive an equivalent value in cash of 418,017 shares in the Company on completion of his three-year contract (on 30 November 2009).
 - Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the Pre-Global Offering Share Option Scheme.
 - The 23,000 shares are held by Linsan Investment Ltd., a private limited company beneficially wholly owned by Lincoln Leong Kwok-kuen.
 - Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the New Joiners Share Option Scheme.
 - Lincoln Leong Kwok-kuen has a derivative interest in respect of 160,000 shares in the Company within the meaning of Part XV of the SFO. That derivative interest represents Mr. Leong's entitlement to receive an equivalent value in cash of 160,000 shares in the Company on 9 April 2010.
 - The office of the Permanent Secretary for Transport and Housing (Transport) is an Alternate Director to the office of the Secretary for Transport and Housing (Eva Cheng). The Secretary for Transport and Housing is a non-executive Director of the Company. Ho Suen-wai is the holder of the post of the Permanent Secretary for Transport and Housing (Transport).
- * Interests as beneficial owner
† Interests of spouse or child under 18 as beneficial owner

Options to Subscribe for Ordinary Shares Granted under the Pre-Global Offering Share Option Scheme, as Referred to in Notes 7B(i) and 47A(i) to the Accounts

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2007	Options vested during the year	Options lapsed during the year	Options exercised during the year	Exercise price per share of options (HK\$)	Options outstanding as at 31 December 2007	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
William Chan Fu-keung	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	217,500	–	–	–	8.44	217,500	–
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	321,000	–	–	–	8.44	321,000	–
Other eligible employees	20/9/2000	41,409,000	5/4/2001 – 11/9/2010	7,291,000	–	–	2,562,500	8.44	4,728,500	23.14

Notes

- The Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") is valid and effective for a period of ten years after 12 September 2000. No option may be offered to be granted under the Pre-IPO Option Scheme on or after the commencement of dealings in shares of the Company on Stock Exchange on 5 October 2000.
- The number of shares to which the option granted to each participant under the Pre-IPO Option Scheme does not exceed 25% of the number of the shares issued and issuable under the Pre-IPO Option Scheme.

Options to Subscribe for Ordinary Shares Granted under the New Joiners Share Option Scheme, as Referred to in Notes 7B(ii) and 47A(ii) to the Accounts

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2007	Options granted during the year	Options vested during the year	Options lapsed during the year	Options exercised during the year	Exercise price per share of options (HK\$)	Options outstanding as at 31 December 2007	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
Lincoln Leong Kwok-kuen	1/8/2003	1,066,000	14/7/2004 – 14/7/2013	1,043,000	–	–	–	–	9.75	1,043,000	–
Francois Lung Ka-kui	22/3/2007	1,066,000	19/3/2008 – 19/3/2017	–	1,066,000	–	–	–	19.404	1,066,000	–
Other eligible employees	1/8/2003	495,200	14/7/2004 – 14/7/2013	268,200	–	–	–	66,000	9.75	202,200	21.51
	12/1/2006	94,000	9/1/2007 – 9/1/2016	94,000	–	31,500	–	31,500	15.45	62,500	22.90
	13/9/2005	94,000	9/9/2006 – 9/9/2015	94,000	–	31,500	–	–	15.97	94,000	–
	23/9/2005	213,000	9/9/2006 – 9/9/2015	213,000	–	71,000	–	–	15.97	213,000	–
	31/3/2006	94,000	20/3/2007 – 20/3/2016	94,000	–	31,500	–	–	18.05	94,000	–
	4/7/2006	94,000	19/6/2007 – 19/6/2016	94,000	–	31,500	–	–	18.30	94,000	–
	17/11/2006	94,000	13/11/2007 – 13/11/2016	94,000	–	31,500	–	31,500	19.104	62,500	24.20
	5/10/2006	94,000	29/9/2007 – 29/9/2016	94,000	–	31,500	–	–	19.732	94,000	–
	12/5/2006	266,500	25/4/2007 – 25/4/2016	266,500	–	89,000	–	–	20.66	266,500	–
	15/5/2006	213,000	25/4/2007 – 25/4/2016	213,000	–	71,000	–	–	20.66	213,000	–
	12/5/2006	213,000	2/5/2007 – 2/5/2016	213,000	–	71,000	–	–	21.00	213,000	–

Notes

- No option may be exercised later than ten years after its date of offer and no option may be offered to be granted more than five years after the adoption of the New Joiners Share Option Scheme ("New Option Scheme") on 16 May 2002.
- Unless approved by shareholders in the manner as required by the Listing Rules, the total number of shares issued and issuable upon exercise of the options granted to any eligible employee under the New Option Scheme together with the total number of shares issued and issuable upon the exercise of any option granted to such eligible employee under any other share option scheme of the Company (including, in each case, both exercised and outstanding options) in any 12-month period must not exceed 1% of the shares of the Company in issue at the date of offer in respect of such option under the New Option Scheme.

Report of the Members of the Board

Options to Subscribe for Ordinary Shares Granted under the 2007 Share Option Scheme, as Referred to in Notes 7B(iii) and 47A(iii) to the Accounts

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2007	Options granted during the year	Options vested during the year	Options lapsed during the year	Options exercised during the year	Exercise price per share of options (HK\$)	Options outstanding as at 31 December 2007	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
Chow Chung-kong	13/12/2007	720,000	10/12/2008 – 10/12/2014	–	720,000	–	–	–	27.60	720,000	–
Russell John Black	12/12/2007	170,000	10/12/2008 – 10/12/2014	–	170,000	–	–	–	27.60	170,000	–
William Chan Fu-keung	13/12/2007	170,000	10/12/2008 – 10/12/2014	–	170,000	–	–	–	27.60	170,000	–
Thomas Ho Hang-kwong	12/12/2007	170,000	10/12/2008 – 10/12/2014	–	170,000	–	–	–	27.60	170,000	–
Lincoln Leong Kwok-kuen	12/12/2007	170,000	10/12/2008 – 10/12/2014	–	170,000	–	–	–	27.60	170,000	–
Francois Lung Ka-kui	12/12/2007	130,000	10/12/2008 – 10/12/2014	–	130,000	–	–	–	27.60	130,000	–
Andrew McCusker	12/12/2007	170,000	10/12/2008 – 10/12/2014	–	170,000	–	–	–	27.60	170,000	–
Leonard Bryan Turk	12/12/2007	170,000	10/12/2008 – 10/12/2014	–	170,000	–	–	–	27.60	170,000	–
Other eligible employees	11/12/2007	45,000	10/12/2008 – 10/12/2014	–	45,000	–	–	–	27.60	45,000	–
	12/12/2007	1,750,000	10/12/2008 – 10/12/2014	–	1,750,000	–	–	–	27.60	1,750,000	–
	13/12/2007	915,000	10/12/2008 – 10/12/2014	–	915,000	–	–	–	27.60	915,000	–
	14/12/2007	1,005,000	10/12/2008 – 10/12/2014	–	1,005,000	–	–	–	27.60	1,005,000	–
	15/12/2007	435,000	10/12/2008 – 10/12/2014	–	435,000	–	–	–	27.60	435,000	–
	17/12/2007	835,000	10/12/2008 – 10/12/2014	–	835,000	–	–	–	27.60	835,000	–
	18/12/2007	445,000	10/12/2008 – 10/12/2014	–	445,000	–	–	–	27.60	445,000	–
	19/12/2007	115,000	10/12/2008 – 10/12/2014	–	115,000	–	–	–	27.60	115,000	–
	20/12/2007	190,000	10/12/2008 – 10/12/2014	–	190,000	–	–	–	27.60	190,000	–
	21/12/2007	45,000	10/12/2008 – 10/12/2014	–	45,000	–	–	–	27.60	45,000	–
	22/12/2007	35,000	10/12/2008 – 10/12/2014	–	35,000	–	–	–	27.60	35,000	–
	24/12/2007	118,000	10/12/2008 – 10/12/2014	–	118,000	–	–	–	27.60	118,000	–
	28/12/2007	35,000	10/12/2008 – 10/12/2014	–	35,000	–	–	–	27.60	35,000	–
	31/12/2007	130,000	10/12/2008 – 10/12/2014	–	130,000	–	–	–	27.60	130,000	–
2/1/2008	75,000	10/12/2008 – 10/12/2014	–	75,000	–	–	–	27.60	75,000	–	
3/1/2008	40,000	10/12/2008 – 10/12/2014	–	40,000	–	–	–	27.60	40,000	–	
4/1/2008	65,000	10/12/2008 – 10/12/2014	–	65,000	–	–	–	27.60	65,000	–	
7/1/2008	125,000	10/12/2008 – 10/12/2014	–	125,000	–	–	–	27.60	125,000	–	

Notes

- 1 No option may be exercised later than seven years after its date of offer and no option may be offered to be granted more than seven years after the adoption of the 2007 Share Option Scheme ("2007 Option Scheme") on 7 June 2007.
- 2 Unless approved by shareholders in the manner as required by the Listing Rules, the total number of shares issued and issuable upon exercise of the options granted to any eligible employee under the 2007 Option Scheme together with the total number of shares issued and issuable upon the exercise of any option granted to such eligible employee under any other share option scheme of the Company (including, in each case, both exercised and outstanding options) in any 12-month period must not exceed 0.2% of the shares of the Company in issue at the date of offer in respect of such option under the 2007 Option Scheme.
- 3 Share options granted during the period from 11 December 2007 to 7 January 2008 were offered to Members of the Executive Directorate and selected employees of the Company on 10 December 2007. Under the 2007 Option Scheme, the date of grant is defined as the date of acceptance of the offer to grant the option. Options granted in January 2008 have not been accounted for in the accounts for the year ended 31 December 2007.

During the year ended 31 December 2007, 1,066,000 options to subscribe for shares of the Company were granted to a Member of the Executive Directorate under the New Joiners Share Option Scheme. In addition, 1,870,000 and 6,403,000 options to subscribe for shares of the Company were granted to 8 Members of the Executive Directorate and 131 employees respectively under the 2007 Share Option Scheme during the period from 11 December 2007 to 7 January 2008. Details of the grant under these two Schemes are set out in the tables above.

The respective closing price per share immediately before the respective date of grant of the options under the two Schemes are set out below. Pursuant to the terms of both Schemes, each grantee undertakes to pay HK\$ 1.00, on demand, to the Company, in consideration for the grant of the options. The share options granted are recognised on an accrued vesting basis in the accounts. The weighted average value per option granted, estimated at the respective date of grant using the Black-Scholes pricing model is as follows:

Date granted	Closing price per share immediately before the date of grant (HK\$)	Estimated risk-free interest rate (%)	Expected life (Years)	Estimated Volatility	Expected dividend per share (HK\$)	Weighted average value per option granted (HK\$)
22/3/2007	19.32	3.96	5	0.21	0.42	3.79
11/12/2007	27.60	2.44	3.5	0.22	0.42	4.65
12/12/2007	27.90	2.48	3.5	0.22	0.42	4.85
13/12/2007	28.00	2.53	3.5	0.22	0.42	4.93
14/12/2007	27.30	2.67	3.5	0.22	0.42	4.55
15/12/2007	27.35	2.74	3.5	0.22	0.42	4.61
17/12/2007	27.35	2.74	3.5	0.22	0.42	4.61
18/12/2007	26.85	2.72	3.5	0.22	0.42	4.29
19/12/2007	27.00	2.73	3.5	0.22	0.42	4.39
20/12/2007	27.60	2.68	3.5	0.22	0.42	4.73
21/12/2007	27.95	2.78	3.5	0.22	0.42	4.99
22/12/2007	28.25	2.83	3.5	0.22	0.42	5.20
24/12/2007	28.25	2.83	3.5	0.22	0.42	5.20
28/12/2007	28.05	2.90	3.5	0.22	0.42	5.09
31/12/2007	28.05	2.86	3.5	0.22	0.42	5.07

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options and requires input of highly subjective assumptions, including the expected life and stock price volatility. Since the Company's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, the Black-Scholes option pricing model does not necessarily provide a reliable measure of the fair value of the share options.

Save as disclosed above:

A none of the Members of the Board or the Executive Directorate of the Company had any interest or short position in

the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO); and

B during the year ended 31 December 2007, no Member of the Board or the 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 352 of the SFO or otherwise notified to the Company and the HKSE pursuant to the Model Code.

Report of the Members of the Board

Directors' Service Contracts

No director proposed for re-election at the forthcoming Annual General Meeting has a service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than statutory compensation.

No Director has a service contract with the Company or any of its subsidiaries which is for a duration which may exceed three years or which requires the Company to, in order to terminate such contract, give a notice period in excess of one year or pay or make other payments equivalent to more than one year's emoluments.

Substantial Shareholders' Interests

Set out below is the name of the party which was interested in 5% or more of the nominal value of the share capital of the Company and the number of shares in which it was interested as at 31 December 2007 as recorded in the register kept by the Company under section 336 of the SFO:

Name	No. of Ordinary Shares	Percentage of Ordinary Shares to total issued share capital
The Financial Secretary Incorporated (in trust on behalf of the Government)	4,301,750,382	76.67

The Company has been informed by the Government that, as at 31 December 2007, approximately 0.90% of the shares of the Company were held for the account of the Exchange Fund. The Exchange Fund is a fund established under the Exchange Fund Ordinance (Cap. 66 of the Laws of Hong Kong) under the control of the Financial Secretary.

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

As at 31 December 2007, the Group had borrowings of HK\$33,695 million with maturities ranging 2008 to 2020 and undrawn committed and uncommitted banking and other facilities of HK\$17,920 million, which were subject to the condition that the Government, being the Company's controlling shareholder, owns more than half in nominal value of the voting share capital of the Company during the lives of the borrowings and the undrawn facilities. Otherwise, immediate repayment of borrowings may be demanded and cancellation of the undrawn facilities may result.

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 2007 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 2007 was attributable to the Company's five largest customers combined by value.

Going Concern

The accounts on pages 127 to 214 have been prepared on a going concern basis. The Board has reviewed the Company's budget for 2008, 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 were entered into (or were ongoing) with persons who are "connected persons" for the purposes of the Listing Rules:

(i) Merger-related Agreements

The Government is a substantial shareholder of the Company and KCRC is an associate of the Company, in each case as defined in the Listing Rules. The Government and KCRC are therefore connected persons of the Company, and the transactions listed in paragraphs B to K below are connected transactions for the Company. Consequently, the Company makes the disclosures below in accordance with Rule 14A.45 of the Listing Rules. Each of the transactions listed in paragraphs B to K below was approved by the independent shareholders of the Company at an Extraordinary General Meeting held on 9 October 2007.

A Payments in Connection with Merger-related Agreements

In connection with the Rail Merger, the following initial payments were made by the Company to KCRC on 2 December 2007 (being the Merger Date):

- an upfront payment of HK\$4.25 billion, payable under the Service Concession Agreement (as described in paragraph C below), being the upfront fee for the right to operate the Service Concession (as defined in paragraph C below) and the consideration for the purchased rail assets; and
- an upfront payment of HK\$7.79 billion payable under the Merger Framework Agreement (as described in paragraph B below) in consideration for the execution of the Property

Package Agreements (as described in paragraph J below) and the sale of the shares in subsidiary companies of KCRC (the “KCRC Subsidiaries”) that were transferred to the Company under the Sale and Purchase Agreement (as described in paragraph D below).

In addition to the initial payments above, the Company is also required to make the following payments to KCRC going forward:

- fixed annual payments of HK\$750 million payable under the Service Concession Agreement, for the right to use and operate the concession property for the operation of the service concession, in arrears on the day immediately preceding each anniversary of the Merger Date which falls during the concession period in respect of the 12 month period up to and including the date on which such payment falls due; and
- variable annual payments payable under the Service Concession Agreement, for the right to use and operate the concession property for the operation of the service concession, in each case, calculated on a tiered basis by reference to the amount of revenue from the KCRC system (as determined in accordance with the Service Concession Agreement) for each financial year of the Company. No variable annual payment is payable in respect of the first 36 months following the Merger Date.

As a complete package deal, other than the payment elements described above and unless stated otherwise in the relevant paragraph below, no specific allocation has been made between the various elements of the Rail Merger.

B Merger Framework Agreement

The Merger Framework Agreement was entered into on 9 August 2007 between the Company, KCRC and the Secretary for Transport and Housing and the Secretary for Financial Services and the Treasury for and on behalf of the Government.

The Merger Framework Agreement contains provisions for the overall structure and certain specific aspects of the Rail Merger, including in relation to:

- a seamless interchange programme;
- corporate governance of the Company Post-Rail Merger;
- payments relating to property enabling works;
- arrangements relating to the establishment of a rolling programme on the level of flat production arising from tenders for railway property development;

- arrangements in relation to the assessment of land premium amounts;
- arrangements in relation to the employees of the Company and KCRC, including provisions preventing the Company from terminating the employment of relevant frontline staff for any reason that relates to the process of integrating the operations of the Company and KCRC;
- the implementation of certain fare reductions;
- arrangements in relation to the proposed Shatin to Central Link;
- KCRC’s continuing responsibility for its existing financial arrangements;
- treatment of KCRC’s cross border leases (“CBLs”);
- the payment of HK\$7.79 billion in respect of the Property Package (as described in paragraph A above and in paragraph J below);
- the allocation of liability for any Pre-Rail Merger and Post-Rail Merger claims by third parties; and
- the Company’s retention of its English name and (pursuant to the MTR Ordinance) the change of its Chinese name to “香港鐵路有限公司”.

C Service Concession Agreement

The Service Concession Agreement was entered into on 9 August 2007 between the Company and KCRC.

The Service Concession Agreement contains provisions in relation to the grant and operation of a service concession and licence granted by KCRC to the Company (“Service Concession”), including in relation to:

- the grant of the Service Concession to the Company to access, use and operate the concession property (other than KCRC railway land referred to immediately below);
- the grant of a licence to access and use certain KCRC railway land;
- the term (being an initial period of 50 years from the Merger Date) of the Service Concession and redelivery of the KCRC system upon expiry or termination of the concession period. The Service Concession will end if the Company’s franchise relating to the KCRC railway is revoked;
- the provision by the Company, to specified standards, of certain services previously provided by KCRC;
- the payments of an upfront payment of HK\$4.25 billion and fixed annual payments and variable annual payments (as described in paragraph A above);

Report of the Members of the Board

- KCRC remaining the legal and beneficial owner of the concession property as at the Merger Date (known as “Initial Concession Property”) and the Company being the legal and beneficial owner of certain future concession property (“Additional Concession Property”);
- the regime for compensation payable by KCRC to the Company if Additional Concession Property is returned to KCRC at the end of the concession period;
- the rights and restrictions of the Company and KCRC in relation to the concession property (including, in relation to operation and maintenance, disposals, security, parting with possession, non-interference and insurance);
- the arrangements in relation to intellectual property rights;
- subject to certain conditions, the Company bearing all risks, liabilities and/or costs whatsoever associated with or arising from the concession property and the land on which any of the concession property is located during the concession period; and
- the arrangements for the return of concession property at the end of the Service Concession and mutual access arrangements which would be applicable if the Service Concession is terminated but the Company continues to operate the MTRC railway (but not the KCRC railway).

D Sale and Purchase Agreement

The Sale and Purchase Agreement was entered into on 9 August 2007 between the Company and KCRC.

The Sale and Purchase Agreement provides the terms pursuant to which the Company acquired certain assets and contracts (the “Purchased Rail Assets”) from KCRC and includes other terms relating to:

- intellectual property;
- apportionment;
- tenancies;
- receivables;
- certain provisions relating to employees; and
- sets out the representations and warranties given by KCRC in relation to the Purchased Rail Assets.

The consideration for the sale of the Purchased Rail Assets (excluding the shares in the KCRC Subsidiaries) formed part of the upfront payment of HK\$4.25 billion. The consideration for the sale of the shares in the KCRC Subsidiaries (which own the Category 1A Properties referred to at paragraph J below and act as property managers) formed part of the payment of HK\$7.79 billion for the property package (as described in paragraph A above and in paragraph J below).

E Operating Agreement

The Operating Agreement was entered into on 9 August 2007 between the Company and the Secretary for Transport and Housing for and on behalf of the Government as contemplated in the MTR Ordinance.

The Operating Agreement is based on the previous Operating Agreement which was signed on 30 June 2000. The Operating Agreement differs from the previous Operating Agreement to provide for, amongst other things, the nature of the combined MTRC railway and KCRC railway. The Operating Agreement includes terms relating to:

- the extension of the Company’s franchise under the MTR Ordinance;
- the access regime in relation to the common property of KCRC and the Company in the event of cessation of the franchise;
- the design, construction and maintenance of the railway;
- passenger services, including procedures and requirements relating to the disruption of train services, hours of operation, service capacity, performance requirements and customer service pledges;
- a framework for the award of new projects and the operation and ownership structure of new railways;
- the adjustment mechanism to be applied to certain of the Company’s fares;
- compensation which may be payable under the MTR Ordinance to the Company in relation to a suspension, expiry or termination of the franchise;
- dispute resolution;
- the provision of assistance to KCRC and Government by the Company upon the expiry or revocation of the franchise;
- review of the terms of the Operating Agreement;
- the furnishing of records in relation to the provision of passenger services;
- the external audit of the Company’s compliance with the customer service pledges and performance requirements set out in the Operating Agreement;
- consultation by Government with the Company before the introduction of new regulations under the MTR Ordinance; and
- the operation of the intercity passenger services and freight services.

F KSL Project Management Agreement

The KSL Project Management Agreement was entered into between the Company and KCRC on 9 August 2007.

Pursuant to the terms of the KSL Project Management Agreement (as amended), the Company is appointed:

- to manage the performance of KCRC's principal obligations to the Government in relation to the design and construction of the Kowloon Southern Link ("KSL") (other than obligations relating to payment);
- to act as the engineer under the various KSL construction contracts;
- to act as KCRC's representative under the various KSL consultancy agreements; and
- to act as KCRC's agent in connection with the KSL under certain circumstances.

The Company itself will not construct, nor be responsible for the costs of, the KSL works.

In return for the performance of these services, the Company will receive a project management fee of approximately HK\$710.8 million and, if the construction of the KSL is completed ahead of time and under budget, an incentive payment (calculated with reference to the amount by which the final outturn cost of the project is under budget) of up to HK\$110 million. The current internal KCRC budget for project management costs was analysed in detail and formed the basis of the fee to be received by the Company.

G West Rail Agency Agreement

The West Rail Agency Agreement and related agreements were entered into on 9 August 2007 between the Company, KCRC and certain KCRC subsidiary companies ("West Rail Subsidiaries"). Pursuant to the terms of the West Rail Agency Agreement, the Company was appointed:

- to act as KCRC's agent, and donee under powers of attorney, to exercise certain rights and perform certain obligations relating to specified development sites along West Rail; and
- to act as agent for, and donee under powers of attorney from, each of the West Rail Subsidiaries to exercise certain rights and perform certain obligations relating to specified development sites along West Rail.

The Company will receive an agency fee of 0.75% of the gross sale proceeds in respect of the unawarded West Rail development sites and 10% of the net profits accrued to the West Rail Subsidiaries under the development agreements in respect of the awarded West Rail development sites. The Company will also recover from the West Rail Subsidiaries its costs (including internal costs) incurred in respect of the West Rail development sites plus 16.5% on-cost, together with interest accrued thereon.

H Outsourcing Agreement

The Outsourcing Agreement was entered into on 9 August 2007 between the Company and KCRC. For the period from 2 December 2007 to 2 December 2009, KCRC, pursuant to the terms of the Outsourcing Agreement, has outsourced certain financial and administrative functions to the Company.

Pursuant to the terms of the Outsourcing Agreement, the Company:

- provides a number of financial and administrative services to KCRC;
- provides certain staff to enable KCRC to operate after the Rail Merger; and
- receives an annual fee of not more than HK\$20 million from KCRC.

The scope of the services to be provided by the Company includes services relating to treasury, financial control, information technology, company secretarial, legal and other corporate functions, human resources, office administration and management of claims.

I KCRC Cross Border Lease Agreements

US CBL Assumption Agreements

Separate US CBL Assumption Agreements were entered into on 30 November 2007 between the Company, KCRC and, variously, Wilmington Trust Company, Buoyant Asset Limited, BA Leasing & Capital Corporation, Utrecht-America Finance Co., Cooperatieve Centrale Raiffeisen-Boerenleenbank B.A., Advanced Asset Limited, Washoe Asset Management Company, Quality Asset Limited, Kasey Asset Limited, Key Equipment Finance Inc., Mercantile Leasing Company (No. 132) Limited, Landesbank Sachsen Aktiengesellschaft, Barclays Bank PLC, Bayerische Landesbank Girozentrale, U.S. Bank National Association, Circuit Asset Limited, Citicorp USA Inc., Shining Asset Limited, Banc of America FSC Holdings Inc., Fluent Asset Limited, Anzef Limited, Societe Generale, Australia and New Zealand Banking Group Limited, Statesman Asset Limited, State Street Bank and Trust Company and Bowman Asset Limited and became effective on 3 December 2007, with respect to each of the US cross border leases originally entered into between KCRC and certain counterparties (each, a "CBL"). Pursuant to each US CBL Assumption Agreement, the Company undertakes to perform, on a joint and several basis with KCRC, the obligations of KCRC under the respective CBLs. As a result thereof, the Company is generally liable to the CBL counterparties in respect of KCRC's obligations under the CBLs and has the right to exercise certain of KCRC's rights under the CBLs.

Report of the Members of the Board

US CBL Allocation Agreement

The US CBL Allocation Agreement was entered into between the Company, KCRC and the KCRC Subsidiaries on 2 December 2007. Pursuant to the US CBL Allocation Agreement, rights, obligations and responsibility for risks relating to the CBLs are delineated and allocated between KCRC and the Company (each of which is jointly and severally liable to specified CBL counterparties, as referred to in the paragraph above headed “US CBL Assumption Agreements”). Under the terms of the US CBL Allocation Agreement, as between the Company and KCRC, the Company is responsible for specified obligations. The Company and KCRC each made representations under the US CBL Allocation Agreement, which include, in the case of those made by KCRC, representations with respect to the status of the CBLs. The Company and KCRC agreed to indemnify each other for certain losses in relation to the CBLs.

J Property Package Agreements

Category 1A Properties

The Category 1A Properties are held by the KCRC Subsidiaries. Under the terms of the Sale and Purchase Agreement, the Company acquired from KCRC the shares in the KCRC Subsidiaries (and thereby indirectly acquired the “Category 1A Properties”).

Category 1B Properties

On 9 August 2007, KCRC and the Company entered into an agreement for sale of purchase under which KCRC agreed to assign certain properties (the “Category 1B Properties”) to the Company on the Merger Date. The relevant assignment was executed between KCRC and the Company on 2 December 2007.

Category 2A Properties

On 9 August 2007, the Government entered into an undertaking that it would, within twelve months of the Merger Date or such further period of time as the Government and the Company may agree, issue to KCRC an offer for the grant at nil premium of Government leases in respect of the land upon which certain properties (the “Category 2A Properties”) are situate. The Category 2A Properties are currently held by KCRC as vested land under the Kowloon-Canton Railway Corporation Ordinance (Cap. 372 of the Laws of Hong Kong) (“KCRC Ordinance”). On 9 August 2007, KCRC entered into an undertaking that it would, immediately after the grant of the Government leases referred to in the preceding sentence, enter into an agreement for sale and purchase to sell the Category 2A Properties to the Company. Assignment of the Category 2A Properties to the Company shall then take place pursuant to the agreement for sale and purchase. Pursuant to the KCRC undertaking and as interim

arrangements until the grant of the Government leases, on 9 August 2007 the following agreements were entered into between KCRC and the Company:

- an agreement that KCRC (as lessor) shall enter into tenancy agreements with the Company (as lessee) at market rent in respect of the Category 2A Properties’ vacant units (with the intention that the Company will then sub-let the vacant units to sub-tenants);
- two licence agreements in respect of the common areas within the Category 2A Properties, pursuant to which KCRC granted the Company the right to use certain common areas until the execution of the Category 2A Properties assignment referred to above;
- a lease enforcement agency agreement appointing the Company as its enforcement agent to enforce KCRC’s current Category 2A Properties tenancy agreements against tenants; and
- an assignment of rental proceeds whereby the proceeds received under KCRC’s current Category 2A Properties tenancy agreements with tenants are assigned to the Company.

Category 2B Property

On 9 August 2007, the Government entered into an undertaking that it would, within twenty four months of the Merger Date or such further period of time as the Government and the Company may agree, issue to the Company an offer for the grant of a Government Lease of a certain property (the “Category 2B Property”) on terms to be agreed. The Category 2B Property is currently held by KCRC as vested land under the KCRC Ordinance for use as staff quarters and a recreational club.

On 9 August 2007, KCRC entered into an undertaking relating to interim arrangements to ensure that, as from the Merger Date, the Company shall be responsible for KCRC’s obligations under licence agreements relating to the Category 2B Property, and for enforcing such agreements. The Company is entitled to proceeds received by KCRC in respect of those licence agreements. The interim arrangements include, inter alia, as from the Merger Date:

- an agreement that KCRC (as licensor) shall grant to the Company (as licensee) possession of the Category 2B Property (without payment of any licence fee or premium), subject to existing licences and the Second Schedule of the KCRC Ordinance, with the right of the Company to sub-license all or any part of the Category 2B Property (subject to it being used as staff quarters and a recreation club);

- until the grant of the Government lease of the Category 2B Property, KCRC has appointed the Company as its enforcement agent to enforce KCRC's current Category 2B Property licence agreements against licensees; and
- KCRC has assigned to the Company the proceeds received under KCRC's current Category 2B Property licence agreements with licensees.

Category 3 Properties

On 9 August 2007, the Company entered into three agreements (the "Category 3 Agreements") and related powers of attorney with KCRC. Each Category 3 Agreement relates to a certain property (each a "Category 3 Property"). KCRC has previously entered into a development agreement in respect of each Category 3 Property. None of the rights and obligations granted to or undertaken by the Company under the Category 3 Agreements may be exercised or performed by the Company if they relate exclusively to concession property situate on any Category 3 Property. Matters affecting the concession property situate on any Category 3 Property are dealt with under the terms of the Service Concession Agreement.

Pursuant to the terms of each Category 3 Agreement, the Company has been appointed to act as KCRC's agent, and donee under powers of attorney, to exercise rights and to perform obligations of KCRC which relate to the Category 3 Property (but excluding the right or obligation to dispose of the relevant Category 3 Property).

The Company is required at all times to comply with statutory restrictions and obligations binding on KCRC which relate to the Category 3 Property, and shall pay all amounts due and payable from KCRC which have been incurred by KCRC as a result of the Company's actions.

In acting as KCRC's agent, the Company is required to act according to prudent commercial principles, and aim to maximise gross profits under the Category 3 Property and to run a safe and efficient railway. In order to assist the Company in performing its agency functions, KCRC has granted powers of attorney to the Company. The Company may only use the powers of attorney to exercise rights and perform obligations conferred or undertaken by it under the relevant Category 3 Agreement. As well as acting as KCRC's agent, the Company has the right to give KCRC instructions in respect of any action or matter relating to each Category 3 Property (including its related development agreement) which the Company is unable to take by reason of the limitation of the scope of its agency powers. KCRC is required to comply promptly with those instructions provided that it is permitted under law, and under the relevant Government grant, to carry out those instructions.

KCRC is required to account for revenue received in respect of a Category 3 Property by way of balance sheet movement (rather than under its profit and loss account), provided that such treatment is permitted under law and accounting principles and practices.

KCRC shall not take any action in respect of a Category 3 Property which is not carried out by the Company (acting as KCRC's agent), or according to the Company's instructions, or otherwise in accordance with the terms of the Category 3 Agreement.

As consideration for acting as KCRC's agent, the Company shall be paid a fee which is expected to be similar in quantum to the profits made by KCRC in respect of the relevant Category 3 Property (after deducting certain initial and upfront payments and consultant contribution costs, in each case paid or to be paid by the relevant developer to KCRC). Generally, the Company's fee shall be payable in instalments promptly following receipt of relevant funds by KCRC (but subject to specified deductions of amounts due from KCRC to the relevant Category 3 Property developer).

The Company has agreed to give certain indemnities to KCRC in respect of each Category 3 Property.

The Company shall be the first manager, or shall ensure that a manager is appointed in respect of, each Category 3 Property (once developed).

The Company's appointment as agent shall terminate when KCRC ceases to have any undivided share in the relevant Category 3 Property, other than concession property, and neither KCRC nor the developer nor the guarantors have any further rights to exercise, or obligations to perform, under the development agreement relating to the relevant Category 3 Property.

Category 4 Properties

On 9 August 2007, the Government entered into an undertaking that it would, within periods to be agreed between the Company and the Government, offer to the Company a private treaty grant in respect of certain development sites ("Category 4 Properties"). The terms of each private treaty grant shall generally be determined by the Government, and the premium for each private treaty grant shall be assessed on a full market value basis ignoring the presence of the railway other than the Tin Shui Wai Terminus, Light Rail, Yuen Long, New Territories.

On 9 August 2007, the Company issued a letter to KCRC confirming that, if there should be any railway premises on the Category 4 Properties, the Company would assign the railway premises to KCRC.

Report of the Members of the Board

Metropolis Equity Sub-participation Agreement

The Metropolis Equity Sub-participation Agreement was entered into on 9 August 2007 between KCRC and the Company. KCRC is obliged to act on the Company's instructions, and pay to the Company any distributions, or proceeds of sale, relating to its shareholding in the property management company The Metropolis Management Company Limited ("Metropolis"). The issued share capital of Metropolis is 25,500 A shares (which are held by KCRC) and 24,500 B shares (which are held by Cheung Kong Property Management Limited). Metropolis' business is property management.

K Liaison Committee Letter

The Liaison Committee Letter was issued on 9 August 2007 by KCRC, the terms of which were acknowledged and agreed to by the Company and the Government.

