

## CEO'S REVIEW OF OPERATIONS AND OUTLOOK

**“...MTR achieved good results in the first half of 2012 by leveraging off reasonable economic conditions in Hong Kong.”**

## **Dear Shareholders and other Stakeholders,**

I am pleased to report that MTR achieved good results in the first half of 2012 by leveraging off reasonable economic conditions in Hong Kong. The Company's financial results were further supported by continued strong operational performance together with world-class safety standards. We maintained our growth momentum by achieving a number of important milestones in Hong Kong and elsewhere. In addition, we carried out a comprehensive review of our strategy to take the Corporation forward and re-affirmed our vision to become a leading multinational company that connects and grows communities with caring service. In our home market of Hong Kong, we strive for continuous service improvements, network growth and value maximisation.

Beyond Hong Kong, we seek to accelerate our pace of growth in the Mainland and other selected international markets.

Our recurrent businesses in Hong Kong, comprising transport operation, station commercial and property rental businesses, continued to benefit from increased patronage and inbound tourism during the first six months of 2012. In property development, we sold virtually all the remaining inventory units at Festival City in Tai Wai and launched pre-sales of The Riverpark at Che Kung Temple Station. We had at the end of May invited tenders for our property development site at Tai Wai Station but following detailed analysis of the tenders received, we decided not to accept any of the tender offers, as acceptance would expose the Company to a substantial risk of not recovering the cost of the development. We are examining the development package with a view to putting the project out for tender again over the next six months or so. As the development agent for the relevant subsidiaries of Kowloon-Canton Railway Corporation (KCRC), we also invited tenders for the Tsuen Wan West Station (TW5) Bayside development in July, and the tender was awarded to Jubilee Year Investments Limited, a subsidiary of Cheung

Kong (Holdings) Limited, on 10 August. "PopCorn" in Tseung Kwan O, our 13<sup>th</sup> shopping mall in Hong Kong, opened for business in March 2012 and was well received by customers.

Our Hong Kong rail network expansion programme, comprising five new rail lines, took a major step forward in May with the signing of the Entrustment Agreement with Government for the last of these lines, namely the Shatin to Central Link. Construction commenced immediately. Construction on the other four new lines continued to make good progress and are on target to be opened for service as scheduled in 2014 and 2015. Our rail operations in the Mainland of China and overseas achieved further operational improvements. The National Development and Reform Commission (NDRC) of the Central Government approved the Hangzhou Metro Line 1 joint venture project in June.



An important initiative I have undertaken since becoming CEO is to launch our Listening • Responding programme, which involves a HK\$1 billion investment to increase train frequencies and upgrade station facilities for the additional comfort and convenience of our passengers. MTR is widely recognised as one of the world's most reliable and high-quality public transport providers. Enhancing attentiveness to our customers' needs and aspirations will help us build on this success. The Listening • Responding programme directly responds to what our passengers have said they would like to see from us. I am very pleased to report that this programme has received positive feedback from our customers.

In our financial results, total revenue for the first half of 2012 rose by 6.1% to HK\$17,154 million. Operating profit before property development, depreciation, amortisation and variable annual payment grew by 8.6% to HK\$6,519 million. Excluding our railway subsidiaries outside of Hong Kong, revenue increased by 8.2% and operating profit by 7.5%, with operating margin decreasing slightly by 0.4 percentage point to 57.2%. Net profit after tax of our recurrent businesses,

which exclude property development and investment property revaluation, increased by 17.6% to HK\$3,597 million. Property development profit for the period was HK\$627 million (HK\$524 million post-tax) compared to HK\$1,445 million in the same period of 2011, and was derived mainly from the sale of remaining inventory units at Festival City in Tai Wai. Due to lower property development profits, excluding investment property revaluation, net profit from underlying businesses attributable to equity shareholders decreased by 5.7% to HK\$4,121 million, representing earnings per share of HK\$0.71. Gain in revaluation of investment properties was HK\$1,740 million as compared with HK\$4,408 million in the first half of 2011. Therefore, net profit attributable to equity shareholders was HK\$5,861 million, equivalent to earnings per share of HK\$1.01 after such revaluation. Your Board has declared an interim dividend of HK\$0.25 per share.



## HONG KONG TRANSPORT OPERATIONS

Total revenue from our Hong Kong transport operation, which comprises rail, bus and other rail-related businesses, was HK\$6,914 million for the first six months of 2012, representing an increase of 6.8% from the same period last year.

### PATRONAGE

Total patronage from all of our rail and bus passenger services in Hong Kong (excluding Intercity railway services) for the first half of 2012 increased by 4.5% to 850.5 million.

Our Domestic Service, which comprises the Kwun Tong, Tsuen Wan, Island, Tung Chung, Tseung Kwan O, Disneyland

Resort, East Rail (excluding Cross-boundary Service), West Rail and Ma On Shan lines, increased patronage by 4.4% to 687.5 million in the first half of 2012, as a result of economic growth and buoyant tourist arrivals, as well as the implementation of our Listening • Responding programme, which supports continuous service improvement in our network.

The Cross-boundary Service to Lo Wu and Lok Ma Chau reported patronage of 53.0 million in the first half of 2012, an increase of 5.4%, while passenger traffic on the Airport Express rose by 7.6% to 6.1 million. Passenger volume on Light Rail, Bus and Intercity railway services was 105.9 million in the first half of 2012, a 4.7% increase.

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Average weekday patronage for all of our rail and bus passenger services in Hong Kong (excluding Intercity) rose by 4.2% to 4.9 million per day in the first half of 2012. The Domestic Service accounted for 81.8% of average weekday patronage, recording a 4.0% increase to 4.0 million per day.

## MARKET SHARE

The Company's overall share of the franchised public transport market in Hong Kong increased further to 45.8% for the first five months of 2012, as compared to 44.9% for the same period in 2011. Within this total, our share of cross-harbour traffic rose to 66.2% from 65.7%. Our market share of Cross-boundary business was 54.4%, while our share of air passengers to and from the airport was 21.7%, both of which were similar to the same period last year.

## FARE REVENUE

Total Hong Kong fare revenue in the first half of 2012 was HK\$6,849 million, 7.1% higher than in the first half of 2011. Within this, Domestic Service revenue accounted for HK\$4,768 million or 69.6% of the total. Average fare per passenger on our Domestic Service increased by 2.7% to HK\$6.93, mainly due to changes in fares and travel patterns.

