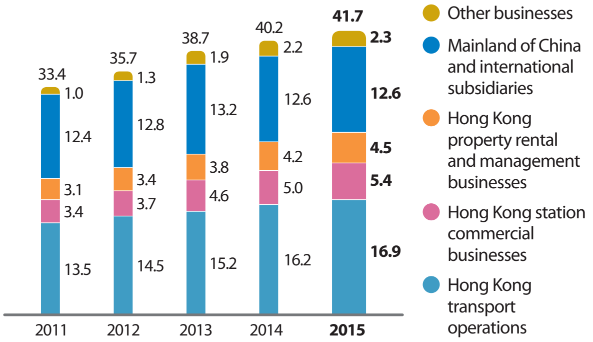
Financial Review

Total Revenue

Total Revenue showed continuous growth and increased by 3.8% to HK$41.7 billion in 2015.

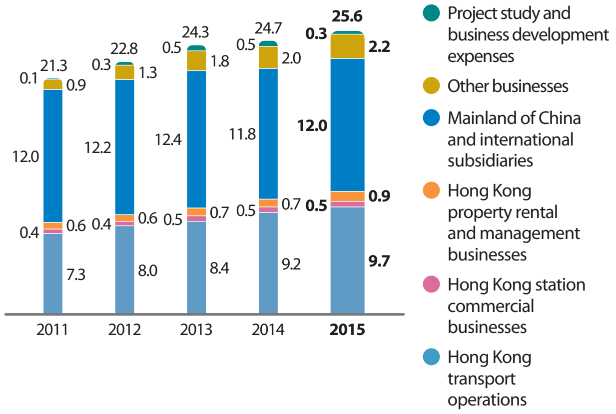
(HK$ billion)



Operating Expenses

Operating expenses in 2015 increased to HK$25.6 billion in support of various service enhancement initiatives.

(HK$ billion)



Profit and Loss

In 2015, the Group recorded reasonable profits from our recurrent businesses and moderate profits from our property development business.

Hong Kong transport operations reported total fare revenue of HK$16,754 million, up 4.3% against 2014. Fare revenues in 2015 amounted to HK$11,819 million for the Domestic Service, HK$3,172 million for the Cross-boundary Service, HK$950 million for the Airport Express, HK$671 million for Light Rail and Bus services and HK$142 million for the Intercity Service. Overall demand for our rail and bus services was higher and total patronage increased by 1.8% to 1,938.2 million in 2015. Average fares for the Domestic, Cross-boundary, Light Rail and Bus services were higher than in 2014, rising by 2.5%, 2.9%, 3.8% and 4.5% respectively. The increases were due to the fare adjustments under the FAM which were partly offset by fare concessions. The Airport Express and Intercity Service are not subject to the FAM. The average fare for the Airport Express decreased by 1.7% owing to fare promotions targeted at achieving higher patronage, while the average fare for the Intercity Service increased by 4.5%. Including other rail-related income of HK$162 million, total revenue from Hong Kong transport operations increased by 4.3% to HK$16,916 million. Expenses related to Hong Kong transport operations grew by 5.0% to HK$9,702 million in 2015 with the opening of the Western extension of the Island Line, as well as increased train trips and more front line operational staff. As a result, the operating profit for Hong Kong transport operations rose by 3.2% to HK$7,214 million, while the operating margin declined by 0.5 percentage point to 42.6%.

Hong Kong station commercial businesses reported growth, with total revenue of HK$5,380 million, an increase of 8.4% over 2014. Station retail revenue grew by 10.7% to HK$3,540 million, due to trade mix refinements, positive rental reversions, and increases in rents in accordance with lease contracts for Duty Free Shops at Lo Wu and Hung Hom stations as well as higher turnover rents from the Lok Ma Chau Station Duty Free Shops. Advertising revenue decreased marginally by 0.8% to HK$1,109 million as the advertising market softened. Telecommunication revenue increased by 14.4% to HK$548 million, due to a one-off project administration fee, incremental revenue from new stations on the Western extension of the Island Line and mobile data capacity enhancement projects by operators. Revenue from other station commercial businesses also saw an 8.3% increase to HK$183 million. Expenses in relation to Hong Kong station commercial businesses increased by 6.8% to HK$550 million, mainly due to higher Government rent and rates. Overall, the operating profit of the Hong Kong station commercial businesses increased by 8.6% to HK$4,830 million, while the operating margin increased slightly by 0.2 percentage point to 89.8%.