The letter sets out the agreement between the parties regarding a "Liaison Committee" established for the purposes of governing certain matters of KCRC between 9 August 2007 and the Merger Date. Upon the completion of the Rail Merger the Liaison Committee was dissolved.

I(ii) Continuing Connected Transactions

The Merger Framework Agreement, the Operating Agreement, the Service Concession Agreement, the KSL Project Management Agreement, the West Rail Agency Agreement (and related powers of attorney), the US CBL Assumption Agreements, the US CBL Allocation Agreement, the Outsourcing Agreement and the agreements in relation to Category 2A, Category 2B and Category 3 Properties, each involves the provision of goods or services on an ongoing basis and therefore each constitutes a continuing connected transaction for the Company under the Listing Rules.

As disclosed in the circular issued by the Company on 3 September 2007 in connection with the Rail Merger, the Stock Exchange has granted a waiver to the Company from strict compliance with the requirements under Chapter 14A of the Listing Rules which would otherwise apply to continuing connected transactions between the Company, the Government and/or KCRC arising as a result of the Rail Merger, subject to certain conditions (the "New Waiver").

In relation to the Operating Agreement and the Service Concession Agreement, pursuant to paragraph A of the New Waiver, the Stock Exchange granted a waiver to the Company from strict compliance with all the continuing connected transaction requirements of Chapter 14A of the Listing Rules.

In relation to the Merger Framework Agreement, the KSL Project Management Agreement, the West Rail Agency Agreement (and related powers of attorney), the US CBL Assumption Agreements, the US CBL Allocation Agreement, the Outsourcing Agreement and the agreements in relation to Category 2A, Category 2B and Category 3 Properties (together the "Continuing Connected Transactions") and in accordance with paragraph B(I)(i) of the New Waiver, the Company confirms that the Independent Non-executive Directors of the Company have reviewed each of the Continuing Connected Transactions and confirmed that the Continuing Connected Transactions were entered into:

- (1) in the ordinary and usual course of business of the Company;
- (2) on normal commercial terms or on terms which are no less favourable to the Company than terms available to or from independent third parties; and
- (3) in accordance with the relevant agreement governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Company has engaged the auditors of the Company to carry out a review of each of the Continuing Connected Transactions in accordance with Hong Kong Standard on Related Services 4400 "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information" issued by the Hong Kong Institute of Certified Public Accountants. In accordance with paragraph B(I)(ii) of the New Waiver, the auditors have provided a letter to the Board of Directors confirming that each of the Continuing Connected Transactions:

- (a) has been approved by the Board of Directors of the Company; and
- (b) has been entered into in accordance with the relevant agreement governing the relevant transaction.

II(i) Non Merger-related Agreements

Land Agreements

A New Grant No.20379 dated 18 May 2007, of Tseung Kwan O Town Lot No.72 for the development at Tseung Kwan O Area 56 (building covenant period expiry date 31 December 2012) with a total consideration or value of HK\$3,345,230,000.

B Following the end of the year under review, the Company accepted on 20 December 2007 the premium offer from the Government and the terms of the further modification letter to be executed into between the Company and the Government in relation to New Grant No. 9689 dated 16 May 2002 and the

ancillary terms and conditions at a total consideration or value of HK\$3,335,000,000. The offer accepted by the Company contains details relating to the arrangements for the implementation of the proposed development on Site E and also on Tseung Kwan O Town Lot No.70 generally. The offer also amends the building covenant period for Site E from “the later of on or before the 30th day of September, 2013 or 66 calendar months from the date of payment of the Site E premium” to “78 calendar months from the date of payment of the Site E premium”, defines the development parameters and the site boundary of Site E, increases the allowable building height for all Sites except that of Site F, Site AB and Site M, reduces the number of school sites and kindergarten classrooms, increases the minimum local open space and requires permitted works to be carried out within The Remaining Portion of Tseung Kwan O Town Lot No.70. A Modification Letter for Site E is to be executed pursuant to the Company’s acceptance within three calendar months from 20 December 2007.

As the Government is a controlling shareholder of the Company and therefore a connected person of the Company, the transaction is a connected transaction for the Company under Rule 14A.13 of the Listing Rules. As disclosed in the announcement of the Company dated 13 January 2005, the Stock Exchange has granted a waiver to the Company from strict compliance with the requirements under Chapter 14A of the Listing Rules which would otherwise apply to connected transactions between the Company and the Government, subject to certain conditions (the “Waiver”).

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

A Supplemental Lease was signed on 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 at an administration fee of HK\$16,200. By a Modification Letter dated 20 December 2003 entered into between the 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 in the consideration of a premium of HK\$1,000 and an administration fee of HK\$16,200. By a Modification Letter executed by the Government and the Company dated 31 May 2004, 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 in the consideration of a premium of HK\$1,000 and an administrative fee of HK\$16,200. By a modification letter dated 1 March 2005 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 in the consideration of a premium of HK\$1,000 and an administrative fee of HK\$16,200. By a Modification Letter dated 9 March 2007 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 in the consideration of a premium of HK\$1,000 and an administrative fee of HK\$18,650.

II(ii) Continuing Connected Transactions

On 30 June 2005, the Company entered into a supplemental agreement with The Hong Kong Airport Authority (“AA”) (“Supplemental Agreement”) for the renewal for a further three-year period of the existing maintenance agreement for the Automated People Mover at Hong Kong International Airport (the “Airport”).

The Company entered into the original maintenance agreement (the “Maintenance Agreement”) with the AA on 18 March 2002. The Maintenance Agreement was for a term of three years, which expired on 6 July 2005. However, the Maintenance Agreement also included an option, exercisable at the discretion of the AA, to extend the term of the agreement at pre-agreed rates and prices for another three years until 6 July 2008.

Since entering into the Maintenance Agreement, the AA has decided to modify and extend the Automated People Mover in order to serve the new Sky Plaza and Sky Pier terminal buildings which are being built at the Airport. This has correspondingly extended the scope of maintenance work for the Automated People Mover. As a result, the price for the option to extend the Maintenance Agreement for a further three-year period has been re-negotiated and reflected in the Supplemental Agreement. Otherwise, the basic terms and conditions of the Maintenance Agreement have not been changed.

Report of the Members of the Board

The AA, being an associate (as defined in the Listing Rules) of Government, a substantial shareholder of the Company, is a connected person of the Company. As the Supplemental Agreement is a transaction between the Company and a connected person (i.e. the AA) (the "Transaction"), it constitutes a connected transaction for the Company. In addition, on the basis that the agreement involves the provision of services on an ongoing basis, the Supplemental Agreement constitutes a continuing connected transaction for the Company. The transaction is subject to the terms of the Waiver.

The above disclosure relating to the Transaction is made in accordance with paragraph (B)(l)(i) of the Waiver and Rule 14A.46 of the Listing Rules.

In accordance with paragraph (B)(l)(iii)(a) of the Waiver, all the Independent Non-executive Directors of the Company have reviewed the Transaction and confirmed that the Transaction was entered into:

- (1) in the ordinary and usual course of the business of the Company;
- (2) on normal commercial terms which are no less favourable to the Company than terms available from independent third parties; and
- (3) in accordance with the Maintenance Agreement and the Supplemental Agreement on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Company has engaged the auditors of the Company to carry out a review of the Transaction in accordance with Hong Kong Standard on Related Services 4400 "Engagements to Perform Agreed-Upon Procedures Regarding Financial Information" issued by the Hong Kong Institute of Certified Public Accountants. In accordance with paragraph (B)(l)(iii)(b) of the Waiver, the auditors have confirmed to the Board of Directors that the Transaction:

(a) has been approved by the Members of the Board of the Company; and

(b) has been entered into in accordance with the terms of the Maintenance Agreement, as amended by the Supplemental Agreement.

Project Agreement

On 6 February 2008, the Company entered into a preliminary project agreement with Government for the undertaking of the pre-authorisation activities of the West Island Line. Pursuant to the agreement, the Company will be paid HK\$400 million to undertake the detailed design of the railway works, carry out all necessary ground investigations, invite and assess tenders for the railway works construction contracts, and carry out ancillary and other support services.

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, 11 March 2008

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Independent Auditor's Report to the Shareholders of MTR Corporation Limited *(Incorporated in Hong Kong with limited liability)*

We have audited the consolidated accounts of MTR Corporation Limited (the "Company") set out on pages 127 to 214, which comprise the consolidated and company balance sheets as at 31 December 2007, and the consolidated profit and loss account, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Directors' Responsibility for the Accounts

The directors of the company are responsible for the preparation and the true and fair presentation of these accounts in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Hong Kong Companies Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of accounts that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these accounts based on our audit. This report is made solely to you, as a body, in accordance with section 141 of the Hong Kong Companies Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the accounts.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated accounts give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2007 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the Hong Kong Companies Ordinance.

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central, Hong Kong

11 March 2008

Consolidated Profit and Loss Account

<i>for the year ended 31 December in HK\$ million</i>	Note	2007	2006
Fare revenue	4	7,115	6,523
Station commercial and rail related revenue	5A	1,741	1,542
Rental, management and other revenue	5B	1,834	1,476
Turnover		10,690	9,541
Staff costs and related expenses	6A	(1,802)	(1,653)
Energy and utilities		(576)	(539)
Operational rent and rates		(99)	(65)
Stores and spares consumed		(130)	(120)
Repairs and maintenance	6B	(521)	(511)
Railway support services		(86)	(80)
Expenses relating to station commercial and rail related businesses		(410)	(410)
Expenses relating to property ownership, management and other businesses		(540)	(345)
Project study and business development expenses	6C	(268)	(267)
General and administration expenses	6D	(183)	(192)
Other expenses	6D	(163)	(158)
Operating expenses before depreciation and amortisation		(4,778)	(4,340)
Operating profit from railway and related businesses before depreciation and amortisation		5,912	5,201
Profit on property developments	8	8,304	5,817
Operating profit before depreciation and amortisation		14,216	11,018
Depreciation and amortisation	9	(2,739)	(2,674)
Merger related expenses	10	(193)	–
Operating profit before interest and finance charges		11,284	8,344
Interest and finance charges	11	(1,316)	(1,398)
Change in fair value of investment properties	18	8,011	2,178
Net gain on acquisition of subsidiaries	27B	187	–
Share of profits less losses of non-controlled subsidiaries and associates	12	99	45
Profit before taxation		18,265	9,169
Income tax	13A	(3,083)	(1,411)
Profit for the year		15,182	7,758
Attributable to:			
– Equity shareholders of the Company	14	15,180	7,759
– Minority interests		2	(1)
Profit for the year		15,182	7,758
Dividends paid and proposed to equity shareholders of the Company attributable to the year	15		
– Interim dividend declared and paid during the year		782	774
– Final dividend proposed after the balance sheet date		1,740	1,554
		2,522	2,328
Earnings per share:	16		
– Basic		HK\$2.72	HK\$1.41
– Diluted		HK\$2.72	HK\$1.41

The notes on pages 132 to 214 form part of the accounts

Consolidated Balance Sheet

<i>at 31 December in HK\$ million</i>	Note	2007	2006
Assets			
Fixed assets			
– Investment properties	18	37,723	22,539
– Other property, plant and equipment	19	79,444	84,404
– Service concession assets	20	15,250	–
		132,417	106,943
Property management rights	21	40	–
Railway construction in progress	22	424	232
Property development in progress	23A	9,066	3,297
Deferred expenditure	24	825	565
Prepaid land lease payments	25	581	594
Interests in non-controlled subsidiaries	26	268	171
Interests in associates	28	205	100
Deferred tax assets	44B	4	1
Investments in securities	29	333	272
Staff housing loans	30	15	25
Properties held for sale	31	756	2,018
Derivative financial assets	32	273	195
Stores and spares	33	642	272
Debtors, deposits and payments in advance	34	5,167	1,894
Loan to a property developer	35	3,532	3,355
Amounts due from the Government and other related parties	36	544	177
Cash and cash equivalents	37	576	310
		155,668	120,421
Liabilities			
Bank overdrafts	38A	2	5
Short-term loans	38A	507	1,114
Creditors, accrued charges and provisions	39	5,412	3,639
Current taxation	44A	3	1
Contract retentions	40	225	193
Amounts due to related parties	41	975	–
Loans and obligations under finance leases	38A	33,541	27,033
Derivative financial liabilities	32	192	515
Obligations under service concession	42	10,685	–
Deferred income	43	515	1,682
Deferred tax liabilities	44B	12,574	9,453
		64,631	43,635
Net assets			
		91,037	76,786
Capital and reserves			
Share capital, share premium and capital reserve	45A	39,828	38,639
Other reserves	46	51,186	38,128
Total equity attributable to equity shareholders of the Company			
		91,014	76,767
Minority interests			
		23	19
Total equity			
		91,037	76,786

Approved and authorised for issue by the Members of the Board on 11 March 2008

Raymond K F Ch'ien

C K Chow

Lincoln K K Leong

The notes on pages 132 to 214 form part of the accounts

Balance Sheet

<i>at 31 December in HK\$ million</i>	Note	2007	2006
Assets			
Fixed assets			
– Investment properties	18	36,562	22,539
– Other property, plant and equipment	19	79,270	84,256
– Service concession assets	20	15,250	–
		131,082	106,795
Property management rights	21	40	–
Railway construction in progress	22	424	232
Property development in progress	23A	9,066	3,297
Deferred expenditure	24	155	283
Prepaid land lease payments	25	581	594
Investments in subsidiaries	27	1,150	184
Staff housing loans	30	15	25
Properties held for sale	31	756	2,018
Derivative financial assets	32	273	195
Stores and spares	33	640	272
Debtors, deposits and payments in advance	34	5,057	1,782
Loan to a property developer	35	3,532	3,355
Amounts due from the Government and other related parties	36	1,315	700
Cash and cash equivalents	37	184	127
		154,270	119,859
Liabilities			
Bank overdrafts	38A	2	5
Short-term loans	38A	186	1,114
Creditors, accrued charges and provisions	39	4,856	3,259
Current taxation	44A	1	–
Contract retentions	40	197	191
Amounts due to related parties	41	12,962	11,718
Loans and obligations under finance leases	38A	21,771	15,518
Derivative financial liabilities	32	192	515
Obligations under service concession	42	10,685	–
Deferred income	43	515	1,682
Deferred tax liabilities	44B	12,574	9,453
		63,941	43,455
Net assets		90,329	76,404
Capital and reserves			
Share capital, share premium and capital reserve	45A	39,828	38,639
Other reserves	46	50,501	37,765
Total equity		90,329	76,404

Approved and authorised for issue by the Members of the Board on 11 March 2008

Raymond K F Ch'ien

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Lincoln K K Leong

The notes on pages 132 to 214 form part of the accounts

Consolidated Statement of Changes in Equity

<i>for the year ended 31 December in HK\$ million</i>	Note	2007	2006
Total equity as at 1 January			
– Attributable to equity shareholders of the Company		76,767	69,875
– Minority interests		19	21
Total equity as at 1 January		76,786	69,896
Cash flow hedges:	46		
Effective portion of changes in fair value, net of deferred tax		(13)	(18)
Transfer from equity			
– to profit and loss account		–	(17)
– to initial carrying amount of non-financial hedged items		(2)	(2)
– to deferred tax		–	3
		(15)	(34)
Surplus on revaluation of self-occupied land and buildings, net of deferred tax	46	202	271
Exchange difference on translation of accounts of overseas subsidiaries	46	25	13
Net income recognised directly in equity		212	250
Net profit for the year		15,182	7,758
Total recognised income and expense for the year		15,394	8,008
Dividends declared or approved during the year	15		
– 2006/2005 final dividend		(1,554)	(1,535)
– 2007/2006 interim dividend		(782)	(774)
		(2,336)	(2,309)
Shares issued during the year	45A		
– Employee Share Option Scheme		23	36
– Scrip Dividend Scheme		1,166	1,153
		1,189	1,189
Employee share-based payments	46	2	3
Movements in equity arising from capital transactions		1,191	1,192
Exchange difference on translation of minority interests		2	–
Reduction in minority interests on disposal of a subsidiary		–	(1)
Total equity as at 31 December		91,037	76,786
Total recognised income and expense for the year attributable to:			
– Equity shareholders of the Company		15,392	8,009
– Minority interests		2	(1)
		15,394	8,008

Consolidated Cash Flow Statement

<i>for the year ended 31 December in HK\$ million</i>	Note	2007	2006
Cash flows from operating activities			
Operating profit from railway and related businesses before depreciation and amortisation		5,912	5,201
Adjustments for:			
Decrease in provision for obsolete stock		(3)	(2)
Loss on disposal of fixed assets		36	37
Deferred project study costs written off		–	26
Amortisation of deferred income from lease transaction		(5)	(6)
Amortisation of prepaid land lease payments		13	14
Decrease/(increase) in fair value of derivative instruments		1	(7)
Unrealised loss/(gain) on revaluation of investment in securities		4	(2)
Employee share-based payment expenses		7	9
Exchange gain		(1)	(1)
Operating profit from railway and related businesses before working capital changes		5,964	5,269
Increase in debtors, deposits and payments in advance		(421)	(53)
Increase in stores and spares		(10)	(17)
Increase in creditors, accrued charges and provisions		433	191
Cash generated from operations		5,966	5,390
Overseas tax paid		(1)	(3)
Net cash generated from operating activities		5,965	5,387
Cash flows from investing activities			
Capital expenditure			
– Purchase of operational railway assets		(944)	(1,334)
– Tseung Kwan O South Project		(203)	(109)
– Disneyland Resort Line Project		(25)	(45)
– Tung Chung Cable Car Project		(82)	(165)
– Tseung Kwan O property development projects		(197)	(134)
– Property fitting out works and other development projects		(643)	(815)
– Other capital projects		(387)	(301)
Payments in respect of the Rail Merger			
– Upfront payment for the service concession		(4,250)	–
– Upfront payment for property package		(7,790)	–
– Cash received for the assumption of assets and liabilities of KCRC		786	–
– Other payments directly attributable to the Rail Merger		(354)	(88)
Receipts in respect of property development		5,824	4,400
Loan to a property developer		–	(4,000)
Purchase of investment in securities		(266)	(194)
Proceeds from sale of investment in securities		202	106
Loans to an associate		(62)	–
Investment in an associate		(103)	(100)
Principal repayments under Staff Housing Loan Scheme		10	9
Net cash used in investing activities		(8,484)	(2,770)
Cash flows from financing activities			
Proceeds from shares issued under share option schemes		23	36
Drawdown of loans		11,391	6,929
Proceeds from issuance of capital market instruments		–	1,499
Repayment of loans		(5,849)	(5,749)
Repayment of capital market instruments		–	(2,450)
Reduction in capital element of finance lease		(141)	(131)
Interest paid		(1,500)	(1,611)
Interest received		50	10
Interest element of finance lease rental payments		(9)	(19)
Finance charges paid		(9)	(16)
Dividends paid		(1,168)	(1,155)
Net cash generated from/(used in) financing activities		2,788	(2,657)
Net increase/(decrease) in cash and cash equivalents		269	(40)
Cash and cash equivalents at 1 January		305	345
Cash and cash equivalents at 31 December	37	574	305

The notes on pages 132 to 214 form part of the accounts

Notes to the Accounts

1 Statement of Compliance

These accounts have been prepared in compliance with the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"). These accounts have also been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKAS") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), and accounting principles generally accepted in Hong Kong. A summary of the principal accounting policies adopted by the Group is set out in note 2.

The HKICPA has issued certain new and revised HKFRSs that are effective for accounting periods beginning on or after 1 January 2007. Changes in accounting policies resulting from initial application of these developments to the extent that they are relevant to the Group for the current and prior accounting periods reflected in these accounts are disclosed in note 2A(iii).

2 Principal Accounting Policies

A Basis of Preparation of the Accounts

(i) The measurement basis used in the preparation of the accounts is historical cost basis except that the following assets and liabilities are stated at their fair value as explained in the accounting policies set out below:

- investment properties (see note 2F(i));
- other leasehold land and buildings, for which the fair values cannot be measured separately at inception of the lease and the entire lease is classified as a finance lease (see note 2F(ii));
- financial instruments classified as investments in securities (see note 2M); and
- derivative financial instruments (see note 2U).

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

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

Judgements made by management in the application of HKFRSs that have significant effect on the accounts and estimates are discussed in note 54.

(iii) The HKICPA has issued a number of new or revised HKFRSs that are first effective or available for early adoption in the current accounting period of the Group and the Company. Any changes in accounting policies resulting from the initial application of these developments to the extent that they are relevant to the Group are summarised below.

(a) Disclosures of financial instruments (HKFRS 7 "Financial instruments: Disclosures") and management of capital (Amendment to HKAS 1 "Presentation of financial statements - Capital disclosures")

As a result of the adoption of HKFRS 7, the accounts have included expanded disclosure about the significance of the Group's financial instruments and the nature and extent of risks arising from those instruments, in addition to the information previously required by HKAS 32 "Financial instruments: Disclosure and presentation". These disclosures are provided throughout the accounts, in particular in note 32.

The amendment to HKAS 1 introduces additional disclosure requirements to provide information about the level of capital and the Group's and the Company's objectives, policies and processes for managing capital. These new disclosures are set out in note 45B.

Both HKFRS 7 and the amendment to HKAS 1 do not have any material impact on the operating results and financial position apart from the additional disclosures in the accounts.

(b) Hong Kong (International Financial Reporting Interpretations Committee) ("HK(IFRIC)") Interpretation 12 "Service concession arrangements"

In 2007, the HKICPA issued HK(IFRIC) Interpretation 12 to provide guidance on the accounting by operators in service concession arrangements to be effective for reporting periods commencing on or after 1 January 2008. As the merger of the Company's operations with Kowloon-Canton Railway Corporation ("KCRC") (see note 3) is considered to include a service concession arrangement under HK(IFRIC) Interpretation 12, the Company has early adopted the Interpretation in the 2007 accounts.

The Group has not applied any other new standard or interpretation that is not yet effective for the current accounting period (see note 55).

2 Principal Accounting Policies *(continued)*

B Basis of Consolidation

The consolidated accounts include the accounts of the Company and its subsidiaries (together referred to as the "Group") and the Group's interest in non-controlled subsidiaries (see note 2D) and associates (see note 2E) made up to 31 December each year. The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from or to the date of their acquisition or disposal, as appropriate.

C Subsidiaries

A subsidiary in accordance with the Hong Kong Companies Ordinance is a company in which the Group, directly or indirectly, holds more than half of the issued share capital, or controls more than half of the voting power, or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the Company has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated accounts. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Minority interests at the balance sheet date, being the portion of the net assets of subsidiaries attributable to equity interests that are not owned by the Company, whether directly or indirectly through subsidiaries, are presented in the consolidated balance sheet and statement of changes in equity within equity, separately from equity attributable to the equity shareholders of the Company. Minority interests in the results of the Group are presented on the face of the consolidated profit and loss account as an allocation of the total profit or loss for the year between minority interests and the equity shareholders of the Company.

Where losses attributable to the minority exceed the minority interest in the equity of a subsidiary, the excess, and any further losses attributable to the minority, are charged against the Group's interest except to the extent that the minority has a binding obligation to, and is able to, make good the losses. All subsequent profits of the subsidiary are allocated to the Group until the minority's share of losses previously absorbed by the Group has been recovered.

Investments in subsidiaries are carried in the Company's balance sheet at cost less any impairment losses (see note 2H(ii)).

D Non-controlled Subsidiaries

Non-controlled subsidiaries are not consolidated in the accounts as the Group does not have effective control over their Boards. The investments in non-controlled subsidiaries are accounted for in the consolidated accounts of the Company using the equity method and are initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of their net assets. The consolidated profit and loss account reflects the Group's share of the results of those non-controlled subsidiaries for the year.

Unrealised profits and losses resulting from transactions between the Group and the non-controlled subsidiaries are eliminated to the extent of the Group's interest in those subsidiaries, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the profit and loss account.

In the Company's balance sheet, its investments in non-controlled subsidiaries are stated at cost less impairment losses (see note 2H(ii)).

E Associates and Jointly Controlled Entities

An associate is an entity over which the Group or the Company has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

A jointly controlled entity is an entity which operates under a contractual arrangement between the Group or the Company and other parties, where the contractual arrangement establishes that the Group or the Company and one or more of the other parties share joint control over the economic activity of the entity.

An investment in an associate or a jointly controlled entity is accounted for in the consolidated accounts of the Company using the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's or the jointly controlled entity's net assets. The consolidated profit and loss account reflects the Group's share of the post acquisition results of the associates and jointly controlled entities for the year.

When the Group's share of losses equals or exceeds its interest in the associate or the jointly controlled entity, the Group's interest is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or the jointly controlled entity. For this purpose, the Group's interest in the associate and the jointly controlled entity is the carrying amount of the investment under the equity method together with the Group's long-term interests that in substance form part of the Group's net investment in the associate or the jointly controlled entity.

Notes to the Accounts

2 Principal Accounting Policies *(continued)*

E Associates and Jointly Controlled Entities *(continued)*

Unrealised profits and losses resulting from transactions between the Group and its associates and jointly controlled entities are eliminated to the extent of the Group's interest in the associates and jointly controlled entities, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the profit and loss account.

In the Company's balance sheet, its investments in associates and jointly controlled entities are stated at cost less impairment losses (see note 2H(ii)).

F Fixed Assets

(i) Investment properties are land and/or buildings which are owned or held under a leasehold interest to earn rental income and/or for capital appreciation.

Investment properties are stated in the balance sheet at fair value as determined semi-annually by independent professionally qualified valuers. Gains or losses arising from changes in the fair value are recognised as profit or loss in the year in which they arise.

Property that is being constructed or developed for future use as investment property is classified as asset under construction within property, plant and equipment and stated at cost until construction or development is complete, at which time it is reclassified as investment property at fair value. Any difference between the fair value of the property at that date and its previous carrying amount is recognised in the profit and loss account.

(ii) Land held for own use under operating leases and buildings thereon, where the fair values of the leasehold interest in the land and buildings cannot be measured separately at inception of the lease are accounted for as being held under a finance lease, unless the buildings are also clearly held under an operating lease. The self-occupied land and buildings are stated in the balance sheet at their fair values on the basis of their existing use at the date of revaluation less any subsequent accumulated depreciation. Revaluations are performed by independent qualified valuers every year, with changes in the value arising on revaluations treated as movements in the fixed asset revaluation reserve, except:

(a) where the balance of the fixed asset revaluation reserve relating to a self-occupied land and building is insufficient to cover a revaluation deficit of that property, the excess of the deficit is charged to the profit and loss account; and

(b) where a revaluation deficit had previously been charged to the profit and loss account and a revaluation surplus subsequently arises, this surplus is firstly credited to the profit and loss account to the extent of the deficit previously charged to the profit and loss account, and is thereafter taken to the fixed asset revaluation reserve.

(iii) Civil works and plant and equipment are stated at cost less accumulated depreciation and impairment losses (see note 2H(ii)).

(iv) Assets under construction are stated at cost less impairment losses (see note 2H(ii)). Cost comprises direct costs of construction, such as materials, staff costs and overheads, together with interest expense capitalised during the period of construction or installation and testing. Capitalisation of these costs ceases and the asset concerned is transferred to the appropriate fixed assets category when substantially all the activities necessary to prepare the asset for its intended use are completed.

(v) Leased assets

(a) Leases of assets under which the lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. Where the Group acquires the use of assets under finance leases, the amounts representing the fair value of the leased asset, or, if lower, the present value of the minimum lease payments (computed using the rate of interest implicit in the lease), of such assets are included in fixed assets and the corresponding liabilities, net of finance charges, are recorded as obligations under finance leases. Depreciation and impairment losses are accounted for in accordance with the accounting policy as set out in notes 2I(iv) and 2H(ii) respectively. Finance charges implicit in the lease payments are charged to the profit and loss account over the period of the leases so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

(b) Leases of assets, other than that mentioned in note 2F(v)(c) below, under which the lessor has not transferred substantially all the risks and rewards of ownership are classified as operating leases. Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies. Impairment losses are accounted for in accordance with the accounting policies on impairment of assets (see note 2H(ii)). Revenue arising from operating leases is recognised in accordance with the Group's revenue recognition policies as set out in note 2AA(iv).

(c) Land held for own use under an operating lease where its fair value cannot be measured separately from the fair value of a building situated thereon at inception of the lease, is accounted for as being held under a finance lease, unless the building is also clearly held under an operating lease (see note 2F(ii)). For these purposes, inception of the lease is the time that the lease was first entered into by the Group, or taken over from the previous lessee, or at the date of construction of those buildings, if later.

(vi) Subsequent expenditure relating to the replacement of certain parts of an existing fixed asset is recognised in the carrying amount of the asset if it is probable that future economic benefit will flow to the Group and the cost of the item can be measured reliably. The carrying amount of those parts that are replaced is derecognised, with gain or loss arising therefrom dealt with in the profit and loss account.

Expenditure on repairs or maintenance of an existing fixed asset to restore or maintain the originally assessed standard of performance of that asset is charged as an expense when incurred.

2 Principal Accounting Policies *(continued)*

F Fixed Assets *(continued)*

Gains or losses arising from the retirement or disposal of a fixed asset or an investment property are determined as the difference between the net disposal proceeds and the carrying amount of the asset. Such gains or losses are recognised as income or expense in the profit and loss account on the date of retirement or disposal. Any related revaluation surplus is transferred from the fixed asset revaluation reserve to retained profits.

(vii) Service concession assets

Where the Group enters into service concession arrangements under which the Group acquires the rights to access, use and operate certain assets for the provision of public services:

- Upfront payments at inception of the service concession are capitalised and amortised on a straight-line basis over the period of the service concession;
- Annual payments over the period of the service concession with the amounts fixed at inception are capitalised at the present value of the total fixed annual payments discounted at the incremental long-term borrowing rate determined at inception, and amortised on a straight-line basis over the period of the service concession with a corresponding liability recognised as obligations under service concession;
- Annual payments for the service concession which are not fixed or determinable at inception and which are contingent on future revenues generated from the service concession over certain thresholds are charged to the profit and loss account in the period when incurred;
- Expenditure directly attributable to the acquisition of the service concession up to inception, including the assumption of certain obligations of the grantor of the service concession, are capitalised and amortised on a straight-line basis over the period of the service concession; and
- Payments for the replacement and/or upgrade of assets subject to the service concession arrangement are capitalised and amortised on a straight-line basis over the shorter of the assets' useful lives and the remaining period of the service concession.

The service concession asset is carried on the balance sheet, as an intangible asset, at cost less accumulated amortisation and impairment losses, if any (see note 2H(ii)).

G Property Management Rights

Where the Group makes payments for acquisition of property management rights, the amounts paid are capitalised as intangible assets and stated in the balance sheet at cost less accumulated amortisation and impairment losses (see note 2H(ii)). The intangible asset is amortised to the profit and loss account on a straight-line basis over the terms of the management rights.

H Impairment of Assets

(i) Impairment of Debtors and Other Receivables

Debtors and other current and non-current receivables are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. If any such evidence exists, the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition of these assets) where the effect of discounting is material.

If in a subsequent period the amount of an impairment loss decreases, the impairment loss is reversed through the profit and loss account.

(ii) Impairment of Other Assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- fixed assets (other than properties carried at revalued amounts);
- service concession assets;
- property management rights;
- railway construction in progress;
- property development in progress;
- prepaid land lease payments;
- deferred expenditure; and
- investments in subsidiaries, non-controlled subsidiaries, associates and jointly controlled entities.

If any such indication exists, the asset's recoverable amount is estimated.

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

Notes to the Accounts

2 Principal Accounting Policies (continued)

H Impairment of Assets (continued)

An impairment loss is recognised in the profit and loss account whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount.

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount of the asset.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the profit and loss account in the year in which the reversals are recognised.

I Depreciation

(i) Investment properties are not depreciated.

(ii) Fixed assets other than investment properties and assets under construction are depreciated on a straight-line basis at rates sufficient to write off their cost or valuation, less their estimated residual value, if any, over their estimated useful lives as follows:

Land and Buildings

Self-occupied land and buildings the shorter of 50 years and the unexpired term of the lease

Civil Works

Excavation and boring Indefinite
Tunnel linings, underground civil structures, overhead structures and immersed tubes 100 years
Station building structures 100 years
Depot structures 80 years
Concrete kiosk structures 20 years
Cableway station tower and theme village structures 27 years

Plant and Equipment

Rolling stock and components 4 – 40 years
Platform screen doors 35 years
Rail track 7 – 30 years
Environmental control systems, lifts and escalators, fire protection and drainage system 7 – 30 years
Power supply systems 7 – 40 years
Aerial ropeway and cabin 5 – 27 years
Automatic fare collection systems, metal station kiosks, and other mechanical equipment 20 years
Train control and signalling equipment, station announcement systems, telecommunication systems and advertising panels 5 – 20 years
Station architectural finishes 20 – 30 years
Fixtures and fittings 10 – 15 years
Maintenance equipment, office furniture and equipment 10 years
Computer software licences and applications 5 – 7 years
Cleaning equipment, computer equipment and tools5 years
Motor vehicles 4 years

Where parts of an item of property, plant and equipment have different useful lives, each part is depreciated separately. The useful lives of the various categories of fixed assets are reviewed annually in the light of actual asset condition, usage experience and the current asset replacement programme.

(iii) No depreciation is provided on assets under construction until construction is completed and the assets are ready for their intended use.

(iv) Depreciation on assets held under finance leases is provided at rates designed to write off the cost of the asset in equal annual amounts over the shorter of the lease term or the anticipated useful life of the asset as set out above, except in cases where title to the asset will be acquired by the Group at the end of the lease where depreciation is provided at rates designed to write off the cost of the asset in equal amounts over the anticipated useful life of the asset.