Fare revenue of the Cross-boundary Service in the first half of 2012 was HK\$1,351 million, an increase of 6.9% when compared with the same period of 2011. Fare revenue of the Airport Express was HK\$387 million, a rise of 7.5%. Light Rail, Bus and Intercity railway fare revenue in the first half of 2012 was HK\$343 million, 6.9% higher than the comparable period of 2011.

Under the Fare Adjustment Mechanism (FAM), the overall fare adjustment rate for MTR fares in 2012 was calculated at +5.4% and was implemented on 17 June. At the same time, we introduced fare concessions estimated at HK\$670 million, which is the largest package of promotions that the Company has ever offered. These concessions will be launched at different times, and they have been carefully structured to benefit a wide range of customers with different travel patterns and to encourage family and community activities. Fare concessions introduced include "Ride 10 Get 1 Free", free travel for children on weekends and public holidays, a 10% discount for every second journey taken on the same day, a Tung Chung Line Monthly Pass and HK\$20 MTR Shops coupons for Monthly Pass purchasers. These promotions are in addition to the numerous other fare concessions we already offer, which include discounted fares for

children, the elderly, persons with disabilities and students. The FAM is subject to review every five years. The first such review will be later this year, and we will work closely and constructively with Government on this exercise.

## PROMOTIONS AND CONCESSIONS

We continued to offer various promotions on the MTR network. These include fare concessions such as monthly passes on the West Rail and East Rail lines, the Tuen Mun – Nam Cheong Day Pass, free Light Rail and MTR Bus connections, and discounted fares for children and local students. Moreover, we were the first public transport operator in Hong Kong to roll out Government's Public Transport Fare Concession Scheme for the elderly and eligible persons with disabilities on 28 June, which encouraged more senior citizens and the disabled to travel through our network. We also launched themed campaigns, including souvenir tickets featuring the popular Angry Birds game. To enhance customer loyalty, the popular MTR Club launched a bonus point scheme for its members to earn points from travelling in our network and shopping in MTR Malls and shops.

The profile of the Ktt service in both Hong Kong and the Mainland of China was also enhanced through a number of initiatives with local and Mainland organisations. Ktt has been honoured with the "Award for Brand Excellence in Guangzhou-Hong Kong Leisure Travel Service" from the Tourism Administration of Guangzhou Municipality in recognition of its excellent service in the travel and tourism sector.

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## OPERATIONS PERFORMANCE IN FIRST HALF 2012

Service performance item	Performance Requirement	Customer Service Pledge Target	Actual Performance
Train service delivery			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.5%	99.5%	<b>99.9%</b>
– East Rail Line (including Ma On Shan Line)	98.5%	99.5%	<b>99.9%</b>
– West Rail Line	98.5%	99.5%	<b>99.9%</b>
– Light Rail	98.5%	99.5%	<b>99.9%</b>
Passenger journeys on time			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line and Disneyland Resort Line	98.5%	99.5%	<b>99.9%</b>
– Airport Express	98.5%	99.0%	<b>99.9%</b>
– East Rail Line (including Ma On Shan Line)	98.5%	99.0%	<b>99.9%</b>
– West Rail Line	98.5%	99.0%	<b>99.9%</b>
Train punctuality			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line and Disneyland Resort Line	98.0%	99.0%	<b>99.8%</b>
– Airport Express	98.0%	99.0%	<b>99.9%</b>
– East Rail Line (including Ma On Shan Line)	98.0%	99.0%	<b>99.9%</b>
– West Rail Line	98.0%	99.0%	<b>99.9%</b>
– Light Rail	98.0%	99.0%	<b>99.9%</b>
Train reliability: train car-km per train failure causing delays ≥ 5 minutes			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	N/A	500,000	<b>3,193,756</b>
– East Rail Line (including Ma On Shan Line) and West Rail Line	N/A	500,000	<b>4,682,710</b>
Ticket reliability: magnetic ticket transactions per ticket failure			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line, Airport Express, East Rail Line (including Ma On Shan Line) and West Rail Line	N/A	8,000	<b>15,372</b>
Add value machine reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.0%	99.0%	<b>99.5%</b>
– East Rail Line (including Ma On Shan Line)	98.0%	99.0%	<b>99.9%</b>
– West Rail Line	98.0%	99.0%	<b>99.7%</b>
– Light Rail	N/A	99.0%	<b>99.6%</b>
Ticket machine reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	97.0%	99.0%	<b>99.6%</b>
– East Rail Line (including Ma On Shan Line)	97.0%	99.0%	<b>99.7%</b>
– West Rail Line	97.0%	99.0%	<b>99.6%</b>
– Light Rail	N/A	99.0%	<b>99.9%</b>
Ticket gate reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	97.0%	99.0%	<b>99.8%</b>
– East Rail Line (including Ma On Shan Line)	97.0%	99.0%	<b>99.9%</b>
– West Rail Line	97.0%	99.0%	<b>99.9%</b>
Light Rail platform Octopus processor reliability			
Escalator reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.0%	99.0%	<b>99.9%</b>
– East Rail Line (including Ma On Shan Line)	98.0%	99.0%	<b>99.9%</b>
– West Rail Line	98.0%	99.0%	<b>99.9%</b>
Passenger lift reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.5%	99.5%	<b>99.8%</b>
– East Rail Line (including Ma On Shan Line)	98.5%	99.5%	<b>99.9%</b>
– West Rail Line	98.5%	99.5%	<b>99.9%</b>
Temperature and ventilation			
– Trains, except Light Rail: to maintain a cool, pleasant and comfortable train environment generally at or below 26°C	N/A	97.0%	<b>99.9%</b>
– Light Rail: on-train air-conditioning failures per month	N/A	<3	<b>0</b>
– Stations: to maintain a cool, pleasant and comfortable environment generally at or below 27°C for platforms and 29°C for station concourses, except on very hot days	N/A	90.0%	<b>99.9%</b>
Cleanliness			
– Train compartment: cleaned daily	N/A	98.5%	<b>99.9%</b>
– Train exterior: washed every 2 days (on average)	N/A	99.0%	<b>100.0%</b>
Northwest Transit Service Area Bus Service			
– Service Delivery	N/A	99.0%	<b>99.8%</b>
– Cleanliness: washed daily	N/A	99.0%	<b>100.0%</b>
Passenger enquiry response time within 6 working days	N/A	99.0%	<b>100.0%</b>

# CEO'S REVIEW OF OPERATIONS AND OUTLOOK

## SERVICE AND PERFORMANCE

During the first six months of 2012, we again exceeded the targets set out in the Operating Agreement and our own more exacting Customer Service Pledges.