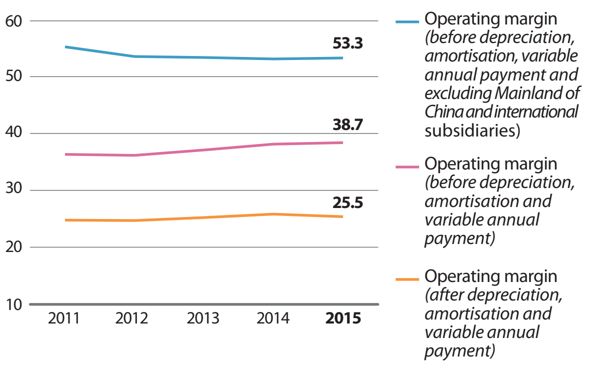
Hong Kong property rental and management businesses continued to deliver good financial results with total revenue increasing by 8.2% to HK$4,533 million. Property rental income grew by 8.2% to HK$4,267 million, as our shopping malls achieved an average of 12% favourable rental reversion in 2015. Our shopping malls and office space at Two International Finance Centre remained close to 100% let as at 31 December 2015. Our Hong Kong property management continued to grow as the number of residential units under management increased by 4,632 units to 96,066 units as at 31 December 2015. Revenue from Hong Kong property management increased by 8.6% to HK$266 million, due to incremental income from new residential units under management. Expenses relating to our Hong Kong property rental and management businesses increased by 15.8% to HK$865 million, mainly due to higher Government rent and rates as well as a one-off provision. The resulting operating profit from Hong Kong property rental and management businesses increased by 6.5% to HK$3,668 million, while the operating margin decreased by 1.3 percentage points to 80.9%.

Our Mainland of China and international subsidiaries, comprising railway related and rail franchise operations in Australia, Sweden and the United Kingdom, as well as rail

Operating Margin

Operating margin further improved to 38.7%.

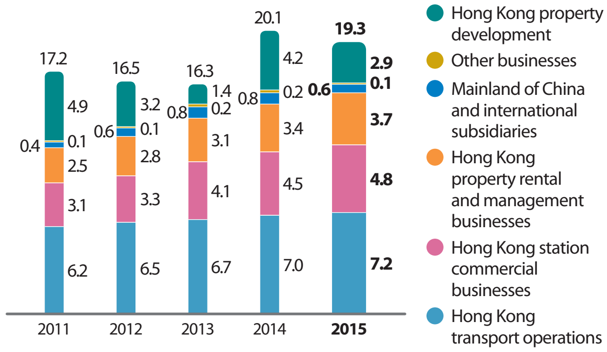
(Percentage)



Operating Profit Contributions*

In 2015, the Group recorded reasonable profits from our recurrent businesses and moderate profits from our property development business.

(HK$ billion)