2 Principal Accounting Policies *(continued)*

J Construction Costs

(i) Costs incurred by the Group in respect of feasibility studies on proposed railway related construction projects (including consultancy fees, in-house staff costs and overheads) are dealt with as follows:

- where the proposed projects are at a preliminary review stage with no certainty of materialising, the costs concerned are written off to the profit and loss account; and
- where the proposed projects are at a detailed study stage, having been agreed in principle by the Members of the Board based on a feasible financial plan, the costs concerned are dealt with as deferred expenditure until such time as a project agreement is reached, whereupon the costs are transferred to railway construction in progress.

(ii) After entering into a project agreement, all costs incurred in the construction of the railway are dealt with as railway construction in progress until commissioning of the railway line, whereupon the relevant construction costs are transferred to fixed assets.

K Property Development

(i) Costs incurred by the Group in respect of site preparation, land costs and acquisition of development rights for as well as interest in connection with loans to property developers are dealt with as property development in progress.

(ii) Payments received from developers in respect of developments are offset against the amounts in property development in progress attributable to that development. Any surplus amounts of payments received from developers in excess of the balance in property development in progress are transferred to deferred income. In these cases, further costs subsequently incurred by the Group in respect of that development are charged against deferred income.

(iii) Expenditure incurred on the development of properties for self-occupation by the Group is transferred to fixed assets when the occupation permits are issued and the properties are put into use.

(iv) When agreement is reached with a developer to redevelop an existing self-occupied property, the relevant property is revalued on an existing use basis prior to commencement of redevelopment. The surplus arising on revaluation is credited to fixed asset revaluation reserve. On commencement of redevelopment, the net book value of the property is transferred to property development in progress.

(v) Where an interest-free loan is provided to a developer as one of the terms of the development contract, such loan is initially stated at fair value which is its present value discounted at the prevailing market rates of interest at inception. The difference between the fair value and the face value of the loan is dealt with as property development in progress during construction and transferred to the profit and loss account upon completion of the development. Notional interest income is credited to the profit and loss account and debited to the loan over the period of the loan so that the fair value of the loan at maturity equates to its face value.

(vi) Profits arising from the development of properties undertaken in conjunction with property developers are recognised in the profit and loss account as follows:

- where the Group receives payments from developers at the commencement of the project, profits arising from such payments are recognised when the foundation and site enabling works are complete and acceptable for development, and after taking into account the outstanding risks and obligations, if any, retained by the Group in connection with the development;
- where the Group receives a right to a share of the net surplus from sale of the development, income is initially recognised by the Group upon the issue of occupation permits provided the amounts of revenue and costs can be estimated reliably. The interest in any unsold properties is subsequently remeasured on a basis consistent with the policy set out in note 2K(viii); and
- where the Group receives a distribution of the assets of the development, profit is recognised based on the fair value of such assets at the time of receipt and after taking into account any outstanding risks and obligations retained by the Group in connection with the development.

Upon recognition of profit, the balance of deferred income or property development in progress related to that development is credited or charged to the profit and loss account, as the case may be.

(vii) Where the Group is liable to pay the developer consideration for the retention of part of a property to be redeveloped, profit attributable to the Group in respect of the redevelopment (including any payment received from the developer) will be recognised in the profit and loss account when the quantum of the obligation of the Group and the amount of realised profit can be determined with reasonable accuracy.

(viii) Where properties are received as a profit distribution upon completion of development and are held for sale, those properties are stated at cost represented by their estimated net realisable value upon receipt. Net realisable value represents the estimated selling price less costs to be incurred in selling the properties. When properties are sold, the carrying amount of those properties is recognised as cost of properties sold in the period in which the related revenue is recognised. The amount of any write-down of properties to net realisable value is recognised as an expense in the period the write-down occurs. The amount of any reversal of any write-down of properties, arising from an increase in net realisable value, is recognised as a reduction in the cost of properties sold in the period in which the reversal occurs.

(ix) Where properties under construction are received as a sharing in kind from a development, these properties are initially recognised in assets under construction at fair value. Further costs incurred in the construction of those assets are capitalised into the assets under construction, which are transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use have been completed.

Notes to the Accounts

2 Principal Accounting Policies *(continued)*

L Jointly Controlled Operations

The arrangements entered into by the Group with developers for property developments without establishing separate entities are considered to be jointly controlled operations pursuant to HKAS 31 "Investments in joint ventures". Under the development arrangements, the Group is normally responsible for its own costs, including in-house staff costs and the costs of enabling works, and the developers normally undertake to pay for all other project costs such as land premium, construction costs, professional fees, etc. Such costs are deductible from the proceeds of sale before surplus proceeds are shared. In respect of its interests in such operations, the Group accounts for the costs of enabling works and land costs paid net of up-front payments received as property development in progress. In cases where up-front payments received from developers exceed the related expenditures incurred by the Group, such excess is recorded as deferred income. Expenses incurred by the Group on staff, overhead and consultancy fees in respect of these developments are also capitalised as property development in progress. The Group's share of income earned from such operations is recognised in the profit and loss account on the basis of note 2K(vi) after netting off any related balance in property development in progress at that time.

M Investments in Securities

The Group's policies for investments in securities (other than investments in its subsidiaries, non-controlled subsidiaries, associates and jointly controlled entities), which are held for trading purpose, are as follows:

- (i) Investments in securities are initially stated at fair value. At each balance sheet date the fair value is remeasured, with any resultant unrealised gain or loss being recognised in the profit and loss account.
- (ii) Investments are recognised/derecognised on the date the Group commits to purchase/sell the investments or they expire.
- (iii) Profit or loss on disposal of investments in securities are determined as the difference between the estimated net disposal proceeds and the carrying amount of the investments and are accounted for in the profit and loss account as they arise.

N Defeasance of Long-term Lease Payments

Where commitments to make long-term lease payments have been defeased by the placement of securities, those commitments and securities (and income and charges arising therefrom) have been netted off in order to reflect the overall commercial effect of the arrangements. These transactions are not accounted for as leases and these liabilities and investment in securities are not recognised as obligations and assets. Any net amount of cash received from such transactions is accounted for as deferred income.

O Stores and Spares

Stores and spares used for railway and business operation are categorised as either revenue or capital. Revenue spares are stated in the balance sheet at cost, using the weighted average cost method and are recognised in the year in which the consumption occurred. Provision is made for obsolescence where appropriate. Capital items are included in fixed assets and stated at cost less aggregate depreciation and impairment losses. Depreciation is charged at the rates applicable to the relevant fixed assets against which the capital spares are held in reserve.

P Long-term Consultancy Contracts

The accounting policy for contract revenue is set out in note 2AA(iii). When the outcome of a fixed-price consultancy contract can be estimated reliably, contract costs are recognised as expense by reference to the stage of completion of the contract activity at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately. When the outcome of a consultancy contract cannot be estimated reliably, contract costs are recognised as an expense in the period in which they are incurred.

Consultancy contracts in progress at the balance sheet date are recorded in the balance sheet at the net amount of costs incurred plus recognised profit less recognised losses and progress billings, and are presented in the balance sheet as the "Gross amount due from customers for contract work" (as an asset) or the "Gross amount due to customers for contract work" (as a liability), as applicable. Progress billings not yet paid by the customer are included in the balance sheet under "Debtors, deposits and payments in advance". Amounts received before the related work is performed are included in the balance sheet, as a liability, under "Creditors, accrued charges and provisions".

Q Cash and Cash Equivalents

Cash and cash equivalents comprise cash at banks and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are also included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

R Debtors, Deposits and Payments in Advance

Debtors, deposits and payments in advance are initially recognised at fair value and thereafter stated at amortised cost less impairment losses for bad and doubtful debts (see note 2H(i)), except where the effect of discounting would be immaterial or the discount is not measurable as the receivables are interest-free loans made to related parties without any fixed repayment terms. In such cases, the receivables are stated at cost less impairment losses for bad and doubtful debts.

2 Principal Accounting Policies (continued)

S Interest-bearing Borrowings

Interest-bearing borrowings are recognised initially at fair value, net of transaction costs incurred. The unhedged portion of interest-bearing borrowings are subsequently stated at amortised costs; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest method.

Subsequent to initial recognition, the carrying amount of the hedged portion of interest-bearing borrowings is remeasured and the change in fair value attributable to the risk being hedged is recognised in the profit and loss account to offset the effect of the gain or loss on the related hedging instrument.

T Creditors, Accrued Charges and Provisions

Creditors, accrued charges and provisions are stated at amortised cost if the effect of discounting would be material, otherwise they are stated at cost.

U Derivative Financial Instruments and Hedging Activities

The Group uses derivative financial instruments such as interest rate swaps and currency swaps to manage its interest rate and foreign exchange exposure. Based on Group policy, these instruments are used solely for reducing or eliminating financial risks associated with the Group's liabilities and not for trading or speculation purposes.

Derivatives are initially recognised at fair value and are subsequently remeasured at their fair value at each balance sheet date. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and the nature of the item being hedged.

Where hedge accounting applies, the Group designates derivatives employed as either: (1) a fair value hedge: to hedge the fair value of recognised liabilities; or (2) a cash flow hedge: to hedge the variability in cash flows of a recognised liability or the foreign currency risk of a firm commitment.

(i) Fair Value Hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the profit and loss account, together with any changes in the fair value of the hedged assets or liabilities that are attributable to the hedged risk.

(ii) Cash Flow Hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised directly in equity. The gain or loss relating to the ineffective portion is recognised immediately in the profit and loss account.

Amounts accumulated in equity are transferred to the profit and loss account in the periods when the hedged liability affects earnings. However, when the firm commitment that is hedged results in the recognition of a non-financial asset, the associated gains and losses that were recognised in equity are transferred from equity and included in the initial cost or carrying amount of the asset.

When a hedging instrument expires or is sold, terminated or exercised, or when a hedge no longer meets the criteria for hedge accounting, the cumulative gain or loss existing in equity at that time shall remain in equity and is recognised when the hedged liability affects profit or loss, or when the firm commitment is recognised as a non-financial asset, in accordance with the above policy. However, when a hedged liability or a firm commitment is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the profit and loss account.

(iii) Derivatives That Do Not Qualify for Hedge Accounting

Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the profit and loss account.

V Employee Benefits

(i) Salaries, annual leave, leave passage allowance and other costs of non-monetary benefits are accrued and recognised as an expense in the year in which the associated services are rendered by employees of the Group, except those benefits incurred for project staff in respect of construction projects and capital works, which are capitalised as part of the cost of the qualifying assets.

(ii) Contributions to defined contribution retirement plans, including contributions to Mandatory Provident Funds ("MPF") as required under the Hong Kong Mandatory Provident Fund Schemes Ordinance, are recognised as an expense in the profit and loss account as incurred, except those contributions for project staff incurred in respect of construction projects and capital works, which are capitalised as part of the cost of the qualifying assets.

(iii) The Group's net obligation in respect of defined benefit retirement plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine the present value, and the fair value of any plan assets is deducted. The discount rate is the yield at balance sheet date on high quality corporate bonds that have maturity dates approximating the terms of the Group's obligations. If there is no deep market in such bonds, the market yield on government bonds would be used. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised either as an expense in the profit and loss account, or capitalised as part of the cost of the relevant construction projects or capital works in the case of project related employees, as the case may be, on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in a similar manner.

Notes to the Accounts

2 Principal Accounting Policies *(continued)*

V Employee Benefits *(continued)*

In calculating the Group's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds ten percent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in the profit and loss account over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation of the Group's net obligation results in a negative amount, the asset recognised is limited to the net total of any cumulative unrecognised net actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

(iv) Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is recognised as a staff cost, unless the original employee expenses qualify for recognition as an asset, on a straight-line basis over the vesting period and taking into account the probability that the options will vest, with a corresponding increase in the employee share-based capital reserve within equity. Fair value is measured by use of a Black-Scholes model, taking into account the terms and conditions upon which the options were granted. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

During the vesting period, the number of share options that is expected to vest is reviewed. Any adjustment to the cumulative fair value recognised in prior years is charged/credited to the profit and loss account for the year of the review, unless the original employee expenses qualify for recognition as an asset, with a corresponding adjustment to the capital reserve. On vesting date, the amount recognised as an expense is adjusted to reflect the actual number of share options that vest (with a corresponding adjustment to the capital reserve). The equity amount is recognised in the capital reserve until either the option is exercised (when it is transferred to the share premium account) or the option expires (when it is released directly to retained profits).

For cash-settled share-based payments, a liability equal to the portion of the services received is recognised at the fair value of the shares determined at each balance sheet date.

(v) Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

W Retirement Schemes

The Group operates both defined contribution and defined benefit retirement schemes.

Employer's contributions to defined contribution retirement schemes including MPF Schemes are recognised in the accounts in accordance with the policy set out in note 2V(ii).

Employer's contributions paid and payable in respect of employees of defined benefit retirement schemes as calculated annually by independent actuaries in accordance with the Retirement Scheme Rules and provisions of the Occupational Retirement Schemes Ordinance, are used to satisfy the pension expenses recognised in the accounts according to note 2V(iii). Any deficit or surplus thereof will be dealt with in the balance sheet as accrued or prepaid benefit expenses, as the case may be.

X Income Tax

(i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Income tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

(ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

(iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases. Deferred tax assets also arise from unused tax losses and unused tax credits.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised. Future taxable profits that may support the recognition of deferred tax assets arising from deductible temporary differences include those that will arise from the reversal of existing taxable temporary differences, provided those differences relate to the same taxation authority and the same taxable entity, and are expected to reverse either in the same period as the expected reversal of the deductible temporary difference or in periods into which a tax loss arising from the deferred tax asset can be carried back or forward. The same criteria are adopted when determining whether existing taxable temporary differences support the recognition of deferred tax assets arising from unused tax losses and credits, that is, those differences are taken into account if they relate to the same taxation authority and the same taxable entity, and are expected to reverse in a period, or periods, in which the tax loss or credit can be utilised.

2 Principal Accounting Policies *(continued)*

X Income Tax *(continued)*

The limited exceptions to recognition of deferred tax assets and liabilities are those temporary differences arising from the initial recognition of assets or liabilities that affect neither accounting nor taxable profit (provided they are not part of a business combination) and investments in subsidiaries to the extent that, in the case of taxable differences, the Group controls the timing of the reversal and it is probable that the differences will not reverse in the foreseeable future, or in the case of deductible differences, unless it is probable that they will reverse in the future.

The amount of deferred tax recognised is measured based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

(iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities if, and only if, the Company or the Group has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:

- in the case of current tax assets and liabilities, the Company or the Group intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
- in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
 - the same taxable entity; or
 - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

Y Financial Guarantee Contracts

Financial guarantees are contracts that require the issuer to make specified payments to reimburse the holder of the guarantee for a loss it incurs because a specified debtor fails to make payment to the holder when due in accordance with the original or modified terms of a debt instrument.

When the Group issues a financial guarantee, where the effect is material, the fair value of the guarantee (being the transaction price, unless the fair value can otherwise be reliably estimated) after netting of any consideration received or receivable at inception is initially debited to the profit and loss account and recognised as deferred income within creditors, accrued charges and provisions.

The amount of the guarantee initially recognised as deferred income is amortised in the profit and loss account over the term of the guarantee as income from financial guarantees issued. In addition, provisions are recognised in accordance with note 22 if and when (i) it becomes probable that the holder of the guarantee will call upon the Group under the guarantee, and (ii) the amount of that claim on the Group is expected to exceed the amount currently carried in creditors, accrued charges and provisions in respect of that guarantee, i.e. the amount initially recognised less accumulated amortisation.

Z Provisions and Contingent Liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Company or Group has a legal or constructive obligation arising as a result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

Notes to the Accounts

2 Principal Accounting Policies *(continued)*

AA Revenue Recognition

Provided it is probable that the economic benefits associated with the transactions will flow to the Group and the amount of revenue can be measured reliably, revenue is recognised in the profit and loss account as follows:

- (i) Fare revenue is recognised when the journey is provided.
- (ii) Advertising income and service fees from telecommunication services provided within the railway are recognised when the services are provided.
- (iii) Contract revenue is recognised when the outcome of a consultancy or service contract can be estimated reliably. Contract revenue is recognised using the percentage of completion method, measured by reference to the percentage of contract costs incurred to date to estimated total contract costs for the contract. When the outcome of a consultancy contract cannot be estimated reliably, revenue is recognised only to the extent of contract costs incurred that it is probable will be recoverable.
- (iv) Rental income from investment properties, station kiosks and other railway premises under operating leases is accounted for in accordance with the terms of the leases. Lease incentives granted are recognised in the profit and loss account as an integral part of the aggregate net lease payments receivable. Contingent rentals are recognised as income in the accounting period in which they are earned. Property management income is recognised when the services are provided.

BB Operating Lease Charges

- (i) Rentals payable under operating leases are charged on a straight-line basis over the period of the lease to the profit and loss account, except for rentals payable in respect of railway construction, property development in progress and proposed capital projects which are capitalised as part of railway construction in progress, property development in progress and deferred expenditure respectively.
- (ii) Prepaid land lease payments for land are stated at cost and are amortised on a straight-line basis over the period of the lease terms to the profit and loss account as land lease expenses.

CC Interest and Finance Charges

Interest expense directly attributable to the financing of capital projects prior to their completion or commissioning is capitalised. Exchange differences arising from foreign currency borrowings related to the acquisition of assets are capitalised to the extent that they are regarded as an adjustment to capitalised interest costs. Interest expense attributable to other purposes is charged to the profit and loss account.

Finance charges implicit in the lease payments on assets held under finance leases are charged to the profit and loss account over the period of the lease so as to produce an approximately constant periodic rate of charge on the remaining balance of the obligations for each accounting period.

DD Foreign Currency Translation

Foreign currency transactions during the year are translated into Hong Kong dollars and recorded at exchange rates ruling at the transaction dates. Foreign currency monetary assets and liabilities are translated into Hong Kong dollars at the exchange rates ruling at the balance sheet date. Exchange gains and losses are recognised in the profit and loss account.

The results of foreign enterprises are translated into Hong Kong dollars at the average exchange rates for the year; balance sheet items are translated into Hong Kong dollars at the rates of exchange ruling at the balance sheet date. The resulting exchange differences are dealt with as a movement in reserves.

EE Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

In accordance with the Group's internal financial reporting system, the Group has chosen business segment information as the primary reporting format. As substantially all the principal operating activities of the Group are carried out in Hong Kong, no geographical segment information is provided.

Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment. Segment revenue, expenses, assets and liabilities are determined before intra-group balances and intra-group transactions are eliminated as part of the consolidation process, except to the extent that such intra-group balances and transactions are between group enterprises within a single segment.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets that are expected to be used for more than one year.

Unallocated items mainly comprise derivative financial assets and liabilities, corporate assets, interest-bearing loans, borrowings, share of results of non-controlled subsidiaries, associates and jointly controlled entities, corporate and financing expenses and minority interests.

2 Principal Accounting Policies *(continued)*

FF Related Parties

For the purposes of these accounts, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals (being members of key management personnel, significant shareholders and/or their close family members) or other entities including entities which are under the significant influence of related parties of the Group where those parties are individuals, and post-employment benefit plans which are for the benefit of employees of the Group or of any entity that is a related party of the Group.

GG Government Grants

Government grants are assistance by Government in the form of transfer of resources in return for the Group's compliance to the conditions attached thereto. Government grants which represent compensation for the cost of an asset will be deducted from the cost of the asset in arriving at its carrying value to the extent of the amounts received and receivable as at the date of the balance sheet. Any excess of the amount of grant received or receivable over the cost of the asset at the balance sheet date will be carried forward as advance receipts to set off against the future cost of the asset.

3 Rail Merger with Kowloon-Canton Railway Corporation

A On 2 December 2007 (the "Appointed Day"), the Company's operations merged with those of the KCRC ("Rail Merger"). The structure and key terms of the Rail Merger were set out in a series of transaction agreements entered into between, inter alia, the Government of the Hong Kong Special Administrative Region, KCRC and the Company including the Service Concession Agreement, Property Package Agreements and Merger Framework Agreement. Key elements of the Rail Merger include the following:

- The expansion of the Company's existing franchise under the Mass Transit Railway Ordinance ("MTR Ordinance") to cover the construction, operation and regulation of railways in addition to the MTRC railway for an initial period of 50 years from the Appointed Day ("Franchise Period"), which may be extended pursuant to the provisions of the MTR Ordinance (note 51I);
- The Service Concession Agreement ("SCA") pursuant to which KCRC granted the Company the right to access, use and operate the KCRC system for an initial term of 50 years (the "Concession Period"), which will be extended if the Franchise Period (as it relates to the KCRC railway) is extended. The SCA also sets out the basis on which the KCRC system will be returned at the end of the Concession Period. In accordance with the terms of the SCA, the Company paid an upfront lump sum to KCRC on the Appointed Day and is obliged to pay an annual fixed payment to KCRC for the duration of the Concession Period. Additionally, commencing after three years from the Appointed Day, the Company is obliged to pay an annual variable fee to KCRC based on the revenue generated from the KCRC system above certain thresholds;
- Under the SCA, the Company is responsible for the expenditure incurred in relation to the maintenance, repair, replacement and upgrade of the KCRC system (with any new assets acquired being classified as "additional concession property"). To the extent that such expenditure exceeds an agreed threshold ("Capex Threshold"), the Company will be reimbursed for any above threshold expenditure at the end of the Concession Period with such reimbursement to be on the basis of depreciated book value;
- In the event that the Concession Period is extended, the fixed annual payment and the variable annual payment will continue to be payable by the Company. On such extension, the Capex Threshold may also be adjusted;
- With effect from the Appointed Day, staff of the Company and KCRC have been employed by the Company on their prevailing terms and conditions of employment. In connection with the Rail Merger, a Staff Voluntary Separation Scheme has been offered to eligible staff (note 10);
- Property Package Agreements whereby property assets comprising certain investment and own-used properties, property management rights and property development rights were acquired by the Company;
- Merger Framework Agreement setting out the framework for the Rail Merger including the implementation of the Fare Adjustment Mechanism whereby the extent to which fares may be adjusted is linked to certain public indices, the provision of a fare reduction starting from the Appointed Day and the guarantee of job security for front line staff employed at the time of the Rail Merger;
- Pursuant to the above and the vesting and novation of certain contracts, the Company assumed certain assets and liabilities of KCRC on the Appointed Day. The assumption of the liabilities of deposits refundable to third parties was subject to compensation by KCRC on the Appointed Day; and
- Other post-Appointed Day arrangements between the Company and KCRC such as the arrangements documented by the Kowloon Southern Link ("KSL") Project Management Agreement, the West Rail Agency Agreement and the Outsourcing Agreement.

Notes to the Accounts

3 Rail Merger with Kowloon-Canton Railway Corporation *(continued)*

B The principal financial terms of the Rail Merger and their financial impact on the 2007 accounts are described in the following paragraphs.

For the acquisition of the service concession, the Company has settled or is liable to settle the following payments to KCRC in respect of the service concession:

- Upfront payment of HK\$4,250 million was paid on the Appointed Day, of which HK\$326 million was in respect of stores and spares, with the balance of HK\$3,924 million for the right to access, use and operate the KCRC system ("initial concession property"), which is capitalised as a service concession asset on the balance sheet and amortised on a straight-line basis over the Concession Period;
- Fixed annual payments of HK\$750 million are payable by the Company to KCRC throughout the Concession Period. The present value of the total fixed annual payments discounted at the Company's estimated long-term incremental borrowing rate of 6.75% amounting to HK\$10,687 million was capitalised as a service concession asset on the balance sheet and amortised on a straight-line basis over the Concession Period with a corresponding liability for obligations under the service concession recognised on the balance sheet; and
- Variable annual payments are payable by the Company to KCRC commencing after the third year from the Appointed Day to the end of the Concession Period. The payments are calculated on a tiered basis by reference to the revenues generated from the operation of the service concession over certain thresholds.

As at 31 December 2007, HK\$49 million was incurred on additional concession property which will be amortised over the shorter of the assets' useful lives and the remaining period of the service concession.

The assumption of the liability of deposits refundable to third parties and other liabilities subject to cash compensation by KCRC on the Appointed Day amounted to HK\$663 million. The assumption of other assets and liabilities not subject to compensation by KCRC on the Appointed Day amounted to a net liability amount of HK\$226 million (note 20), formed part of the cost of acquiring the service concession and was capitalised accordingly.

On the Appointed Day, the Company paid a total consideration of HK\$7,790 million for the transfer of the economic benefits of the property package from KCRC as follows:

- Acquisition of certain properties or property holding subsidiaries from KCRC at a consideration of HK\$2,840 million. The excess of the fair value of these properties at the balance sheet date over the consideration has been recognised as a gain in the profit and loss account;
- Acquisition of property development rights for eight development sites for a consideration of HK\$4,910 million, which was recognised at cost as property development in progress on the balance sheet. Pursuant to the transaction agreements, when the development sites which have not been awarded as at the Appointed Day are subsequently awarded, the Company is obliged to pay KCRC an agreed amount of HK\$875 million in respect of enabling works carried out by KCRC for such sites, which will be settled by the receipt of mandatory payments from property developers when the sites are awarded;
- Acquisition of certain property management rights from KCRC in respect of existing and future managed properties at a consideration of HK\$40 million. The amount was capitalised and subject to amortisation on a straight-line basis over the period of the management rights;
- Assumption of certain assets and liabilities with a net liability amount of HK\$123 million relating to the property package with corresponding cash settlement from KCRC; and
- Acquisition of certain other subsidiaries of KCRC.

The Rail Merger also gave rise to the following:

- The Company obtained a new loan financing facility of HK\$10 billion as part of the financing for the above arrangements; and
- Deferred expenditure of HK\$492 million incurred in connection with the acquisition of the respective assets was capitalised.

Income and expenditure and assets and liabilities in relation to the operation of the service concession are accounted for in the respective line items of the Group's and the Company's profit and loss accounts and balance sheets.

4 Fare Revenue

Fare revenue comprises:

<i>in HK\$ million</i>	2007	2006
Domestic Service	6,213	5,911
Cross-boundary Service	201	–
Airport Express	655	612
Light Rail, Bus and Intercity	46	–
	7,115	6,523

The Domestic Service comprises the Kwun Tong, Tsuen Wan, Island, Tung Chung, Tseung Kwan O and Disneyland Resort lines, and additional services of the East Rail excluding Cross-boundary Service, West Rail and Ma On Shan lines after the Rail Merger. The Cross-boundary Service, Light Rail, Bus and Intercity are also KCRC transport services provided by the Company after the Rail Merger.

5 Non-fare Revenue

A Station Commercial and Rail Related Revenue

Station commercial and rail related revenue comprise:

<i>in HK\$ million</i>	2007	2006
Advertising	593	534
Duty free shops and kiosk rental	499	391
Telecommunication income	233	259
Consultancy income	193	199
Miscellaneous business revenue	223	159
	1,741	1,542

B Rental, Management and Other Revenue

<i>in HK\$ million</i>	2007	2006
Property rental income:		
– Telford Plaza	524	492
– Luk Yeung Galleria	118	122
– Paradise Mall	111	112
– Maritime Square	300	281
– International Finance Centre	147	128
– Ginza Mall – Beijing	90	–
– Elements	93	–
– Other properties	198	128
	1,581	1,263
Property management income	168	149
	1,749	1,412
Ngong Ping 360 business revenue	85	64
	1,834	1,476

Notes to the Accounts

5 Non-fare Revenue *(continued)*

B Rental, Management and Other Revenue *(continued)*

Included in rental income is HK\$72 million (2006: HK\$64 million) in respect of the provision of air conditioning services. Ginza Mall commenced operations in January 2007 and Elements in October 2007. Rental income from other properties includes rent in respect of investment properties acquired from KCRC upon the Rail Merger on 2 December 2007 of HK\$21 million.

Ngong Ping 360 business revenue comprises revenue generated from the Tung Chung cable car operations and related businesses at the Ngong Ping Theme Village, which commenced on 18 September 2006. During the period from 12 June to 30 December 2007, the cable car operation was suspended for investigation and then repair and improvement after a deropement incident.

6 Operating Expenses

A Staff costs comprise:

<i>in HK\$ million</i>	2007	2006
Amount charged to profit and loss account under:		
– staff costs and related expenses	1,802	1,653
– repairs and maintenance	59	58
– expenses relating to station commercial and rail related businesses	162	145
– expenses relating to property ownership, management and other businesses	55	40
– project study and business development expenses	136	115
– staff voluntary separation payments	175	–
– other line items	21	42
Amount capitalised in:		
– railway construction in progress	49	40
– property development in progress	83	79
– assets under construction and other projects	318	309
– service concession assets	23	–
Amount recoverable	233	197
Total staff costs	3,116	2,678

The following expenditures are included in staff costs:

<i>in HK\$ million</i>	2007	2006
Share based payments	7	9
Contributions to defined contribution plans and Mandatory Provident Fund	38	23
Expense recognised in respect of defined benefit plans (note 49E)	98	123
	143	155

6 Operating Expenses (continued)

B Repairs and maintenance costs relate mainly to contracted maintenance and revenue works. Other routine repairs and maintenance works are performed by in-house operations, the costs of which are included under staff costs and stores and spares consumed.

C Project study and business development expenses comprise:

<i>in HK\$ million</i>	2007	2006
Business development expenses	239	245
Miscellaneous project study expenses	29	22
	268	267

Business development expenses relate mainly to studies on business opportunities in China and Europe in line with the Group's business strategy.

D Included in general and administration expenses and other expenses are the following charges/(credits):

<i>in HK\$ million</i>	2007	2006
Auditors' remuneration		
– audit services	5	5
– tax services	1	1
– other services	–	–
	6	6
Loss on disposal of fixed assets	36	37
Derivative financial instruments:		
– foreign exchange contracts – ineffective portion of cash flow hedges	(1)	(8)
– transfer from hedging reserve	2	1
Amortisation of land lease expenses (note 25)	13	14
Unrealised loss/(gain) on revaluation of investment in securities	4	(2)

In addition to the amounts of auditors remuneration charged to general and administration expense, HK\$5 million (2006: nil) was incurred on audit and tax related services in respect of the Rail Merger.

E Operating lease expenses charged to the profit and loss account comprise:

<i>in HK\$ million</i>	2007	2006
Shopping centre, office building, staff quarters and bus depot	59	46
Amount capitalised	(1)	(1)
	58	45

Notes to the Accounts

7 Remuneration of Members of the Board and the Executive Directorate

A Remuneration of Members of the Board and the Executive Directorate

(i) The emoluments of the Members of the Board and the Executive Directorate of the Company were as follows:

<i>in HK\$ million</i>	Fees	Base pay, allowances and benefits in kind	Retirement scheme contribution	Variable remuneration related to performance	Total
2007					
Members of the Board					
– Raymond Ch'ien Kuo-fung	1.0	–	–	–	1.0
– Cheung Yau-kai	0.2	–	–	–	0.2
– David Gordon Eldon	0.2	–	–	–	0.2
– Christine Fang Meng-sang	0.2	–	–	–	0.2
– Edward Ho Sing-tin	0.3	–	–	–	0.3
– Lo Chung-hing	0.2	–	–	–	0.2
– Ng Leung-sing (appointed on 18 December 2007)	–	–	–	–	–
– Abraham Shek Lai-him (appointed on 18 December 2007)	–	–	–	–	–
– T. Brian Stevenson	0.3	–	–	–	0.3
– Ceajer Chan Ka-keung (appointed on 10 July 2007)	0.1	–	–	–	0.1
– Eva Cheng (appointed on 1 July 2007)	0.1	–	–	–	0.1
– Sarah Liao Sau-tung (retired on 1 July 2007)	0.1	–	–	–	0.1
– Frederick Ma Si-hang (retired on 10 July 2007)	0.1	–	–	–	0.1
– Alan Wong Chi-kong	0.2	–	–	–	0.2
Members of the Executive Directorate					
– Chow Chung-kong	–	5.9	–*	5.1	11.0
– Russell John Black	–	3.8	0.1	1.7	5.6
– William Chan Fu-keung	–	3.7	0.1	1.7	5.5
– Thomas Ho Hang-kwong	–	3.8	0.1	1.6	5.5
– Lincoln Leong Kwok-kuen	–	3.8	0.5	1.7	6.0
– Francois Lung Ka-kui	–	3.5	0.5	0.8	4.8
– Andrew McCusker	–	3.7	0.1	1.4	5.2
– Leonard Bryan Turk	–	3.7	0.1	1.7	5.5
	3.0	31.9	1.5	15.7	52.1

* C K Chow is a member of the Company's Mandatory Provident Fund Scheme. The total contributions paid by the Company in each of the years 2006 and 2007 were HK\$12,000.

7 Remuneration of Members of the Board and the Executive Directorate (continued)

A Remuneration of Members of the Board and the Executive Directorate (continued)

<i>in HK\$ million</i>	Fees	Base pay, allowances and benefits in kind	Retirement scheme contribution	Variable remuneration related to performance	Total
2006					
Members of the Board					
– Raymond Ch'ien Kuo-fung	1.0	–	–	–	1.0
– Cheung Yau-kai	0.2	–	–	–	0.2
– David Gordon Eldon	0.2	–	–	–	0.2
– Christine Fang Meng-sang	0.2	–	–	–	0.2
– Edward Ho Sing-tin	0.3	–	–	–	0.3
– Lo Chung-hing	0.2	–	–	–	0.2
– T. Brian Stevenson	0.3	–	–	–	0.3
– Sarah Liao Sau-tung	0.2	–	–	–	0.2
– Frederick Ma Si-hang	0.2	–	–	–	0.2
– Alan Wong Chi-kong	0.2	–	–	–	0.2
Members of the Executive Directorate					
– Chow Chung-kong	–	5.9	–*	4.2	10.1
– Russell John Black	–	3.7	0.3	1.0	5.0
– William Chan Fu-keung	–	3.5	0.3	1.0	4.8
– Thomas Ho Hang-kwong	–	3.6	0.3	0.9	4.8
– Lincoln Leong Kwok-kuen	–	3.5	0.5	1.0	5.0
– Francois Lung Ka-kui	–	3.4	0.4	0.9	4.7
– Andrew McCusker	–	3.5	0.3	0.9	4.7
– Leonard Bryan Turk	–	3.5	0.3	1.0	4.8
	3.0	30.6	2.4	10.9	46.9

The above emoluments do not include the fair value of share options, as estimated at the date of granting, awarded to Members of the Executive Directorate whose entitlements are as follows:

(a) Options granted under the New Joiners Share Option Scheme (the "New Option Scheme")

The options granted to Francois K K Lung on 27 September 2005 lapsed on 17 October 2006 in accordance with the terms of the New Option Scheme. He was granted options in respect of 1,066,000 shares on 22 March 2007 and the respective fair value of the share-based payments recognised for the year ended 31 December 2007 was HK\$1.1 million.

