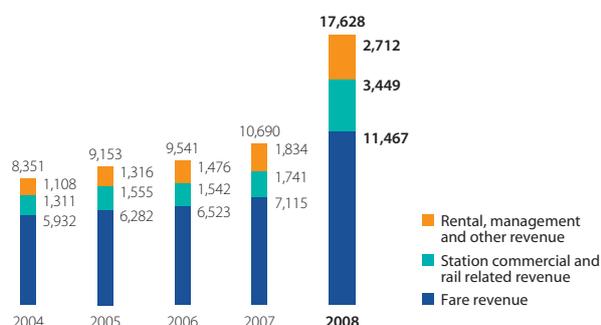


Financial Review

Turnover

Revenue increased across the board due to full-year impact of the Rail Merger.

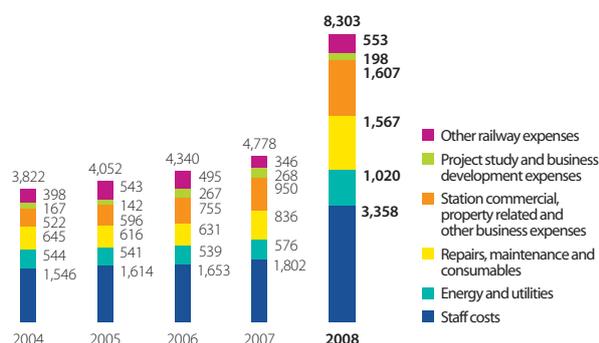
in HK\$ million



Operating Expenses

The cost increases were in line with network expansion after the Rail Merger.

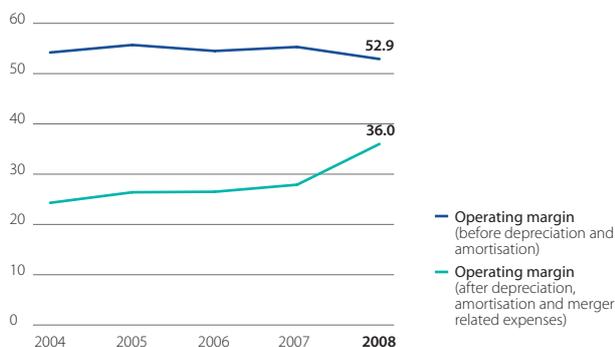
in HK\$ million



Operating Margin

Operating margin before depreciation and amortisation dropped due to fare reduction and lower margin of the pre-merger KCRC businesses.

Percentage



Review of 2008 Financial Results

Profit and Loss

The Group's revenue and operating profit from recurring businesses achieved strong growth in 2008 with the full-year impact of the Rail Merger. Total revenue rose by 64.9% to HK\$17,628 million while operating profit from railway and related businesses increased by 57.7% to HK\$9,325 million.

Total fare revenue for 2008 increased by 61.2% to HK\$11,467 million with fare revenue from Domestic Service increasing by 27.6% to HK\$7,930 million as a result of a 31.6% increase in patronage to 1,205 million and a 3% decrease in average fare to HK\$6.58. Compared with the combined fare revenue of the Company and pre-merger KCRC in 2007, fare revenue from Domestic Service in 2008 decreased by 1% due to a 4.8% decrease in average fare resulting from the one-off fare reduction implemented on the Rail Merger Day partly offset by a 4% increase in patronage. Fare revenue from Cross-boundary Service, when compared with the equivalent 12 month revenue for such service in 2007, rose by 1.2% to HK\$2,283 million with patronage increasing by 1.4% to 93 million and average fare decreasing slightly by 0.2% to HK\$24.45. Fare revenue from Airport Express increased by 2.7% to HK\$673 million with a patronage growth of 4.2% to 10.6 million and an average fare decrease of 1.4% to HK\$63.47 due to the change in trip distribution and free ride promotions. Light Rail, Bus and Intercity services contributed a total of HK\$581 million in fare revenue, a growth of 0.8% from the equivalent 12 month revenue for such services in 2007.