MTR's exceptional operating performance was acknowledged when it was named "Best Metro Asia-Pacific" at the prestigious 2012 Metrorail Awards in London in April 2012. At the same event, MTR was recognised for offering the "Best Customer Experience Initiative". These awards reflect MTR's world-class service standards and outstanding achievements. In addition, the Airport Express won the "Global AirRail Awards 2012 – Customer Service Excellence Award", organised by AirRail News, in May 2012.

The HK\$1 billion Listening • Responding programme has identified enhancement opportunities in our network.

Several new trains have been put into service, allowing us to increase train frequencies by 368 train trips per week on the busiest parts of the railway network, such as the Tsuen Wan, Kwun Tong and Island lines. The enhanced train frequency has resulted in an immediate improvement in relieving congestion and waiting time for trains at some of the most crowded points in our system, such as at Admiralty Station on the Tsuen Wan Line during the evening peak hours.

The programme has also seen enhancement to station facilities that make MTR journeys more convenient and comfortable, especially for elderly passengers, passengers using wheelchairs and those travelling with baby prams. In the past few months, three new lifts have been put into service at Cheung Sha Wan, Jordan and Sham Shui Po stations. The fourth one will commence service soon in Sheung Wan Station. Nine more lifts are also planned to be added into the railway network so that all 83 stations (excluding Racecourse) will be equipped with at least one lift in the future. In addition, we plan to install 52 more wide gates and 231 platform seats at stations by 2013.

We are also on track to honour our commitment to add toilet facilities at all existing and future interchange stations that currently do not have them. These facilities will be added when the interchange stations undergo major refurbishment works. Currently, we are finalising the design for toilets in Mong Kok, Prince Edward and Admiralty stations. A new toilet facility is about to be opened at Sheung Wan Station.

We continued to apply the latest technology to improve passenger information. For instance, we have installed more information display panels in stations, introduced interactive Digital Way-finders for trial at Mong Kok Station from May

2012, and launched two mobile applications for smartphones, namely "MTR Tourist" and "Next Train" in June 2012. We also launched an "MTR App Talent Quest" in April 2012 to encourage the public to come up with creative ideas for mobile applications that facilitate the use of MTR. Over 500 enrolments were received locally and internationally. The contest results will be announced in October 2012.

In addition, during the first half of 2012, major renovations were completed at Sha Tin Station. New entrances were completed at Tseung Kwan O Station and are currently underway at seven more stations.

The safety of our passengers, employees and work partners is an absolute priority in everything we do. We have hired more than 160 additional station and platform assistants to lend a helping hand to passengers in need. To further enhance the safety of East Rail Line mid-life refurbished trains, we have completed the upgrade of train doors to detect small obstacles. We are also installing safety belts and backing plates for wheelchair users in most of our Light Rail vehicles. To promote safe travel on the railway, we launched the Platform Gap Safety Campaign in April 2012, with safety icons appearing on posters and train door stickers at MTR stations and Light Rail stops. We also launched an annual Escalator Safety Campaign in July 2012 to enhance awareness of escalator safety.

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## HONG KONG STATION COMMERCIAL BUSINESS

Revenue from our Hong Kong station commercial business in the first half of 2012 was HK\$1,699 million, an increase of 11.3% compared to the first half of 2011, on the back of further improvements in station shop rentals and advertising revenues.

Within this total, station retail revenue increased by 12.4% to HK\$1,036 million, largely as a result of increases in the number of shops and rental rates. The number of station shops increased from 1,294 at the end of December 2011 to 1,320 at the end of June 2012, following renovations at six stations. This also boosted the total area of station retail space over the same period to 55,635 square metres, an increase of 703 square metres since the end of 2011.

Advertising revenue in the first half of 2012 increased by 12.0% over the comparable period of 2011 to HK\$428 million. During this period innovative digital sales initiatives were launched, including the info-service package blending real-time weather and UV index information with advertisements. The in-train TV service was extended to the new MTR trains on the Kwun Tong Line to provide infotainment to passengers. We also installed new plasma TVs in Sha Tin Station.

Revenue from our telecommunications business in the first half of 2012 increased by 2.5% over the first half of 2011 to HK\$167 million. In order to meet increasing mobile data demand, we facilitated telecom operators to increase 3G data capacity and signal reception and conducted a technical trial for 4G.



## PROPERTY AND OTHER BUSINESSES

The Hong Kong residential market remained active in the first half of 2012, with several primary launches well-received by the market. Low interest rates continued to lend support to

the market. Nonetheless, volatility in the financial markets and the unresolved Eurozone debt crisis cast a shadow on the property market, and transaction volumes were subdued.

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### PROPERTY DEVELOPMENT PACKAGES AWARDED AND TO BE COMPLETED

Location	Developers	Type	Gross floor area (sq. m.)	Period of package tenders	Expected completion date
<b>LOHAS Park Station</b>					
Package Two (Le Prestige, Le Prime, La Splendeur)	Cheung Kong (Holdings) Ltd.	Residential Kindergarten	309,696 800	Awarded in January 2006	By phases from 2010-2012
Package Three	Cheung Kong (Holdings) Ltd.	Residential Kindergarten	128,544 1,000	Awarded in November 2007	2013
<b>Che Kung Temple Station</b>					
The Riverpark	New World Development Co. Ltd.	Residential Retail Kindergarten	89,792 193 670	Awarded in April 2008	2012
<b>Austin Station</b>					
Sites C and D	New World Development Co. Ltd. and Wheelock Properties Limited	Residential	119,116	Awarded in March 2010	2014
<b>Tuen Mun Station*</b>					
	Sun Hung Kai Properties Ltd.	Residential Retail	119,512 25,000	Awarded in August 2006	By phases from 2012-2013
<b>Tsuen Wan West Station*</b>					
TW7	Cheung Kong (Holdings) Ltd.	Residential	113,064	Awarded in September 2008	2013
TW5 Cityside	Chinachem Group	Residential Retail	66,114 11,210	Awarded in January 2012	2018
TW5 Bayside	Cheung Kong (Holdings) Ltd.	Residential Retail Kindergarten	167,100 40,000 550	Awarded in August 2012	2018
<b>Nam Cheong Station*</b>					
	Sun Hung Kai Properties Ltd.	Residential Retail Kindergarten	214,700 26,660 1,000	Awarded in October 2011	By phases from 2017-2019

\* as a development agent for the relevant subsidiaries of KCRC

### PROPERTY DEVELOPMENT PACKAGES TO BE AWARDED NOTES 1 AND 2

Location	No. of packages envisaged	Type	Gross floor area (sq. m.)	Period of package tenders	Expected completion date
<b>LOHAS Park Station</b>					
	6 – 10	Residential Retail	1,025,220 – 1,035,220 39,500 – 49,500	2013-2017	2020
<b>Tai Wai Station</b>					
	1	Residential Retail	190,480 62,000	2013	2018-2019
<b>Tin Shui Wai Light Rail</b>					
	1	Residential Retail	91,051 205	2013	2018
<b>Wong Chuk Hang Station</b>					
	3	Residential Retail	357,500 47,000	2015-2020	2024
<b>Ho Man Tin Station</b>					
	2	Residential	128,400	2015-2018	2021

Notes:

1. Property development packages for which we are acting as development agent for the relevant subsidiaries of KCRC are not included.
2. These property development packages are subject to review in accordance with planning approval, land grant conditions and completion of statutory processes.