The options granted to Lincoln K K Leong under the New Option Scheme were fully vested in 2006. No share-based payment was recognised for the year ended 31 December 2007 (2006: HK\$0.3 million) in respect of his shares granted under this scheme.

(b) Options granted under the 2007 Share Option Scheme (the "2007 Option Scheme")

Share options were granted to all Members of the Executive Directorate under the Company's 2007 Option Scheme, which were offered to them on 10 December 2007. Under the 2007 Option Scheme, the date of grant is defined as the date of acceptance of the offer to grant the option. The entitlements of each of the Members are as follows:

- CK Chow was granted options in respect of 720,000 shares on 13 December 2007, and the respective fair value of the share-based payments recognised for the year ended 31 December 2007 was HK\$0.071 million;
- Russell J Black, Thomas H K Ho, Lincoln K K Leong, Andrew McCusker and Leonard B Turk were each granted options in respect of 170,000 shares on 12 December 2007, and the respective fair value of the share-based payments recognised for the year ended 31 December 2007 was HK\$0.017 million for each respective Member of the Executive Directorate;

Notes to the Accounts

7 Remuneration of Members of the Board and the Executive Directorate (continued)

A Remuneration of Members of the Board and the Executive Directorate (continued)

- William F K Chan was granted options in respect of 170,000 shares on 13 December 2007, and the respective fair value of the share-based payments recognised for the year ended 31 December 2007 was HK\$0.017 million; and
- Francois K K Lung was granted options in respect of 130,000 shares on 12 December 2007, and the respective fair value of the share-based payments recognised for the year ended 31 December 2007 was HK\$0.013 million.

The details of directors' interest in the Company's shares are disclosed under the paragraph "Board Members' and Executive Directorate's Interests in Shares" of the Report of the Members of the Board and note 47.

(ii) C K Chow has a derivative interest in respect of 418,017 shares within the meaning of Part XV of the Securities and Futures Ordinance ("SFO"). The derivative interest represents C K Chow's entitlement to receive an equivalent value in cash of 418,017 shares on completion of his three-year contract ending on 30 November 2009.

On 12 April 2007, Lincoln K K Leong was granted a derivative interest in respect of 160,000 shares in the Company within the meaning of Part XV of the SFO. The derivative interest represents Lincoln K K Leong's entitlement to receive an equivalent value in cash of 160,000 shares on 9 April 2010.

The arrangements were offered to C K Chow and Lincoln K K Leong in order to provide a competitive level of compensation which is also closely tied to the performance of the Company.

(iii) The aggregate emoluments of Members of the Board and the Executive Directorate for the year pursuant to section 161 of the Hong Kong Companies Ordinance was HK\$53.4 million (2006: HK\$60.6 million).

(iv) 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 Mass Transit Railway Ordinance (Chapter 556 of the Laws of Hong Kong)) 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. Dr. Raymond Ch'ien Kuo-fung, a Member of the Board, was appointed as the non-executive Chairman of the Company with effect from 21 July 2003 for a term of three years. In July 2006, he was re-appointed as the non-executive Chairman of the Company until 31 July 2007. In July 2007, Dr. Ch'ien was re-appointed as the non-executive Chairman of the Company with effect from 1 August 2007 for a term up to 31 December 2007 or the day to be appointed by the Secretary for Transport and Housing by notice published in the Gazette under the Rail Merger Ordinance, whichever was the earlier. On 8 August 2007, he was appointed as the non-executive Chairman of the Company after the Rail Merger for a term of two years commencing from the Appointed Day. All of the five individuals with the highest emoluments are Members of the Executive Directorate whose emoluments are disclosed above.

B Share Options

Options exercised and outstanding in respect of each Member of the Executive Directorate as at 31 December 2007 are set out under the paragraph "Board Members' and Executive Directorate's Interests in Shares" of the Report of the Members of the Board. Details of the options granted to Members of the Executive Directorate are as follows:

(i) Pre-Global Offering Share Option Scheme

Under the Company's Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") described in note 47A(i), each Member of the Executive Directorate, except C K Chow, Lincoln K K Leong, Francois K K Lung and Andrew McCusker, was granted options on 20 September 2000 to acquire 1,066,000 shares. C K Chow, Lincoln K K Leong and Francois K K Lung joined the Company on 1 December 2003, 1 February 2002 and 26 September 2005 respectively, and are not beneficiaries of the Pre-IPO Option Scheme. Andrew McCusker was granted 266,500 options on 20 September 2000 under the Pre-IPO Option Scheme and no additional share options were granted upon his appointment as a Member of the Executive Directorate on 1 October 2005.

Under the vesting terms of the Pre-IPO Option Scheme, each eligible Member of the Executive Directorate must continue to beneficially own (i) at all times after 26 October 2001, at least 23,000 shares; and (ii) at all times after 26 October 2002, at least 46,000 shares, in each case, up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier).

(ii) New Joiners Share Option Scheme

Under the New Joiners Share Option Scheme as described in note 47A(ii), Lincoln K K Leong and Francois K K Lung, Members of the Executive Directorate, were granted options to acquire 1,066,000 shares on 1 August 2003 and 27 September 2005 respectively.

Under the vesting terms of the New Option Scheme, Lincoln K K Leong must continue to beneficially own (i) at all times on and after 4 August 2004, at least 23,000 shares; and (ii) at all times on and after 4 August 2005, at least 46,000 shares, up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier).

Under the vesting terms of the New Option Scheme, Francois K K Lung was required to beneficially own at all times on and after 17 October 2006, at least 23,000 shares up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier). Francois K K Lung's options lapsed on 17 October 2006 in accordance with the terms of the New Option Scheme.

On 22 March 2007, Francois K K Lung was granted options to acquire 1,066,000 shares under the New Option Scheme. Under the vesting terms of the New Option Scheme, Francois K K Lung was required to beneficially own (i) at all times on and after 9 April 2008, at least 23,000 shares; and (ii) at all times on and after 9 April 2009, at least 46,000 shares, up to and including the date on which he has exercised his option in full or the date on which his option lapses (whichever is earlier).

7 Remuneration of Members of the Board and the Executive Directorate (continued)

B Share Options (continued)

(iii) 2007 Share Option Scheme

Under the 2007 Share Option Scheme as described in note 47A(iii), all Members of the Executive Directorate were granted options to acquire shares in December 2007. CK Chow was granted options to acquire 720,000 shares; Russell J Black, William F K Chan, Thomas H K Ho, Lincoln K K Leong, Andrew McCusker and Leonard B Turk were each granted options to acquire 170,000 shares; and Francois K K Lung was granted options to acquire 130,000 shares.

Under the vesting terms of the options granted in December 2007, the options granted will be evenly vested in respect of their underlying shares over a period of three years from 10 December 2007.

8 Profit on Property Developments

<i>in HK\$ million</i>	2007	2006
Profit on property developments comprises:		
Transfer from deferred income on		
– up-front payments (note 23B(i))	861	1,213
– sharing in kind (note 23B(ii))	363	555
Share of surplus from development	7,077	3,724
Income recognised from sharing in kind	21	342
Other overhead costs	(18)	(17)
	8,304	5,817

9 Depreciation and Amortisation

Depreciation and amortisation comprise:

<i>in HK\$ million</i>	2007	2006
Depreciation charge on:		
Railway operations		
– on fixed assets held under finance leases	19	19
– on other railway fixed assets	2,501	2,504
Assets relating to station commercial and rail related businesses	73	82
Assets relating to property ownership, management and other businesses	68	22
Unallocated corporate assets	53	47
	2,714	2,674
Amortisation charge on:		
Service concession assets	25	–
Property management rights	–	–
	25	–
	2,739	2,674

Notes to the Accounts

10 Merger Related Expenses

Merger related expenses comprise:

<i>in HK\$ million</i>	2007	2006
Staff Voluntary Separation Scheme payments (i)	175	–
Merger expenses (ii)	18	–
	193	–

(i) In connection with the Rail Merger on 2 December 2007, a Staff Voluntary Separation Scheme (“VSS”) was offered to eligible staff affected by the Rail Merger, with compensation determined according to individual staff’s year of services. Applications of approximately 390 staff were approved by the Company to terminate their employment under the VSS, based on which the VSS compensation was calculated and accrued.

(ii) Starting from the completion of the Rail Merger on 2 December 2007, other merger related expenses not eligible for capitalisation have been charged to the profit and loss account.

11 Interest and Finance Charges

<i>in HK\$ million</i>	2007	2006
Interest expenses in respect of:		
Bank loans, overdrafts and capital market instruments wholly repayable within 5 years	1,004	1,143
Bank loans and capital market instruments not wholly repayable within 5 years	498	504
Obligations under finance leases	4	15
Obligations under service concession	60	–
Finance charges	19	25
Exchange gain	(5)	(2)
	1,580	1,685
Derivative financial instruments:		
Fair value hedges	62	(19)
Cash flow hedges:		
– transfer from hedging reserve	(2)	(18)
– ineffective portion	–	2
Derivatives not qualified for hedge accounting	(3)	8
	57	(27)
Interest expenses capitalised	(93)	(126)
	1,544	1,532
Interest income in respect of:		
Deposits with banks and other financial institutions	(43)	(4)
Loan to non-controlled subsidiary and associate	(7)	(5)
Staff housing loans	(1)	(2)
	(51)	(11)
Interest income from loan to a property developer	(177)	(123)
	1,316	1,398

Interest expenses capitalised were calculated at the average cost of borrowings to the Group on a monthly basis. The average interest rates for each month varied from 5.3% to 5.8% per annum during the year (2006: 5.4% to 5.6% per annum).

During the year, fair value gain on fair value hedges comprising interest rate and cross currency swaps was HK\$414 million (loss in 2006: HK\$204 million) whereas the fair value loss on the underlying financial assets and liabilities being hedged was HK\$476 million (gain in 2006: HK\$223 million) resulting in a net loss of HK\$62 million (gain in 2006: HK\$19 million).

12 Share of Profits Less Losses of Non-controlled Subsidiaries and Associates

Share of profits less losses of non-controlled subsidiaries and associates comprises:

<i>in HK\$ million</i>	2007	2006
Share of profit before taxation of non-controlled subsidiaries (note 26)	125	80
Share of profit/(loss) before taxation of associates (note 28)	3	(23)
	128	57
Share of income tax of non-controlled subsidiaries (note 26)	(28)	(12)
Share of income tax of associates (note 28)	(1)	-
	99	45

13 Income Tax

A Income tax in the consolidated profit and loss account represents:

<i>in HK\$ million</i>	2007	2006
Current tax		
– overseas tax for the year	3	2
Deferred tax		
– origination and reversal of temporary differences on:		
– change in fair value of investment properties	1,402	381
– utilisation of tax losses	1,608	1,197
– others	70	(169)
	3,080	1,409
	3,083	1,411

No provision for current Hong Kong Profits Tax has been made in the consolidated profit and loss account in respect of the Company and its subsidiaries, as the Company and its subsidiaries either have accumulated tax losses brought forward which are available for set off against current year's assessable profits or have sustained tax losses for the year ended 31 December 2007. Taxation for overseas subsidiaries is charged at the appropriate current rates of taxation ruling in the relevant countries.

Provision for deferred tax on temporary differences arising in Hong Kong is calculated at Hong Kong Profits Tax rate at 17.5% (2006: 17.5%).

B Reconciliation between tax expense and accounting profit at applicable tax rates

	2007		2006	
	<i>HK\$million</i>	%	<i>HK\$million</i>	%
Profit before taxation	18,265		9,169	
Notional tax on profit before taxation, calculated at the rates applicable to profits in the tax jurisdictions concerned	3,186	17.4	1,584	17.3
Tax effect of non-deductible expenses	53	0.3	27	0.3
Tax effect of non-taxable revenue	(162)	(0.9)	(230)	(2.5)
Tax effect of unused tax losses not recognised	6	0.0	30	0.3
Actual tax expenses	3,083	16.8	1,411	15.4

Notes to the Accounts

14 Profit Attributable to Equity Shareholders

The consolidated profit attributable to equity shareholders includes a profit of HK\$14,883 million (2006: HK\$7,717 million) which has been dealt with in the accounts of the Company.

15 Dividends

During the year, dividends paid and proposed to equity shareholders of the Company comprised:

<i>in HK\$ million</i>	2007	2006
Dividends paid and payable in respect of 2007		
– Interim dividend of 14 cents (2006: 14 cents) per share	782	774
– Final dividend proposed after the balance sheet date of 31 cents (2006: 28 cents) per share	1,740	1,554
	2,522	2,328
Dividend in respect of 2006		
– Final dividend of 28 cents (2005: 28 cents) per share approved and paid in 2007	1,554	1,535

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

During the year, scrip dividend elections were offered to all shareholders except shareholders with registered addresses in the United States of America or any of its territories or possessions. The Company's majority shareholder, The Financial Secretary Incorporated ("FSI"), had elected to receive part of its entitlement to dividends in the form of scrip to the extent necessary to ensure that the amount payable in cash would not exceed 50% of the total dividend payable. Details of dividends paid to the FSI are disclosed in note 51N. On 8 November 2006, the FSI agreed to extend the scrip dividend arrangement for another three financial years until the financial year ending 31 December 2009.

16 Earnings Per Share

A Basic earnings per share

The calculation of basic earnings per share is based on the profit for the year attributable to equity shareholders of HK\$15,180 million (2006: HK\$7,759 million) and the weighted average number of ordinary shares of 5,573,736,592 in issue during the year (2006: 5,510,345,238), calculated as follows:

	2007	2006
Issued ordinary shares at 1 January	5,548,613,951	5,481,856,439
Effect of scrip dividends issued	24,065,067	25,713,468
Effect of share options exercised	1,057,574	2,775,331
Weighted average number of ordinary shares at 31 December	5,573,736,592	5,510,345,238

B Diluted earnings per share

The calculation of diluted earnings per share is based on the profit for the year attributable to equity shareholders of HK\$15,180 million (2006: HK\$7,759 million) and the weighted average number of ordinary shares of 5,578,838,104 in issue during the year (2006: 5,516,115,460) after adjusting for the number of dilutive potential ordinary shares under the employee share option schemes, calculated as follows:

	2007	2006
Weighted average number of ordinary shares at 31 December	5,573,736,592	5,510,345,238
Number of ordinary shares deemed to be issued for no consideration	5,101,512	5,770,222
Weighted average number of ordinary shares (diluted) at 31 December	5,578,838,104	5,516,115,460

16 Earnings Per Share (continued)

C Both basic and diluted earnings per share would have been HK\$1.54 (2006: HK\$1.08) if the calculation is based on profit from underlying businesses attributable to equity shareholders, i.e. excluding increase in fair value of investment properties net of related deferred tax, adjusted as follows:

<i>in HK\$ million</i>	2007	2006
Profit attributable to equity shareholders	15,180	7,759
Increase in fair value of investment properties	(8,011)	(2,178)
Deferred tax on change in fair value of investment properties (note 13A)	1,402	381
Profit from underlying businesses attributable to equity shareholders	8,571	5,962

17 Segmental Information

Segmental information is presented in accordance with the Group's business segments, which comprise the following:

Railway operations: The operation of an urban mass transit railway system within Hong Kong and an Airport Express serving both the Hong Kong International Airport and the AsiaWorld-Expo at Chek Lap Kok and following the Rail Merger, with effect from 2 December 2007, the KCR system consisting of KCR Lines (comprising the East Rail excluding Cross-boundary Service, West Rail and Ma On Shan lines), Cross-boundary Service, Light Rail, Bus and Intercity passenger services.

Station commercial and rail related businesses: Commercial activities including letting of advertising and retail space, bandwidth services on the railway telecommunication system, railway consultancy services, freight and rail related subsidiaries' businesses.

Property ownership, management and other businesses: Property rental, property management and, commencing from September 2006, operations relating to Ngong Ping 360.

Property developments: Property development at locations relating to the railway system.

17 Segmental Information (continued)

<i>in HK\$ million</i>	Railway operations	Station commercial and rail related businesses	Property ownership, management and other businesses	Total railway operations and related activities	Property developments	Total
2007						
Liabilities						
Segmented liabilities	2,764	1,034	1,128	4,926	1,614	6,540
Obligations under service concession	10,685	–	–	10,685	–	10,685
Deferred income	115	–	–	115	400	515
	13,564	1,034	1,128	15,726	2,014	17,740
Unallocated liabilities						46,891
Total liabilities						64,631
Other Information						
Capital expenditure on:						
Operational assets	31	2	11	44	–	44
Assets under construction	625	123	19	767	620	1,387
Investment properties	–	–	3,204	3,204	–	3,204
Service concession assets	14,886	–	–	14,886	–	14,886
Property management rights	–	–	40	40	–	40
Railway construction in progress	263	–	–	263	–	263
Property development in progress	–	–	–	–	6,239	6,239
Non-cash expenses other than depreciation and amortisation	36	3	1	40	–	40

* Operational assets include property, plant and equipment and other assets employed in the operations of individual business segments.

Notes to the Accounts

17 Segmental Information (continued)

<i>in HK\$ million</i>	Railway operations	Station commercial and rail related businesses	Property ownership, management and other businesses	Total railway operations and related activities	Property developments	Total
2006						
Revenue	6,523	1,542	1,476	9,541	–	9,541
Operating expenses before depreciation and amortisation	(3,003)	(410)	(345)	(3,758)	–	(3,758)
	3,520	1,132	1,131	5,783	–	5,783
Profit on property developments	–	–	–	–	5,817	5,817
Operating profit before depreciation and amortisation	3,520	1,132	1,131	5,783	5,817	11,600
Depreciation and amortisation	(2,523)	(82)	(22)	(2,627)	–	(2,627)
	997	1,050	1,109	3,156	5,817	8,973
Unallocated corporate expenses						(629)
Operating profit before interest and finance charges						8,344
Interest and finance charges						(1,398)
Change in fair value of investment properties			2,178			2,178
Share of profits less losses of non-controlled subsidiaries and associates						45
Income tax						(1,411)
Profit for the year ended 31 December 2006						7,758
Assets						
Operational assets *	76,097	2,503	22,971	101,571	825	102,396
Assets under construction	1,037	9	63	1,109	3,796	4,905
Railway construction in progress	232	–	–	232	–	232
Property development in progress	–	–	–	–	3,297	3,297
Deferred expenditure	395	–	–	395	–	395
Prepaid land lease payments	594	–	–	594	–	594
Investments in securities	272	–	–	272	–	272
Properties held for sale	–	–	–	–	2,018	2,018
Loan to a property developer	–	–	–	–	3,355	3,355
	78,627	2,512	23,034	104,173	13,291	117,464
Interests in non-controlled subsidiaries						171
Interests in associates						100
Unallocated assets						2,686
Total assets						120,421
Liabilities						
Segmented liabilities	1,988	511	711	3,210	623	3,833
Deferred income	120	–	–	120	1,562	1,682
	2,108	511	711	3,330	2,185	5,515
Unallocated liabilities						38,120
Total liabilities						43,635

17 Segmental Information (continued)

<i>in HK\$ million</i>	Railway operations	Station commercial and rail related businesses	Property ownership, management and other businesses	Total railway operations and related activities	Property developments	Total
2006						
Other Information						
Capital expenditure on:						
Operational assets	64	4	1	69	–	69
Assets under construction	1,075	116	63	1,254	898	2,152
Investment properties	–	–	469	469	–	469
Railway construction in progress	430	–	–	430	–	430
Property development in progress	–	–	–	–	1,113	1,113
Non-cash expenses other than depreciation and amortisation	37	11	–	48	–	48

As substantially all of the principal operating activities of the Group were carried out in Hong Kong throughout the reporting periods, no geographical analysis is provided.

18 Investment Properties

Movements and analysis of the Group's investment properties, all of which are held in Hong Kong and carried at fair value, are as follows:

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Valuation				
At 1 January	22,539	19,892	22,539	19,892
Additions through Rail Merger	2,840	–	1,874	–
Transfer from assets under construction (note 19)	4,027	–	4,027	–
Other additions	364	469	169	469
Change in fair value	8,011	2,178	8,011	2,178
Transfer to self-occupied land and buildings (note 19)	(58)	–	(58)	–
At 31 December	37,723	22,539	36,562	22,539
Long leases	1,609	1,437	1,609	1,437
Medium-term leases	36,114	21,102	34,953	21,102
	37,723	22,539	36,562	22,539

During 2007, phase 1 of the retail shopping centre at Union Square ("Elements") was completed and the value of the shell and cost of fitting-out works, which was carried as assets under construction in other property, plant and equipment, was transferred to investment properties.

All investment properties of the Group were revalued at open market value at 31 December 2007 by an independent firm of surveyors, Jones Lang LaSalle Limited (2006: DTZ Debenham Tie Leung), who have among their staff Members of the Hong Kong Institute of Surveyors. The valuations are based on a "term and reversion basis", which capitalises the existing and reversionary net rental income having regard to market valuation checks on comparable sale and yields. The net increase in fair value of HK\$8,011 million (2006: HK\$2,178 million) arising from the revaluation has been credited to the profit and loss account.

The group's future minimum lease receipts in respect of investment properties under non-cancellable operating leases are disclosed together with those in respect of other properties under note 19D.

Notes to the Accounts

19 Other Property, Plant and Equipment

The Group

<i>in HK\$ million</i>	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation					
At 1 January 2007	1,989	46,544	57,767	4,905	111,205
Additions	–	–	44	1,387	1,431
Capitalisation adjustments *	–	(42)	(49)	–	(91)
Disposals/Write-offs	–	(4)	(371)	–	(375)
Surplus on revaluation (note 46)	193	–	–	–	193
Reclassification	–	(61)	61	–	–
Transfer from deferred expenditure (note 24)	–	–	59	44	103
Transfer from/(to) investment properties (note 18)	58	–	–	(4,027)	(3,969)
SkyPlaza Platform Project commissioned (note 22)	–	–	71	–	71
Other assets commissioned	–	34	1,238	(1,272)	–
At 31 December 2007	2,240	46,471	58,820	1,037	108,568
At Cost	–	46,471	58,820	1,037	106,328
At 31 December 2007 Valuation	2,240	–	–	–	2,240
Aggregate depreciation					
At 1 January 2007	–	3,864	22,937	–	26,801
Charge for the year	52	387	2,279	–	2,718
Capitalisation adjustments *	–	(1)	(3)	–	(4)
Written back on disposal	–	(2)	(337)	–	(339)
Written back on revaluation (note 46)	(52)	–	–	–	(52)
Reclassification	–	(12)	12	–	–
At 31 December 2007	–	4,236	24,888	–	29,124
Net book value at 31 December 2007	2,240	42,235	33,932	1,037	79,444
Cost or Valuation					
At 1 January 2006	1,705	46,188	56,339	3,661	107,893
Additions	–	–	69	2,152	2,221
Disposals/Write-offs	–	(20)	(370)	(2)	(392)
Surplus on revaluation (note 46)	284	–	–	–	284
Tung Chung Cable Car Project commissioned (note 22)	–	375	824	–	1,199
Other assets commissioned	–	1	905	(906)	–
At 31 December 2006	1,989	46,544	57,767	4,905	111,205
At Cost	–	46,544	57,767	4,905	109,216
At 31 December 2006 Valuation	1,989	–	–	–	1,989
Aggregate depreciation					
At 1 January 2006	–	3,492	21,018	–	24,510
Charge for the year	45	380	2,249	–	2,674
Written back on disposal	–	(8)	(330)	–	(338)
Written back on revaluation (note 46)	(45)	–	–	–	(45)
At 31 December 2006	–	3,864	22,937	–	26,801
Net book value at 31 December 2006	1,989	42,680	34,830	4,905	84,404

* Capitalisation adjustments relate to certain railway assets capitalised at time of commissioning based on contractors' claimed values. Such assets' final values have been adjusted downward following finalisation of contract claims with contractors at lower final contract values during the year.

Depreciation charge for the year was HK\$2,714 million (2006: HK\$2,674 million), comprising depreciation for the year of HK\$2,718 million (2006: HK\$2,674 million) less capitalisation adjustments of HK\$4 million (2006: nil).

19 Other Property, Plant and Equipment (continued)

The Company

<i>in HK\$ million</i>	Self-occupied land and buildings	Civil works	Plant and equipment	Assets under construction	Total
Cost or Valuation					
At 1 January 2007	1,989	46,544	57,195	4,832	110,560
Additions	–	–	39	1,346	1,385
Capitalisation adjustments *	–	(42)	(43)	–	(85)
Disposals/Write-offs	–	(4)	(371)	–	(375)
Surplus on revaluation (note 46)	193	–	–	–	193
Reclassification	–	(61)	61	–	–
Transfer from deferred expenditure (note 24)	–	–	59	44	103
Transfer from/(to) investment properties (note 18)	58	–	–	(4,027)	(3,969)
SkyPlaza Platform Project commissioned (note 22)	–	–	71	–	71
Other assets commissioned	–	34	1,132	(1,166)	–
At 31 December 2007	2,240	46,471	58,143	1,029	107,883
At Cost	–	46,471	58,143	1,029	105,643
At 31 December 2007 Valuation	2,240	–	–	–	2,240
Aggregate depreciation					
At 1 January 2007	–	3,864	22,440	–	26,304
Charge for the year	52	387	2,262	–	2,701
Capitalisation adjustments *	–	(1)	(3)	–	(4)
Written back on disposal	–	(2)	(334)	–	(336)
Written back on revaluation (note 46)	(52)	–	–	–	(52)
Reclassification	–	(12)	12	–	–
At 31 December 2007	–	4,236	24,377	–	28,613
Net book value at 31 December 2007	2,240	42,235	33,766	1,029	79,270
Cost or Valuation					
At 1 January 2006	1,705	46,188	55,676	3,637	107,206
Additions	–	–	65	2,069	2,134
Disposals/Write-offs	–	(20)	(241)	(2)	(263)
Surplus on revaluation (note 46)	284	–	–	–	284
Tung Chung Cable Car Project commissioned (note 22)	–	375	824	–	1,199
Other assets commissioned	–	1	871	(872)	–
At 31 December 2006	1,989	46,544	57,195	4,832	110,560
At Cost	–	46,544	57,195	4,832	108,571
At 31 December 2006 Valuation	1,989	–	–	–	1,989
Aggregate depreciation					
At 1 January 2006	–	3,492	20,428	–	23,920
Charge for the year	45	380	2,216	–	2,641
Written back on disposal	–	(8)	(204)	–	(212)
Written back on revaluation (note 46)	(45)	–	–	–	(45)
At 31 December 2006	–	3,864	22,440	–	26,304
Net book value at 31 December 2006	1,989	42,680	34,755	4,832	84,256

* Capitalisation adjustments relate to certain railway assets capitalised at time of commissioning based on contractors' claimed values. Such assets' final values have been adjusted downward following finalisation of contract claims with contractors at lower final contract values during the year.

Depreciation charge for the year was HK\$2,697 million (2006: HK\$2,641 million), comprising depreciation for the year of HK\$2,701 million (2006: HK\$2,641 million) less capitalisation adjustments of HK\$4 million (2006: nil).

Notes to the Accounts

19 Other Property, Plant and Equipment (continued)

All of the Group's self-occupied land and buildings are held in Hong Kong under medium-term leases and carried at fair value.

A All self-occupied land and buildings were revalued at open market value on an existing use basis at 31 December 2007 by an independent firm of surveyors, Jones Lang LaSalle Limited (2006: DTZ Debenham Tie Leung), who have among their staff Members of the Hong Kong Institute of Surveyors. The valuation resulted in a revaluation surplus of HK\$245 million (2006: HK\$329 million), which net of deferred tax of HK\$43 million (2006: HK\$58 million) (note 44B), has been transferred to the fixed asset revaluation reserve account (note 46).

The carrying amount of the self-occupied land and buildings at 31 December 2007 would have been HK\$928 million (2006: HK\$892 million) had the land and buildings been stated at cost less accumulated depreciation.

B Assets under construction include a partially renovated shell of the retail shopping centre at Union Square, Kowloon Station and its car parking spaces received by the Company as a sharing in kind from the development. During 2007, phase 1 of the shopping centre ("Elements") was completed and transferred to investment properties (note 18). The properties under construction are stated at cost, which is deemed to be the fair value upon receipt (note 2K(ix)) determined by reference to an open market valuation undertaken by an independent firm of surveyors, Jones Lang LaSalle Limited, who have among their staff Members of the Hong Kong Institute of Surveyors.

C In addition to the self-occupied land and buildings treated as being held under finance leases in note 19A above, the Group has the following assets held under agreements which are treated as finance leases:

The Group and The Company

<i>in HK\$ million</i>	Civil works Eastern Harbour Crossing	
	2007	2006
Cost	1,254	1,254
Less: Aggregate depreciation	326	307
Net book value	928	947

In 1986, the Company entered into a Management Agreement (the "1986 Agreement") with New Hong Kong Tunnel Company Limited ("NHKTC") to operate the Eastern Harbour Crossing ("EHC") until February 2008. Included in the assets held under the 1986 Agreement are railway and ancillary works relating to the rail tunnel.

At the expiry of the 1986 Agreement, title to the assets will, pursuant to the Eastern Harbour Crossing Ordinance, be vested in the Government which in turn entered into a Memorandum of Understanding dated 17 October 1986 with the Company to the effect that the assets will be vested in the Company on terms to be agreed between the Company and the Government. On 30 June 2000, the Company entered into a further agreement with the Government pursuant to which the relevant assets will be vested by the Government into the Company in 2008 for a nominal consideration and the Company agreed to indemnify the Government for certain amounts which are expected to be nominal. On this basis, the semi-annual payments made by the Company to NHKTC in respect of the EHC are dealt with in these accounts as payments under a finance lease.

The Group has made its final lease payment under the 1986 Agreement to NHKTC during the year. On 5 February 2008, the Company entered into a new Operating Agreement with NHKTC whereby both companies agreed to share the future costs of maintenance, care, upkeep and repair of certain common facilities and utilities of the EHC assets; and the Company to carry out repair, maintenance and upkeep of the railway and assets solely for purpose of rail use in respect of the EHC following expiry of the 1986 Agreement.

D The Group leases out investment properties and station kiosks, including duty free shops, under operating leases. The leases typically run for an initial period of one to ten years, with an option to renew the lease after that date at which time all terms will be renegotiated. Lease payments are usually adjusted annually to reflect market rentals. Certain leases above carry additional rental based on turnover, some of which are with reference to thresholds. Lease incentives granted are amortised in the profit and loss account as an integral part of the net lease payment receivable.

The gross carrying amounts of investment properties of the Group and the Company held for use in operating leases were HK\$37,723 million (2006: HK\$22,539 million). The gross carrying amounts of station kiosks held for use in operating leases were HK\$482 million (2006: HK\$439 million) and the related accumulated depreciation charges were HK\$127 million (2006: HK\$108 million).

19 Other Property, Plant and Equipment (continued)

The Group's total future minimum lease receipts under non-cancellable operating leases are receivable as follows:

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Within 1 year	3,024	1,350
After 1 year but within 5 years	6,355	1,875
Later than 5 years	181	161
	9,560	3,386

As at 31 December 2007, HK\$4,493 million of the future minimum lease receipts under non-cancellable operating leases was in connection with investment properties, duty free shops and station kiosks pursuant to the Rail Merger.

E In March 2003, the Group entered into a series of structured transactions with unrelated third parties to lease out and lease back certain of its passenger cars ("Lease Transaction") involving a total original cost of HK\$2,562 million and a total net book value of HK\$1,674 million as at 31 March 2003. Under the Lease Transaction, the Group has leased the assets to institutional investors in the United States (the "Investors"), who have prepaid all the rentals in relation to the lease agreement. Simultaneously, the Group has leased the assets back from the Investors based on terms ranging from 21 to 29 years with an obligation to pay rentals in accordance with a pre-determined payment schedule. The Group has an option to purchase the Investors' leasehold interest in the assets at the expiry of the lease term for fixed amounts. Part of the rental prepayments received from the Investors has been invested in debt securities to meet the Group's rental obligations and the amount payable for exercising the purchase option under the Lease Transaction. The Group has an obligation to replace these debt securities with other debt securities in the event those securities do not meet certain credit ratings requirements. In addition, the Group has provided standby letters of credit to the Investors to cover additional amounts payable by the Group in the event the transactions are terminated prior to the expiry of the lease terms.

The Group retains legal title to the assets and there are no restrictions on the Group's ability to utilise these assets in the operation of the railway business.

As a result of the Lease Transaction, the Group received total cash of approximately HK\$3,688 million and committed to long-term lease payments with an estimated net present value in March 2003 of approximately HK\$3,533 million, which have been defeased by purchase of debt securities to meet the payment obligations. The Group received in 2003 the cash amount of HK\$141 million net of costs from the Lease Transaction.

As the Group is not able to control the investment account in pursuit of its own objectives and its obligations to pay the lease payments are funded by the proceeds of the above investments, those liabilities and investments in debt securities are not recognised in March 2003 as obligations and assets of the Group. The net amount of cash received by the Group has been accounted for as deferred income.

20 Service Concession Assets

Service concession assets are in respect of the Company's right to access, use and operate the KCRC system pursuant to the Rail Merger.