Revenue from station commercial and rail related businesses also recorded strong growth in 2008. Advertising revenue increased by 25% to HK\$741 million, an increase of 11.3% over the equivalent comparable combined revenue of the Company and pre-merger KCRC in 2007 (Combined Non-fare Revenue). Revenue from station retail business rose 209.8% to HK\$1,546 million, or 42.3% from the equivalent Combined Non-fare Revenue, mainly attributable to the increased retail area from the Rail Merger, which included the addition of Duty Free shops, favourable rental renewal rates and the full-year effect of new shops at Lok Ma Chau station. Telecommunication income increased by 49% from last year and 27.6% from the equivalent Combined Non-fare Revenue in 2007 to HK\$356 million.

million, mainly due to a termination payment received from a telecommunication service operator. Excluding this one-off item, telecommunication income would have increased by 13% as compared to 2007, or decreased by 3.2% from the equivalent Combined Non-fare Revenue in 2007 due to the shift of mobile usage from 2G to 3G. Consultancy business recorded a revenue decrease of 18.1% to HK\$158 million mainly due to the completion of the majority of the works on Shanghai Metro Line 9 and a more focused strategy on consulting. Including other miscellaneous incomes, total revenue from station commercial and rail related businesses increased by 98.1% to HK\$3,449 million, or a growth of 33.4% from the equivalent Combined Non-fare Revenue in 2007.

Rental, management and other revenue in 2008 increased by 47.9% from last year to HK\$2,712 million with revenue from property rental and management in 2008 increasing by 46.1% to HK\$2,556 million, or 27.6% over the equivalent Combined Non-fare Revenue in 2007, reflecting the strong demand for office and retail space early on in the year, as well as the full-year effect of the opening of Elements. Ngong Ping 360 generated HK\$156 million of revenue in 2008.

Total operating costs rose by 73.8% to HK\$8,303 million in 2008, mainly due to the Rail Merger with increases in staff costs, energy and utilities, operational rent and rates, repairs and maintenance as well as general and administration expenses. The larger increase in stores and spares consumed was attributable to the overhaul of West Rail and East Rail trains. In line with revenue growth, expenses relating to station commercial and rail related businesses increased by 100.5% while expenses relating to property ownership, management and other businesses increased by 45.4%. Compared with the comparable combined operating costs of the Company and pre-merger KCRC in 2007, total operating costs would have increased by 9.9%.

Operating profit from railway and related businesses before depreciation and amortisation therefore increased by 57.7% to HK\$9,325 million. Operating margin decreased from 55.3% in 2007 to 52.9% in 2008 due to the fare reduction at the time of the Rail Merger and the lower operating margin of the pre-merger KCRC businesses.

Profit from Underlying Businesses of
HK\$8,185 million

Net Profit attributable to Equity Shareholders of
HK\$8,284 million

Turnover Increased 64.9% to
HK\$17,628 million

Profit Contribution from Property Development of
HK\$4,670 million

Net Assets Increased 7.5% to
HK\$97,822 million

Net Cash Inflow of
HK\$3,698 million
Generated to Reduce Borrowings

HK\$1,750 million
New Financings Raised on Attractive Terms

Credit Ratings Upgraded
to **AA+** and Affirmed
at **Aa2** on par with Hong Kong SAR

Financial Review

Profits on property developments in 2008 amounted to HK\$4,670 million mainly from profit booking relating to The Capitol at LOHAS Park and The Palazzo in Shatin, and to a lesser extent, the sale of units in inventory at Harbour Green and The Arch, as well as deferred income recognition for properties at Coastal Skyline and Caribbean Coast at Tung Chung Station and Elements at Kowloon Station. Compared with 2007, property development profits decreased by 43.8% due to the significant profit recognised from Le Point in Tseung Kwan O in 2007 and the decline in property prices in the second half of 2008. As a result, operating profit before depreciation and amortisation decreased slightly by 1.6% to HK\$13,995 million.

Depreciation and amortisation charges increased by 7% to HK\$2,930 million due to the additional amortisation charge on service concession assets relating to the Rail Merger. Merger related expenses, comprising post-merger integration expenses not eligible for capitalisation, decreased by 72.5% to HK\$53 million as a result of the one-off provision for Voluntary Separation Scheme payments in 2007.

Interest and finance charges increased by 51.8% to HK\$1,998 million mainly due to the full year interest on debt and the capitalised fixed annual payment, both relating to the Rail Merger. Average borrowing cost decreased to 4.8% from 5.6% in 2007. With the decline in property prices during the second half of the year, a net pre-tax loss in investment property valuation of HK\$146 million was recorded as compared with a net pre-tax gain of HK\$8,011 million last year. The Company's share of net profit from non-controlled subsidiaries and associates increased by 60.6% to HK\$159 million, comprising HK\$136 million from Octopus Holdings Limited and HK\$23 million from London Overground Rail Operations Ltd.