Hong Kong's prime Central office market was also impacted by increasing uncertainty in the Eurozone. Office take-up has slowed, and some office expansion plans have been postponed. Grade-A office rentals remained under pressure as vacancies in Central increased to more than 5% from about 3.5% in 2011. Retail leasing performed well, supported by good leasing demand from international retailers in light of the increasing number of Mainland shoppers.

## PROPERTY DEVELOPMENT

Profit from property development in the first half of 2012 was HK\$627 million, which mainly comprised profits from the sale of inventory units at Festival City, with all three phases in that development substantially sold. In the second quarter of 2012 we launched pre-sales of The Riverpark at Che Kung Temple Station, with about 53% of 981 units sold as at 30 June 2012.

In property tendering, we launched our Tai Wai Station tender at the end of May. Following detailed analysis of the tenders received, we decided not to accept any of the tender submissions. We are examining the development package with a view to putting the project out for tender again over the next six months or so. For West Rail development sites, where we act as agent for the relevant subsidiaries of KCRC, we re-tendered the Tsuen Wan West Station (TWS) Bayside site in July and the tender was awarded to Jubilee Year Investments Limited, a subsidiary of Cheung Kong (Holdings) Limited, on 10 August.

We also continue to explore other property development opportunities for potential sites along existing and new railway lines in accordance with Government policy. The Siu Ho Wan Depot site on Lantau Island has been identified by the Government as a potential site for residential development, and we are collaborating with Government on planning and technical issues related to the development of this site.

In our property development projects, we continue to enhance safety by strengthening controls for high-risk activities via method statements and risk assessments prior to commencing work. We have also introduced a "Pictorial Method Statement and Risk Assessment Campaign" to effectively demonstrate safe work procedures on site.

To promote sustainable property developments in Hong Kong, we require all our future residential developments meet the Hong Kong BEAM Plus Gold Standard.

## PROPERTY RENTAL AND MANAGEMENT BUSINESSES

Revenue from our property rental and property management businesses in the first half of 2012 was HK\$1,730 million, 10.9% higher than the comparable period in 2011.

Total property rental income in Hong Kong and the Mainland of China rose by 11.4% over the first half of 2011 to HK\$1,632 million. In Hong Kong, our shopping mall portfolio achieved an average increase of 15% in rental reversion for the period. At the end of June 2012, the occupancy rate of our 13 shopping malls in Hong Kong and the Corporation's 18 floors at Two International Finance Centre was close to 100%.

In March 2012, we opened our 13th shopping mall in Hong Kong, "PopCorn", which is located directly above Tseung Kwan O Station. This new mall covers a gross floor area of 20,000 square metres and houses some 100 tenants, including numerous international brands and a large cinema. Occupancy upon opening was 100%.

As at 30 June 2012, the Company's attributable share of retail investment properties in Hong Kong was 212,082 square metres of lettable floor area, following the opening of PopCorn. Our attributable share of office and other investment properties remained broadly unchanged at 40,969 and 11,003 square metres of lettable floor area respectively.

Our programme of upgrading our retail portfolio saw the completion of renovation works at Plaza Ascot in Fo Tan and the partial completion of the trade-mix revamp at Maritime Square in Tsing Yi. Throughout our malls, we retrofitted energy efficiency equipment to enhance energy conservation and secured Indoor Air Quality Certification (Good Class) from the Environmental Protection Department. Effective marketing underpinned our property portfolio's performance, with Elements, Telford Plaza and our MTR Malls "Must-have" Weekly Gift Campaign" promotion programme all securing a number of awards.

In the Mainland of China, Ginza Mall in Beijing retained its occupancy rate of 98% as of the end of June 2012 and achieved an average increase of 14% in rental reversion for the period.

Property management revenue in the first half of 2012 increased by 3.2% to HK\$98 million. As at 30 June 2012, the number of residential units under our management in Hong Kong had fallen by 1,432 to 84,730, after the Company exited from the management of Pierhead Garden in Tuen Mun in early 2012, while the area of commercial space under our management rose to 764,725 square metres following the opening of PopCorn. The residential and commercial area in the Mainland of China that we manage stood at 313,266 square metres.

Our property management operations attained numerous awards and recognitions in areas such as energy efficiency, horticultural maintenance, clubhouse management and air and water quality, from a variety of Government and industry bodies.

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At all our managed properties and shopping malls, we have further enhanced the safety process and workflow in which some of the industry's best practice initiatives are being pioneered.

### OTHER BUSINESSES

The Ngong Ping cable car was closed for nine weeks for repairs and maintenance works relating to the un-scheduled replacement of bearings and the annual servicing inspection, following a service disruption incident in late January 2012. As a result of this closure, revenue from the cable car and its associated theme village recorded a 25.0% drop in revenue in the first half of 2012 to HK\$87 million. Ridership continued to be supported by various promotions, and visitor numbers for the first six months of 2012 were over 468,000, with premium Crystal Cabin rides accounting for approximately 32.6% of total rides.