The Group and The Company

<i>in HK\$ million</i>	Initial concession property	Additional concession property	Total
2007			
Cost			
At 1 January 2007	–	–	–
Additions through the Rail Merger			
– Upfront payment *	3,924	–	3,924
– Principal element of fixed annual payments (note 42)	10,687	–	10,687
– Others (note 3B)	226	31	257
Additions during the year	–	18	18
Transfer from deferred expenditure (note 24)	389	–	389
At 31 December 2007	15,226	49	15,275
Accumulated amortisation			
At 1 January 2007	–	–	–
Charge for the year	25	–	25
At 31 December 2007	25	–	25
Net book value at 31 December 2007	15,201	49	15,250

* Upfront payment for service concession is represented by payment on the Appointed Day, amounting to HK\$4,250 million, net of stores and spares of HK\$326 million acquired.

Notes to the Accounts

21 Property Management Rights

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Cost		
At 1 January	-	-
Addition through the Rail Merger	40	-
At 31 December	40	-
Accumulated amortisation		
At 1 January	-	-
Charge for the year	-	-
At 31 December	-	-
Net book value at 31 December	40	-

22 Railway Construction in Progress

The Group and The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure	Capitalised on commissioning (note 19)	Transfer to stores and spares	Balance at 31 Dec
2007					
Tseung Kwan O South Project					
Construction costs	117	197	-	-	314
Consultancy fees	10	1	-	-	11
Staff costs and other expenses	43	38	-	-	81
Finance costs	5	13	-	-	18
	175	249	-	-	424
SkyPlaza Platform Project					
Construction costs	40	10	(50)	-	-
Staff costs and other expenses	14	4	(18)	-	-
Finance costs	3	-	(3)	-	-
	57	14	(71)	-	-
Total	232	263	(71)	-	424

22 Railway Construction in Progress (continued)

The Group and The Company (continued)

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure	Capitalised on commissioning (note 19)	Transfer to stores and spares	Balance at 31 Dec
2006					
Tseung Kwan O South Project					
Construction costs	18	99	–	–	117
Consultancy fees	8	2	–	–	10
Staff costs and other expenses	16	27	–	–	43
Finance costs	1	4	–	–	5
	43	132	–	–	175
Tung Chung Cable Car Project					
Construction costs	755	193	(943)	(5)	–
Consultancy fees	51	24	(75)	–	–
Staff costs and other expenses	79	15	(94)	–	–
Finance costs	48	39	(87)	–	–
	933	271	(1,199)	(5)	–
SkyPlaza Platform Project					
Construction costs	24	16	–	–	40
Staff costs and other expenses	6	8	–	–	14
Finance costs	–	3	–	–	3
	30	27	–	–	57
Total	1,006	430	(1,199)	(5)	232

A Tseung Kwan O South Project

The construction of future railway stations along the Tseung Kwan O Line is covered by the Project Agreement with the Government signed on 4 November 1998.

The project's target completion is in 2009. The capital cost for the project based on the defined scope of works and programme is estimated at approximately HK\$1 billion.

At 31 December 2007, the Company had incurred expenditure of HK\$424 million (excluding HK\$2 million spares capitalised in other property, plant and equipment) on the project (2006: HK\$175 million) and had authorised outstanding commitments on contracts totalling HK\$147 million (2006: HK\$321 million) related to the project.

B SkyPlaza Platform Project

The Project Agreement between Airport Authority and the Company for the design, construction, financing and operation of the SkyPlaza Platform Project was signed on 18 July 2005.

The project was completed and started to serve the public on 28 February 2007. Negotiation on the final accounts with various contractors is being performed. It is anticipated that the total cost estimate of the project will be approximately HK\$0.1 billion.

C Kowloon Southern Link ("KSL") Project

After the Rail Merger, the construction of KSL remains a responsibility of KCRC who continues to fund the relating construction costs. Pursuant to the KSL Project Management Agreement, the Company acts as a project management agent to KCRC in connection with the KSL under certain circumstances in return for a project management fee plus incentive payment if the construction of KSL is completed ahead of time and under budget. Expenditure incurred by the Company for the project management is charged to the profit and loss account while the project management fee is recognised as revenue in accordance with the Company's accounting policy on revenue recognition of contracts. In 2007, HK\$24 million of project management fee was recognised as income in the profit and loss account. KSL will form part of the service concession on opening for service which is scheduled in 2009.

Notes to the Accounts

23 Property Development in Progress

Under the Airport Railway Agreement related to the construction of the Airport Railway, the Government had granted to the Company development rights on the land ("Land Grant") over the five station sites along the railway at market value for property development. In preparing the sites for development, the Company incurs costs related to foundation and site enabling works and expects the costs to be reimbursed by property developers in the form of up-front cash payments when development packages are awarded. In accordance with the development agreements entered into with property developers, the developers are also responsible for the balance of the development costs.

Notwithstanding having entered into the development agreements with the developers, the Company being the grantee of the land remains primarily responsible for the fulfilment of all the conditions and obligations in the Land Grant. Such conditions and obligations include the type and quantity of the developments that must be built, public facilities to be provided, and the completion date of the project.

Costs of foundation, site enabling works and land costs incurred by the Company are capitalised as property development in progress and payments received from developers are credited to property development in progress to offset costs incurred in respect of the same development. In cases where payments received from developers exceed the related expenditure incurred by the Company, such excess is recorded as deferred income (note 23B(i)). In these cases, any subsequent expenditure incurred by the Company in respect of that development will be charged against deferred income. Deferred income is to be recognised as profits of the Company at the appropriate time after charging any remaining costs related to foundation and site enabling works, and after taking into account the outstanding risks and obligations retained by the Company relating to each development. Until such time as deferred income is recognised as profit, it is recorded as a liability of the Company in recognition of the Company's obligations under the Land Grant.

The Tseung Kwan O Extension ("TKE") Project Agreement entered into in 1998 between the then Secretary for Transport, for and on behalf of the Government, and the Company in respect of the construction of the Tseung Kwan O Extension provides the Company with the right to undertake property developments at four station and depot sites along the Tseung Kwan O Line ("Tseung Kwan O Extension Property Projects") under separate land grant agreements. The basis of accounting for development costs incurred by the Company and payment related thereto is consistent with that for the property developments along the Airport Railway.

In addition, the Company acquired property development rights on eight development sites, comprising three awarded and five not yet awarded sites along the East Rail Line, Kowloon Southern Link and Light Rail ("ERL/KSL/LR Property Projects"), from KCRC pursuant to the Rail Merger (note 3A).

A Property Development in Progress

The Group and The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure	Offset against payments received from developers (note 23B(ii))	Transfer out on project completion	Balance at 31 Dec
2007					
Airport Railway Property Projects	–	139	(139)	–	–
Tseung Kwan O Extension Property Projects	3,297	288	(278)	–	3,307
ERL/KSL/LR Property Projects	–	5,812	(53)	–	5,759
	3,297	6,239	(470)	–	9,066
2006					
Airport Railway Property Projects	–	106	(106)	–	–
Tseung Kwan O Extension Property Projects	2,756	1,007	(452)	(14)	3,297
	2,756	1,113	(558)	(14)	3,297

Tseung Kwan O Extension Projects includes capitalised interest of HK\$768 million (2006: HK\$768 million) in connection with the Company's interest-free loan of HK\$4,000 million extended to the developer of Package 2, Tseung Kwan O Area 86 property development project in 2006 (note 35). ERL/KSL/LR Property Projects include the acquisition cost for the property development rights for eight development sites from KCRC of HK\$4,910 million and mandatory payments of HK\$875 million (note 3B).

23 Property Development in Progress (continued)

B Deferred Income on Property Development

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Deferred income on property development comprises:		
– Up-front payments received from developers (note 23B(i))	321	1,120
– Sharing in kind (note 23B(ii))	79	442
	400	1,562

(i) Deferred Income on Up-front Payments

The Group and The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Payments received from developers	Offset against development in progress (note 23A)	Amount recognised as profit (note 8)	Balance at 31 Dec
2007					
Airport Railway Property Projects	1,120	120	(139)	(861)	240
Tseung Kwan O Extension Property Projects	–	359	(278)	–	81
ERL/KSL/LR Property Projects	–	53	(53)	–	–
	1,120	532	(470)	(861)	321
2006					
Airport Railway Property Projects	2,419	20	(106)	(1,213)	1,120
Tseung Kwan O Extension Property Projects	42	410	(452)	–	–
	2,461	430	(558)	(1,213)	1,120

(ii) Deferred Income on Sharing in Kind

Under the property development agreement in respect of an Airport Railway development package, the Company received during 2004 certain portions of the shell of a retail centre at Union Square, Kowloon Station and its car parking spaces. Part of the property development profit is deferred as the Company has an obligation under the development agreement to complete the fitting-out works. On this basis, movements of the deferred income on this sharing in kind during the year are set out below:

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Balance as at 1 January	442	997
Less: Amount recognised as profit (note 8)	(363)	(555)
Balance as at 31 December	79	442

Notes to the Accounts

23 Property Development in Progress *(continued)*

C Stakeholding Funds

As stakeholder under certain Airport Railway and Tseung Kwan O Extension Property Projects, the Company receives and manages deposit monies and sales proceeds in respect of sales of properties under those developments. These monies are placed in separate designated bank accounts and, together with any interest earned, will be released to the developers for the reimbursement of costs of the respective developments in accordance with the terms and conditions of the Government Consent Schemes and development agreements. Any balance remaining will only be released for distribution after all obligations relating to the developments have been met. Accordingly, the balances of the stakeholding funds and the corresponding bank balances have not been included in the Group's and the Company's balance sheets. Movements in stakeholding funds during the year were as follows:

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Balance as at 1 January	6,860	3,478
Stakeholding funds received	19,439	22,843
Add: Interest earned thereon	260	176
	26,559	26,497
Disbursements during the year	(21,295)	(19,637)
Balance as at 31 December	5,264	6,860
<i>Represented by:</i>		
Balances in designated bank accounts as at 31 December	5,262	6,858
Retention receivable	2	2
	5,264	6,860

D West Rail Property Developments

As part of the Rail Merger, the Company was appointed to act as the agent of KCRC and certain KCRC subsidiary companies ("West Rail Subsidiaries") in the development of specified development sites along the West Rail. The Company will receive an agency fee of 0.75% of the gross sale proceeds in respect of the unawarded West Rail development sites and 10% of the net profits accrued to the West Rail Subsidiary under the development agreement in respect of an awarded West Rail development site. The Company will also recover from the West Rail Subsidiaries all the costs incurred in respect of the West Rail development sites plus 16.5% on-cost, together with interest accrued thereon. In 2007, the reimbursable costs incurred by the Company including on-cost and interest accrued was HK\$1 million.

24 Deferred Expenditure

The Group

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure during the year	Transfer to other property, plant and equipment (note 19)	Transfer to service concession assets (note 20)	Balance at 31 Dec
2007					
Merger expenditure	170	322	(103)	(389)	–
Expenditure on proposed capital projects	395	430	–	–	825
	565	752	(103)	(389)	825
2006					
Merger expenditure	72	98	–	–	170
Expenditure on proposed capital projects	209	186	–	–	395
	281	284	–	–	565

24 Deferred Expenditure (continued)

The Company

<i>in HK\$ million</i>	Balance at 1 Jan	Expenditure during the year	Transfer to other property, plant and equipment (note 19)	Transfer to service concession assets (note 20)	Balance at 31 Dec
2007					
Merger expenditure	170	322	(103)	(389)	–
Expenditure on proposed capital projects	113	42	–	–	155
	283	364	(103)	(389)	155
2006					
Merger expenditure	72	98	–	–	170
Expenditure on proposed capital projects	43	70	–	–	113
	115	168	–	–	283

Merger expenditure comprised external consultancy, incremental direct staff costs and expenses in relation to the Rail Merger. The expenditure was capitalised as other property, plant and equipment or service concession asset according to the nature of the expenses on the Appointed Day.

The expenditure incurred on the proposed capital projects for the year mainly relates to design works for the Shenzhen Metro Line 4 Project in China, the West Island Line and South Island Line (East) Projects in Hong Kong.

25 Prepaid Land Lease Payments

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Cost		
At 1 January	732	732
Addition	–	–
At 31 December	732	732
Accumulated amortisation		
At 1 January	138	124
Charge for the year	13	14
At 31 December	151	138
Net book value at 31 December	581	594

A The above prepaid land lease payments, all of which relate to land held for railway depots in Hong Kong, is analysed as follows:

The Group and The Company

<i>in HK\$ million</i>	2007	2006
At net book value		
– long leases	154	157
– medium-term leases	427	437
	581	594

B The lease of the land on which the civil works, plant and equipment are situated for the operation of the railway was granted to the Company under a running line lease for the period up to 29 June 2050 which can be extended for further periods of 50 years at nominal payment (note 51C).

Under the terms of the lease, the Company undertakes to keep and maintain all the leased areas, including underground and overhead structures, at its own cost. With respect to parts of the railway situated in structures where access is shared with other users, such as the Lantau Fixed Crossing, the Company's obligation for maintenance is limited to the railway only. All maintenance costs incurred under the terms of the lease have been dealt with as railway operating costs in the profit and loss account.

Notes to the Accounts

26 Interests in Non-controlled Subsidiaries

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Unlisted shares, at cost	–	–	24	24
Share of net assets	268	171	–	–
	268	171	24	24

The following list contains the particulars of all major non-controlled subsidiaries of the Group:

Name of company	Issued and paid up ordinary share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
Octopus Holdings Limited	HK\$42,000,000	57.4%	57.4%	–	Hong Kong	Investment holding
Octopus Cards Limited	HK\$42,000,000	57.4%	–	100%	Hong Kong	Operate a contactless smartcard common payment system in Hong Kong
Octopus Connect Limited	HK\$2	57.4%	–	100%	Hong Kong	Customer relationship management service
Octopus Investments Limited	HK\$2	57.4%	–	100%	Hong Kong	Investment holding
Octopus Knowledge Limited	HK\$2	57.4%	–	100%	Hong Kong	Marketing and management of overseas automatic fare collection consultancy projects
Octopus Netherlands Limited	HK\$1	57.4%	–	100%	Hong Kong	Consultancy services on introducing a smartcard system in the Netherlands
Octopus Rewards Limited	HK\$1	57.4%	–	100%	Hong Kong	Develop and operate a common loyalty scheme
Octopus Solutions Limited	HK\$2	57.4%	–	100%	Hong Kong	Project management
Octopus Systems Limited	HK\$2	57.4%	–	100%	Hong Kong	Project management
Octopus Cards Macau Limited	MOP10,000	57.4%	–	100%	Macau	Promote the contactless common payment system in Macau
Octopus Cards (NL) B.V.	EUR18,000	57.4%	–	100%	Netherlands	Project management on introducing a smartcard system in the Netherlands

In June 1994, the Company entered into an agreement with four local transport companies, Kowloon-Canton Railway Corporation, The Kowloon Motor Bus Company (1933) Limited (subsequently replaced by KMB Public Bus Services Holdings Limited), Citybus Limited and The Hongkong and Yaumati Ferry Co., Limited (subsequently replaced by New World First Bus Services Limited and New World First Ferry Services Limited), to incorporate a company, Creative Star Limited, now Octopus Cards Limited ("OCL"), to undertake the development and operation of the "Octopus" contactless smart card ticketing system, which was initially used by the shareholding transport companies. Although the Company currently holds a 57.4% interest in the issued shares of OCL, its appointees to the Board of Directors of OCL are limited to 49% of the voting rights at board meetings. The shareholders have agreed to provide the necessary funding to OCL for its operations and for the development of the "Octopus" system.

26 Interests in Non-controlled Subsidiaries (continued)

On 20 April 2000, OCL received approval from The Hong Kong Monetary Authority ("HKMA") to become a deposit-taking company ("DTC") for purposes of extending the use of Octopus cards to a wider range of services, including those that are non-transport related. Prior to becoming a DTC, the Octopus card was exempted from the definition of "multi-purpose card" under the Banking Ordinance (Chapter 155 of the Laws of Hong Kong) on the basis that its use was restricted to transport related services only.

On 17 January 2001, the Company entered into a Shareholders' Agreement with the other shareholders of OCL. Under this agreement, the Company disposed of a shareholding interest of 10.4% in OCL to certain other shareholders of OCL for a consideration of HK\$16 million, together with a deferred consideration to be received in the event of OCL subsequently becoming a stock exchange listed company.

On 21 October 2005, the Company and the other shareholders of OCL entered into a number of agreements to adjust the arrangements relating to OCL, in order to make the non-payment businesses of OCL into new, separate subsidiaries independent of the payment business of OCL that is regulated by the HKMA. Accordingly, a new holding company, Octopus Holdings Limited ("OHL"), has been set up to hold the entire issued share capital of each of these new companies as well as OCL. The Company's effective interest in OHL and its subsidiaries is 57.4%.

At the same time, the shareholders of OHL made a loan in aggregate amounting to HK\$150 million to OHL pursuant to a Subordinated Loan Agreement, with each shareholder lending an amount in proportion to its shareholding in OHL. The Company has therefore lent HK\$86 million to OHL (or 57.4% of the total amount of the loan). The loan is for a term of five years and is unsecured, the rights of the lenders are subordinated in all respects to the rights of the other unsubordinated creditors of OHL in respect of all other unsubordinated liabilities, and interest on the loan is payable at a rate of 5.5% per annum.

During the year ended 31 December 2007, a total amount of HK\$62 million (2006: HK\$56 million) was paid by the Company to OCL in respect of the central clearing services provided by OCL to the Company. During the same period, load agent fees and fees for handling Octopus card issuance and refund amounting to HK\$9 million (2006: HK\$9 million) and HK\$6 million (2006: HK\$5 million) respectively were received from OCL in respect of services and facilities provided by the Company at various MTR stations. In addition, interest income of HK\$5 million (2006: HK\$5 million) was received from OHL in respect of the subordinated loan provided by the Company to OHL in 2005.

During the year, service fees amounting to HK\$2 million (2006: HK\$2 million) were also received from OCL in respect of rental of computer equipment and services and warehouse storage space payable to the Company under a service agreement.

The condensed consolidated profit and loss account and the balance sheet for OHL are shown below:

Consolidated Profit and Loss Account

Year ended 31 December in HK\$ million	2007 (Audited)	2006 (Audited)
Turnover	465	382
Other operating income	53	23
	518	405
Staff costs	(101)	(99)
Load agent fees and bank charges for add value services	(60)	(54)
Other expenses	(152)	(97)
Operating profit before depreciation	205	155
Depreciation	(63)	(70)
Operating profit before interest and finance charges	142	85
Net interest income	76	55
Profit before taxation	218	140
Income tax	(49)	(22)
Profit for the year	169	118
Group's share of profit before taxation (note 12)	125	80
Group's share of income tax (note 12)	(28)	(12)

Notes to the Accounts

26 Interests in Non-controlled Subsidiaries (continued)

Consolidated Balance Sheet

at 31 December <i>in HK\$ million</i>	2007 (Audited)	2006 (Audited)
Assets		
Fixed assets	126	156
Investments	1,746	1,521
Cash at banks and on hand	424	314
Other assets	170	190
	2,466	2,181
Liabilities		
Card floats and card deposits due to cardholders	(1,574)	(1,446)
Amounts due to related parties	(21)	(65)
Other liabilities	(405)	(373)
	(2,000)	(1,884)
Net assets	466	297
Equity		
Share capital	42	42
Retained profits	424	255
	466	297
Group's share of net assets	268	171

27 Investments in Subsidiaries

The Company

<i>in HK\$ million</i>	2007	2006
Unlisted shares, at cost	1,153	187
Less: Impairment losses	3	3
	1,150	184

27 Investments in Subsidiaries (continued)

A Investments in subsidiaries include HK\$24 million (2006: HK\$24 million) in respect of investments in non-controlled subsidiaries, the relevant details of which are disclosed in note 26. The following list contains details of controlled subsidiaries as defined under note 2C as at 31 December 2007, which have been consolidated into the Group's accounts.

Name of company	Issued and paid up ordinary/registered share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
<u>Subsidiaries held throughout 2007</u>						
Glory Goal Limited	HK\$10,000	100%	100%	–	Hong Kong	Investment holding
MTR (Estates Management) Limited *	HK\$1,000	100%	100%	–	Hong Kong	Investment holding and property management
MTR (Shanghai Project Management) Limited	HK\$1,000	100%	100%	–	Hong Kong	Railway consultancy services, property investment and development
MTR Beijing Line 4 Investment Company Limited	HK\$1	100%	100%	–	Hong Kong	Investment holding
MTR China Consultancy Company Limited	HK\$1,000	100%	100%	–	Hong Kong	Railway consultancy services
MTR China Property Limited	HK\$1,000	100%	100%	–	Hong Kong	Property management
MTR Engineering Services Limited	HK\$1,000	100%	100%	–	Hong Kong	Engineering services
MTR Property Agency Co. Limited	HK\$2	100%	100%	–	Hong Kong	Property agency
MTR Rail Transport Training (International) Company Limited	HK\$2,800,000	100%	100%	–	Hong Kong	Provide rail transport training
MTR Shenzhen Investment Holding Limited	HK\$400,000	100%	100%	–	Hong Kong	Investment holding
MTR Telecommunication Company Limited	HK\$100,000,000	100%	100%	–	Hong Kong	Radio communication services
MTR Travel Limited	HK\$2,500,000	100%	100%	–	Hong Kong	Travel services
Rail Sourcing Solutions (International) Limited	HK\$2	100%	100%	–	Hong Kong	Global railway supply and sourcing services
TraxComm Limited	HK\$15,000,000	100%	100%	–	Hong Kong	Fixed telecommunication network services
Hong Kong Cable Car Limited *	HK\$1,000	100%	100%	–	Hong Kong	Dormant
Lantau Cable Car Limited *	HK\$1,000	100%	100%	–	Hong Kong	Dormant
MTR (Shanghai Metro Management) Limited *	HK\$1,000	100%	100%	–	Hong Kong	Dormant
Candiman Limited *	US\$1	100%	100%	–	British Virgin Islands	Investment holding
Fasttrack Insurance Ltd.	HK\$77,500,000	100%	100%	–	Bermuda	Insurance underwriting
MTR Corporation (C.I.) Limited	US\$1,000	100%	100%	–	Cayman Islands/Hong Kong	Finance
MTR Finance Lease (001) Limited *	US\$1	100%	100%	–	Cayman Islands/Hong Kong	Finance
Chongqing Premier Property Management Co. Ltd. * (Incorporated)	US\$150,000	70%	–	70%	The People's Republic of China	Property management
MTR (Beijing) Commercial Facilities Management Co. Ltd. (Incorporated)	HK\$93,000,000	100%	–	100%	The People's Republic of China	Property management

Notes to the Accounts

27 Investments in Subsidiaries (continued)

Name of company	Issued and paid up ordinary/registered share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
MTR (Beijing) Property Services Co. Limited * (Incorporated)	RMB3,000,000	100%	100%	–	The People's Republic of China	Property management
MTR Consultancy (Beijing) Co. Ltd. (Incorporated)	HK\$1,000,000	100%	100%	–	The People's Republic of China	Railway consultancy services, marketing and promotion
MTR Consulting (Shenzhen) Co. Ltd. (Incorporated)	HK\$1,000,000	100%	100%	–	The People's Republic of China	Railway consultancy services
MTR Corporation (Shenzhen) Limited (Incorporated)	HK\$250,000,000	100%	–	100%	The People's Republic of China	Conduct early-stage preparatory work for Shenzhen Metro Line 4 project
Shanghai Hong Kong Metro Construction Management Co. Ltd. (Incorporated)	HK\$15,000,000	60%	–	60%	The People's Republic of China	Railway construction management and development
MTR Corporation (IKF) Limited	GBP29	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (No.2) Limited	GBP1	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (Silverlink) Limited	GBP1	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (SWT) Limited	GBP1	100%	–	100%	United Kingdom	Investment holding
MTR Corporation (UK) Limited	GBP29	100%	100%	–	United Kingdom	Investment holding
Rail Sourcing Solutions (UK) Limited *	GBP1	100%	–	100%	United Kingdom	Railway supply and sourcing services
<u>Subsidiaries acquired during 2007 pursuant to the Rail Merger</u>						
Hanford Garden Property Management Company Limited	HK\$10,000	100%	100%	–	Hong Kong	Property management
Pierhead Garden Management Company Limited	HK\$50,000	100%	100%	–	Hong Kong	Property management
Royal Ascot Management Company Limited	HK\$50,000	100%	100%	–	Hong Kong	Property management
Sun Tuen Mun Centre Management Company Limited	HK\$50,000	100%	100%	–	Hong Kong	Property management
V-Connect Limited	HK\$1,000	100%	100%	–	Hong Kong	Telecommunication
<u>Other subsidiary acquired/established during 2007</u>						
Ngong Ping 360 Limited	HK\$2	100%	100%	–	Hong Kong	Operation of cable car system and the Ngong Ping Theme Village
MTR Corporation (Shenzhen) Training Centre * (Incorporated)	RMB2,000,000	100%	–	100%	The People's Republic of China	Provide rail transport training

* Subsidiaries not audited by KPMG. The financial statements of the subsidiaries not audited by KPMG reflect total net assets and total turnover constituting less than 1% of the respective consolidated totals.

27 Investments in Subsidiaries (continued)

B Purchase of Subsidiary Companies

in HK\$ million	Fair value of assets and liabilities acquired				Cash consideration paid	Gain/(loss) on acquisition
	Investment properties	Other property, plant and equipment	Other net assets	Net assets acquired		
Principal subsidiaries acquired from KCRC pursuant to the Merger Transaction:						
– Hanford Garden Property Management Company Limited	130	–	–	130	110	20
– Pierhead Garden Management Company Limited	770	–	–	770	637	133
– Sun Tuen Mun Centre Management Company Limited	261	–	–	261	219	42
Other subsidiaries acquired	–	1	1	2	10	(8)
	1,161	1	1	1,163	976	187

The contribution to the Group's revenue and profit after tax from these subsidiaries is not significant for the year ended 31 December 2007.

28 Interests in Associates

The Group

in HK\$ million	2007	2006
Share of net assets	205	100

The Group and the Company had interests in the following associates as at 31 December 2007:

Name of company	Issued and paid up ordinary/registered share capital	Proportion of ownership interest			Place of incorporation and operation	Principal activities
		Group's effective interest	Held by the Company	Held by subsidiary		
Beijing MTR Corporation Limited (Incorporated)	RMB1,380,000,000	49%	–	49%	The People's Republic of China	Railway construction, management and development
London Overground Rail Operations Ltd (previously known as MTR Laing Metro Limited)*	GBP2	50%	–	50%	United Kingdom	Railway management
South Western Railway Limited	GBP2	50%	–	50%	United Kingdom	Bidding vehicle

* Companies not audited by KPMG.

During the year, Great South Eastern Railway Limited and MTR Laing Railway Company Limited, joint venture companies established for bidding of the Integrated Kent Franchise and the Thameslink/Great Northern Franchise in United Kingdom in which the Group held 29% and 50% interest respectively, were dissolved following unsuccessful bidding of the franchises.

The registered share capital of Beijing MTR Corporation Limited is RMB1,380 million of which 49% (RMB676 million) is to be contributed by the Group. During the year ended 31 December 2007, the Group has made a further equity contribution of HK\$103 million making a cumulative equity contribution of HK\$203 million as at 31 December 2007.

Notes to the Accounts

28 Interests in Associates *(continued)*

The summary financial information of the Group's effective interests in associates is as follows:

<i>in HK\$ million</i>	2007	2006
Non-current assets	692	185
Current assets	147	6
Non-current liabilities	(40)	(25)
Current liabilities	(594)	(105)
Net assets	205	61
Income	118	–
Expenses	(115)	(23)
Profit/(loss) before taxation	3	(23)
Income tax	(1)	–
Net profit/(loss) for the year	2	(23)

29 Investments in Securities

Investments in securities represent debt securities held by an overseas insurance underwriting subsidiary comprising:

The Group

<i>in HK\$ million</i>	2007	2006
Trading securities listed overseas, at fair value		
– maturing within 1 year	50	35
– maturing after 1 year	283	237
	333	272

30 Staff Housing Loans

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Balance at 1 January	25	34
Redemption	(7)	(5)
Repayment	(3)	(4)
Balance at 31 December	15	25

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Amounts receivable:		
– within 1 year	3	4
– after 1 year	12	21
	15	25

The MTR Staff Housing Loan Scheme, a Company financed scheme, was introduced in 1997 to replace, on a phased basis, the previous arrangements whereby interest subsidies were paid by the Company to eligible employees. All housing loans granted to employees carry interest either at the prevailing Best Lending Rate less 1.75% per annum or at the Company's Average Cost of Borrowings plus 0.75% per annum, and are secured by mortgages over the relevant properties.

The Company considers that the nominal value of housing loans is not significantly different from their fair values.

31 Properties Held for Sale

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Properties held for sale		
– at cost	649	876
– at net realisable value	107	1,142
	756	2,018

Properties held for sale at 31 December 2007 comprised mainly residential units, retail and car parking spaces at the Olympic Station, Kowloon Station and Tung Chung Station along the Airport Railway, as well as Hang Hau Station, Tiu Keng Leng Station, Tseung Kwan O Area 55b and Area 57a developments along the Tseung Kwan O Line. They represent either properties received by the Company as sharing in kind or as part of the profit distribution upon completion of the development and the attributable interest in unsold units of shared surplus developments for which occupation permits have been issued. The properties are stated in the balance sheet at the lower of cost, which is deemed to be their fair value upon initial recognition as determined by reference to an independent open market valuation at the date of receipt (notes 2K(vi) and (viii)), and their net realisable value at the balance sheet date. Net realisable value represents the estimated selling price less costs to be incurred in selling the properties. The net realisable values as at 31 December 2007 and 2006 are determined by reference to an open market valuation of the properties as at those dates, undertaken by independent firms of surveyors, Jones Lang LaSalle Limited and DTZ Debenham Tie Leung respectively, who have among their staff Members of the Hong Kong Institute of Surveyors.

Properties held for sale at net realisable value are stated net of provision of HK\$12 million (2006: HK\$49 million), made in order to state these properties at the lower of their cost and estimated net realisable value.

Notes to the Accounts

32 Derivative Financial Assets and Liabilities

A Fair Value

The contracted notional amounts, fair values and maturities based on contractual undiscounted cash flows of derivative financial instruments outstanding are as follows:

The Group and The Company

in HK\$ million	Notional amount	Fair value	Contractual undiscounted cash flow maturing in				Total
			Less than 1 year	1-2 years	2-5 years	Over 5 years	
2007							
Derivative Financial Assets							
Gross settled:							
Foreign exchange forwards							
– fair value hedges :	7	–					
– inflow			7	–	–	–	7
– outflow			(7)	–	–	–	(7)
– cash flow hedges :	777	15					
– inflow			684	7	103	–	794
– outflow			(669)	(6)	(102)	–	(777)
– not qualified for hedge accounting :	265	3					
– inflow			266	3	–	–	269
– outflow			(262)	(3)	–	–	(265)
Cross currency swaps							
– fair value hedges :	2,012	70					
– inflow			175	2,034	40	–	2,249
– outflow			(120)	(1,985)	(31)	–	(2,136)
Net settled:							
Interest rate swaps							
– fair value hedges	4,698	184	34	59	93	43	229
– cash flow hedges	300	1	1	–	–	–	1
	8,059	273	109	109	103	43	364
Derivative Financial Liabilities							
Gross settled:							
Foreign exchange forwards							
– cash flow hedges :	593	1					
– inflow			–	591	–	–	591
– outflow			–	(593)	–	–	(593)
Cross currency swaps							
– fair value hedges :	14,480	142					
– inflow			182	3,982	4,822	5,789	14,775
– outflow			(145)	(3,983)	(4,884)	(5,969)	(14,981)
Net settled:							
Interest rate swaps							
– cash flow hedges	2,242	49	(15)	(18)	(16)	(2)	(51)
– not qualified for hedge accounting	100	–	–	–	–	–	–
	17,415	192	22	(21)	(78)	(182)	(259)
Total	25,474						

32 Derivative Financial Assets and Liabilities (continued)

A Fair Value (continued)

in HK\$ million	Notional amount	Fair value	Contractual undiscounted cash flow maturing in				Total
			Less than 1 year	1-2 years	2-5 years	Over 5 years	
2006							
Derivative Financial Assets							
Gross settled:							
Foreign exchange forwards							
– cash flow hedges :	418	5					
– inflow			230	185	8	–	423
– outflow			(226)	(184)	(8)	–	(418)
– not qualified for hedge accounting :	650	4					
– inflow			644	7	3	–	654
– outflow			(641)	(7)	(2)	–	(650)
Cross currency swaps							
– fair value hedges :	2,032	53					
– inflow			173	171	2,043	–	2,387
– outflow			(128)	(128)	(2,020)	–	(2,276)
Net settled:							
Interest rate swaps							
– fair value hedges	3,373	128	26	26	39	85	176
– cash flow hedges	400	4	3	2	–	–	5
– not qualified for hedge accounting	1,000	1	2	–	–	–	2
	7,873	195	83	72	63	85	303
Derivative Financial Liabilities							
Gross settled:							
Foreign exchange forwards							
– cash flow hedges :	9	1					
– inflow			8	–	–	–	8
– outflow			(9)	–	–	–	(9)
– not qualified for hedge accounting :	1	–					
– inflow			1	–	–	–	1
– outflow			(1)	–	–	–	(1)
Cross currency swaps							
– fair value hedges :	14,480	458					
– inflow			203	188	8,656	5,722	14,769
– outflow			(160)	(160)	(8,838)	(6,030)	(15,188)
Net settled:							
Interest rate swaps							
– fair value hedges	150	26	(10)	(5)	(9)	(9)	(33)
– cash flow hedges	2,242	24	(7)	(7)	(7)	(3)	(24)
– not qualified for hedge accounting	1,908	6	(7)	–	–	–	(7)
	18,790	515	18	16	(198)	(320)	(484)
Total	26,663						

Notes to the Accounts

32 Derivative Financial Assets and Liabilities (continued)

A Fair Value (continued)

The discounted cash flow method, which discounts the future contractual cash flows at the current market interest and foreign exchange rates that are available to the Group for similar financial instruments, is the main valuation technique used to determine the fair value of the Group's borrowings and derivative financial instruments such as interest rate swaps and cross currency swaps. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date.