* Excluding project study and business development expenses

franchise operations and property related activities in the Mainland of China. Revenue and expenses were recorded at HK$12,572 million and HK$11,986 million, respectively. The resulting operating profit was HK$586 million, a decrease of 27.3% from 2014. On a constant exchange rate basis and excluding the new start-up operations of MTRX, MTR Crossrail, MTS and JV-SMNW, the operating profit of our railway related subsidiaries outside of Hong Kong would have been 2.9% lower than in 2014. In Australia, the revenue and expenses of MTM were HK$7,755 million and HK$7,293 million, respectively, with the resulting operating profit decreasing by 20.3% to HK$462 million in 2015. On a constant exchange rate basis, the resulting operating profit decreased by 4.8%, due to a lower level of project activities. In Sweden, MTRS reported revenue and expenses of HK$2,714 million and HK$2,603 million, respectively. The resulting operating profit was HK$111 million, down from HK$127 million in 2014. On a constant exchange rate basis, the resulting operating profit increased by 8.2%, benefited from continuous improvement in operational performance. In the Mainland of China, the revenue and expenses of the Shenzhen Metro Longhua Line were HK$665 million and HK$528 million, respectively. The resulting operating profit decreased by 6.2% to HK$137 million, mainly due to increases in maintenance expenses and staff costs partly offset by higher revenue brought by a 12% increase in patronage. The operating profit of our property rental and management businesses in the Mainland of China was HK$27 million, at the same level as in 2014.

Other businesses, including Ngong Ping 360, our consultancy business and project management services to the Government for the entrustment works regarding the Express Rail Link and Shatin to Central Link, recorded an overall operating profit of HK$126 million, down 34.7% from 2014. The decrease was mainly due to lower operating profit from Ngong Ping 360 as a result of a decline in visitor numbers. This decline was mainly due to 28 fewer operating days in 2015 because of rope maintenance work, as well as the drop in inbound tourism to Hong Kong in 2015. Overall, the operating margin dropped by 3.5 percentage points to 5.5%.

Including project study and business development expenses amounting to HK$304 million in 2015, operating profit before Hong Kong property development, depreciation, amortisation and variable annual payment arising from recurrent businesses was HK$16,260 million. Together with marketing expenses of HK$140 million for the pre-sale of Tiara in Shenzhen as mentioned above, total operating profit before Hong Kong property development, depreciation, amortisation and variable annual payment increased by 4.5% to HK$16,120 million. The operating margin increased by 0.3 percentage point to 38.7%.

Hong Kong property development profit before tax in 2015 was HK$2,891 million, mainly comprising of the booking of profits from Hemera and surplus from the sale of inventory units. This was HK$1,325 million lower than 2014 when substantial property development profits were recognised from The Austin and Grand Austin.

Variable annual payment to KCRC on relevant revenue generated from the use of KCRC assets was HK$1,649 million, an increase of 12.0% over 2014, as a larger portion of revenue was charged under the highest progressive rate of 35%. Depreciation and amortisation increased by 10.4% to HK$3,849 million, mainly due to the additional depreciation charge relating to the operations of the Western extension of the Island Line in 2015. Net interest and finance charges were HK$599 million, up HK$54 million over 2014 due to lower interest income on reduced cash balances. Investment property revaluation gains amounted to HK$2,100 million in 2015, down from HK$4,035 million in 2014.

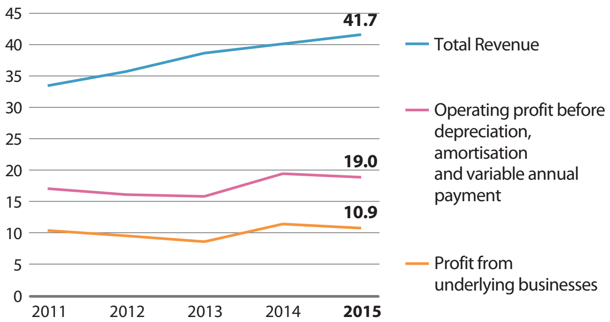
Our share of profits from associates increased from HK$121 million in 2014 to HK$361 million in 2015. Profit sharing from Octopus Holdings Limited increased by HK$9 million to HK$235 million. Our share of profit from BJMTR amounted to HK$236 million in 2015, an increase of HK$51 million from 2014, due to the impact of fare increase since December 2014.

Financial Review

Net Results from Underlying Businesses

In 2015, underlying business profit decreased to HK$10.9 billion resulted from lower property development profits.