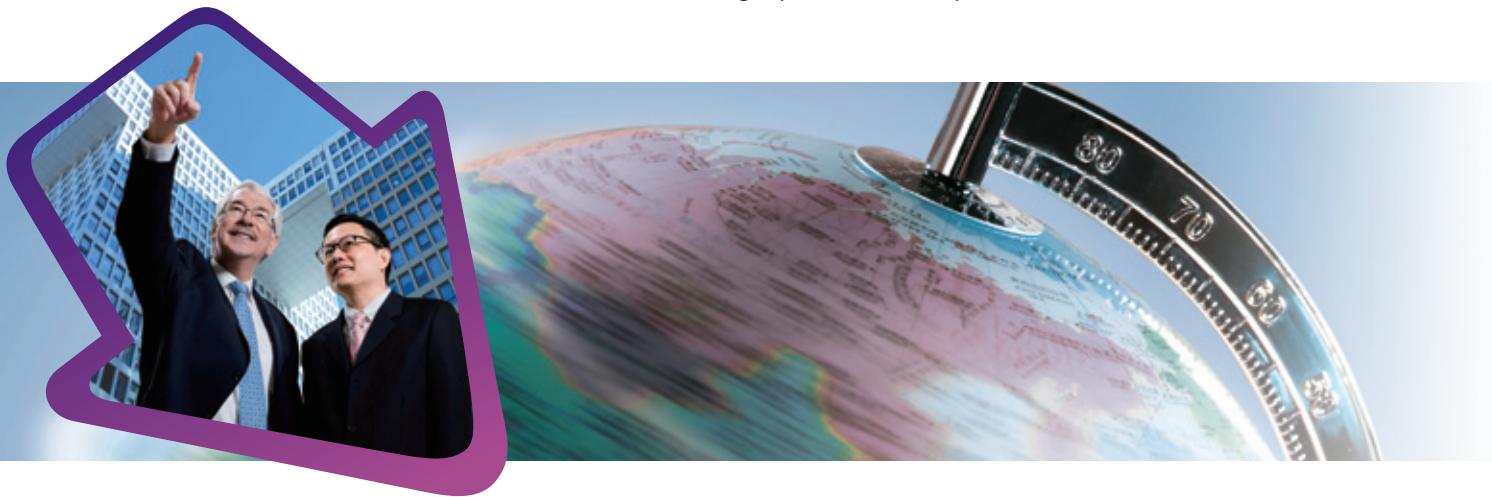
Revenue from the consultancy business in the first half of 2012 was HK\$44 million, a decrease of 4.3% from the comparable period of 2011. In Australia, a contract was signed with UGL Unipart Rail Services Pty Ltd in January 2012 to support its rolling stock maintenance works in New South Wales, and in February 2012, a Memorandum of Understanding was signed

with the Abu Dhabi Department of Transport to establish a long-term partnership to develop sustainable rail services there. In Hong Kong, the Automated People Mover midfield concourse extension subcontract was signed with Airport Authority Hong Kong in February 2012.

Octopus continues to expand its reach in the retail sector. By the end of June 2012, over 5,000 service providers in Hong Kong were using the Octopus service. Octopus in circulation were 20.74 million. Average daily transaction volume and value were 12.1 million and HK\$123.9 million respectively. The Company's share of Octopus' net profit for the first half of 2012 was HK\$95 million, a 17.3% increase over the first half of 2011.

Octopus worked with Guangdong Lingnan Pass Company Limited to jointly launch the "Octopus Lingnan Pass" in July 2012, combining Octopus and Lingnan Pass functions into one card for travelling and spending in Hong Kong and Guangdong province in the Mainland of China.

Project management income from KCRC and Government in the first half of 2012 was HK\$331 million, 26.3% higher than the comparable period of 2011, mainly due to higher project management fees related to the Entrustment Agreement for the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link).



## MAINLAND OF CHINA AND OVERSEAS BUSINESSES

Revenue for the first half of 2012 from our railway subsidiaries outside of Hong Kong, Metro Trains Melbourne Pty. Ltd. (MTM), MTR Stockholm AB (MTRS) and MTR Corporation (Shenzhen) Limited (SZMTR), was HK\$6,335 million. This represents a rise of 2.7% over the first half of 2011 and mainly reflects the contribution from Phase 2 of the Shenzhen Metro Longhua Line. Operating costs were HK\$6,002 million, resulting in a 35.4% increase in operating profit to HK\$333 million and an operating profit margin of 5.3%.

For our associates, total contributions from Beijing MTR Corporation Limited (BJMTR), London Overground Rail Operations Ltd (LOROL) and Tunnelbanan Teknik Stockholm AB rose by HK\$130 million to HK\$204 million compared with the first half of 2011, mainly due to the increased contribution from Beijing Metro Line 4 (BJL4).

Total passengers carried by our rail subsidiaries and associates outside of Hong Kong were approximately 556.5 million in the first six months of 2012, against some 460 million in the same

period of 2011. The increase was primarily due to the opening of Shenzhen Metro Longhua Line and increasing patronage on our Beijing lines.

## MAINLAND OF CHINA

In the Mainland of China, BJL4 and the Daxing Line operations exceeded concession requirements. Ridership of the combined line in the first six months of 2012 was 170 million passenger trips, with average daily patronage of over 930,000, an increase of 11.6% over the same period in 2011.

Shenzhen Metro Longhua Line commenced full line operations in June 2011, and operational performance exceeded targets during the first six months of 2012, including those for average train service delivery and punctuality. Ridership was 53 million, with average daily patronage of over 293,000. Our property development project above the depot in Shenzhen Metro Longhua Line continues to make progress. We aim to develop this property by ourselves and have started architectural and design works. We target to complete the regulatory approvals for this project in the second quarter of 2013. The total developable gross floor area of the site is approximately 206,167 square metres.

## OVERSEAS

In the UK, during the first half of 2012, LOROL completed its investment programme to refurbish its stations. Total ridership was over 56 million, with average weekday patronage of over 350,000. With its excellent service, LOROL was awarded the title of London's Public Transport Operator of the Year for the second year in a row at the 9th London Transport Awards and it was chosen as the World's Most Improved Metro at the 2012 Metrorail Awards in London.

In Stockholm, MTRS operations have shown improvements in train availability and punctuality. Total ridership for the first six months was over 160 million, with average weekday patronage exceeding 1.1 million.

In Melbourne, MTM enjoyed enhanced operational performance and exceeded its target for service punctuality, achieving this by way of timetable upgrades and the commissioning of 38 new trains. Total ridership for the first six months was over 100 million, with average weekday patronage of over 790,000.



## FUTURE GROWTH

The Company's future growth is supported by our network extension projects in Hong Kong and further investments in the Mainland of China and overseas.

### GROWTH IN HONG KONG

Further progress was made during the first half of 2012 on the five major projects which will bring efficient, affordable and environmentally sustainable rail services to more districts of Hong Kong.

The 3-km West Island Line, an extension of the Island Line, is targeted to open in 2014. As at the end of June, 93% of excavation works for tunnels and 95% of excavation works for stations were complete. Structural works at Hong Kong University Station commenced in May 2012. At Sheung Wan, station modification works have continued, and the removal of a portion of the existing tunnel overrun is in progress to make way for the construction of the new west-bound tunnel towards Sai Ying Pun. The method being employed is a major innovation in the world of tunnel construction.

