# Chairman's letter

Dear Stakeholder,

This is my first opportunity to address the various stakeholders of MTR Corporation (MTR) since my appointment as Chairman of the Company on 21 July 2003. I am honoured by the appointment and look forward to working with the management team of the Company ably led by Acting Chief Executive Officer, Mr. Phil Gaffney.

Firstly, a word of thanks to Mr. Jack So who left the Company on 20 July 2003. Under Jack's leadership MTR achieved many successes including the completion of both the Airport Railway and Tseung Kwan O Line, the development of the many property packages along the Airport Railway, the development of Octopus Cards, the successful expansion of our external consultancy businesses and, of course, the listing of the Company's shares on The Stock Exchange of Hong Kong. In the Company's operations, Jack and his management team were relentless in cutting costs to increase efficiency whilst at the same time providing enhanced levels of service; the station and train modernisation programme, the North Point Interchange, and platform screen doors are examples of such service enhancement. Leveraging off the Company's assets to increase revenues was another of Jack's priorities; the success of the Company's advertising and kiosk rental businesses at stations and the recent establishment of TraxComm Limited are testament to this focus on revenue enhancement. On behalf of MTR, I thank Jack for his leadership, devotion and hard work which has resulted in the Company being the success it is today.

In the first half of 2003, the Company recorded net earnings of HK$113 million, a significant reduction of 93% compared with the same period last year. Earnings per share were HK$0.02. As noted in the CEO's review of operations and outlook, besides the impact of SARS, the revision of an accounting standard on income tax, lower property development profits and higher depreciation and interest costs due to the opening of the Tseung Kwan O Line, all contributed to this decline. A number of these items, such as deferred tax, are non-cash charges. The second half of the year should see improvements in financial results, particularly in our property development profits with the receipt of our 18 floors in Two IFC. However, the Company's operating profit before depreciation, interest and taxes remains strong at HK$2,492 million in the first half.

Severe Acute Respiratory Syndrome (SARS) was a severely painful experience for the people of Hong Kong. On behalf of MTR we thank and salute Hong Kong's medical workers who fought so bravely against the disease. I would also thank all the staff of MTR, particularly our front-line staff, for their hard work and professionalism during the SARS crisis. SARS impacted every aspect of MTR's operations and the Company responded accordingly. From significantly increased cleaning in our trains, stations and rental properties to enhanced ventilation in both trains and stations, the Company ensured that customer health and safety was paramount whilst from a financial perspective, initiatives were undertaken to reduce costs. With the abatement of SARS, we launched a number of initiatives to regain revenue including promotions on our railway and our shopping centres. These promotions had their desired results and I am pleased to report that the average weekday patronage on our MTR Lines has recovered to 2.2 million in June from a low of 1.8 million recorded in April 2003, while "foot traffic" in our shopping centres has recovered to exceed pre-SARS levels. The Airport Express has shown reasonable recovery but patronage remains affected by the reduced airline business.

Longer term and in retrospect, the SARS crisis might well be seen as a harbinger of profound and positive societal changes that will underpin Hong Kong's dynamism and continuing success.

As a major public transport operator, we are often in the public and political lime-light. The last six months have seen much discussions in the public domain on two issues: namely the Company's property development and the possibility of fare reduction.

Property development, an integral part of MTR's business model enunciated in the Company's IPO Prospectus in 2000, has been criticised for contributing to excess supply.

The current general over-supply of residential units is a function of a number of factors, including the economic downturn, deflation, low consumer confidence, unemployment and the relatively high level of construction starts in the late 1990's. It is more a demand side problem, for which the solution will come eventually from demand recovery, given new land supply is held constant for the time being.

The Company's record demonstrates that the business model of "rail plus property development" has been successful and in fact is being emulated elsewhere. This model has provided Hong Kong with a first class metro system which has not required any subsidy from Government; almost unique in the world, and which has garnered international kudos for both Hong Kong and the Company. The Government has enjoyed reasonable financial returns from the equity investments it has made in the Company and benefited from the significant land premiums paid by the Company and our development partners. These land premiums have totalled HK$58 billion since 1995.

The Company has presented these facts to the Government and expressed the wish that Government be conservative regarding something that has consistently worked well over the long run.

The issue of fare discounts and fare setting mechanism have also aroused much public discussion. From its inception, the Company has been sensitive to the needs of the travelling public. After all, to be commercially successful, a company must serve its customers well and be price competitive.

As a publicly listed company with many international and domestic institutional shareholders as well as numerous domestic retail shareholders, the Company has a clear duty to deliver financial value to shareholders, which is inseparable from profit performance. The Company has been diligent in raising efficiency, evidenced by the 26% drop in operating costs per car-km since 1998. However, there are limits to cost reduction in a business which has to deliver a safe, reliable and frequent service to over 2.2 million riders every day.

Somewhere between the purist positions of charging what the market can bear and a free ride, the Company has positively engaged the Government in discussions regarding striking a right balance that abides by Hong Kong's time honoured principles of user pay, market autonomy and giving the travelling public excellent value and service. We believe these objectives are not mutually exclusive within the general framework of "fare autonomy" and are confident of an outcome that will be beneficial to all.

Another matter that is of strong shareholder and public interest is the possible consolidation of Hong Kong's rail industry. We believe if properly implemented, a merger between the Company and Kowloon-Canton Railway Corporation (KCRC) can create tremendous economic value for Hong Kong. We also recognise it will be a complex and massive exercise requiring much skill and resolve. We await a timely decision by Government on this matter. In the meantime, we welcome any opportunity to work profitably with KCRC to improve the competitiveness and overall service quality of the rail industry.

I am pleased to see that the management is actively pursuing improvements to the bus feeder services to MTR, particularly on Hong Kong Island and in southern Kowloon. These improved services together with a reduction in redundant bus routes, could lead to a much greater level of integration between bus and rail, providing better services to the public and improving road congestion and street level air pollution.

Finally, I would thank Mr. Phil Gaffney, the management and all the staff of MTR for their hard work and support.

Raymond K. F. Ch'ien

Dr. Raymond Ch'ien Kuo-fung, *Chairman*
Hong Kong, 31 July 2003