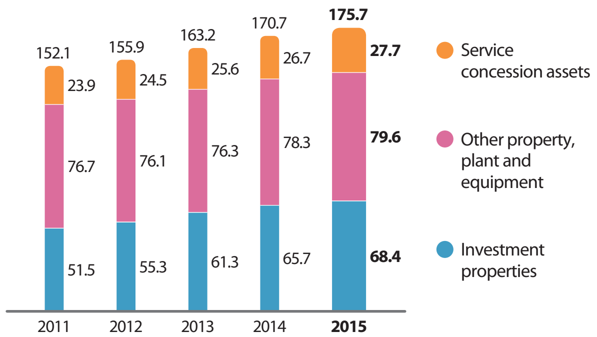
(HK$ billion)



Fixed Assets Growth

Fixed assets at 2015 year-end further increased to HK$175.7 billion due to asset additions for Hong Kong rail system and revaluation gains on investment properties.

(HK$ billion)



Our share of profit from LOROL and management fee income to the Group amounted to HK$39 million and HK$15 million, an increase from HK$24 million and HK$14 million in 2014, respectively. For HZMTR, our share of loss narrowed from HK$315 million in 2014 to HK$151 million in 2015, mainly due to higher fare revenue and fare subsidy and a number of one-off adjustments, partly offset by incremental interest expenses. Our share of profit from TBT increased by HK$7 million to HK$12 million in 2015 due to a decrease in operating expenses. Our share of profits from the other associates amounted to a loss of HK$10 million in 2015, mainly owing to initial losses in respect of our new franchise in Australia.

Net profit attributable to shareholders, after deducting income tax of HK$2,237 million and profits shared by non-controlling interests of HK$144 million, decreased from HK$15,606 million in 2014 to HK$12,994 million in 2015. Earnings per share therefore decreased from HK$2.69 to HK$2.22. Excluding investment property revaluation, the underlying profit attributable to equity shareholders was HK$10,894 million, with earnings per share of HK$1.87. Underlying profit from our recurrent businesses grew by 6.7% to HK$8,565 million, while post-tax property development profits decreased from HK$3,547 million in 2014 to HK$2,329 million in 2015. Return on average equity attributable to equity shareholders arising from underlying businesses was 6.5% in 2015, compared to 7.3% in 2014.

In line with our progressive ordinary dividend policy, the Board has proposed a final ordinary dividend of HK$0.81 per share, giving a full year ordinary dividend of HK$1.06 per share, higher than the HK$1.05 per share for 2014, with a scrip dividend option offered. In addition, with the approval of the Company's independent shareholders for the XRL Agreement obtained on 1 February 2016, and the approval of LegCo obtained on 11 March 2016 for Government's additional funding olibgations under the XRL Agreement, the first tranche of the special dividend of HK$2.20 per share will be paid to shareholders in the second half of 2016 and the second tranche, also of HK$2.20 per share, will then be paid in the second half of 2017.

Statement of Financial Position

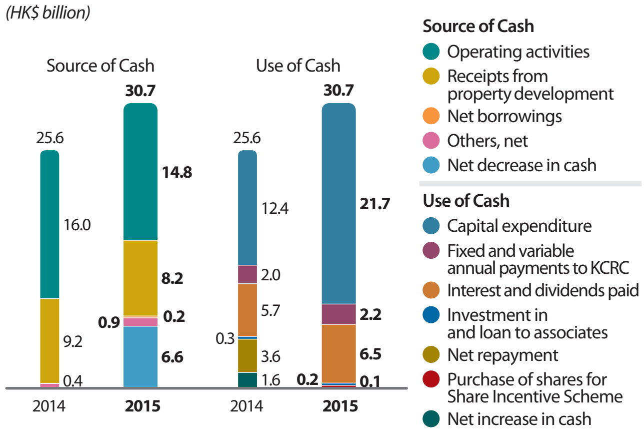
Our statement of financial position remains strong, with net assets increasing by 4.1% to HK$170,171 million at the end of 2015, compared with the end of 2014.