## CEO'S REVIEW OF OPERATIONS AND OUTLOOK

All electrical and mechanical (E&M) contracts have been awarded and are progressing well, with all key E&M system design works completed.

The 7-km South Island Line (East), targeted to open in 2015, will extend MTR services from Admiralty to the Southern District of Hong Kong Island, with a train depot located in Wong Chuk Hang. Major achievements during the period include the diaphragm wall for the new Admiralty Station, works required within the nullah for the new Wong Chuk Hang Station as well as open blasting works for the Wong Chuk Hang Depot. Excavation to formation level in Wong Chuk Hang Depot is now 90% complete. Construction contracts for the Wong Chuk Hang Depot superstructure, trackwork and overhead line works, as well as all major E&M contracts, have been awarded.

The 2.6-km Kwun Tong Line Extension will extend the Kwun Tong Line from Yau Ma Tei Station to new stations in Ho Man Tin and Whampoa. By the end of June 2012, the excavation works for Ho Man Tin Station were 35% complete. Shaft excavation for tunnelling works in Ho Man Tin was in progress, while pipe piling for the concourses at Whampoa Station was about 30% complete. All major civil, building services and system-wide E&M contracts have been awarded. The extension is on track to open in 2015.

The 26-km Express Rail Link, which is being funded by Government, will provide high-speed cross-boundary rail services connecting Hong Kong to Shenzhen, Guangzhou and the Mainland of China's high-speed intercity passenger rail network. Services are expected to start in 2015. Government has entrusted the design and construction of the line to the Company and has agreed to invite the Company to operate the railway service on a concession basis upon completion.

Two more Tunnel Boring Machines (TBM) were launched at Nam Cheong during this period. As at the end of June, 30% of the tunnelling works for drill and blast tunnels, 10% of the tunnelling works for TBM tunnels and 30% of the excavation works for the West Kowloon Terminus were completed. All major E&M contracts have been awarded, including those for signalling and rolling stock. Agreement was also reached on the final scheme design interface between the West Kowloon Terminus and the West Kowloon Cultural District.

On 29 May 2012, we entered into an entrustment agreement with Government for the construction and commissioning of the Shatin to Central Link. This follows receipt of the formal project authorisation and funding approval, and it enables our project team to focus on the delivery of this important new

rail link. A Ground Breaking Ceremony was held on 22 June 2012 to mark the commencement of construction works.

Largely funded by Government, the 17-km line consists of ten stations, with six interchange stations, namely Tai Wai, Diamond Hill, Ho Man Tin, Hung Hom, Exhibition and Admiralty stations. It will play a critical part in connecting all districts of Hong Kong with an integrated rail network and expanding our train services further in East Kowloon.

The section between Tai Wai and Hung Hom is expected to be completed in 2018, and the Hung Hom to Admiralty section in 2020. It is estimated that the line will create some 15,000 jobs throughout the construction period.

Procurement of civil and E&M contracts is in progress, and District Council and Community Liaison Group consultations are underway. Foundation piles and substructure works for the new International Mail Centre, together with 20% of the superstructure, have been completed.

In order to address the safety challenges brought about by the substantial increase in staff, contractors and site activities for our five concurrent projects, we launched a "Don't Walk By" Safety Week in May across more than 100 work sites. This program successfully raised awareness of safe practices among all our workers and contractors. In addition, a "Construction Worker Life Insurance Scheme" was launched in April 2012, providing payment to the families of any worker who dies during the course of employment, regardless of cause.

The Company is looking forward to receiving positive results from Government's Review and Update of the Second Railway Development Study (RDS-2U). The study will determine which future railway projects would best support prosperity in Hong Kong and the Mainland.

### GROWTH IN THE MAINLAND OF CHINA AND OVERSEAS

In the Mainland of China, our joint venture with Hangzhou Metro Group Limited to invest in and operate Hangzhou Metro Line 1 received approval from the NDRC in June 2012, and the formal joint venture agreement was signed on 17 July. The line will commence operations in the fourth quarter of 2012. In Beijing on 10 August, BJMTR submitted a bid to invest in a Public-Private-Partnership project for Beijing Metro Line 14, a 47-km line running from the southwest to the northeast of Beijing. We continue our discussions with relevant Government bodies to seek further investment opportunities in the Mainland.

In March 2012 the Company was shortlisted by the UK's Department for Transport to bid for two rail operating franchises, the Essex Thameside and the Thameslink franchises. Work is now underway to prepare for the two tenders, the results of which will be announced in 2013.

## FINANCIAL REVIEW

The Group's recurrent businesses continued to show strong growth in the first half of 2012. Compared with the same period in 2011, total revenue was 6.1% higher at HK\$17,154 million. Revenue from Hong Kong transport operations rose by 6.8% to HK\$6,914 million, supported by a 4.5% patronage growth and an increase in average fare of 2.5%. Revenue from station commercial business in Hong Kong grew by 11.3% to HK\$1,699 million, as positive economic momentum supported both strong advertising demands and favourable station kiosk rental reversions. Property rental and management income, benefitting from positive rental reversion as well as the opening of PopCorn in March 2012, increased by 10.9% to HK\$1,730 million. Revenue from other businesses grew by 8.2% to HK\$476 million on account of additional project management works on the Express Rail Link and the Shatin to Central Link offset by a 25.0% decrease in revenue from Ngong Ping 360 due to un-scheduled repair and maintenance works. Outside of Hong Kong, our railway subsidiaries increased their combined revenue contributions by 2.7% to HK\$6,335 million, attributed to the additional revenue from Shenzhen Metro Longhua Line Phase 2 which commenced operation in June 2011, as well as an increase in franchise income from MTM.

Total operating costs increased by 4.6%, a lower rate than revenue growth, to HK\$10,635 million. Excluding railway subsidiaries outside of Hong Kong, the cost growth was 9.2%. Expenses on Hong Kong transport operations, increased by 7.0% with staff costs, energy and utilities as well as operational rent and rates increasing by 7.0%, 9.4% and 11.9% respectively due to additional headcounts, energy consumption for service improvements and above-inflationary price escalations. Expenses for Hong Kong station commercial business increased by 18.2% due to higher rent and rate charged in addition to the incremental costs incurred to support the revenue growth. For property rental and management businesses, operating costs decreased by 0.3% due to a scheduled lump sum payment in 2011 in relation to the Ginza Mall lease in Beijing. Excluding such lump sum payment, operating costs would have increased by 6.3%. For other businesses, expenses increased by 20.5% due to the un-scheduled repair and maintenance work costs incurred at Ngong Ping 360 and increase in project management

activities. During the first half of 2012, the Group committed further resources in pursuing business opportunities outside of Hong Kong, mainly for the preparation of Hangzhou Metro Line 1 operation and two franchise bids in the UK. This resulted in an increase in project study and business development expenses from HK\$51 million for the same period in 2011 to HK\$100 million in 2012.