Profit before taxation decreased by 50.6% to HK\$9,027 million and accordingly, taxation decreased by 75.8% to HK\$747 million due to the profit reduction as well as the impact on deferred tax from the lowering of the Hong Kong profits tax rate from 17.5% to 16.5% effective from 2008. Current tax for 2008 amounted to HK\$1,024 million, which was partly offset by deferred tax credit of HK\$277 million resulting mainly from the reduction in profits tax rate. Net profit for the Group in 2008 decreased by 45.5% to HK\$8,280 million whilst net profit attributable to equity shareholders was HK\$8,284 million. Correspondingly, earnings per share decreased from HK\$2.72 in 2007 to HK\$1.47 in 2008.

Excluding investment property revaluation and the related deferred tax provision, net profit from underlying businesses attributable to equity shareholders decreased by 4.5% from HK\$8,571 million to HK\$8,185 million, reflecting lower property development profits being offset by substantial growth in earnings from our recurring businesses. Earnings per share based on underlying profit decreased by 5.8% from HK\$1.54 to HK\$1.45.

With the strong financial results, particularly from our recurring businesses, the Board has recommended a final dividend of HK\$0.34 per share, which when added to the interim dividend of HK\$0.14 per share, will bring full year dividend to HK\$0.48 per share, an increase of HK\$0.03 per share or 6.7% compared with 2007. The final dividend, amounting to HK\$1,925 million in total, offers a scrip dividend option to all shareholders except those with registered addresses in the United States of America or any of its territories or possessions. As in previous years, The Financial Secretary Incorporated ("FSI") has agreed to receive its entitlement to dividends in the form of shares to the extent necessary to ensure that a maximum of 50% of the Company's total dividend will be paid in cash.

Balance Sheet

The Group's balance sheet strengthened further in 2008 with a 7.5% increase in net assets from HK\$91,037 million as at 31 December 2007 to HK\$97,822 million as at 31 December 2008.

Total fixed assets decreased from HK\$132,417 million in 2007 to HK\$131,004 million as at 31 December 2008 due to depreciation charges for the year. Railway construction in progress, mainly related to the LOHAS Park Station project, increased from HK\$424 million in 2007 to HK\$658 million. Deferred expenditure, comprising advance works on Shenzhen Metro Line 4 and design costs on potential railway extensions such as the West Island Line and South Island Line East, increased from HK\$825 million in 2007 to HK\$1,988 million.

Property development in progress includes development costs incurred on property developments, costs for acquiring property development rights in the Rail Merger, land premium payments and the deemed interest element of the interest free loan to a developer. During the year, property development in progress decreased from HK\$9,066 million in 2007 to HK\$7,895 million due to the transfer-out of the half land premium for The Capitol and acquisition cost of The Palazzo upon completion of these developments, partly offset by the half land premium paid for the Che Kung Temple development site. Properties

held for sale increased from HK\$756 million in 2007 to HK\$2,228 million, mainly comprising residential units at The Palazzo and The Arch as well as retail space at Island Harbourview. Property management rights decreased from HK\$40 million in 2007 to HK\$35 million due to amortisation.

Investment in securities increased from HK\$333 million to HK\$471 million. Derivative financial assets and liabilities increased from HK\$273 million and HK\$192 million respectively in 2007 to HK\$528 million and HK\$305 million as at 31 December 2008, mainly due to decline in interest rates during the period.

Interests in non-controlled subsidiaries and associates increased from HK\$268 million and HK\$205 million respectively in 2007 to HK\$381 million and HK\$743 million in 2008 as a result of continued net asset growth at Octopus Holdings Limited and London Overground Rail Operations Ltd as well as, for interest in associates, the injection of the last tranche of equity into the Beijing Metro Line 4 project.

Debtors, deposits and payments in advance increased from HK\$5,167 million in 2007 to HK\$7,190 million as at 31 December 2008 due to the increase in accounts receivable relating to property development, which increased from HK\$3,774 million to HK\$5,818 million. This increase in property development receivable was mainly due to receivables from pre-sales of units at The Capitol and The Palazzo. Amounts due from the Government and other related parties decreased from HK\$544 million in 2007 to HK\$426 million, comprising mainly payments due from KCRC in respect of project management for the Kowloon Southern Link and various capital works relating to the Rail Merger as well as payments from the Government in respect of West Rail property developments and detailed design works on the Express Rail Link and Shatin to Central Link.