Total assets increased by HK$13,951 million during the year to HK$241,103 million at 31 December 2015. Total fixed assets increased by HK$5,063 million to HK$175,719 million. The increase was mainly due to renewal and upgrade works for our existing Hong Kong railway network, revaluation gains on our investment properties and self-occupied properties, as well as the transfer of the construction costs of Sai Ying Pun Station on the Western extension of the Island Line from railway construction in progress upon its opening in March 2015. The increase was partly offset by depreciation, amortisation and disposals. Railway construction in progress increased by HK$2,835 million to HK$19,064 million, mainly as a result of further construction work for the South Island Line (East) and Kwun Tong Line Extension. Property development in progress increased by HK$10,493 million to HK$17,983 million, mainly due to cash contributions paid for the LOHAS Park Package 7 and Tai Wai Station property development projects. Interests in associates increased by HK$115 million to HK$5,912 million, mainly due to further equity injection into BJMTR and our share of profits from associates in 2015. Debtors, deposits and payments in advance increased by HK$1,338 million to HK$5,135 million, due to the increase in receivables from our property sales in Hong Kong. Amounts due from related parties amounted to HK$1,636 million, an increase of HK$563 million, mainly due to the increase in recoverable costs receivable from the Government for the advanced works of the Shatin to Central Link and a loan provided to our associate, Tianjin TJ-Metro MTR Construction Company Limited. Cash, bank balances and deposits decreased by HK$6,575 million to HK$12,318 million, mainly due to contributions paid for the LOHAS Park Package 7 and Tai Wai Station property development projects as well as capital expenditure for our Hong Kong existing railway networks and railway extension projects.

Cash Utilisation

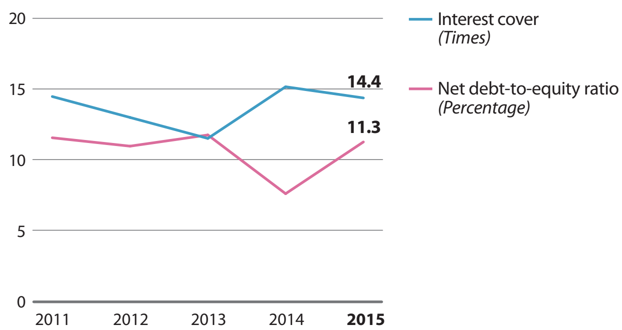
In 2015, net decrease in cash was mainly due to higher cash outflow for capital expenditure on Hong Kong Property Development projects and Hong Kong rail system.

(HK$ billion)



Debt Servicing Capability

Gearing ratio maintained at a healthy level of 11.3% in 2015.



Total liabilities of the Group increased from HK$63,670 million at the end of 2014 to HK$70,932 million at the end of 2015, with total borrowing increasing by HK$304 million to HK$20,811 million. Creditors and accrued charges increased by HK$6,439 million to HK$22,860 million predominately due to sales proceeds received in advance in respect of Tiara in Shenzhen. Amounts due to related parties amounted to HK$1,858 million, an increase of HK$251 million, resulting from an increase in the variable annual payment due to KCRC. Current tax liabilities balance decreased by HK$43 million to HK$953 million, while deferred tax liabilities balances increased by HK$232 million to HK$11,209 million in 2015.

Share capital increased by HK$1,037 million to HK$46,317 million mainly as a result of new shares issued under the employee share option scheme. Together with the increase in retained profits, net of dividends paid, shares held for the Share Incentive Scheme, and an increase in fixed asset revaluation reserve and other reserves of HK$5,693 million, total equity attributable to shareholders of the Company increased by HK$6,730 million to HK$170,055 million at 31 December 2015.

The net debt-to-equity ratio increased from 7.6% at 31 December 2014 to 9.1% at 30 June 2015 and 11.3% at 2015 year-end.