The Group's derivative financial instruments consist predominantly of interest rate and cross currency swaps, and the relevant interest rate swap curves as of 31 December 2007 and 2006 were used to discount financial instruments. For Hong Kong dollars, interest rates used ranged from 2.945% to 4.122% (2006: 3.904% to 4.185%), U.S dollars from 3.832% to 5.161% (2006: 5.062% to 5.431%) and Euro from 4.097% to 4.982% (2006: 3.721% to 4.348%).

The table above details the remaining contractual maturities at the balance sheet date of the Group's and the Company's derivative financial liabilities and assets, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the balance sheet date) and the earliest date the Group and the Company can be required to pay.

B Financial Risks

The Group's operating activities and financing activities expose it to three main types of financial risks, namely interest rate risk, foreign exchange risk and credit risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge its exposure to interest rate and foreign exchange risks. These instruments are employed solely for hedging and not for trading or speculation purposes.

Risk management is carried out under policies approved by the Board of Directors. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as liquidity risk, interest rate risk, foreign exchange risk, credit risk, concentration risk, use of derivative financial instruments and non-derivative financial instruments, and investing excess liquidity. The Board regularly reviews these policies and authorises changes if necessary based on operating and market conditions and other relevant factors.

(i) Liquidity Risk

Liquidity risk refers to the risk that funds will not be available to meet liabilities as they fall due, and it results from timing and amount mismatches of cash inflow and outflow. The Group adopts a prudent approach to managing liquidity risk by maintaining sufficient cash balances and an adequate amount of committed banking facilities at all times to provide forward coverage of all of its funding needs including working capital, debt refinancing, dividend payments, capital expenditures and new investments for a set minimum period of time of between 6 to 15 months.

The following table details the remaining contractual maturities at the balance sheet date of the Group's and the Company's non-derivative financial liabilities, which are based on contractual undiscounted cash flows (including interest payments computed using contractual rates or, if floating, based on rates current at the balance sheet date) and the earliest date the Group and the Company can be required to pay:

The Group

in HK\$ million	2007				2006			
	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total
Long-term loans and obligations under finance leases								
Amounts repayable beyond 5 years	11,221	–	–	11,221	11,662	614	–	12,276
Amounts repayable within a period of between 2 and 5 years	6,676	11,563	–	18,239	13,808	2,299	–	16,107
Amounts repayable within a period of between 1 and 2 years	7,903	542	–	8,445	2,324	2,194	–	4,518
Amounts repayable within 1 year	2,339	1,042	–	3,381	1,376	1,399	150	2,925
	28,139	13,147	–	41,286	29,170	6,506	150	35,826

32 Derivative Financial Assets and Liabilities (continued)

B Financial Risks (continued)

The Company

in HK\$ million	2007				2006			
	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total
Long-term loans and obligations under finance leases								
Amounts repayable beyond 5 years	657	–	–	657	675	614	–	1,289
Amounts repayable within a period of between 2 and 5 years	5,071	11,563	–	16,634	11,268	2,299	–	13,567
Amounts repayable within a period of between 1 and 2 years	6,404	542	–	6,946	814	2,194	–	3,008
Amounts repayable within 1 year	825	721	–	1,546	825	1,399	150	2,374
	12,957	12,826	–	25,783	13,582	6,506	150	20,238

(ii) Interest Rate Risk

The Group's interest rate risk arises from borrowings. Borrowings issued at fixed rates expose the Group to fair value interest rate risk whilst borrowings based on floating rates expose the Group to cash flow interest rate risk. The Group manages its exposure to interest rate risk by using mostly interest rate swaps.

(iii) Foreign Exchange Risk

Foreign exchange risk arises when recognised assets and liabilities are denominated in a currency that is not the Group's functional currency.

The Group manages its exposure to the foreign exchange risk by using mostly cross currency swaps and forward foreign exchange contracts.

(iv) Credit Risk

Credit risk refers to the risk that a counterparty will be unable to pay amounts in full when due. For the Group, this arises mainly from the deposits it maintains and the derivative financial instruments that it has entered into with various banks and counterparties. To limit its exposure to credit risk, the Group places deposits and enters into derivative financial instruments only with financial institutions with acceptable credit ratings. For derivative financial instruments, the Group further quantifies and monitors its credit exposure by estimating the current fair market values and the potential change in fair market values of these instruments based on the "value-at-risk" concept. The Group also applies set-off and netting arrangements to reduce its counterparty credit exposure.

The maximum exposure to credit risk of the Group at the reporting date with respect to derivative financial assets and bank deposits is represented respectively by its carrying amount of the derivative financial assets and aggregate amount of deposit on its balance sheet.

(v) Concentration Risk

The Group has no significant concentrations of credit risk with respect to the aggregate value of transactions it has entered into with various banks and counterparties. To reduce concentration risk, the Group assigns to each deposit-taking bank a credit rating based limit in accordance with credit policy approved by the Board. Pursuant to this policy, the Group also assigns mark-to-market limits to all its counterparties, and monitors the current and potential exposures due to derivative financial instruments against these limits.

Notes to the Accounts

33 Stores and Spares

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Stores and spares expected to be consumed:				
– within 1 year	347	156	345	156
– after 1 year	315	124	315	124
	662	280	660	280
Less: Provision for obsolete stock	20	8	20	8
	642	272	640	272

Included in stores and spares as at 31 December 2007 are items acquired from KCRC, amounting to HK\$326 million, upon the Rail Merger on 2 December 2007 (note 3B).

Stores and spares expected to be consumed after 1 year comprise mainly contingency spares and stocks kept to meet cyclical maintenance requirements.

34 Debtors, Deposits and Payments in Advance

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Debtors, deposits and payments in advance relate to:				
– Property development projects	3,774	825	3,774	825
– Railway operations and others	1,393	1,069	1,283	957
	5,167	1,894	5,057	1,782

The Group's credit policy in respect of receivables arising from its principal activities are as follows:

(i) Rentals, advertising and telecommunications service fees are billed monthly with due dates ranging from 7 to 50 days. Tenants of the Group's investment properties and station kiosks are required to pay three months' rental deposit upon the signing of lease agreements.

(ii) Amounts receivable under interest rate and currency swap agreements with financial institutions are due in accordance with the respective terms of the agreements.

(iii) Consultancy services income are billed monthly and are due within 30 days.

(iv) Debtors in relation to contracts and capital works entrusted to the Group, subject to any agreed retentions, are due within 21 days upon the certification of work in progress.

(v) Amounts receivable from property purchasers are due in accordance with terms of respective sales and purchases agreements.

Fare revenue is collected either in cash for single and two-ride tickets or through Octopus Cards with daily settlement.

The ageing analysis of debtors included above is as follows:

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Amounts not yet due	4,201	1,157	4,211	1,145
Overdue by 30 days	172	102	145	96
Overdue by 60 days	19	18	13	17
Overdue by 90 days	14	6	9	4
Overdue by more than 90 days	55	150	48	143
Total debtors	4,461	1,433	4,426	1,405
Deposits and payments in advance	552	342	477	258
Prepaid pension costs	154	119	154	119
	5,167	1,894	5,057	1,782

34 Debtors, Deposits and Payments in Advance (continued)

Amounts not yet due includes HK\$3,731 million (2006: HK\$689 million) relating to property development which are due according to the forms of sales and purchases agreements and HK\$400 million (2006: HK\$478 million) receivable from certain stakeholding funds (note 23C) awaiting finalisation of the respective development accounts.

As at 31 December 2007, all debtors, deposits and payments in advance were expected to be recovered within one year except for HK\$139 million (2006: HK\$160 million) included in the amounts relating to deposits and receivables in respect of railway operations and others, which were expected to be recovered between one to three years. The nominal values less impairment losses for bad and doubtful debts are not discounted as it is considered that the effect of discounting would not be significant.

Included in debtors, deposits and payments in advance are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

<i>in \$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Euro	1	1	1	1
New Taiwan dollar	20	37	20	37
Pound sterling	1	1	1	–
Renminbi	41	4	–	–
United States dollar	24	25	24	24
Won	–	1	–	1

35 Loan to a Property Developer

The Group and The Company

<i>in HK\$ million</i>	2007		2006	
	Nominal amount	Carrying amount	Nominal amount	Carrying amount
Interest-free loan to a property developer	4,000	3,532	4,000	3,355

The loan was provided to the developer of Package 2, Tseung Kwan O Area 86 property development project under the terms of the development agreement. The loan is interest-free and guaranteed by the developer's ultimate holding company and is repayable on completion of the respective phases of the project.

36 Amounts Due from the Government and Other Related Parties

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Amounts due from:				
– the Government	34	40	34	40
– the Housing Authority	22	22	22	22
– KCRC	261	3	261	3
– non-controlled subsidiaries	96	94	96	94
– associates	131	18	138	18
– other subsidiaries of the Company (net of impairment losses)	–	–	764	523
	544	177	1,315	700

The amount due from the Government relates to outstanding receivables and retention, as well as provision for contract claims recoverable from the Government, in connection with infrastructure works entrusted to the Company.

The amount due from the Housing Authority relates to site formation works entrusted to the Company by the Housing Authority in respect of the Tseung Kwan O Extension Project.

The amount due from KCRC relates to KCRC's cost sharing in respect of the integration works for the Rail Merger, payments to the Company for the services provided regarding the Outsourcing Agreement and KSL Project Management Agreement and certain reimbursable expenditures of KCRC settled by the Company on KCRC's behalf.

Notes to the Accounts

36 Amounts Due from the Government and Other Related Parties *(continued)*

The amount due from non-controlled subsidiaries includes the outstanding balance of a loan to, including interest receivable from, Octopus Holdings Limited (note 26).

The amount due from associates includes the outstanding balance of a loan, amounting to HK\$62 million (GBP 4 million), to London Overground Rail Operations Ltd (note 52H).

All contract retentions on the above entrusted works were due for release within one year. All other amounts due from the Government and other related parties were expected to be received within 12 months.

The nominal values of amounts due from the Government and other related parties are considered not significantly different from their fair values as the amounts due are expected to be substantially settled within 24 months.

37 Cash and Cash Equivalents

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Deposits with banks and other financial institutions	46	34	42	34
Cash at banks and on hand	530	276	142	93
Cash and cash equivalents in the balance sheet	576	310	184	127
Bank overdrafts (note 38B)	(2)	(5)	(2)	(5)
Cash and cash equivalents in the cash flow statement	574	305	182	122

During the year, the Group recognised deferred income and received properties in kind in respect of property development of HK\$1,245 million (2006: HK\$3,833 million), which did not involve movements of cash or cash equivalents.

Included in cash and cash equivalents in the balance sheet are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

<i>in \$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Euro	3	2	3	2
Pound sterling	1	–	1	–
New Taiwan dollar	38	22	38	22
Renminbi	197	70	–	–
Swiss franc	–	2	–	2
United States dollar	7	8	–	–

38 Loans and Obligations under Finance Leases

A By Type

The Group

<i>in HK\$ million</i>	2007			2006		
	Carrying amount	Fair value	Repayable amount	Carrying amount	Fair value	Repayable amount
Capital market instruments						
Listed or publicly traded:						
US dollar Global notes due 2009	5,746	6,060	5,834	5,651	6,100	5,834
US dollar Global notes due 2010	4,649	5,126	4,679	4,511	5,056	4,679
Debt issuance programme (Eurobond due 2014)	4,580	4,790	4,663	4,380	4,565	4,663
	14,975	15,976	15,176	14,542	15,721	15,176
Unlisted:						
Debt issuance programme notes due 2008 to 2020	7,121	7,493	7,097	7,046	7,383	7,075
HK dollar notes due 2008	506	502	500	515	512	500
	7,627	7,995	7,597	7,561	7,895	7,575
Total capital market instruments	22,602	23,971	22,773	22,103	23,616	22,751
Bank loans	10,939	10,944	10,921	4,789	4,706	4,757
Obligations under finance leases (note 38C)	–	–	–	141	141	141
Loans and obligations under finance leases	33,541	34,915	33,694	27,033	28,463	27,649
Bank overdrafts	2	2	2	5	5	5
Short-term loans	507	507	507	1,114	1,114	1,114
Total	34,050	35,424	34,203	28,152	29,582	28,768

The Company

<i>in HK\$ million</i>	2007			2006		
	Carrying amount	Fair value	Repayable amount	Carrying amount	Fair value	Repayable amount
Capital market instruments						
Listed or publicly traded:						
US dollar Global notes due 2009	5,746	6,060	5,834	5,651	6,100	5,834
US dollar Global notes due 2010	4,649	5,126	4,679	4,511	5,056	4,679
	10,395	11,186	10,513	10,162	11,156	10,513
Unlisted:						
Debt issuance programme notes due 2018	437	615	448	426	597	465
	437	615	448	426	597	465
Total capital market instruments	10,832	11,801	10,961	10,588	11,753	10,978
Bank loans	10,939	10,944	10,921	4,789	4,706	4,757
Obligations under finance leases (note 38C)	–	–	–	141	141	141
Loans and obligations under finance lease	21,771	22,745	21,882	15,518	16,600	15,876
Bank overdrafts	2	2	2	5	5	5
Short-term loans	186	186	186	1,114	1,114	1,114
Total	21,959	22,933	22,070	16,637	17,719	16,995

Notes to the Accounts

38 Loans and Obligations under Finance Leases (continued)

A By Type (continued)

As at 31 December 2007, the Group had available undrawn committed bank loan facilities amounting to HK\$6,300 million (2006: HK\$5,700 million). In addition, the Group had a number of uncommitted facilities with undrawn amounts totalling HK\$15,464 million (2006: HK\$14,946 million), comprising a debt issuance programme and short-term bank loan facilities.

The fair values are based on the discounted cash flows method which discounts the future contractual cash flows at the current market interest and foreign exchange rates that is available to the Group for similar financial instruments.

The Group's derivative financial instruments consist predominantly of interest rate and cross currency swaps, and the Group used the relevant interest rate swap curves as of 31 December 2007 and 2006 to discount financial instruments. For Hong Kong dollars, interest rates used ranged from 2.945% to 4.122% (2006: 3.904% to 4.185%), U.S dollars from 3.832% to 5.161% (2006: 5.062% to 5.431%) and Euro from 4.097% to 4.982% (2006: 3.721% to 4.348%).

The carrying amounts of short-term loans and overdrafts approximated their fair values.

The amounts of borrowings, denominated in a currency other than the functional currency of the entity to which they relate, before and after currency hedging activities are as follows:

The Group

in \$ million	Before hedging activities		After hedging activities	
	2007	2006	2007	2006
Euro	8	10	–	–
Pound Sterling	4	–	4	–
Renminbi	300	–	300	–
United States dollar	2,117	2,118	6	8

The Company

in \$ million	Before hedging activities		After hedging activities	
	2007	2006	2007	2006
Euro	8	10	–	–
Pound Sterling	4	–	4	–
United States dollar	1,417	1,418	6	8

B By Repayment Terms

The Group

in HK\$ million	2007				2006			
	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total
Long-term loans and obligations under finance leases								
Amounts repayable beyond 5 years	10,008	–	–	10,008	10,088	600	–	10,688
Amounts repayable within a period of between 2 and 5 years	4,931	10,611	–	15,542	11,663	2,092	–	13,755
Amounts repayable within a period of between 1 and 2 years	6,834	155	–	6,989	1,000	2,030	–	3,030
Amounts repayable within 1 year	1,000	155	–	1,155	–	35	141	176
	22,773	10,921	–	33,694	22,751	4,757	141	27,649
Bank overdrafts	–	2	–	2	–	5	–	5
Short-term loans	–	507	–	507	–	1,114	–	1,114
	22,773	11,430	–	34,203	22,751	5,876	141	28,768
Less: Unamortised discount/premium/finance charges outstanding	(101)	(19)	–	(120)	(103)	(3)	–	(106)
Adjustment due to fair value change of financial instruments	(70)	37	–	(33)	(545)	35	–	(510)
Total carrying amount of debt	22,602	11,448	–	34,050	22,103	5,908	141	28,152

38 Loans and Obligations under Finance Leases (continued)

B By Repayment Terms (continued)

The Company

<i>in HK\$ million</i>	2007				2006			
	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total	Capital market instruments	Bank loans and overdrafts	Obligations under finance leases	Total
Long-term loans and obligations under finance leases								
Amounts repayable beyond 5 years	448	-	-	448	465	600	-	1,065
Amounts repayable within a period of between 2 and 5 years	4,679	10,611	-	15,290	10,513	2,092	-	12,605
Amounts repayable within a period of between 1 and 2 years	5,834	155	-	5,989	-	2,030	-	2,030
Amounts repayable within 1 year	-	155	-	155	-	35	141	176
	10,961	10,921	-	21,882	10,978	4,757	141	15,876
Bank overdrafts	-	2	-	2	-	5	-	5
Short-term loans	-	186	-	186	-	1,114	-	1,114
	10,961	11,109	-	22,070	10,978	5,876	141	16,995
<i>Less: Unamortised discount/premium/finance charges outstanding</i>	(37)	(19)	-	(56)	(51)	(3)	-	(54)
<i>Adjustment due to fair value change of financial instruments</i>	(92)	37	-	(55)	(339)	35	-	(304)
Total carrying amount of debt	10,832	11,127	-	21,959	10,588	5,908	141	16,637

The amounts repayable within 1 year in respect of long-term loans and obligations under finance leases are included in long-term loans as these amounts are intended to be refinanced on a long-term basis.

C Obligations under Finance Leases

As at 31 December 2007 and 2006, the Group and the Company's obligations under finance leases were as follows:

The Group and The Company

<i>in HK\$ million</i>	2007			2006		
	Present value of the minimum lease payments	Interest expense relating to future periods	Total minimum lease payments	Present value of the minimum lease payments	Interest expense relating to future periods	Total minimum lease payments
Amounts repayable within 1 year	-	-	-	141	9	150
	-	-	-	141	9	150

Obligations under finance lease are the Group's and the Company's commitments to make future payments to New Hong Kong Tunnel Company Limited under the agreement for the Eastern Harbour Crossing which is treated as a finance lease (note 19C).

Notes to the Accounts

38 Loans and Obligations under Finance Leases (continued)

D Bonds and Notes Issued and Redeemed

Bonds and notes issued during the year ended 31 December 2007 and 2006 comprise:

The Group

in HK\$ million	2007		2006	
	Principal amount	Net consideration received	Principal amount	Net consideration received
Debt issuance programme notes	–	–	1,500	1,499

The above notes were issued by a subsidiary, MTR Corporation (C.I.) Limited. The notes issued are unconditionally and irrevocably guaranteed by the Company; and are direct, unsecured, unconditional and unsubordinated to other unsecured and unsubordinated obligations of MTR Corporation (C.I.) Limited. The obligations of the Company under the guarantee are direct, unsecured, unconditional, and unsubordinated to other unsecured and unsubordinated obligations of the Company. The net proceeds received from the issues were on lent to the Company for general working capital, refinancing or other corporate purposes.

None of the Group's unlisted debt securities was redeemed during the year ended 31 December 2007 (2006: HK\$2,450 million).

None of the Group's listed debt securities was redeemed during the year ended 31 December 2007 and 2006.

E Guarantees and Pledges

(i) There were no guarantees given by the Government in respect of loan facilities as at 31 December 2007 and 2006.

(ii) As at 31 December 2007, certain assets held by MTR Corporation (Shenzhen) Limited, an indirect wholly owned subsidiary of the Company, in the Mainland of China were pledged as security for a RMB400 million short-term bank loan facility granted to it.

Apart from the above, none of the other Group's assets was charged or subject to any encumbrance as at 31 December 2007.

F Interest Rates

Outstanding amount of total borrowings, excluding obligations under finance leases, of HK\$34,050 million (2006: HK\$28,011 million) comprise:

The Group

	Fixed rate borrowings and borrowings swapped to fixed rates		Variable rate borrowings and borrowing swapped from fixed rate	
	Carrying amount HK\$ million	Interest rate % p.a.	Carrying amount HK\$ million	Interest rate % p.a.
2007				
Amounts repayable beyond 5 years	7,821	4.2 - 8.4	2,129	(Note)
Amounts repayable within a period of between 2 and 5 years	4,627	4.3 - 7.5	10,882	
Amounts repayable within a period of between 1 and 2 years	3,080	4.2 - 7.5	3,830	
Amounts repayable within 1 year	1,528	3.1 - 5.8	153	
	17,056		16,994	2.9 - 7.1
2006				
Amounts repayable beyond 5 years	7,667	4.2 - 8.4	2,711	(Note)
Amounts repayable within a period of between 2 and 5 years	7,517	4.2 - 7.5	5,904	
Amounts repayable within a period of between 1 and 2 years	1,207	3.1 - 5.5	1,844	
Amounts repayable within 1 year	557	4.9 - 5.5	604	
	16,948		11,063	3.1 - 7.3

38 Loans and Obligations under Finance Leases (continued)

F Interest Rates (continued)

The Company

	Fixed rate borrowings and borrowings swapped to fixed rates		Variable rate borrowings and borrowing swapped from fixed rate	
	Carrying amount HK\$ million	Interest rate % p.a.	Carrying amount HK\$ million	Interest rate % p.a.
2007				
Amounts repayable beyond 5 years	1,600	4.2 - 8.4	(1,162)	(Note)
Amounts repayable within a period of between 2 and 5 years	4,627	4.3 - 7.5	10,631	
Amounts repayable within a period of between 1 and 2 years	3,080	5.5 - 7.5	2,830	
Amounts repayable within 1 year	707	3.1 - 5.5	(354)	
	10,014		11,945	2.9 - 7.1
2006				
Amounts repayable beyond 5 years	1,590	4.2 - 8.4	(562)	(Note)
Amounts repayable within a period of between 2 and 5 years	7,517	4.3 - 7.5	4,754	
Amounts repayable within a period of between 1 and 2 years	707	3.1 - 5.5	1,329	
Amounts repayable within 1 year	557	4.9 - 5.5	604	
	10,371		6,125	3.1 - 7.3

Note: In respect of the variable rate borrowings and borrowings swapped from fixed rate, the interest rates quoted are their contract rates as at balance sheet date subject to repricing in less than one year.

G Sensitivity Analysis

(i) Foreign Exchange Risk

After taking into account hedging activities to reduce exposure to currency risk, the aggregate amounts of the Group's recognised assets and liabilities denominated in a currency that is not the Group's functional currency at the reporting date as at 31 December 2006 and 2007 were considered minimal. Accordingly, the Group did not perform any sensitivity analysis with respect to foreign exchange risk.

(ii) Interest Rate Risk

As at 31 December 2007, it is estimated that a general increase/decrease of 200 basis points in interest rates, with all other variables held constant, would decrease/increase the Group's profit after tax and retained profits by approximately HK\$232/233 million (2006: HK\$163/163 million). Other components of consolidated equity would increase/decrease by approximately HK\$133/147 million (2006: HK\$161/182 million) in response to the general increase/decrease in interest rates.

The sensitivity analysis above has been determined assuming that the change in interest rates had occurred at the balance sheet date and had been applied to the exposure to interest rate risk for both derivative and non-derivative financial instruments in existence at that date. The 200 basis point increase or decrease represents management's assessment of a reasonable possible change in interest rates over the period until the next annual balance sheet date. The analysis is performed on the same basis for 2006.

Notes to the Accounts

39 Creditors, Accrued Charges and Provisions

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Creditors, accrued charges and provisions				
– Airport Railway Project	70	79	70	79
– Tseung Kwan O Extension Project	120	152	120	152
– Property projects and management	1,766	1,263	1,665	1,263
– Railway operations and others	3,400	2,089	2,945	1,709
Gross amount due to customers for contract work	56	56	56	56
	5,412	3,639	4,856	3,259

The above amounts are mainly related to capital projects which are settled upon certification of work in progress and swap interest payable. The Group has no significant balances of trade creditors resulting from its provision of transportation services.

The aggregate amount of costs incurred plus recognised profits less recognised losses, included in the gross amount due to customers for contract work at 31 December 2007, was HK\$244 million (2006: HK\$179 million).

The gross amount due to customers for contract work at 31 December 2007 that is expected to be settled after more than one year is HK\$56 million (2006: HK\$56 million).

The analysis of creditors included above by due dates is as follows:

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Due within 30 days or on demand	1,354	645	1,128	456
Due after 30 days but within 60 days	652	651	573	589
Due after 60 days but within 90 days	218	103	204	97
Due after 90 days	1,563	1,472	1,359	1,377
	3,787	2,871	3,264	2,519
Rental and other refundable deposits	1,462	631	1,429	603
Accrued employee benefits	163	137	163	137
Total	5,412	3,639	4,856	3,259

Creditors, accrued charges and provisions in respect of the capital projects and other construction works include provisions for claims on completed contracts, which were capitalised as part of the related assets. Most of these claims have been resolved and it is anticipated that, subject to unforeseen circumstances, the remaining amount required to be paid will be sufficiently covered by the above mentioned provisions of the respective projects. The carrying amounts of such claim provisions and their movements are not separately disclosed in view of their commercial sensitivity.

As at 31 December 2007, all creditors, accrued charges and provisions were expected to be settled within one year except for HK\$920 million (2006: HK\$512 million) included in the amounts relating to railway operations and others, which were expected to be settled after one year. The amounts due after one year are mainly rental deposits received from shop and station kiosk tenants and advance income received from telecommunication services operators, majority of which are due to be repaid within three years. The Group considers the effect of discounting these deposits would be immaterial.

The nominal values of creditors, accrued charges and provisions are not significantly different from their fair values.

Included in creditors, accrued charges and provisions are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

<i>in \$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Euro	4	3	4	3
Japanese Yen	39	5	39	5
New Taiwan dollar	1	3	1	3
Pound sterling	1	1	1	1
Renminbi	202	95	–	–
Swiss franc	–	1	–	1
United States dollar	53	53	38	39

40 Contract Retentions

The Group

<i>in HK\$ million</i>	Due for release after 12 months	Due for release within 12 months	Total
2007			
Railway extension projects	34	52	86
Railway operations	98	41	139
	132	93	225
2006			
Railway extension projects	19	48	67
Railway operations	34	92	126
	53	140	193

The Company

<i>in HK\$ million</i>	Due for release after 12 months	Due for release within 12 months	Total
2007			
Railway extension projects	34	24	58
Railway operations	98	41	139
	132	65	197
2006			
Railway extension projects	19	46	65
Railway operations	34	92	126
	53	138	191

The effect of discounting these contract retentions is considered immaterial as these amounts are substantially due to be released within 24 months.

Included in contract retentions are the following amounts denominated in a currency other than the functional currency of the entity to which they relate:

<i>in \$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Renminbi	26	3	–	–
Swiss franc	–	3	–	3

Notes to the Accounts

41 Amounts Due to Related Parties

The followings are amounts due to the subsidiaries and other related Group companies:

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Amounts due to:				
– KCRC	975	–	975	–
– subsidiaries	–	–	11,987	11,718
	975	–	12,962	11,718

Amounts due to KCRC of HK\$975 million includes mandatory payments payable to KCRC in respect of the sites subject to the property development rights acquired in the Rail Merger and related interest and the accrued portion of the first fixed annual payment in respect of the service concession.

Amounts due to the subsidiaries of HK\$10,763 million (2006: HK\$11,515 million) are expected to be settled after one year.

Amounts due to the Company's subsidiaries includes HK\$11,960 million (2006: HK\$11,704 million) due to MTR Corporation (C.I.) Limited in respect of proceeds from bonds and notes issued by the subsidiary, which were on-lent to the Company for its general corporate purposes with specified repayment dates and interest rates (note 38D), and accrued interest. These amounts are stated at their fair values. The remaining balances due to subsidiaries are non-interest bearing and have not been discounted as they do not have any fixed repayment terms and the amount is not material.

42 Obligations under Service Concession

As at 31 December 2007, the Group and the Company had the following obligations under service concession in respect of the fixed annual payments described in note 3:

<i>in HK\$ million</i>	2007	2006
Total fixed annual payments capitalised at inception	10,687	–
Less: Amount repaid/payable during the year	2	–
Balance as at 31 December	10,685	–

The outstanding balance as at 31 December 2007 is repayable as follows:

<i>in HK\$ million</i>	Present value of fixed annual payments	Interest expense relating to future periods	Total fixed annual payments
Amounts repayable beyond 5 years	10,520	23,168	33,688
Amounts repayable within a period of between 2 and 5 years	105	2,145	2,250
Amounts repayable within a period of between 1 and 2 years	31	719	750
Amounts repayable within 1 year	29	721	750
	10,685	26,753	37,438

43 Deferred Income

The Group and The Company

<i>in HK\$ million</i>	2007	2006
Deferred income on property development (note 23B)	400	1,562
Deferred income on lease out and lease back transaction (note 19E)	120	126
Less: Amount recognised as income	5	6
	115	120
	515	1,682

44 Income Tax in the Balance Sheet

A Current taxation in the consolidated balance sheet comprised overseas tax liabilities in respect of consultancy services income earned offshore, chargeable at the appropriate current tax rates of taxation ruling in the relevant countries.

B Deferred tax assets and liabilities recognised

The components of deferred tax assets and liabilities recognised in the balance sheet and the movements during the year are as follows:

The Group

<i>in HK\$ million</i>	Deferred tax arising from					
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Cash flow hedges	Tax losses	Total
2007						
At 1 January 2007	8,749	2,681	205	(2)	(2,181)	9,452
Addition through subsidiary acquisition	–	–	–	–	(2)	(2)
Charged/(credited) to consolidated profit and loss account	60	1,402	10	–	1,608	3,080
Charged to reserves (note 46)	–	43	–	(3)	–	40
At 31 December 2007	8,809	4,126	215	(5)	(575)	12,570
2006						
At 1 January 2006	8,895	2,242	228	5	(3,378)	7,992
Charged/(credited) to consolidated profit and loss account	(146)	381	(23)	–	1,197	1,409
Charged to reserves (note 46)	–	58	–	(7)	–	51
At 31 December 2006	8,749	2,681	205	(2)	(2,181)	9,452

The Company

<i>in HK\$ million</i>	Deferred tax arising from					
	Depreciation allowances in excess of related depreciation	Revaluation of properties	Provision and other temporary differences	Cash flow hedges	Tax losses	Total
2007						
At 1 January 2007	8,743	2,681	205	(2)	(2,174)	9,453
Charged/(credited) to profit and loss account	59	1,402	10	–	1,610	3,081
Charged to reserves (note 46)	–	43	–	(3)	–	40
At 31 December 2007	8,802	4,126	215	(5)	(564)	12,574
2006						
At 1 January 2006	8,896	2,242	228	5	(3,360)	8,011
Charged/(credited) to profit and loss account	(153)	381	(23)	–	1,186	1,391
Charged to reserves (note 46)	–	58	–	(7)	–	51
At 31 December 2006	8,743	2,681	205	(2)	(2,174)	9,453

Notes to the Accounts

44 Income Tax in the Balance Sheet (continued)

B Deferred tax assets and liabilities recognised (continued)

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Net deferred tax asset recognised in the balance sheet	(4)	(1)	–	–
Net deferred tax liability recognised in the balance sheet	12,574	9,453	12,574	9,453
	12,570	9,452	12,574	9,453

C The Group has not recognised deferred tax assets in respect of its subsidiaries' cumulative tax losses of HK\$217 million (2006: HK\$155 million) as it is not probable that future taxable profits against which the losses can be utilised will be available in the relevant tax jurisdictions and entities.

45 Share Capital and Capital Management

A Share Capital, Share Premium and Capital Reserve

<i>in HK\$ million</i>	2007	2006
Authorised: 6,500,000,000 shares of HK\$1.00 each	6,500	6,500
Issued and fully paid: 5,611,057,035 shares (2006: 5,548,613,951 shares) of HK\$1.00 each	5,611	5,549
Share premium	7,029	5,902
Capital reserve	27,188	27,188
	39,828	38,639

Pursuant to the Articles of Association of the Company, the capital reserve can only be applied in paying up in full unissued shares to be allotted and distributed as fully paid bonus shares to the shareholders of the Company.

Share premium represents the amount by which the issue price of shares exceeds the par value of those shares. The application of the share premium account is governed by section 48B of the Hong Kong Companies Ordinance.

New shares issued and fully paid up during the year comprise:

	Number of shares	Option/ scrip price HK\$	Proceeds credited to		
			Share capital account HK\$ million	Share premium account HK\$ million	Total HK\$ million
Employee share options exercised					
– Pre-Global Offering Share Option Scheme	2,562,500	8.440	3	19	22
– New Joiners Share Option Scheme	66,000	9.750	–	1	1
	31,500	15.450	–	–	–
	31,500	19.104	–	–	–
Issued as 2006 final scrip dividends	39,183,554	19.800	39	737	776
Issued as 2007 interim scrip dividends	20,568,030	18.970	20	370	390
	62,443,084		62	1,127	1,189

An analysis of the Company's outstanding share options as at 31 December 2007 are disclosed in note 47.

B Capital Management

The Group's primary objectives in managing capital are to safeguard its ability to continue as a going concern, and to generate sufficient profit to maintain growth and provide an adequate return to its shareholders.

The Group manages the amount of capital in proportion to risk, and makes adjustments to its capital structure through the amount of dividend payment to shareholders, issuance of scrip and new shares, and managing its debt portfolio in conjunction with projected financing requirement. The Financial Secretary Incorporated of the Government of the Hong Kong SAR is the majority shareholder of the Company holding 4,301,750,382 shares as of 31 December 2007, representing 76.67% of total equity interest in the Company.