Operating profit before property developments, depreciation, amortisation and variable annual payment ("EBITDA") increased by 8.6% to HK\$6,519 million, with operating margin improving from 37.1% in 2011 to 38.0%. Excluding railway subsidiaries outside of Hong Kong, EBITDA increased by 7.5% to HK\$6,186 million with only a slight change in margin from 57.6% to 57.2%. Property development profit for the first half of 2012 was 56.6% less than the same period last year at HK\$627 million, which was mainly derived from the sale of units in inventory at Festival City and The Palazzo. Depreciation and amortisation were maintained to the 2011 level at HK\$1,613 million. Variable annual payment increased by 33.6% to HK\$402 million as the revenue threshold for the highest progressive rate of 35% has been reached. As a result of lower property development profit, profit before interest and finance charges decreased by 7.3% to HK\$5,131 million.

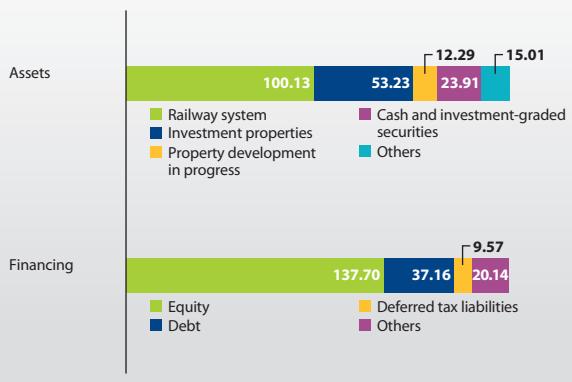
Interest and finance charges decreased by 5.9% to HK\$432 million. The increase in value of investment properties since the end of 2011 was HK\$1,740 million as compared with HK\$4,408 million for the same period last year. The share of profits from non-controlled subsidiaries and associates grew significantly by 92.9% to HK\$299 million mainly due to the good performance of BJMTR. Of the HK\$119 million increase in profit contribution from BJMTR, HK\$66 million was attributable to finalisation of accounting adjustments relating to prior years.

With lower profits from property development and property revaluation, net profit attributable to shareholders after deducting HK\$796 million of income tax and HK\$81 million of profit shared by non-controlling interests was HK\$5,861 million, decreasing by 33.2%. Earnings per share therefore decreased from HK\$1.52 to HK\$1.01. Excluding investment property revaluation, profit from underlying businesses attributable to shareholders decreased by 5.7% to HK\$4,121 million, of which HK\$524 million, a 60.0% reduction from the same period of 2011, was derived from property developments and HK\$3,597 million, a 17.6% increase over the first half of 2011, was derived from recurrent businesses. Earnings per share based on the underlying business profit decreased from HK\$0.76 to HK\$0.71. The Board has declared an interim dividend of HK\$0.25 per share.

# CEO'S REVIEW OF OPERATIONS AND OUTLOOK

## SIMPLIFIED BALANCE SHEET

As at 30 June 2012  
(HK\$ billion)



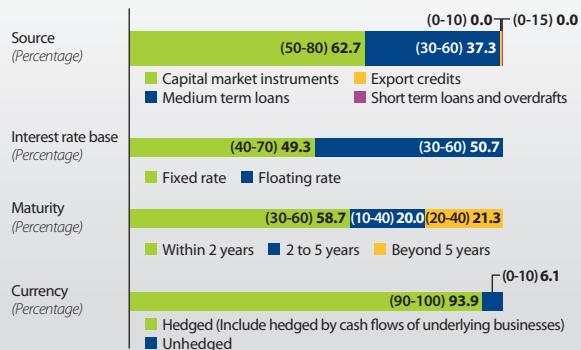
The Group's balance sheet strengthened further with net assets increasing by 2.3% from HK\$134,649 million as at 31 December 2011 to HK\$137,696 million as at 30 June 2012. Total assets increased by 3.4% to HK\$204,573 million as a result of the investment property revaluation gain, further construction of the South Island Line (East) and Kwun Tong Line Extension as well as property development costs incurred. The sale of properties during the half year reduced properties held for sale and correspondingly increased debtors, deposits and payments in advance as well as cash balances. Total liabilities increased by 5.8% to HK\$66,877 million mainly due to the increase in loans and other obligations of HK\$3,134 million for financing the upcoming investments in Mainland of China and capital expenditures, rise in deferred income of HK\$354 million in respect of the Shenzhen Metro Longhua Line government subsidy and increase in tax liabilities of HK\$344 million. Total loan outstanding as at 30 June 2012 was HK\$26,302 million. With the increase in cash balance, the net debt-to-equity ratio reduced from 11.4% as at 31 December 2011 to 9.9% as at 30 June 2012.

Cash flow of the Group remained strong in the first half of 2012. Before tax payment, operating activities generated HK\$7,817 million in cash, increasing by 26.6% from the same period of 2011. The Shenzhen Metro Longhua Line government subsidy of RMB522 million (HK\$637 million) for 2012 was received during the first half, while the same amount for last year was received in the second half of 2011. After accounting for this receipt and the tax payment

## PREFERRED FINANCING MODEL AND DEBT PROFILE

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

(Preferred Financing Model) vs. Actual debt profile  
As at 30 June 2012



of HK\$479 million, the Group had HK\$7,975 million of cash inflow from operating activities. Cash received from property developments was HK\$2,625 million mainly from the sale of units at Festival City and The Palazzo. Including dividends and loan repayments received from the non-controlled subsidiaries and associates and asset disposal proceeds, total cash inflow during the first half of 2012 was HK\$10,817 million. Total cash outflow in the period was HK\$9,237 million, comprising mainly capital expenditure of HK\$5,100 million for the construction of new extension projects, asset additions for existing operations and expenditures on property developments, the first full-year variable annual payment of HK\$647 million, net interest payment of HK\$330 million and dividend payments of HK\$3,020 million. As a result, the Group generated net cash inflow of HK\$1,580 million in the first half of 2012. To prepare for the projected payments on Mainland investments and capital expenditures in the second half year, the Group made HK\$3,193 million of net borrowing and redeemed HK\$921 million of medium term notes in the first half of 2012. Cash, bank balances and deposits of the Group therefore increased by HK\$5,694 million to HK\$21,794 million as at 30 June 2012.