Cash Flow

Net cash generated from operating activities decreased by HK$1,271 million to HK$14,773 million in 2015. The decrease was mainly due to increased tax payments and lower working capital movements. Receipts from Hong Kong property developments of HK$2,707 million, mainly relate to the surplus proceeds from Hemera and Grand Austin. Receipts from Shenzhen Longhua Line Depot property development were $5,527 million, relating to the sales proceeds of Tiara. Including other cash receipts, such as dividends received from associates and proceeds from new shares issued under the employee share option scheme, totalling HK$940 million, net cash receipts from operating and investing activities decreased from HK$25,595 million in 2014 to HK$23,947 million in 2015.

For railway operations, total capital expenditure during the year was HK$9,687 million, including HK$4,216 million for the purchase of assets for our Hong Kong transport operations' existing railways and related operations, HK$4,760 million for the construction of Hong Kong railway extension projects, HK$553 million for Shenzhen Metro Longhua Line railway operations and HK$158 million for other overseas transport operations. For property related businesses, total capital expenditure was HK$11,983 million, including HK$10,253 million for property development projects (mainly contributions paid in relation to the LOHAS Park Package 7 and Tai Wai Station property development projects) and HK$609 million for investment properties in Hong Kong, as well as HK$1,121 million for Tiara in Shenzhen. The Group paid fixed and variable annual payments to KCRC amounting to HK$2,222 million and cash dividends to our equity shareholders amounting to HK$5,748 million. After net interest payment of HK$577 million, dividends to holders of non-controlling interests of HK$157 million and other payments, net cash payments increased from HK$20,349 million in 2014 to HK$30,676 million in 2015.

Overall, net cash outflow before financing activities was HK$6,729 million. After net loan drawdown of HK$154 million, the Group's cash balance decreased from HK$18,893 million at 31 December 2014 to HK$12,318 million at 31 December 2015.

Financing Activities

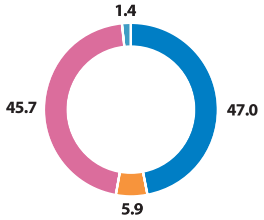
Following the end of the asset purchase program by the U.S. Federal Reserve in 2014, long-term interest rates started to rise at the beginning of 2015, except for a brief period in January when the 30-year Treasury yield unexpectedly sank to an all-time low on disappointing GDP figures and reduced expectations of higher interest rates.

This rising trend was sustained by a steady recovery built around a strong employment market and improving consumer sentiment, but upside was capped by a lack of serious inflation, with the 10-year Treasury yield ending the year modestly higher at 2.27%, up from 2.17% at the end of 2014.

Sources of Borrowing

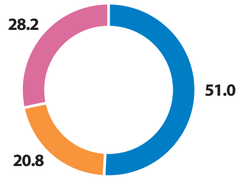
Although Hong Kong is our main market, our strategy is to diversify our funding sources and maintain ready access to other important international markets.

(Percentage) (As at 31 December 2015)



By market

- Hong Kong
- Asia
- US
- Europe



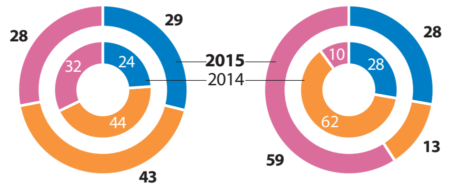
By instrument

- Medium term notes
- Bank loans
- US$ Eurobonds

Use of Interest Rate and Currency Risk Hedging Products

The Company uses derivative financial instruments for hedging purposes, and has a strict policy of limiting their usage for hedging purposes only.

(Percentage) (As at 31 December 2015)*



By instrument

- Interest rate swaps
- Cross currency & interest rate swaps
- Foreign exchange forwards

By maturity

- Beyond 5 years
- 2 to 5 years
- Within 2 years

* Calculated based on nominal value

At the short end, the Fed decided to 'normalise' interest rates and implemented its first rate hike since 2006, increasing the Fed Funds Target Rate by 25 basis points in December to 0.25% - 0.50%. In anticipation of the well-publicised move, 3-month USD-LIBOR rose from 0.26% p.a. at the beginning of the year to 0.61% p.a. at the end of the year.