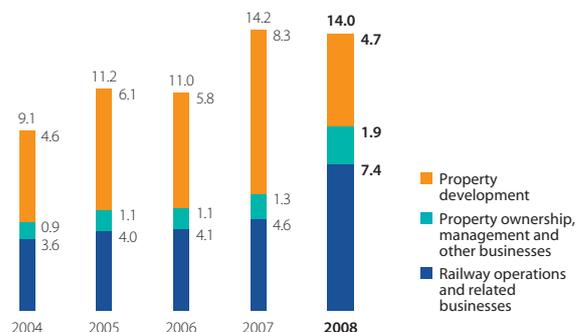
Total loans outstanding decreased from HK\$34,050 million in 2007 to HK\$31,289 million due to loan reduction from net cash generated during the year.

Amounts due to related parties included the Group's obligation to reimburse KCRC after tender award on the costs of property enabling works for certain KCRC property development sites and the accrued fixed annual payment for the service concession. The amount decreased from HK\$975 million in 2007 to HK\$882 million as at 31 December 2008, reflecting the reimbursement made to KCRC on enabling works for the Che Kung Temple development upon tender award during the year.

Operating Profit Contributions

Significant growths in profits were achieved in recurring businesses after the Rail Merger.

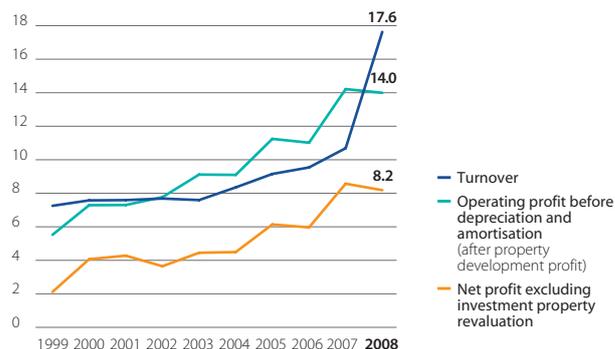
in HK\$ billion



Net Results from Underlying Businesses

Net profits remained strong due to increased profits from recurring businesses despite lower property development profits.

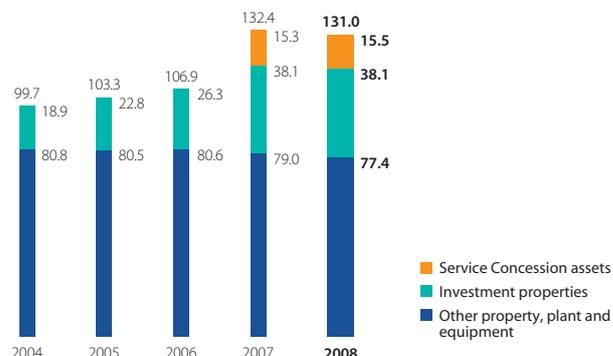
in HK\$ billion



Fixed Assets Growth

Fixed assets as at 31 December 2008 slightly decreased due to depreciation charges for the year.

in HK\$ billion



Financial Review

Deferred income decreased from HK\$515 million in 2007 to HK\$156 million as at 31 December 2008 following profit recognition for Coastal Skyline and Caribbean Coast at Tung Chung Station and Elements at Kowloon Station.

With the Company's cumulative tax losses being full-utilised in 2008, provisional tax for the assessable year of 2008/09 of HK\$575 million was paid in 2008. Current tax liabilities as at 31 December 2008 amounted to HK\$450 million. Deferred tax liabilities decreased from HK\$12,574 million in 2007 to HK\$12,220 million, mainly due to the reduction in profits tax rate.

Share capital, share premium and capital reserve increased by HK\$1,291 million to HK\$41,119 million at the end of 2008 as a result of shares issued for scrip dividend and share options exercised. Together with the increase in retained earnings, net of dividends, of HK\$5,796 million partly offset by the decrease in fixed asset revaluation reserve and other reserves of HK\$300 million, total equity attributable to equity shareholders of the Company increased by HK\$6,787 million to HK\$97,801 million as at 31 December 2008. Including obligations under service concession as a component of debt, the Group's net debt-to-equity ratio decreased from 48.5% at 2007 year end to 42.1% at 2008 year end.