45 Share Capital and Capital Management (continued)

B Capital Management (continued)

The Group monitors capital on the basis of the net debt-to-equity ratio, which is calculated on net borrowings as a percentage of the total equity attributable to shareholders of the Company where net borrowings are represented by the aggregate of loans, obligations under finance leases, bank overdrafts and obligations under service concession net of cash and cash equivalents. The Group's net debt-to-equity ratios over the past 5 years between 2002 and 2006 have been trending downward from nearly 60% towards 30% and rose to 49% as of 31 December 2007 due to increase in borrowings to finance payments for the Rail Merger and the incorporation of the obligations under service concession as a component of debt.

Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

46 Other Reserves

The Group

in HK\$ million	Attributable to equity shareholders of the Company					
	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Exchange reserve	Retained profits	Total
2007						
Balance as at 1 January 2007	968	(10)	5	17	37,148	38,128
Cash flow hedges:						
Effective portion of changes in fair value, net of deferred tax	–	(13)	–	–	–	(13)
Transfer from equity						
– to profit and loss account	–	–	–	–	–	–
– to initial carrying amount of non-financial hedged items	–	(2)	–	–	–	(2)
– to deferred tax	–	–	–	–	–	–
2006 final dividend	–	–	–	–	(1,554)	(1,554)
2007 interim dividend	–	–	–	–	(782)	(782)
Surplus on revaluation, net of deferred tax (notes 19 and 44)	202	–	–	–	–	202
Employee share-based payments	–	–	2	–	–	2
Exchange difference on translation of accounts of overseas subsidiaries	–	–	–	25	–	25
Profit for the year	–	–	–	–	15,180	15,180
Balance as at 31 December 2007	1,170	(25)	7	42	49,992	51,186
2006						
Balance as at 1 January 2006	697	24	2	4	31,698	32,425
Cash flow hedges:						
Effective portion of changes in fair value, net of deferred tax	–	(18)	–	–	–	(18)
Transfer from equity						
– to profit and loss account	–	(17)	–	–	–	(17)
– to initial carrying amount of non-financial hedged items	–	(2)	–	–	–	(2)
– to deferred tax	–	3	–	–	–	3
2005 final dividend	–	–	–	–	(1,535)	(1,535)
2006 interim dividend	–	–	–	–	(774)	(774)
Surplus on revaluation, net of deferred tax (notes 19 and 44)	271	–	–	–	–	271
Employee share-based payments	–	–	3	–	–	3
Exchange difference on translation of accounts of overseas subsidiaries	–	–	–	13	–	13
Profit for the year	–	–	–	–	7,759	7,759
Balance as at 31 December 2006	968	(10)	5	17	37,148	38,128

Notes to the Accounts

46 Other Reserves (continued)

The Company

<i>in HK\$ million</i>	Fixed asset revaluation reserve	Hedging reserve	Employee share-based capital reserve	Retained profits	Total
2007					
Balance as at 1 January 2007	968	(10)	5	36,802	37,765
Cash flow hedges:					
Effective portion of changes in fair value, net of deferred tax	–	(13)	–	–	(13)
Transfer from equity					
– to profit and loss account	–	–	–	–	–
– to initial carrying amount of non-financial hedged items	–	(2)	–	–	(2)
– to deferred tax	–	–	–	–	–
2006 final dividend	–	–	–	(1,554)	(1,554)
2007 interim dividend	–	–	–	(782)	(782)
Surplus on revaluation, net of deferred tax (notes 19 and 44)	202	–	–	–	202
Employee share-based payments	–	–	2	–	2
Profit for the year	–	–	–	14,883	14,883
Balance as at 31 December 2007	1,170	(25)	7	49,349	50,501
2006					
Balance as at 1 January 2006	697	24	2	31,394	32,117
Cash flow hedges:					
Effective portion of changes in fair value, net of deferred tax	–	(18)	–	–	(18)
Transfer from equity					
– to profit and loss account	–	(17)	–	–	(17)
– to initial carrying amount of non-financial hedged items	–	(2)	–	–	(2)
– to deferred tax	–	3	–	–	3
2005 final dividend	–	–	–	(1,535)	(1,535)
2006 interim dividend	–	–	–	(774)	(774)
Surplus on revaluation, net of deferred tax (notes 19 and 44)	271	–	–	–	271
Employee share-based payments	–	–	3	–	3
Profit for the year	–	–	–	7,717	7,717
Balance as at 31 December 2006	968	(10)	5	36,802	37,765

The fixed asset revaluation reserve was set up to deal with the surpluses or deficits arising from the revaluation of self-occupied land and buildings (note 2F(ii)).

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of hedging instruments used in cash flow hedges pending subsequent recognition of the hedged cash flow in accordance with the accounting policy adopted for cash flow hedges in note 2U(ii).

The employee share-based capital reserve comprises the fair value of share options granted which are yet to be exercised, as explained in accounting policy under note 2V(iv). The amount will either be transferred to the share premium account when the option is exercised, or be released directly to retained profits if the option is expired or forfeited.

The exchange reserve comprises all foreign exchange differences arising from the translation of the accounts of foreign enterprises. The reserve is dealt with in accordance with the accounting policy set out in note 2DD.

Apart from retained profits, the other reserves are not available for distribution to shareholders because they do not constitute realised profits. In addition, the Company considers the cumulative surpluses on revaluation of investment properties, net of tax of HK\$18,280 million (2006: HK\$11,671 million) included in retained profits are non-distributable as they also do not constitute realised profits. As at 31 December 2007, the Company considers that the total amount of reserves available for distribution to equity shareholders amounted to HK\$31,069 million (2006: HK\$25,131 million).

Included in the Group's retained profits as at 31 December 2007 is an amount of HK\$192 million (2006: HK\$93 million), being the retained profits attributable to the non-controlled subsidiaries and associates.

47 Share-based Payments

A Equity-settled Share-based Payments

The Group granted equity-settled share options to its Members of the Executive Directorate and certain employees under three share option schemes namely, the Pre-Global Offering Share Option Scheme, the New Joiners Share Option Scheme and the 2007 Share Option Scheme. Details of the schemes are as follows:

(i) Pre-Global Offering Share Option Scheme

In connection with the Initial Public Offering ("IPO") and Stock Exchange listing of the Company's shares in October 2000, a Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") was established. Under the Pre-IPO Option Scheme, a total of 769 employees including all the Members of the Executive Directorate, except C K Chow, Lincoln K K Leong and Francois K K Lung who were appointed on 1 December 2003, 1 February 2002 and 26 September 2005 respectively, were granted on 20 September 2000 options to purchase an aggregate of 48,338,000 shares, representing 0.9% of the issued share capital of the Company as at 31 December 2007. The options carry an exercise price of HK\$8.44 per share, which was equivalent to 90% of the IPO offer price of HK\$9.38 per share. The options may be exercised prior to 11 September 2010, subject to the vesting provisions under the Scheme. As of 31 December 2007, all options granted under the Pre-IPO Option Scheme have vested.

In 2007, a total of 2,562,500 previously vested share options have been exercised. The weighted average closing price in respect of the share options exercised during the year was HK\$23.12 per share. In addition, no share options lapsed as a result of the resignation of option holders during the year. As at 31 December 2007, total options to subscribe for 5,267,000 (2006: 7,829,500) shares remained outstanding.

(ii) New Joiners Share Option Scheme

In May 2002, the New Joiners Share Option Scheme (the "New Option Scheme") was adopted at the 2002 Annual General Meeting to provide share options to new members of the top and senior management of the Company who did not participate in the Pre-IPO Option Scheme. Under the Rules of the New Option Scheme, a maximum of 5,056,431 shares, which represent 0.1% of the issued share capital of the Company as at 31 December 2007, may be issued pursuant to the exercise of options granted under the New Option Scheme. Options granted will be evenly vested in respect of their underlying shares over a period of three years from the date on which the relevant option is offered. The exercise price of any option granted under the New Option Scheme is to be determined by the Company upon the offer of grant of the option and which should not be less than the greatest of (i) the average closing price of an MTR share for the five business days immediately preceding the day of offer of such option; (ii) the closing price of an MTR share on the day of offer of such option, which must be a business day; and (iii) the nominal value of an MTR share. The New Option Scheme expired on 16 May 2007 and no options could be granted under this Scheme on or after that date.

The following table summarises the outstanding share options granted under the New Option Scheme since inception:

Date of grant	Number of share options	Exercise price HK\$	Exercisable period
1 August 2003	1,245,200	9.75	on or prior to 14 July 2013
13 September 2005	94,000	15.97	on or prior to 9 September 2015
23 September 2005	213,000	15.97	on or prior to 9 September 2015
12 January 2006	62,500	15.45	on or prior to 9 January 2016
31 March 2006	94,000	18.05	on or prior to 20 March 2016
12 May 2006	266,500	20.66	on or prior to 25 April 2016
12 May 2006	213,000	21.00	on or prior to 2 May 2016
15 May 2006	213,000	20.66	on or prior to 25 April 2016
4 July 2006	94,000	18.30	on or prior to 19 June 2016
5 October 2006	94,000	19.732	on or prior to 29 September 2016
17 November 2006	62,500	19.104	on or prior to 13 November 2016
22 March 2007	1,066,000	19.404	on or prior to 19 March 2017

Notes to the Accounts

47 Share-based Payments (continued)

A Equity-settled Share-based Payments (continued)

Movements in the number of share options outstanding and their related weighted average exercise prices were as follows:

	2007		2006	
	Number of options	Weighted average exercise price HK\$	Number of options	Weighted average exercise price HK\$
Outstanding at 1 January	2,780,700	14.598	2,910,700	12.809
Granted during the year	1,066,000	19.404	1,256,500	19.570
Exercised during the year	(129,000)	13.426	(132,500)	9.750
Lapsed during the year	–	–	(1,254,000)	15.940
Outstanding at 31 December	3,717,700	16.017	2,780,700	14.598
Exercisable at 31 December	1,775,700	12.377	1,413,700	10.200

The weighted average closing price in respect of the share options exercised during the year was HK\$22.80 (2006: HK\$20.43).

Share options outstanding at 31 December 2007 had the following exercise prices and remaining contractual lives:

Exercise price	2007		2006	
	Number of options	Remaining contractual life years	Number of options	Remaining contractual life years
HK\$9.75	1,245,200	5.54	1,311,200	6.53
HK\$15.97	307,000	7.69	307,000	8.69
HK\$15.45	62,500	8.02	94,000	9.02
HK\$18.05	94,000	8.22	94,000	9.22
HK\$20.66	479,500	8.32	479,500	9.32
HK\$21.00	213,000	8.34	213,000	9.34
HK\$18.30	94,000	8.47	94,000	9.47
HK\$19.732	94,000	8.75	94,000	9.75
HK\$19.104	62,500	8.87	94,000	9.87
HK\$19.404	1,066,000	9.22	–	–
	3,717,700	7.61	2,780,700	7.96

According to the Black-Scholes pricing model, the fair values of options granted during the year ended 31 December 2007 were as follows:

Date of grant	Inputs into the Black-Scholes pricing model						
	Fair value of options granted	Share price immediately before grant date	Exercise price	Expected volatility	Expected life	Risk-free interest rate	Expected dividend per share
	HK\$	HK\$	HK\$		years	%	HK\$
22 March 2007	3.79	19.32	19.404	0.21	5.00	3.96	0.42

When computing fair values of the options granted, expected volatility was determined by calculating the historical volatility of the Group's share price over the previous 5 years and the expected life adopted was assumed to be the fifth year after granting of the options, with expected dividends based on historical dividends. In addition, vesting terms under the grants have been taken into account whilst no market conditions associated with the share option grants have been considered. Changes in the subjective input assumptions could materially affect the fair value estimate.

47 Share-based Payments (continued)

A Equity-settled Share-based Payments (continued)

(iii) 2007 Share Option Scheme

Following the expiry of the New Option Scheme in May 2007, the 2007 Share Option Scheme (the "2007 Option Scheme") was submitted and approved at the 2007 Annual General Meeting to enhance the Company's ability to attract the best available personnel, to retain and motivate critical and key employees, to align their interest to the long-term success of the Company and to provide them fair and market competitive remuneration. Under the Rules of the 2007 Option Scheme, a maximum of 277,461,072 shares, which represent 5% of the issued share capital of the Company as at 7 June 2007, may be issued pursuant to the exercise of options granted under all share option schemes of the Company including the 2007 Option Scheme. Options granted will be vested in respect of their underlying shares not less than 1 year from the date on which the relevant option is offered. The exercise price of any option granted under the 2007 Option Scheme is to be determined by the Company upon the offer of grant of the option and which should not be less than the greatest of (i) the average closing price of an MTR share for the five business days immediately preceding the day of offer of such option; (ii) the closing price of an MTR share on the day of offer of such option, which must be a business day; and (iii) the nominal value of an MTR share.

The following table summarises the outstanding share options granted under the 2007 Option Scheme since inception. In total, share options in respect of 8,273,000 shares were offered to Members of the Executive Directorate and selected employees of the Company on 10 December 2007 and were accepted by the employees during the period from 11 December 2007 to 7 January 2008. Under the 2007 Option Scheme, the date of grant is defined as the date of acceptance of the offer to grant the option.

Date of grant	Number of share options	Exercise price HK\$	Exercisable period
11 December 2007	45,000	27.60	on or prior to 10 December 2014
12 December 2007	2,730,000	27.60	on or prior to 10 December 2014
13 December 2007	1,805,000	27.60	on or prior to 10 December 2014
14 December 2007	1,005,000	27.60	on or prior to 10 December 2014
15 December 2007	435,000	27.60	on or prior to 10 December 2014
17 December 2007	835,000	27.60	on or prior to 10 December 2014
18 December 2007	445,000	27.60	on or prior to 10 December 2014
19 December 2007	115,000	27.60	on or prior to 10 December 2014
20 December 2007	190,000	27.60	on or prior to 10 December 2014
21 December 2007	45,000	27.60	on or prior to 10 December 2014
22 December 2007	35,000	27.60	on or prior to 10 December 2014
24 December 2007	118,000	27.60	on or prior to 10 December 2014
28 December 2007	35,000	27.60	on or prior to 10 December 2014
31 December 2007	130,000	27.60	on or prior to 10 December 2014
2 January 2008 *	75,000	27.60	on or prior to 10 December 2014
3 January 2008 *	40,000	27.60	on or prior to 10 December 2014
4 January 2008 *	65,000	27.60	on or prior to 10 December 2014
7 January 2008 *	125,000	27.60	on or prior to 10 December 2014

* Options granted in January 2008 have not been accounted for in the accounts for the year ended 31 December 2007.

Movements in the number of share options outstanding and their related weighted average exercise prices were as follows:

	2007	
	Number of options	Weighted average exercise price HK\$
Granted during the year	7,968,000	27.60
Exercised during the year	-	-
Lapsed during the year	-	-
Outstanding at 31 December	7,968,000	27.60
Exercisable at 31 December	-	-

Notes to the Accounts

47 Share-based Payments (continued)

A Equity-settled Share-based Payments (continued)

Share options outstanding at 31 December 2007 had the following exercise prices and remaining contractual lives:

Exercise price	2007	
	Number of options	Remaining contractual life years
HK\$27.60	7,968,000	7
	7,968,000	7

According to the Black-Scholes pricing model, the fair values of options granted during the year ended 31 December 2007 were as follows:

Date of grant	Inputs into the Black-Scholes pricing model						
	Fair value of options granted HK\$	Share price immediately before grant date HK\$	Exercise price HK\$	Expected volatility	Expected life years	Risk-free interest rate %	Expected dividend per share HK\$
11 December 2007	4.65	27.60	27.60	0.22	3.50	2.44	0.42
12 December 2007	4.85	27.90	27.60	0.22	3.50	2.48	0.42
13 December 2007	4.93	28.00	27.60	0.22	3.50	2.53	0.42
14 December 2007	4.55	27.30	27.60	0.22	3.50	2.67	0.42
15 December 2007	4.61	27.35	27.60	0.22	3.50	2.74	0.42
17 December 2007	4.61	27.35	27.60	0.22	3.50	2.74	0.42
18 December 2007	4.29	26.85	27.60	0.22	3.50	2.72	0.42
19 December 2007	4.39	27.00	27.60	0.22	3.50	2.73	0.42
20 December 2007	4.73	27.60	27.60	0.22	3.50	2.68	0.42
21 December 2007	4.99	27.95	27.60	0.22	3.50	2.78	0.42
22 December 2007	5.20	28.25	27.60	0.22	3.50	2.83	0.42
24 December 2007	5.20	28.25	27.60	0.22	3.50	2.83	0.42
28 December 2007	5.09	28.05	27.60	0.22	3.50	2.90	0.42
31 December 2007	5.07	28.05	27.60	0.22	3.50	2.86	0.42

When computing fair values of the options granted, expected volatility was determined by calculating the historical volatility of the Group's share price over the previous 3.5 years and the expected life adopted was assumed to be three and a half years after granting of the options, with expected dividends based on historical dividends. In addition, vesting terms under the grants have been taken into account whilst no market conditions associated with the share option grants have been considered. Changes in the subjective input assumptions could materially affect the fair value estimate.

(iv) During the year, the equity-settled share-based payments recognised in respect of the above share option schemes were as follows:

<i>in HK\$ million</i>	2007	2006
Equity-settled share-based payments in respect of:		
– New Option Scheme	1	3
– 2007 Option Scheme	1	–
	2	3

47 Share-based Payments *(continued)*

B Cash-settled Share-based Payments

(i) C K Chow did not participate in the Company's Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme. He was entitled to receive an equivalent value in cash of 700,000 shares on completion of his initial three-year contract on 30 November 2006. Pursuant to this contract and following the completion of the contract period, HK\$13,396,600 was paid to C K Chow on 1 December 2006 (at a price of HK\$19.138 per share derived in accordance with the terms of the grant by reference to the average closing price of the Company's shares on the 20 business days immediately preceding 30 November 2006).

(ii) C K Chow will be entitled to receive an equivalent value in cash of 418,017 shares in the Company on completion of his contract on 30 November 2009. As at 31 December 2007, an amount of HK\$4.1 million (2006: HK\$6.2 million) has been recorded as share-based payment expense for the year. Fair value of the outstanding entitlement is calculated based on the closing price of the Company's shares at year-end date. As at 31 December 2007, the fair value of these shares was HK\$28.70 per share (2006: HK\$19.56).

(iii) Lincoln K K Leong has a derivative interest in the Company's shares, which entitled him to receive an equivalent value in cash of 160,000 shares in the Company on 9 April 2010. As at 31 December 2007, an amount of HK\$1.1 million (2006: nil) has been recorded as share-based payment expense for the year, measured at the same basis as described in note 47B(ii) above.

48 Retirement Schemes

The Company operates two occupational retirement schemes, the MTR Corporation Limited Retirement Scheme (the "MTR Scheme") and a top-up scheme, the MTR Corporation Limited Retention Bonus Scheme (the "RBS"). In addition, in accordance with the Mandatory Provident Fund ("MPF") Schemes Ordinance, the Company has set up an MPF Scheme on 1 December 2000 by participating in a master trust scheme provided by an independent MPF service provider. Employees eligible can choose between the MTR Scheme and the MPF Scheme while temporary employees are required to join the MPF Scheme.

Following the Rail Merger on 2 December 2007, the Group has assumed the operations of KCRC's two retirement schemes, namely the Kowloon-Canton Railway Corporation Retirement Benefit Scheme (the "KCR Scheme") which is a defined contribution scheme, and a MPF scheme ("KCR MPF Scheme") for employees who did not opt for or who were not eligible for the KCR Scheme.

The assets of these schemes are held under the terms of separate trust arrangements so that the assets are kept separate from those of the Company.

A The MTR Scheme

The MTR Scheme was established under trust at the beginning of 1977. The MTR Scheme contains both defined benefit and defined contribution elements. The MTR Scheme was registered under the Occupational Retirement Schemes Ordinance (Chapter 426 of the Laws of Hong Kong) ("ORSO") with effect from 31 October 1994. On 3 July 2000, exemption was granted by the MPF Authority to maintain the MTR Scheme and offer it as an alternative to the MPF Scheme.

The MTR Scheme provides both a hybrid benefit section and a defined contribution benefit section, offering benefits on retirement, permanent disability, death and leaving service to its members. The hybrid benefit section provides benefits based on the greater of a multiple of final salary and accumulated contributions with investment returns. The defined contribution benefit section, which was implemented on 1 April 1999, is a member choice plan which provides retirement benefits based on accumulated contributions and investment returns only. Promotees who are promoted after 1 April 1999 can choose to join either the defined contribution benefit section or to remain in the hybrid benefit section. As the hybrid benefit section was closed to new entrants on 31 March 1999, staff joining the Company on or after 1 April 1999 who would be eligible to join the Retirement Scheme can choose to join either the defined contribution benefit section or, commencing 1 December 2000, the MPF Scheme.

(i) The Hybrid Benefit Section

Members' contributions to the hybrid benefit section are based on a fixed percentage of basic salary. The Company's contributions are determined by the Executive Directorate with reference to an actuarial valuation. At 31 December 2007, the total membership was 5,655 (2006: 5,749). In 2007, members contributed HK\$66 million (2006: HK\$65 million) and the Company contributed HK\$152 million (2006: HK\$166 million) to the hybrid benefit section. The net asset value of the hybrid benefit section as at 31 December 2007 was HK\$7,929 million (2006: HK\$6,906 million).

(ii) The Defined Contribution Benefit Section

Both members' and the Company's contributions to the defined contribution benefit section are based on fixed percentages of members' basic salary. As at 31 December 2007, the total membership under this section was 591 (2006: 599). In 2007, total members' contributions were HK\$10.8 million (2006: HK\$9.9 million) and the total contribution from the Company was HK\$22.0 million (2006: HK\$20.3 million). The net asset value as at 31 December 2007 was HK\$188.9 million (2006: HK\$141.7 million).

According to the terms of the trust deed, forfeitures were transferred to the reserve account to be utilised at the discretion of the Company.

Notes to the Accounts

48 Retirement Schemes (continued)

A The MTR Scheme (continued)

(iii) Actuarial Valuations

Actuarial valuations are carried out annually in accordance with the ORSO. A full actuarial valuation of the Retirement Scheme, comprising both the hybrid and the defined contribution benefit sections, was carried out at 31 December 2007 by Towers, Perrin, Forster & Crosby, Inc., an independent firm of consulting actuaries, using the Attained Age Method. The principal actuarial assumptions used included a long-term rate of investment return net of salary increases of 2.0% (2006: 2.0%) per annum, together with appropriate allowances for expected rates of mortality, turnover, redundancy and retirement and an adjustment for salary increases expected over the short term. The actuary confirmed that, at the valuation date:

(a) the Scheme was solvent, with assets more than adequate to cover the aggregate value of members' vested benefits had all members left the Scheme; and

(b) the value of the Scheme's assets was more than sufficient to cover the aggregate past service liability on the assumption that the Scheme continued in force. The corresponding funding level was 117%.

B RBS

The RBS was established under trust as of 1 January 1995. The RBS is a defined benefit scheme and applies to all employees classified by the Company as staff working on designated projects and who are not on gratuity terms. The RBS provides for benefits to be payable only in the event of redundancy for accrued service up to 31 December 2002. The RBS was registered under the Occupational Retirement Schemes Ordinance with effect from 1 December 1995. As at 31 December 2007, there were 322 members (2006: 358) under the RBS.

The RBS is non-contributory for members. The Company's contributions are determined by the Executive Directorate with reference to an actuarial valuation and are charged as part of the staff costs to various projects on the basis of the amount contributed. During 2006 and 2007, the Company was not required to make any contributions to the Scheme. The net asset value of the RBS as at 31 December 2007 was HK\$12 million (2006: HK\$12 million).

Actuarial valuations are carried out annually. A full actuarial valuation of the RBS was carried out at 31 December 2007 by Towers, Perrin, Forster & Crosby, Inc. using the Attained Age Method. The principal actuarial assumptions used included an expected weighted rate of investment return net of salary increases, of approximately -2.0% (2006: -1.25%) per annum, together with appropriate allowance for expected rates of redundancy. The actuary confirmed that, at the valuation date:

(a) due to the nature of the RBS which provides for benefits only on redundancy, there was no aggregate vested liability, and thus the RBS was technically solvent; and

(b) the value of the RBS assets, together with the future contributions recommended by the actuary and to be adopted by the Company, would be sufficient to meet the liabilities of the RBS on an on-going basis.

C MPF Scheme

Effective from the MPF commencement date of 1 December 2000, the Company joined The Bank Consortium MPF Plan which has been registered with the Mandatory Provident Fund Schemes Authority and authorised by the Securities and Futures Commission. As at 31 December 2007, the total number of employees of the Company participating in the MPF Scheme was 885 (2006: 726). In 2007, total members' contributions were HK\$3.9 million (2006: HK\$2.7 million) and total contribution from the Company was HK\$4.5 million (2006: HK\$3.0 million).

D The KCR Scheme

The KCR Scheme is a defined contribution scheme which was established on 1 February 1983 under trust. The KCR Scheme was registered under the Occupational Retirement Scheme Ordinance with effect from 16 November 1994.

All benefits payable under the KCR Scheme are calculated by reference to the employer's contributions and members' own contributions, based on fixed percentages of member's basic salaries, together with investment returns on these contributions.

As of 31 December 2007, the total number of employees participating in the KCR Scheme was 3,949 (2006: 4,063). Since the Appointed Day, total contribution from the members and the Company were HK\$4.5 million and HK\$9.5 million respectively.

E KCR MPF Scheme

The KCR MPF Scheme is operated under the Hong Kong Mandatory Provident Fund Schemes Ordinance. It is a defined contribution retirement plan administered by independent trustees. The KCR MPF Scheme was introduced on 1 April 2000 to employees who did not opt for or who were not eligible for the KCR Scheme.

As of 31 December 2007, the total number of employees participating in the KCR MPF Scheme was 2,578 (2006: 2,643). Since the Appointed Day, total contribution from the members and the Company were HK\$1.9 million and HK\$1.9 million respectively.

49 Defined Benefit Retirement Plan Obligations

The Group makes contributions to two defined benefit plans that provide benefits for employees upon retirement or termination of services for other reasons (note 48). The movements in respect of these defined benefit plans during the year are summarised as follows.

A The amounts recognised in the balance sheets are as follows:

The Group and The Company

<i>in HK\$ million</i>	2007			2006		
	Retirement Scheme	RBS	Total	Retirement Scheme	RBS	Total
Present value of funded obligations	(8,577)	(1)	(8,578)	(7,311)	(3)	(7,314)
Fair value of plan assets	7,929	12	7,941	6,906	12	6,918
Net unrecognised actuarial (gains)/losses	796	(5)	791	520	(5)	515
Net asset	148	6	154	115	4	119

A portion of the above asset is expected to be recovered after more than one year. However, it is not practicable to segregate this amount from the amounts receivable in the next twelve months, as future contributions will also relate to future services rendered and future changes in actuarial assumptions and market conditions. The Group expects to pay HK\$155 million in contribution to the Retirement Scheme in 2008.

B Plan assets consist of the following:

The Group and The Company

<i>in HK\$ million</i>	2007			2006		
	Retirement Scheme	RBS	Total	Retirement Scheme	RBS	Total
Equity securities	3,696	–	3,696	3,623	–	3,623
Bonds	3,976	–	3,976	3,128	–	3,128
Cash	311	12	323	198	12	210
	7,983	12	7,995	6,949	12	6,961
Voluntary units	(54)	–	(54)	(43)	–	(43)
	7,929	12	7,941	6,906	12	6,918

Included in the plan assets are investments in the Company's ordinary shares and debt securities of nil (2006: HK\$1 million) and HK\$13 million (2006: HK\$13 million) respectively.

C Movements in the present value of the defined benefit obligations

The Group and The Company

<i>in HK\$ million</i>	2007			2006		
	Retirement Scheme	RBS	Total	Retirement Scheme	RBS	Total
At 1 January	7,311	3	7,314	5,974	7	5,981
Members' contributions paid to the Schemes	66	–	66	65	–	65
Benefits paid by the Schemes	(125)	–	(125)	(91)	(1)	(92)
Current service cost	264	–	264	253	–	253
Interest cost	271	–	271	251	–	251
Actuarial (gains)/losses	790	(2)	788	859	(3)	856
At 31 December	8,577	1	8,578	7,311	3	7,314

Notes to the Accounts

49 Defined Benefit Retirement Plan Obligations (continued)

D Movements in plan assets

The Group and The Company

in HK\$ million	2007			2006		
	Retirement Scheme	RBS	Total	Retirement Scheme	RBS	Total
At 1 January	6,906	12	6,918	5,899	13	5,912
Group's contributions paid to the Schemes	152	–	152	166	–	166
Members' contributions paid to the Schemes	66	–	66	65	–	65
Benefits paid by the Schemes	(125)	–	(125)	(91)	(1)	(92)
Expected return on plan assets	416	–	416	357	–	357
Actuarial gains/(losses)	514	–	514	510	–	510
At 31 December	7,929	12	7,941	6,906	12	6,918

E Expense recognised in the consolidated profit and loss account is as follows:

in HK\$ million	2007			2006		
	Retirement Scheme	RBS	Total	Retirement Scheme	RBS	Total
Current service cost	264	–	264	253	–	253
Interest cost	271	–	271	251	–	251
Expected return on plan assets	(416)	–	(416)	(357)	–	(357)
Net actuarial (gain)/loss recognised	–	(1)	(1)	–	(1)	(1)
Expense recognised	119	(1)	118	147	(1)	146
Less: Amount capitalised	20	–	20	24	(1)	23
	99	(1)	98	123	–	123

The retirement expense is recognised under staff costs and related expenses in the consolidated profit and loss account.

F Actual return on plan assets

in HK\$ million	2007	2006
Retirement Scheme	930	867
RBS	–	–

G The principal actuarial assumptions used as at 31 December 2007 (expressed as weighted average) are as follows:

	2007		2006	
	Retirement Scheme	RBS	Retirement Scheme	RBS
Discount rate at 31 December	3.50%	3.00%	3.75%	3.50%
Expected rate of return on plan assets	6.00%	2.50%	6.00%	2.75%
Future salary increases	4.00%	4.50%	4.00%	4.00%

The expected long-term rate of return on plan assets have been determined after taking into account actual experience, expected investment volatility and inflation in the long-term. Furthermore, it is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The amount is based exclusively on historical returns, without adjustments.

49 Defined Benefit Retirement Plan Obligations (continued)

H Historical information

The Group and The Company

<i>in HK\$ million</i>	Retirement Scheme				
	2007	2006	2005	2004	2003
Present value of funded obligations	(8,577)	(7,311)	(5,974)	(5,456)	(4,277)
Fair value of plan assets	7,929	6,906	5,899	5,365	4,638
Surplus/(deficits) in the Scheme	(648)	(405)	(75)	(91)	361
Experience adjustments arising on plan liabilities - gain/(loss)	(556)	(464)	(98)	(154)	(178)
Experience adjustments arising on plan assets - gain/(loss)	514	510	119	243	560

<i>in HK\$ million</i>	RBS				
	2007	2006	2005	2004	2003
Present value of funded obligations	(1)	(3)	(7)	(7)	(14)
Fair value of plan assets	12	12	13	14	14
Surplus/(deficits) in the Scheme	11	9	6	7	-
Experience adjustments arising on plan liabilities - gain/(loss)	1	3	(2)	5	7
Experience adjustments arising on plan assets - gain/(loss)	-	-	-	-	-

Notes to the Accounts

50 Interests in Jointly Controlled Operations

The Group has the following jointly controlled operations in respect of its awarded property development projects as at 31 December 2007.

Location/ Development Package	Land Use	Total Gross Floor Area (sq.m.)	Actual or Expected Date of Completion of Construction Works*
Hong Kong Station	Office/Retail/Hotel	415,894	Completed by phases from 1998 – 2005
Kowloon Station			
Package One	Residential	147,547	Completed in 2000
Package Two	Residential	210,319	Completed by phases from 2002 – 2003
Package Three	Residential/Cross Border Bus Terminus	105,113	Completed in 2005
Package Four	Residential	128,845	Completed in 2003
Package Five, Six and Seven	Residential/Office/Retail/Hotel/ Serviced Apartment/Kindergarten	504,350	By phases from 2006 – 2010
Olympic Station			
Package One	Residential/Office/Retail/Indoor Sports Hall	309,069	Completed in 2000
Package Two	Residential/Retail/Market	268,650	Completed in 2001
Package Three	Residential/Kindergarten	104,452	Completed in 2006
Tsing Yi Station	Residential/Retail/Kindergarten	292,795	Completed in 1999
Tung Chung Station			
Package One	Residential/Office/Retail/Hotel/ Kindergarten	361,531	Completed by phases from 1999 – 2005
Package Two	Residential/Retail/Kindergarten	255,949	Completed by phases from 2002 – 2008
Package Three	Residential/Retail/Wet Market/ Kindergarten	413,154	By phases from 2002 – 2008
Hang Hau Station	Residential/Retail	142,152	Completed in 2004
Tiu Keng Leng Station	Residential/Retail	253,765	Completed by phases from 2006 – 2007
Tseung Kwan O Station			
Area 55b	Residential/Retail	96,797	Completed in 2006
Area 57a	Residential/Retail	29,642	Completed in 2005
Area 56	Residential/Hotel/Retail/Office	163,130	2011
Tseung Kwan O Area 86			
Package One	Residential/Retail/Residential Care Home for the Elderly	139,840	2008
Package Two	Residential/Kindergarten	310,496	By phases from 2009 – 2010
Package Three	Residential/Kindergarten	129,544	2012
Choi Hung Park-and-Ride	Residential/Retail	21,538	Completed in 2005

* Completion based on issuance of occupation permit

The Group's assets held in relation to these joint venture operations include various site foundation works and related staff and overhead costs, land costs, acquisition cost of development rights and interest expense. These are set off against any up-front payments received from developers in relation to that development package, and the balance is shown on the balance sheet either as property development in progress or deferred income (note 23) as the case may be. As at 31 December 2007, total property development in progress in respect of these jointly controlled operations was HK\$1,961 million (2006: HK\$2,028 million) and total deferred income was HK\$400 million (2006: HK\$1,562 million).