During the period, owing to ample liquidity and benign inflation in Hong Kong, the 10-year HK dollar swap rate declined from 2.25% p.a. to 1.92% p.a., whilst 3-month HKD-HIBOR rose slightly from 0.38% p.a. to 0.39% p.a..

During the year, the Group continued its dual financing strategy of arranging bilateral banking facilities to provide sufficient coverage for forward funding needs and to take advantage of low interest rates to lock into attractive fixed rate funding to further extend and diversify our debt maturity profile.

Based on this strategy, the Group has arranged additional bilateral banking facilities totalling HK$4,800 million at more competitive fees and tighter credit margins. In January, the Group took advantage of the unexpected dip in long-term interest rates and issued its debut 40-year HKD fixed rate note at a very favourable level through private placement. Towards the latter part of the year, when long-term rates softened, the Group took advantage and issued a number of long-term fixed rate notes through private placement, including 30-year and 10-year HKD fixed rate notes, as well as a 15-year AUD fixed rate note, which was swapped to HKD. Totalling about HK$1,200 million, these fixed rate notes helped further lengthen and diversify our debt maturity profile, whilst providing attractive, cost effective long-term funding.

Cost of Borrowing

The Group's consolidated gross debt position increased from HK$20,507 million at year-end 2014 to HK$20,811 million at year-end 2015. The weighted average borrowing cost of the Group decreased slightly to 3.5% p.a. from 3.6% p.a. due to continuing low interest rates, as well as the reduction in benchmark lending rates by People's Bank of China, which helped lower borrowing costs for project loans in the Mainland of China.

Treasury Risk Management

The Board of Directors approved policies for overall treasury risk management covering areas of liquidity risk, interest rate risk, foreign exchange risk, credit risk, concentration risk, use of derivative financial instruments and the investment of excess liquidity.

The Group's Preferred Financing Model (the "Model") is well established as an integral part of our risk management policy. The Model specifies the preferred mix of fixed and floating rate debt, sources of funds from capital and loan markets and the debt maturity profile, as well as a permitted level of foreign currency debts and an adequate length of financing horizon for the coverage of forward funding requirements, against which financing related liquidity, interest rate and currency risks are monitored and controlled.

In accordance with Board policy, derivative financial instruments will only be used for controlling or hedging risk exposures, and not for speculation. Derivative instruments currently used by the Group are over-the-counter derivatives, and comprise exclusively of interest rate swaps, cross currency swaps and foreign exchange forward contracts.

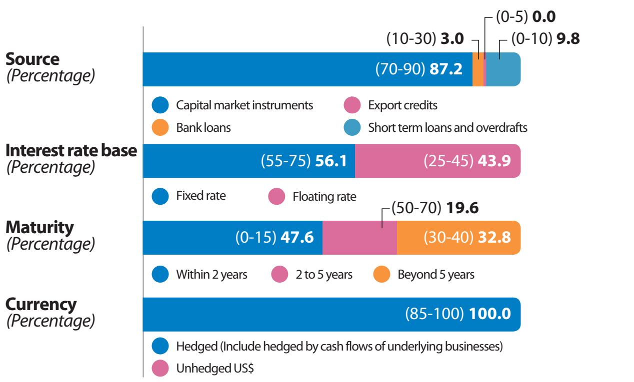
To control and diversify counterparty risks, the Group limits exposure to credit risk by placing deposits and transacting derivative instruments with financial institutions that have acceptable investment grade credit ratings.

In accordance with Board policy, all derivative instruments with counterparties are subject to a counterparty limit based on the counterparty's credit ratings. Credit exposure is estimated based on the estimated fair market value and largest potential loss arising from these instruments using a "value-at-risk" concept, and monitored and controlled against respective counterparty limits. In addition, the Group applies set-off and netting arrangements across different instruments with the same counterparty to further reduce risk.