Cash Flow

Net cash inflow generated from railway and related activities increased from HK\$5,974 million in 2007 to HK\$8,921 million in 2008, while cash receipts from developers and purchasers in respect of property development projects decreased from HK\$5,824 million in 2007 to HK\$4,448 million in 2008 due to timing difference on property receipts. Including the HK\$400 million of government grant for the West Island Line project as well as the loan repayments and dividend distribution from non-controlled subsidiaries and associates of HK\$132 million, total cash inflow for 2008 increased by HK\$2,165 million to HK\$13,901 million over 2007. Outflows for capital projects and property developments increased by HK\$3,407 million to HK\$5,896 million in 2008 primarily due to new railway projects, an increase in capital expenditures on the expanded railway network after the Rail Merger, and the half land premium for the Che Kung Temple property development. After settlement of the fixed annual payment of HK\$750 million on the service concession, the equity injection of HK\$515 million into the Beijing Line 4

associate company and payments on interest, dividends and other working capital, net cash inflow before non-recurring merger related payments decreased from HK\$6,477 million in 2007 to HK\$4,014 million in 2008. Net cash inflow of the Group in 2008, after non-recurring merger related expenses of HK\$316 million, amounted to HK\$3,698 million, of which HK\$3,538 million was used to reduce borrowings.

Financing Activities

New Financings

In September 2008, what began in the USA in 2007 as a subprime mortgage crisis developed into a full-blown global financial crisis. With major banks and financial institutions suffering unprecedented losses and much depleted capital bases, global debt markets almost ground to a halt with lenders unwilling to lend and credit spreads increasing to unprecedented levels. As major governments worldwide moved to recapitalise banks, improve credit market liquidity and formulate massive fiscal stimulus plans, the US Federal Reserve aggressively cut the Fed Funds rate to an unprecedented level of 0 – 0.25%. In response, short- and long-term rates declined precipitously in the USA and yield curves flattened, reflecting the significant risk of price deflation.

In Hong Kong, both interbank and corporate lending activities also contracted significantly as banks continued to deleverage. Credit margins increased, further straining the financing capability of even the most creditworthy borrowers. Mirroring the drop in US interest rates, 3-month HIBOR rates declined significantly from a high of 4.5% in October to 0.95% by year end, whilst the yield of 10-year Hong Kong Exchange Fund Note dropped to 1.2%.

As the current crisis unfolded, the Group continued to be in a strong liquidity position, enjoying significant operating cash surplus and maintaining substantial undrawn committed banking facilities, all of them arranged prior to the crisis. Because of its well funded position, the Group did not embark on any major financing activities during the year. Instead, to further strengthen liquidity, it had chosen to tap, on an opportunistic basis, pockets of supply of Hong Kong dollars in the debt market via private placements. In this manner the Group raised a total of HK\$1.75 billion during the year at highly attractive rate levels through note issuance from the debt issuance programme, reflecting investors' continued strong confidence in the Group. As at the end of 2008, the Group had total undrawn committed facilities of HK\$10.4 billion, which together with continuing strong operating cash flows are expected to meet all our cash requirements well into the second half of 2010.

Cost of Borrowing

Benefitting from declining interest rates, the Group's average borrowing cost for 2008 fell to 4.8% from 5.6% in 2007. However, net interest expense charged to the Profit and Loss Account, after interest capitalised of HK\$149 million, rose to HK\$1,998 million in 2008 from HK\$1,316 million in 2007, mainly due to the full year impact of interest on additional borrowings to finance the Rail Merger as well as the interest element of HK\$721 million on the capitalised fixed annual merger payments.

Treasury Risk Management

The Board of Directors approves policies for overall treasury risk management including specific areas, such as liquidity risk, interest rate risk, foreign exchange risk, credit risk, concentration risk, use of derivative and non-derivative financial instruments, as well as investment of excess liquidity.

The Group's well established Preferred Financing Model (the "Model") is an integral part of these risk management policies. The Model specifies the preferred mix of fixed and floating rate debts, sources of funds from capital and loan markets, and debt maturity profile as well as a permitted level of foreign currency debts and an adequate length of financing horizon for coverage of forward funding requirements, against which the Group's financing related liquidity, interest rate and currency risk exposures are measured, monitored and controlled. During 2008, in accordance with the Model, the Group has maintained a well diversified debt portfolio with adequate forward coverage of funding requirements.