During the year ended 31 December 2007, profits of HK\$8,304 million (2006: HK\$5,817 million) were recognised (note 8).

51 Material Related Party Transactions

The Financial Secretary Incorporated, which holds approximately 77% of the Company's issued share capital on trust for the Government of the Hong Kong SAR, is the majority shareholder of the Company. Transactions between the Group and Government departments, agencies or Government controlled entities, other than those transactions such as the payment of fees, taxes, leases and rates, etc. that arise in the normal dealings between the Government and the Group, are considered to be related party transactions pursuant to HKAS 24 "Related party disclosures" and are identified separately in these accounts.

Members of the Board and Members of the Executive Directorate, and parties related to them including their close family members, are also considered to be related parties of the Group. Transactions with these parties, except for those involving a Member of the Board or his related parties where the relevant Member abstains from voting, are separately disclosed in the accounts.

Major related party transactions entered into by the Group in prior years which are still relevant for the current year include:

- A** The Company entered into the Airport Railway Agreement with the Government on 5 July 1995 for the construction of the Airport Railway. In addition to specifying the parameters for the design, construction and operation of the Tung Chung and Airport Express Lines, the Agreement also included provisions for the granting of land to the Company for property development (note 23).
- B** The Company entered into the TKE Project Agreement with the Government on 4 November 1998 for the design, construction, financing and operation of the Tseung Kwan O Extension and the granting of land for commercial and residential property developments along the railway extension.
- C** On 30 June 2000, the Appointed Day for the purposes of the Mass Transit Railway Ordinance, the Company was granted a franchise, for an initial period of 50 years, to operate the existing mass transit railway, and to operate and construct any extension to the railway. On the same day, the Company entered into an Operating Agreement ("OA") with the Government which detailed provisions for the design, construction, maintenance and operation of the railway under the franchise. Pursuant to the terms of the OA, the Company's franchise will be extended for further periods of 50 years upon satisfying certain capital expenditure requirements at no payment and without any change in the terms of the franchise. The OA also provides that upon extension of the franchise and subject to the Government's prevailing land policy on the date on which the franchise is extended, certain consequential amendments will be made to agreements between the Government and the Company in relation to the mass transit railway, including the renewal of various railway running line leases and land leases at nominal cost. With effect from 2 December 2007, the OA was replaced by a new operating agreement, details of which are set out in note 51I below.
- D** On 14 July 2000, the Company received a comfort letter from the Government 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 franchise period. In addition, on 3 August 2007, the Government wrote to KCRC confirming that, subject to all necessary approvals being obtained, the period of certain of KCRC's land interests (which are the subject of the service concession) will be extended so that they are coterminous with the Concession Period.
- E** On 24 July 2002, the Company entered into an agreement with the Government specifying the parameters for the design, construction, financing and operation of the Disneyland Resort Line ("DRL"). In connection with the financing of the DRL Project, the Government agreed to provide financial support through the Government waivers of its entitlement to cash dividends in respect of its shareholding. Such committed financial support has been met in 2004. The DRL was completed in June 2005 and commenced operation on 1 August 2005.
- F** On 19 November 2003, the Company entered into a formal project agreement with the Government to develop, on a build, operate and transfer basis, the Tung Chung Cable Car System together with a Theme Village at Ngong Ping on the Lantau Island under a franchise granted by the Government for a period of 30 years commencing on 24 December 2003. The project was completed with operation commenced on 18 September 2006.
- G** On 24 January 2005, the Company accepted an offer from the Government to allow the Company to proceed with the proposed development on Site F of Tseung Kwan O Town Lot No. 70, Area 86, at an assessed land premium of HK\$2,319 million together with other ancillary terms and conditions as specified in the modification letter to be entered into between the Company and the Government. Upon award of the development package on 8 February 2005, the agreed land premium, of which one-half or HK\$1,160 million was paid by the Company, was settled.
- H** On 18 July 2005, the Company entered into a project agreement with the Airport Authority for the procurement of MTR station extension works and related railway facilities to serve the SkyPlaza at the Hong Kong International Airport. The project was completed during the year with the facilities opened on 28 February 2007. Details of the project are described in note 22B.

During the year, the Group has had the following material related party transactions:

- I** In connection with the Rail Merger, the Company entered into a new operating agreement with the Government ("new OA"), which is based on the existing OA referred to in note 51C. On the Appointed Day, the Company's existing franchise under the Mass Transit Railway Ordinance was expanded to cover railways other than the existing MTR railway for an initial period of 50 years from the Appointed Day ("expanded franchise"). The new OA detailed the design, construction, maintenance and operation of the railways under the expanded franchise. Pursuant to the terms of the new OA (and the MTR Ordinance), the Company's franchise may be extended for further periods of 50 years (from the date of the extension) upon satisfying certain capital expenditure requirements at no payment and without any change in the terms of the franchise. The new OA includes terms relating to the Company's obligations in relation to electrical power supply, control centres, the monitoring of environmental conditions, the provision of accommodation for the Hong Kong Police Force, the notification of certain events to the Commissioner for Transport, hours of operation and service capacity, performance requirements, customer service pledges and safety management. The new OA also sets out a framework for the award of new railway projects in Hong Kong and introduces a fare adjustment mechanism. A detailed description of the new OA is contained in the circular to shareholders in respect of the Extraordinary General Meeting convened to approve the Rail Merger.

Notes to the Accounts

51 Material Related Party Transactions (continued)

J Other than the new OA described in note 51I above, the Company also entered into the following principal agreements with KCRC and the Government in connection with the Rail Merger:

(i) Merger Framework Agreement, which contains provisions for the overall structure and certain specific aspects of the rail merger, including the seamless interchange programme, corporate governance, certain employee arrangements, implementation of certain fare reductions, the payments for property package, arrangements relating to flat production and land premium, the treatment of KCRC's cross border leases, Shatin to Central Link arrangements and the allocation of liabilities for certain pre and post merger claims by third parties;

(ii) Service Concession Agreement, which contains provisions in relation to the grant of the right to access, use and operate the concession property and a licence to access and use certain KCRC land; the term of the service concession; the arrangements for the redelivery of the KCRC system upon concession expiry; the provision of ex-KCRC services by the Company to specified standards; the obligation to pay upfront and annual payments; the legal and beneficial ownership of future concession property (Additional Concession Property); and the regime for compensation payable by KCRC upon return of the Additional Concession Property;

(iii) Sale and Purchase Agreement, which sets out the terms pursuant to which the Company acquired certain assets and contracts from KCRC;

(iv) Kowloon Southern Link ("KSL") Project Management Agreement, which sets out the terms on which the Company was appointed by KCRC to project manage the design and construction of the KSL in return for a management fee of approximately HK\$710.8 million and an incentive payment of up to HK\$110 million if the construction of the KSL is completed ahead of time and under budget. The Company itself will not construct, nor be responsible for the costs of the KSL works. On opening of service, the KSL will form part of the service concession;

(v) West Rail Agency Agreement, which sets out the terms on which the Company was appointed to act as KCRC's agent and to exercise certain rights and perform certain obligations relating to specified development sites along the West Rail;

(vi) US Cross Border Lease ("CBL") Assumption Agreements and US CBL Allocation Agreement, which set out the terms on which the Company has undertaken to perform, on a joint and several basis with KCRC, the obligations of KCRC under the respective CBLs; and delineates and allocates the obligations and responsibility for risks relating to the CBLs. Details of the commitment of the Company in connection with these agreements are specified in note 52E;

(vii) Outsourcing Agreement, which sets out the terms on which the Company is to provide certain financial and administrative services to KCRC after the Rail Merger, in return for an annual fee of HK\$19.8 million; and

(viii) Property Package Agreements, which set out the arrangements in respect of the acquisition of the property package. These arrangements include the assignment of certain properties by KCRC to the Company, the acquisition of certain properties by the Company through its acquisition of certain KCRC subsidiaries under the Sale and Purchase Agreement, the granting of leases on certain properties by the Government to the Company and the relating interim arrangements before such granting is effective, the management of certain development sites by the Company in return for a fee substantially equal to the profits from the developments, and the granting of certain potential development sites to the Company.

A detailed description of each of these documents is contained under the paragraph "Connected Transactions" of the Report of the Members of the Board.

On 8 June 2007, the Legislative Council approved the Rail Merger Ordinance which came into effect on the Appointed Day. Amongst other things, the Rail Merger Ordinance amends the KCRC Ordinance and the MTR Ordinance to provide the necessary legislative framework for the Rail Merger and the operation by the Company of the MTRC railway, KCRC railway and certain other railways under one franchise, and enables KCRC to enter into the Service Concession Agreement referred to in note 51J(ii) above with the Company.

K In connection with the construction of various railway projects, certain essential project works are embedded within the infrastructure works to be undertaken by the Government or certain of its related parties. These works have been entrusted to the Government and its related parties and are payable on an actual cost basis according to architectural certifications. The Government and certain of its related parties, on the other hand, have entered into entrustment agreements with the Company for the construction of various other infrastructure works that are also reimbursable according to actual costs certified. Details of the amounts paid and the amounts receivable and payable as at 31 December 2007 are provided in notes 22, 36 and 41 respectively.

L The Company has business transactions with its non-controlled subsidiaries in the normal course of operations, details of which are disclosed in note 26.

M The Group has paid remuneration to the Members of the Board and Members of the Executive Directorate. Details of these transactions are described in note 7A. In addition, the Members of the Executive Directorate were granted share options under the Company's Pre-Global Offering Share Option Scheme and New Joiners Share Option Scheme. Details of the terms of these directors' options are disclosed in note 7B and under the paragraph "Board Members' and Executive Directorate's Interests in Shares" of the Report of the Members of the Board. Their gross remuneration charged to the profit and loss account is summarised as follows:

<i>in HK\$ million</i>	2007	2006
Short-term employee benefits	50.6	44.5
Post-employment benefits	1.5	2.4
Equity compensation benefits	6.5	6.5
	58.6	53.4

The above remuneration is included in staff costs and related expenses.

51 Material Related Party Transactions (continued)

N During the year, the following dividends were paid to the Government:

<i>in HK\$ million</i>	2007	2006
Cash dividends paid	765	777
Shares allotted in respect of scrip dividends	1,025	990
	1,790	1,767

O On 6 February 2008, the Company entered into a preliminary project agreement with the Government for the undertaking of the pre-authorisation activities of the West Island Line. Pursuant to the agreement, the Company will be paid HK\$400 million to undertake the detailed design of the railway works, carry out all necessary ground investigations, invite and assess tenders for the railway works construction contracts, and carry out ancillary and other support services.

52 Commitments

A Capital Commitments

(i) Outstanding capital commitments as at 31 December 2007 not provided for in the accounts were as follows:

The Group

<i>in HK\$ million</i>	Railway operations	Railway extension projects	Property projects and management	Overseas project	Total
2007					
Authorised but not yet contracted for	916	–	68	–	984
Authorised and contracted for	547	152	377	633	1,709
	1,463	152	445	633	2,693
2006					
Authorised but not yet contracted for	476	–	428	5	909
Authorised and contracted for	353	325	676	72	1,426
	829	325	1,104	77	2,335

The Company

<i>in HK\$ million</i>	Railway operations	Railway extension projects	Property projects and management	Total
2007				
Authorised but not yet contracted for	889	–	68	957
Authorised and contracted for	547	152	377	1,076
	1,436	152	445	2,033
2006				
Authorised but not yet contracted for	476	–	428	904
Authorised and contracted for	353	325	676	1,354
	829	325	1,104	2,258

Included in the amounts authorised but not yet contracted for are costs that will not be subject to capital contracts such as staff costs, overhead expenses and capitalised interest.

Notes to the Accounts

52 Commitments (continued)

A Capital Commitments (continued)

(ii) The commitments under railway operations comprise the following:

The Group and The Company

<i>in HK\$ million</i>	Improvement and enhancement works	Acquisition of property, plant and equipment	Total
2007			
Authorised but not yet contracted for	905	11	916
Authorised and contracted for	538	9	547
	1,443	20	1,463
2006			
Authorised but not yet contracted for	454	22	476
Authorised and contracted for	349	4	353
	803	26	829

B Operating Lease Commitments

The Group had operating leases on office buildings, staff quarters, bus depot and a shopping centre in Beijing as at 31 December 2007. The total future minimum lease payments under non-cancellable operating leases are payable as follows:

<i>in HK\$ million</i>	The Group		The Company	
	2007	2006	2007	2006
Payable within one year	67	53	17	5
Payable after one but within five years	228	250	13	5
	295	303	30	10

The above includes HK\$24 million (2006: HK\$2 million) in respect of the office accommodation and quarters for construction project staff, majority of which are subject to rent reviews. The Group has the right to acquire the shopping centre in Beijing at a pre-determined price during the first five years of the lease term, which commenced from April 2006, or release its obligation as a tenant by making a compensation to the landlord upon expiry of the fifth year. The Group also obtained a bank guarantee of RMB 12.5 million in respect of quarterly rental payment arrangement with the landlord of the Ginza Mall shopping centre in Beijing.

C Liabilities and Commitments in Respect of Property Management Contracts

The Group has, over the years, jointly developed with outside property developers certain properties above or adjacent to railway depots and stations. Under most of the development agreements, the Group retained the right to manage these properties after their completion. The Group, as manager of these properties, enters into services contracts with outside contractors for the provision of security, cleaning, maintenance and other services on behalf of the managed properties. The Group is primarily responsible for these contracts, but any contract costs incurred will be reimbursed by the owners and tenants of the managed properties from the management funds as soon as they are paid.

As at 31 December 2007, the Group had total outstanding liabilities and contractual commitments of HK\$969 million (2006: HK\$773 million) in respect of these works and services. Cash funds totalling HK\$989 million (2006: HK\$788 million) obtained through monthly payments of management service charges from the managed properties are held by the Group on behalf of those properties for settlement of works and services provided.

D Material Financial Guarantee Contracts

The Company provides guarantees to investors of debt securities issued by one of its subsidiaries, MTR Corporation (C.I.) Limited (note 38D), which amounted to approximately HK\$11,812 million (in notional amount) as at 31 December 2007. Proceeds from such debts issued have been on lent to the Company. As such, the primary liabilities have already been recorded in the Company's balance sheet.

The Group provides standby letters of credit to the Investors to the Lease Transaction (note 19) to cover additional amounts payable by the Group in the event the transactions are terminated prior to the expiry of the lease terms. As at 31 December 2007, the amount of such standby letters of credit totalled approximately US\$95 million (HK\$743 million).

52 Commitments (continued)

E US Cross Border Lease ("CBL") Agreements

In connection with the Rail Merger in December 2007, the Company entered into a number of agreements ("US CBL Assumption Agreements") with respect to the CBLs that KCRC had entered into with its CBL counterparties in relation to certain of its property and equipment ("CBL Property") between 1998 and 2003. Pursuant to the US CBL Assumption Agreements, the Company has undertaken to perform, on a joint and several basis with KCRC, the obligations of KCRC under the respective CBLs.

In addition, the Company has entered into a US CBL Allocation Agreement with KCRC, whereby the rights, obligations and responsibility for risks relating to the CBLs are delineated and allocated between the Company and KCRC. Generally, the Company is responsible for operational matters, such as repair, maintenance and insurance of the CBL Property, and KCRC is responsible for all other obligations, including payment of periodic rents and collateral related obligations. Despite this allocation of obligations, the Company is prima facie jointly and severally liable to the CBL counterparties for any failure of KCRC to perform its obligations under the CBLs.

KCRC and the Government of Hong Kong have agreed to indemnify the Company for its reasonable costs incurred as a result of the due and proper performance by the Company of its obligations under the CBLs (unless such costs would have been incurred in any event). In addition, KCRC has agreed to indemnify the Company for losses and reasonable costs incurred arising from KCRC not complying with its obligations under the CBLs or from any breach of KCRC's representations, covenants and agreements provided for in relation to the CBLs.

The Company has agreed to indemnify each of the Government of Hong Kong and KCRC for losses and reasonable costs incurred arising from any breach of the Company's representations, covenants and agreements provided for in relation to the CBLs.

F Service Concession

Pursuant to the Rail Merger, the Company is obliged under the Service Concession Agreement ("SCA") to pay an annual fixed payment of HK\$750 million to KCRC over the period of the service concession. Additionally, commencing after three years from the Appointed Day, the Company is obliged to pay an annual variable fee to KCRC based on the revenue generated from the KCRC system above certain thresholds. Furthermore, under the SCA, the Company is obliged to maintain, repair, replace and/or upgrade the KCRC system over the period of the service concession which is to be returned at the expiry of the service concession.

G Investments in China

(i) Investment in Line 4 of Shenzhen Metro System ("Shenzhen Line 4")

In January 2004, the Group entered into an Agreement in Principle for a Build-Operate-Transfer ("BOT") project with the Shenzhen Municipal People's Government ("Shenzhen Government") in respect of the construction of Phase 2 of Shenzhen Line 4 of the proposed Shenzhen Metro System and the operation of the entire line for a term of 30 years. In May 2005, the Group and the Shenzhen Government initialed the project Concession Agreement. The project is subject to approval from the Central Government.

Shenzhen Line 4 is a 21-kilometre urban railway running from Huanggang to Longhua New Town in Shenzhen, forming the major north-south railway corridor of the Shenzhen Special Economic Zone. Upon completion of Phase 2 of Shenzhen Line 4, both Phases 1 and 2 will be operated by the Company's subsidiary established in Shenzhen. Total investment of the project is estimated at RMB 6.0 billion (HK\$6.4 billion) which will be financed by equity capital contributed by the Group of RMB 2.4 billion (HK\$2.6 billion) and the balance by bank loans in Renminbi.

Preparatory work including design and tendering and expanded trial section work is in progress. As of 31 December 2007, costs of HK\$670 million (2006: HK\$282 million) incurred for the project have been included in deferred expenditure and the Group had other contract commitments totalling HK\$633 million (2006: HK\$77 million) in relation to this project. Under the Agreement in Principle and the approval document issued by Shenzhen Development and Reform Bureau, there are certain buy-back arrangements with Shenzhen Government on the project-related costs incurred by the Group should the project not be approved by the Central Government.

(ii) Investment in Beijing Metro Line 4 Project ("Beijing Line 4")

In December 2004, an Agreement in Principle was entered into between the Group, Beijing Infrastructure Investment Co. Ltd ("BIIC") and Beijing Capital Group ("BCG"), both are subsidiaries of the Beijing Municipal People's Government, to form a public-private partnership company ("PPP") for the investment in the Beijing Line 4 project, which involves the investment, construction and operation of the line for a term of 30 years. In September 2005, approval from the Central Government for the project was obtained. The PPP, Beijing MTR Corporation Limited, completed all registration requirements and obtained its business license in January 2006. In April 2006, Concession Agreement with the Beijing Municipal People's Government was signed.

Beijing Line 4 is a 29-kilometre underground metro line running from Majialou Station to Longbeicun Station, forming a main north-south traffic artery of Beijing. The total investment for the Beijing Line 4 project is estimated at RMB 15.3 billion (HK\$16.3 billion), of which 70% will be borne by the Beijing Municipal People's Government to finance mainly land acquisition and civil construction. Total investment by the PPP is RMB 4.6 billion (HK\$4.9 billion), contributing to 30% of the total investment in the project to finance mainly the electrical and mechanical systems and rolling stock. Both the Group and BCG each owns 49% interests of the PPP whilst BIIC owns the remaining 2% interest. The PPP is to operate and responsible for maintenance of Beijing Line 4 for a term of 30 years. The PPP has a registered capital of approximately RMB 1.4 billion (HK\$1.5 billion), of which RMB 676 million (HK\$722 million) will be contributed and owned by the Group. As of 31 December 2007, the Group has made an equity contribution of HK\$203 million, representing about 30% of the registered capital committed by the Group. Apart from equity, the PPP's investment is financed by non-recourse bank loans provided by Industrial and Commercial Bank of China and China Development Bank.

Tenders for the provision of trains and related electrical and mechanical systems are substantially completed. A total of 64 contracts have been awarded. Equipment production is underway. As of 31 December 2007, the PPP has in respect of the contracts awarded, total contract commitments amounting to approximately RMB 2.3 billion (HK\$2.5 billion) (2006: HK\$1.9 billion).

Notes to the Accounts

52 Commitments *(continued)*

H Investments in Europe

On 2 July 2007, London Overground Rail Operations Ltd ("LOROL") (formerly known as MTR Laing Metro Limited), the 50/50 partnership between the Group and Laing Rail Limited was awarded the concession to operate the new London Overground service in Greater London for seven years from 11 November 2007 with an option for a two year extension. London Overground is a semi-orbital route of five rail lines serving West, North and East London and will act as a crucial link for the 2012 Olympic Games. The total London Overground route network measures 107.2 kilometres.

Under the terms of the concession agreement between LOROL and Transport for London ("TfL"), LOROL has provided a performance bond of GBP 15 million to TfL, which is jointly and severally indemnified by the parent companies, that is the Company and Laing Rail Limited, through parent company guarantees. The bond may be called by TfL if the concession is terminated early as a result of default.

On 23 October 2007, the Company and Laing Rail Limited entered into a Loan Facility Agreement with LOROL. The loan facility was divided into two parts : (i) unsecured floating rate senior debt of GBP 4 million with interest at 2.5% per annum above the published Bank of England base rate from time to time and the final loan repayment is in 2008; and (ii) unsecured fixed rate subordinated debt of GBP 5 million with interest rate at 11% per annum and final repayment date on the date of expiry or the earlier termination of the term of the London Rail Concession under the concession agreement. Each lender shares 50% of the loan facility commitment.

53 Post Balance Sheet Events

A In October 2007, the Chief Executive announced in his 2007/08 Policy Address the proposed lowering of the profits tax rate by 1% point to 16.5% in fiscal year 2008/09. On 27 February 2008, the Financial Secretary affirmed such proposed tax rate reduction in his 2008/09 budget. Subject to Legislative Council's approval and formal adoption of this revised tax rate, the Company's accumulated deferred tax liabilities as at 31 December 2007 would be reduced by HK\$719 million to HK\$11,855 million.

B On 11 March 2008, the Government announced its decision for the Company to proceed further with the planning and design of the Shatin-to-Central Link and the Kwun Tong Line extension to Whampoa. The Shatin-to-Central Link will be based on the scheme proposed by the Company under the Rail Merger. The first phase from Tai Wai to Hung Hom is expected to be opened in 2015 while the second phase from Hung Hom to Central is expected to be opened in 2019. The Company will continue discussions with the Government on the operation of the Shatin-to-Central Link by way of a service concession. The Kwun Tong Line extension is expected to be operational by 2015 and the Company will discuss the implementation details of this project with the Government based on the ownership approach using property development rights to bridge the funding gap.

54 Accounting Estimates and Judgements

A Key sources of accounting estimates and estimation uncertainty include the following:

(i) Estimated Useful Life and Depreciation of Property, Plant and Equipment

The Group estimates the useful lives of the various categories of property, plant and equipment on the basis of their design lives, planned asset maintenance programme and actual usage experience. Depreciation is calculated using the straight-line method at rates sufficient to write off their cost or valuation over their estimated useful lives (note 2I).

(ii) Impairment of Long-lived Assets

The Group reviews its long-lived assets for indications of impairment at each balance sheet date according to accounting policies set out in note 2H(ii). In analysing potential impairments identified, the Group uses projections of future cash flows from the assets based on management's assignment of a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

(iii) Pension Costs

The Group employs independent valuation professionals to conduct annual assessment of the actuarial position of the Group's retirement plans. The determination of the Group's obligation and expense for the defined benefit element of these plans is dependent on certain assumptions and factors provided by the Company, which are disclosed in notes 48A(iii) and 48B.

(iv) Revenue Recognition on Property Development

Recognition of property development profits requires management's estimation of the final project costs upon completion and, in the case of property distribution-in-kind, the properties' fair value upon recognition. The Company takes into account independent qualified surveyors report, past experience on sales and marketing costs, as well as the prevailing market conditions when estimating final project costs on completion; and makes reference to professionally qualified valuers' reports in determining the estimated fair value of property distribution-in-kind.

(v) Properties Held for Sale

The Group values unsold properties at the lower of their costs or net realisable values (note 31) at the balance sheet date. In ascertaining the properties' net realisable values, which are represented by the estimated selling prices less costs to be incurred in relation to the sales, the Group employs independent valuation professionals to assess the properties' estimated selling prices, and makes estimations on further selling and property holding costs to be incurred based on past experience and with reference to general market practice.

54 Accounting Estimates and Judgements *(continued)*

A Key sources of accounting estimates and estimation uncertainty include the following: *(continued)*

(vi) *Interest-free Loan to a Property Developer*

The Group estimated the fair value of the interest-free loan to a developer at its present value discounted at the prevailing market rates of interest at inception.

(vii) *Valuation of Investment Properties*

The valuation of investment properties requires management's input of various assumptions and factors relevant to the valuation. The Group conducts annual revaluation of its investment properties by independent professionally qualified valuers based on these assumptions agreed with the valuers prior to adoption.

(viii) *Franchise*

The current franchise under which the Group is operating allows it to run the mass transit railway system until 1 December 2057. Pursuant to the terms stipulated in the new Operating Agreement with the Government, the Company considers that it has the legal right to extend the franchise for further periods of 50 years upon expiry of each franchise term (note 511). The Group's depreciation policies (note 21) in respect of certain assets' lives which extend beyond 2057 are on this basis.

(ix) *Income Tax*

Certain treatments adopted by the Company in its tax returns in the past years are yet to be finalised with the Hong Kong Inland Revenue Department. In assessing the Company's income tax and deferred taxation in the 2007 accounts, the Company has followed the tax treatments it has adopted in those tax returns, which may be different from the final outcome in due course.

(x) *Project Provisions*

The Group establishes project provisions for the settlement of estimated claims that may arise due to time delays, additional costs or other unforeseen circumstances common to major construction contracts. The claims provisions are estimated based on an assessment of the Group's liabilities under each contract by professionally qualified personnel, which may differ from the actual claims settlement.

(xi) *Deferred Expenditure*

As disclosed in note 2J(i), the Group capitalises proposed railway project costs in deferred expenditure when the projects are at a detailed study stage and having been approved in principle by the Members of the Board. Such decision involves the Board's judgement on the outcome of the proposed project.

(xii) *Fair Value of Derivatives and Other Financial Instruments*

In determining the fair value of financial instruments, the Group uses its judgement to select a variety of methods and make assumptions that are mainly based on market conditions existing at each balance sheet date. For financial instruments that are not traded in active markets, the fair values were based on the discounted cash flows method which discounts the future contractual cash flows at the current market interest or foreign exchange rates, as applicable, for similar financial instruments that were available to the Group at the time.

(xiii) *Obligations under Service Concession*

In determining the present value of the obligations under service concession, the discount rate adopted was the Company's estimated long-term incremental cost of borrowing at inception after due consideration of the Company's existing fixed rate borrowing cost, future interest rate and inflation trends.

B Critical accounting judgements in applying the group's accounting policies

(i) *Provisions and Contingent Liabilities*

The Group recognises provisions for liabilities of uncertain timing or amount when the Group has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as contingent liability. As at 31 December 2007, the Group considered that it had no disclosable contingent liabilities as there were neither pending litigations nor events with potential obligation which were probable to result in material outflow of economic benefits to the Group.

(ii) *Non-controlled Subsidiaries*

The Company regards Octopus Holdings Limited and its subsidiaries (the "OHL Group") as non-controlled subsidiaries. In determining whether the Group has control over these subsidiaries, the Company has taken into account its voting right conferred to it under the Shareholder's Agreement of OHL and the effective influence it may exercise over the decision of OHL's Board. Throughout the year ended 31 December 2007, the Group considered that its voting right in the OHL Group has been maintained at 49% despite an equity interest of 57.4%. As such, the OHL Group of companies were accounted for as non-controlled subsidiaries in the Group's accounts.

Notes to the Accounts

55 Possible Impact of Amendments, New Standards and Interpretations Issued but Not Yet Effective for the Annual Accounting Period Ended 31 December 2007

The HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2007 and which have not been adopted in these accounts. The Group considered that the following new standards will apply to its accounts in future.

	Effective for accounting periods beginning on or after
HKFRS 8 "Operating segments"	1 January 2009
HK(IFRIC) Interpretation 13 "Customer loyalty programmes"	1 July 2008
HK(IFRIC) Interpretation 14 "HKAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction"	1 January 2008

The Group is in the process of making an assessment of what the impact of these new standards and interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of HKFRS 8 may result in new or amended disclosure and changes in presentation of the accounts while the adoption of HK(IFRIC) Interpretation 13 may have an impact on the Group's results of operations and financial positions. However, the adoption of HK(IFRIC) Interpretation 14 is unlikely to have a significant impact on the Group's result of operation and financial position.

56 Approval of Accounts

The accounts were approved by the Board on 11 March 2008.

Glossary

Airport Express	Train service provided between AsiaWorld-Expo Station and Hong Kong Station
Appointed Day or Day One or Merger Date	2 December 2007 when the Rail Merger was completed
Articles of Association	The articles of association of the Company
Board	The board of directors of the Company
Bus	Feeder bus services operated in support of West Rail Line, East Rail Line and Light Rail
Company or MTR Corporation	MTR Corporation Limited 香港鐵路有限公司, a company which was incorporated under the Companies Ordinance (Chapter 32 of the Laws of Hong Kong) on 26 April 2000
Computershare	Computershare Hong Kong Investor Services Limited
Cross-boundary Service or Cross-boundary	Journeys with destination to / commencing from Lo Wu and Lok Ma Chau stations
Customer Service Pledge	Annually published performance targets in accordance with the Operating Agreement
Director and Member of the Board	A member of the Board
Domestic Service	Collective name for MTR Lines and KCR Lines
FSI	The Financial Secretary Incorporated, a corporation solely established under the Financial Secretary Incorporation Ordinance (Chapter 1015 of the Laws of Hong Kong)
Government	The Government of the Hong Kong SAR
Group	The Company and its subsidiaries
HKSE or Stock Exchange	The Stock Exchange of Hong Kong Limited
Hong Kong or Hong Kong SAR or HKSAR	The Hong Kong Special Administrative Region of the People's Republic of China
Integrated MTR System	Collective name for MTR System and KCR System
Intercity	Intercity passenger services operated between Hong Kong and certain major cities in the Mainland of China such as Guangzhou, Beijing and Shanghai
Interest Cover	Operating profit before depreciation and amortisation divided by gross interest and finance charges before capitalisation and interest income from loan to a property developer
KCRC	Kowloon-Canton Railway Corporation
KCR Lines	Collective name for East Rail Line (excluding Cross-boundary Service), West Rail Line and Ma On Shan Line
KCR System	Collective name for KCR Lines, Cross Boundary Service, Light Rail, Bus and Intercity services
Light Rail	Light rail system serving North West New Territories
Listing Rules	The Rules Governing the Listing of Securities on the Stock Exchange
Mainland or Mainland China or Mainland of China	The People's Republic of China
MTR Lines	Collective name for the Kwun Tong Line, Tsuen Wan Line, Island Line, Tung Chung Line, Tseung Kwan O Line and Disneyland Resort Line
MTR Ordinance	The Mass Transit Railway Ordinance (Chapter 556 of the Laws of Hong Kong)
MTR System	Collective name for MTR Lines and Airport Express
Net Debt-to-equity Ratio	Loans, obligations under finance leases, bank overdrafts and obligations under service concession net of cash and cash equivalents in the balance sheet as a percentage of the total equity attributable to equity shareholders of the Company
Operating Agreement	The agreement entered into by the Company and the Government on 30 June 2000 for the operation of the MTR System in the Pre-Merger period and a new agreement entered on 9 August 2007 for the operation of the Integrated MTR System after the Rail Merger
Operating Margin	Operating profit from railway and related businesses before depreciation and amortisation as a percentage of turnover
Ordinary Shares	Ordinary shares of HK\$1.00 each in the capital of the Company
Post-Merger or Post-Rail Merger	Refers to the period from 2 December 2007 to 31 December 2007
Pre-Merger or Pre-Rail Merger	Refers to the period from 1 January 2007 to 1 December 2007
Rail Merger or Merger	The merger of the rail operations of MTR Corporation and KCRC and the acquisition of certain property interests by MTR Corporation from KCRC, full details of which are set out in the Rail Merger Circular. The Rail Merger was completed on 2 December 2007
Rail Merger Bill or Rail Merger Ordinance	The Rail Merger Bill refers to the draft legislation on the Rail Merger which was passed by the Legislative Council of Hong Kong on 8 June 2007 and became the Rail Merger Ordinance (Ordinance No.11 of 2007)
Rail Merger Circular	Refers to the circular dated 3 September 2007 despatched to the Company's shareholders in connection with the Rail Merger
Return on Average Equity Attributable to Equity Shareholders	Profit attributable to equity shareholders of the Company as a percentage of the average of the beginning and closing total equity attributable to equity shareholders of the Company of the period
SEC	The U.S. Securities and Exchange Commission
Service Concession	The service concession and licence granted by KCRC to the Company under the Service Concession Agreement, full details of which are set out in the Rail Merger Circular
Service Quality Index	A measure of customer satisfaction for the services provided by MTR Lines and Airport Express based on the service attributes (excluding fares) weighted by the corresponding importance from the customer research

Shareholder Services

Any matters relating to your shareholding, such as transfer of shares, change of name or address, and loss of share certificates should be addressed in writing to the Registrar:

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