Preferred Financing Model and Debt Profile

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

(Preferred Financing Model) *vs.* **Actual debt profile** *As at 31 December 2015*



Deposits and short-term investments are subject to separate counterparty limits based on the counterparty's credit ratings, its note issuing bank status in Hong Kong, and the length of time that a deposit or short-term investment will be maintained with the counterparty.

The Group actively monitors the credit ratings and credit related changes of all its counterparties using additional information such as credit default swaps, and will, based on these changes, adjust the counterparty limits accordingly.

In managing liquidity risk, the Group will maintain sufficient cash balance and undrawn committed banking facilities to provide forward coverage of at least 12 to 24 months of projected cash requirements. The Group also conducts regular stress testing to identify and estimate any potential shortfall in future cash flow, and would arrange new financing or take other appropriate action as necessary to reduce the risk of a material liquidity shortfall.

Credit Rating

Through the year, the Company's credit ratings remained strong and on a par with the Hong Kong SAR Government.

The Company's issuer and senior unsecured debt ratings, as well as its short-term rating were affirmed in June 2015 by Moody's Investors Service at "Aa1" and "P-1" respectively with a stable outlook.

The Company's long-term corporate credit and short-term ratings were affirmed in September 2015 by Standard & Poor's at respectively "AAA" and "A-1+" with a stable outlook.

This was followed in October 2015 by affirmation from Rating & Investment Information Inc. of Japan of the Company's issuer and short-term credit ratings of "AA+" and "a-1+" respectively, with a stable outlook.

Following the Company's announcement regarding the XRL Agreement on 30 November 2015, credit rating agencies have confirmed that the Company's credit ratings remain unchanged.

Financing Capacity

The Group's capital expenditure programme consists of three parts – Hong Kong railway projects, Hong Kong property investment and development, and Mainland of China and overseas investments.

Capital expenditure for Hong Kong railway projects comprises investment in and expenditure relating to the new ownership projects of the South Island Line (East) and the Kwun Tong Line Extension, as well as outlays for maintaining and upgrading existing rail lines. The concession projects of the Express Rail Link (for the project cost of up to HK$84.42 billion) and the Shatin to Central Link are generally funded by the Government, although for the latter the Company will share certain costs for the rolling stock and signalling systems attributable to the East Rail and Ma On Shan lines.

Capital expenditure for Hong Kong property investment and development comprises mainly of costs associated with work for property development, fitting-out and the renovation of shopping centres, and payments of portions of land premiums for certain property development projects. Expenditure for Mainland of China and overseas investments consists primarily of the equity contribution to BJMTR for the BJL14 project, remaining capital expenditure for Shenzhen Metro Longhua Line, and investment in the Longhua depot property development project.

Based on current programmes, total net capital expenditure for the next three years from 2016 to 2018 (inclusive) is estimated at HK$27.3 billion for Hong Kong railway projects, HK$5.2 billion for Hong Kong property investment and development, and HK$7.5 billion for Mainland of China and overseas investments, giving a total of HK$40.0 billion. Out of this total, it is estimated that HK$20.4 billion will be incurred in 2016, HK$10.3 billion in 2017, and HK$9.3 billion in 2018.

In addition, with the approval of the Company's independent shareholders for the XRL Agreement obtained on 1 February 2016, and the approval of LegCo obtained on 11 March 2016 for Government's additional funding obligations under the XRL Agreement, the Company will have funding requirements of approximately HK$12.88 billion in each of 2016 and 2017 to cover the aggregate special dividend of approximately HK$25.76 billion (calculated based on the number of shares outstanding as at 31 October 2015).

The Group believes that based on its available cash balance and unused committed banking facilities, as well as its ready access to both the loan and debt capital markets, it will have sufficient financing capacity to fund the above capital expenditure projects and the special dividend.

Credit ratings	Short-term ratings*	Long-term ratings*
Standard & Poor's	A-1+/A-1+	AAA/AAA
Moody's	-/P-1	Aa1/Aa1
Rating & Investment Information, Inc. (R&I)	a-1+	AA+

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