

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

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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.

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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.

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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);

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- 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, Anzeff 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.

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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.

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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