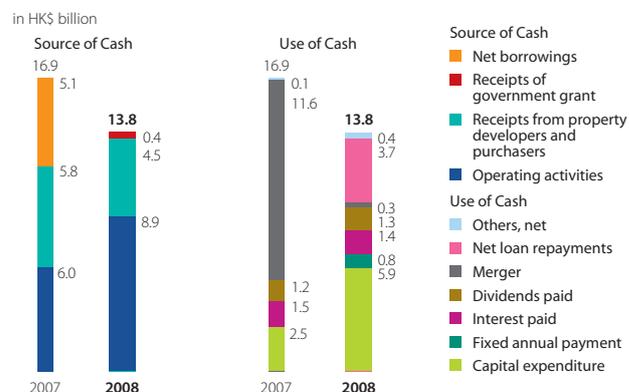
The use of derivative financial instruments to control and hedge against interest rate and foreign exchange risk exposures forms an integral part of the Group's risk management strategy. In accordance with Board policy, these instruments shall only be used for controlling or hedging risk exposures, and cannot be used for speculative purposes. All of the derivative instruments used by the Group are over-the-counter derivatives comprising principally interest rate swaps, cross currency swaps and foreign exchange forward contracts.

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

All derivative financial instruments are subject to a maximum counterparty limit based on the respective counterparty's credit ratings in accordance with policy approved by the Board. Credit exposure in terms of estimated fair market value of and

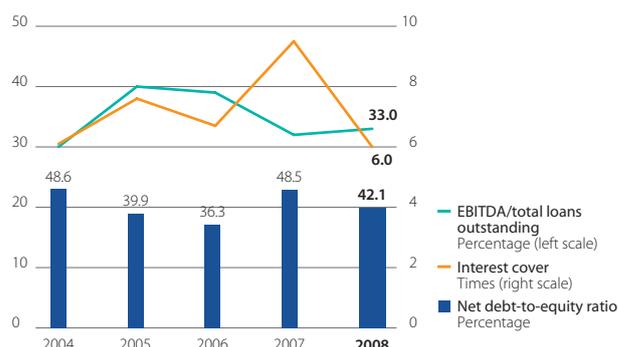
Cash Utilisation

Net cash inflow generated in 2008 was used to reduce borrowings.



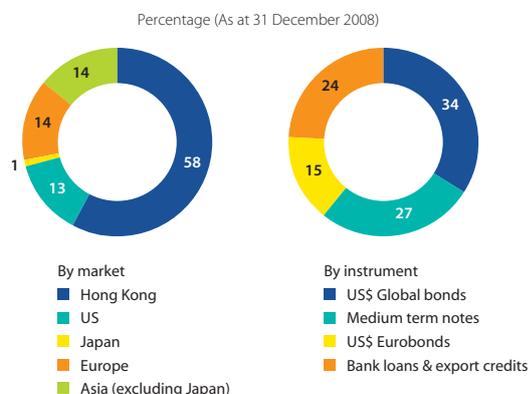
Debt Servicing Capability

Total debt outstanding including obligations under service concession decreased in 2008, with a corresponding decrease in debt-to-equity ratio.



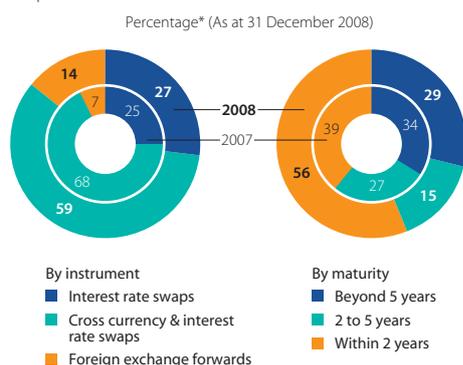
Sources of Borrowing

One of our strategies is to diversify our funding sources both in terms of markets and instruments.



Use of Interest Rate and Currency Risk Hedging Products

Derivative financial instruments are used for hedging purposes only, and no speculation is allowed.



* Calculated based on nominal value

largest potential loss arising from these instruments based on the "value-at-risk" concept is measured, monitored and controlled against respective counterparty limits. To further reduce risk exposure, the Group also applies set-off and netting arrangements across all derivative financial instruments and other financial transactions with the same counterparty.

All deposits are similarly subject to a separate counterparty limit based on the respective counterparty's credit ratings and/or status as Hong Kong's note issuing bank. There is also a limit on the length of time that the Group can maintain a deposit with a counterparty based upon its credit ratings. Deposit outstanding and maturity profile are monitored on a frequent basis to ensure they are within the approved limits.