## FINANCING ACTIVITIES

Growth of the US economy significantly slowed in the first half of 2012. This, together with safe haven demand from the deepening European sovereign debt crisis and the Federal Reserve's Operation Twist, drove Treasury yields to their lowest levels ever, with 10-year yield reaching a historical low of

1.452% per annum. Interbank rates, whilst remaining subdued, crept up slightly with the average 3-month USD-LIBOR and 3-month HKD-HIBOR rising to around 0.49% per annum and 0.40% per annum, from 0.29% per annum and 0.25% per annum respectively during the same period last year.

The USD primary market in Hong Kong was exceedingly active during the period. Enticed by attractive interest rates and investor demand, a large number of top-tier Hong Kong issuers raised debt from the US dollar market, some for the first time, causing total issuance volume to hit a record high of US\$17.6 billion.

Taking advantage of the favourable financing window, the Group launched a 5-year USD300 million public bond in March. Based on a strong order book of US\$1.7 billion, the bond was priced at 99.175% of face value with a coupon rate of 2% per annum, the lowest-ever for a corporate five-year US dollar bond in Hong Kong, to yield 2.175% per annum, or 115 basis points over 5-year Treasury. The bond was issued under the Group's USD3 billion Debt Issuance Programme and is listed on the Hong Kong Stock Exchange. Investors included a diverse group of institutional investors from Hong Kong, Asia and Europe comprising fund managers, insurance companies, central banks and banks.

The favourable condition in the debt capital market, however, was not mirrored in the loan market. Reacting to higher funding costs and the need to strengthen capital ahead of the new Basel III banking regulations, banks continued to scale back lending by charging higher fees and credit margins and by reducing maturities of loans.

Despite the challenges, the Group managed to leverage its strong financial position and banking relationships to arrange bilateral banking facilities totalling HK\$3,150 million, comprising 3- and 5-year revolving term loan facilities at attractive costs.

With the new bond issue, bilateral banking facilities and debt private placements, the Company has further strengthened its liquidity position and financial flexibility. At the end of June 2012, the Company had total cash, bank deposits and short-term investment balance of HK\$21,318 million as well as total undrawn committed banking facilities of HK\$3,150 million, which together will help provide forward coverage of the Company's funding needs well into 2013.

Owing to higher finance charges from increased financing activities compared with the first half of 2011, the Group's weighted average borrowing cost increased slightly to 3.3% per annum, from 3.1% per annum during the same period of 2011.



## HUMAN RESOURCES

The number of people employed by the Company, together with its controlled subsidiaries, was 14,816 in Hong Kong and 6,873 outside of Hong Kong as at 30 June 2012.

During the six months under review we continued to implement our strategic 5-year manpower plan to attract and develop people in support of our business growth. A total of

799 new hires were made, and 538 people were promoted internally to facilitate succession planning, project completion and business expansion. Our recruitment efforts encompassed outreach via universities and other institutions. Partnering with the Hong Kong Council of Social Service and NGOs, our Community Recruitment Programme in Tung Chung served as an additional channel for recruitment while providing

## CEO'S REVIEW OF OPERATIONS AND OUTLOOK

employment opportunities to those living in remote districts. To demonstrate our continual support of the development of the construction industry, the Company actively participated in a number of job fairs to promote career opportunities for young graduates and engineers. Our staff turnover remained very low at 3.8%.

Our Corporate Leadership Pipeline ensures a sustainable supply of leaders at all levels. The fourth batch of Executive Associate Scheme entrants completed their group learning activity during the first half, and nomination for the succeeding batch has commenced. Recruitment for the 2012 intake of Graduate Trainees, Graduate Engineers and Functional Associates was completed, with a total of 40 young talents ready to join the Company.

To develop talent at all levels, 2,475 training and development courses were held during the first half of 2012, providing 3.1 training man-days per employee. Our training and development programmes have continued, among other things, to sustain the culture of caring service, innovation and continuous learning, while the Work Improvement Team Programme is building an improvement culture in which members of staff are encouraged to put forward innovative ideas and proposals to improve work processes.

In the first half of 2012, 2,600 sessions of our "Enhanced Staff Communication Programme" were organised, with a participating headcount of more than 28,000, to reinforce two-way communication between line managers and staff.

## COMMUNITY ENGAGEMENT

Engagement with the communities we serve through our integrated rail plus property business model is central to the way we operate. We provide regular communication channels to talk and listen to our passengers and stakeholders. These include passenger profile surveys, Customer Voice surveys, the "MTR Opinion Zone" and live radio phone-in programmes, which allow passengers to express their opinions freely.

In support of our new railway projects under construction in Hong Kong, we hold regular community liaison meetings. These meetings enable us to communicate the proposed designs, construction programmes and methods to the local communities and receive their feedback. We have been especially active in recent months with consultations on the Shatin to Central Link.

## OUTLOOK

The global economic outlook remains challenging with continued uncertainties in Europe and slowing growth in the Mainland of China. Although a number of our businesses are less sensitive to economic changes, slowing growth in Hong Kong together with the additional fare concessions we have announced will impact the overall growth of our recurrent businesses.

In our property development business, the booking of profits for The Riverpark at Che Kung Temple Station will depend, firstly, on sales proceeds from the units sold exceeding development costs and, secondly, receipt of the Occupation Permit. We currently expect to receive the Occupation Permit for this development later this year.

In our property tendering activities, we are examining the Tai Wai Station package with a view to putting the project out for tender again within the next six months or so. Subject to market conditions, we aim to tender the Tin Shui Wai Light Rail site over the same period. For West Rail property developments, where we act as agent for the relevant subsidiaries of KCRC, we may tender out the Long Ping Station (North) and Long Ping Station (South) sites over the next six months.

As we approach the fifth anniversary of the merger with KCRC, later on this year will see the first bi-lateral review of the FAM. We will work constructively with Government on this review. More generally, we look forward to working with the new Government to ensure that Hong Kong continues to benefit from safe, efficient and sustainable transport services that underpin economic competitiveness and quality of life.

Finally I would like to thank my fellow directors and colleagues for all their support in this period since my appointment as CEO.



Jay H Walder, Chief Executive Officer  
Hong Kong, 13 August 2012