The Group actively monitors credit ratings and changes of all its counterparties and other information such as the counterparties' credit default swap levels, and would on the basis of this information adjust the maximum counterparty limits of and/or credit exposure to its counterparties.

The Group adopts a prudent approach to managing liquidity risk, and will maintain sufficient undrawn committed banking facilities to provide forward coverage of at least 6 to 15 months of all projected cash requirements, including debt repayments and capital expenditures, as specified by the Model. The Group also conducts stress testing of its projected cash flow to analyse liquidity risk, and would arrange additional banking facilities or debt issuance or otherwise take appropriate actions if necessary should such stress tests reveal significant risk of material cash flow shortfall.

Credit Ratings

The Company was the first Hong Kong corporate entity to obtain internationally recognised credit ratings and has since maintained strong investment grade ratings on a par with the Hong Kong SAR Government, reflecting its strong financial position and support from the Government.

In June, Moody's re-affirmed the Company's foreign currency issuer and senior unsecured debt ratings at Aa2 with a stable outlook, the same as the Hong Kong SAR Government. Subsequently in July, Standard & Poor's upgraded the Company's foreign currency issuer and senior unsecured debt ratings from AA to AA+ with a stable outlook, in line with the same corresponding upgrade of the sovereign rating for the Hong Kong SAR Government.

In August, Rating & Investment Inc. of Japan raised the Company's foreign currency issuer and Hong Kong dollar issuer

ratings to AA+ from AA, and re-affirmed its Hong Kong dollar short-term credit rating at a • 1+, with a stable outlook.

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

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

Financing Capacity

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

Capital expenditure for railway projects in Hong Kong comprises mainly investment in and expenditures relating to new railway projects, such as the West Island Line, South Island Line East and Kwun Tong Line Extension, as well as outlays for maintaining and upgrading the existing rail lines. For property investment and development, it comprises mainly the remaining fit-out works for Elements, fit-out works for the retail areas of The Capitol and Tseung Kwan O Area 56, common infrastructure works for the Area 86 development sites, as well as renovation of various existing shopping centres in Hong Kong. For overseas investments, it consists mainly of equity contribution to Shenzhen Metro Line 4.

Based on current programmes, total capital expenditures for the next three years of 2009, 2010 and 2011 are estimated at HK\$23.3 billion for railway projects in Hong Kong, HK\$1.0 billion for property investment and development in Hong Kong, and HK\$1.9 billion for overseas investments, mainly our equity contribution to Shenzhen Metro Line 4. Out of this total budget of HK\$26.2 billion, an estimated amount of HK\$6.0 billion is expected to be incurred in 2009, HK\$5.9 billion in 2010, and HK\$14.3 billion in 2011. These numbers exclude Government grants receivable for West Island Line.

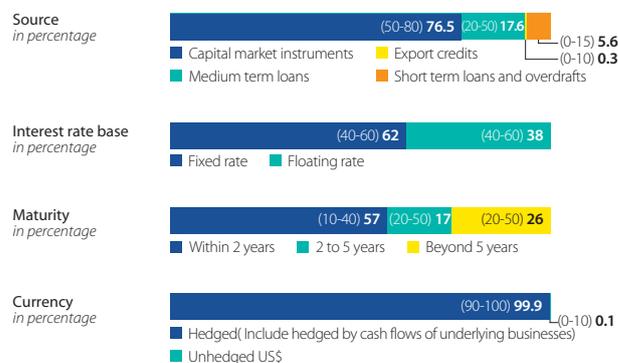
Our current financing coverage horizon based on the above capital expenditure programme taking into account loan repayments, strong cash flows from our businesses and committed undrawn banking facilities of HK\$10.4 billion as at 31 December 2008, extends into the second half of 2010.

With the current global financial crisis continuing to develop, fund raising in the capital and loan markets will remain difficult in the foreseeable future. However, with our well funded situation, significant forward coverage, and continuing support from investors, we remain confident that we will attract the necessary funds for our capital expenditure programme.

Preferred Financing Model and Debt Profile

The Preferred Financing Model provides guidance on fund raising and risk management, helping to achieve a well balanced debt portfolio.

(Preferred Financing Model) vs. Actual debt profile As at 31 December 2008



Investment in New Railway Lines and Existing Network in Hong Kong

Projected capital expenditures between 2009-2011, based on existing network and committed projects, are estimated at HK\$23.3 billion, excluding Government grants receivable for West Island Line.

