FINANCIAL REVIEW

A review of the Group's results and operations is featured in the preceding sections. This section discusses and analyses these results in a greater level of detail.

CONSOLIDATED PROFIT OR LOSS

	Six months ended 30 June		Favourable/ (Unfavourable) Change	
HK$ million	**2023**	2022	HK$ million	%
Total Revenue	**27,574**	**23,033**	**4,541**	**19.7**
Recurrent Business Profit/(Loss)ζ				
EBIT#				
Hong Kong Transport Services				
– Hong Kong Transport Operations	**(774)**	(2,775)	2,001	72.1
– Hong Kong Station Commercial Businesses	**1,798**	1,098	700	63.8
Total Hong Kong Transport Services	**1,024**	(1,677)	2,701	n/m
Hong Kong Property Rental and Management Businesses	**1,990**	1,865	125	6.7
Mainland China and International Railway, Property Rental and Management Subsidiaries*	**290**	791	(501)	(63.3)
Other Businesses, Project Study and Business Development Expenses	**(146)**	(317)	171	53.9
Share of Profit of Associates and Joint Ventures	**632**	490	142	29.0
Total Recurrent EBIT (before Impairment Loss)	**3,790**	**1,152**	**2,638**	**229.0**
Impairment Loss on Shenzhen Metro Line 4	**–**	(962)	962	n/m
Total Recurrent EBIT (after Impairment Loss)	**3,790**	**190**	**3,600**	**n/m**
Interest and Finance Charges	**(626)**	(501)	(125)	(25.0)
Income Tax	**(569)**	(171)	(398)	(232.7)
Non-controlling Interests	**(175)**	(196)	21	10.7
Recurrent Business Profit/(Loss)	**2,420**	**(678)**	**3,098**	**n/m**
Property Development Profit (Post-tax)				
Hong Kong	**712**	7,747	(7,035)	(90.8)
Mainland China	**20**	39	(19)	(48.7)
Property Development Profit (Post-tax)	**732**	**7,786**	**(7,054)**	**(90.6)**
Underlying Business Profitε	**3,152**	**7,108**	**(3,956)**	**(55.7)**
Gain/(Loss) from Fair Value Measurement of Investment Properties (Post-tax)				
Gain/(Loss) from Fair Value Remeasurement on Investment Properties	**21**	(2,376)	2,397	n/m
Gain from Fair Value Measurement of Investment Properties on Initial Recognition from Property Development	**1,005**	–	1,005	n/m
Gain/(Loss) from Fair Value Measurement of Investment Properties (Post-tax)	**1,026**	**(2,376)**	**3,402**	**n/m**
Net Profit Attributable to Shareholders of the Company	**4,178**	**4,732**	**(554)**	**(11.7)**

ζ : *Recurrent business profit/(loss) represents profit/(loss) from the Group's Hong Kong transport operations, Hong Kong station commercial businesses, Hong Kong property rental and management businesses, Mainland China and international railway, property rental and management businesses, and other businesses (excluding fair value measurement of investment properties in Hong Kong and Mainland China)*

\# : *EBIT represents profit before interest, finance charges and taxation*

* : *Excluding the impairment loss of HK$962 million in respect of Shenzhen Metro Line 4 in Mainland China for the six months ended 30 June 2022*

ε : *Underlying business profit represents profit/(loss) from the Group's recurrent businesses and property development businesses*

n/m: not meaningful

Our recurrent business financial performance for the six months ended 30 June 2023 shows gradual recovery, having benefited from the removal of anti-pandemic restrictions and phased reopening of rail links with Mainland China. On the other hand, our property development business delivered modest profits from LOHAS Park Package 11 and various completed projects, as compared to three of our development projects having profits booked in the same period last year.

Total Revenue

The Group's total revenue for the six months ended 30 June 2023 increased by 19.7% to HK$27,574 million when compared to the same period in 2022. The increase was mainly contributed by (i) recovery in Domestic Service patronage as well as patronage growth resulting from a full six-month operation of the East Rail Line cross-harbour extension, compared to the low base of revenue recorded during the same period last year following the outbreak of the fifth wave of COVID-19 in Hong Kong; (ii) gradual resumption of Cross-boundary and High Speed Rail fare revenue together with Duty Free rental income following the phased reopening of rail links with Mainland China; and (iii) higher revenue from our Melbourne transport operations. These factors were partly offset by (i) decrease in design and delivery project income of the Sydney Metro City & Southwest project; and (ii) decrease in revenue in Sweden.

Recurrent Business Profit/(Loss)

The Group recorded recurrent business profit of HK$2,420 million during the six months ended 30 June 2023 compared to a loss of HK$678 million in the same period last year. The improvement in recurrent business profit was mainly contributed by (i) the aforementioned increased revenue in Hong Kong transport operations ("HKTO") and Hong Kong station commercial businesses ("HKSC") following the resumption of cross-boundary rail services, as well as the low base of revenue recorded in the same period last year; and (ii) the impairment provision of HK$962 million in respect of Shenzhen Metro Line 4 made in the first half of 2022.

EBIT

HKTO: EBIT loss narrowed substantially by HK$2,001 million, or 72.1%, to HK$774 million for the six months ended 30 June 2023 compared to an EBIT loss of HK$2,775 million in the same period of 2022. This was the result of increased revenue arising from (i) a rebound in our Domestic patronage as COVID-19 has mostly subsided; (ii) recovery in Cross-boundary Service, High Speed Rail and Airport Express revenue after the removal of anti-pandemic restrictions and phased reopening of rail links with Mainland China; and (iii) the impact of a full six-month operating period for the East Rail Line cross-harbour extension, which opened in May 2022.

These favourable results were partially offset by (i) increased operating expenses due to inflation, enhanced train services in Domestic Service, resumption of operations for Cross-boundary Service and High Speed Rail, and incremental costs from the new East Rail Line cross-harbour extension, despite our continuous collective effort in maintaining stringent cost control measures; (ii) higher depreciation from railway asset renewal or commissioning; and (iii) higher variable annual payment to KCRC.

HKSC: EBIT increased significantly by HK$700 million, or 63.8%, to HK$1,798 million, predominantly due to the resumption of Duty Free Shop revenue after the reopening of boundary crossing stations. Other station retail rentals continued to be adversely affected by negative rental reversions on renewals and new lets.

Hong Kong property rental and management businesses: EBIT increased by HK$125 million, or 6.7%, to HK$1,990 million. This was mainly due to fewer rental concessions being granted and amortised during the six months ended 30 June 2023 when compared to the same period last year, though it was partly offset by the adverse impact of negative rental reversions.

Mainland China and international railway, property rental and management business subsidiaries: EBIT for the six months ended 30 June 2023 decreased significantly by HK$501 million, or 63.3%, to HK$290 million. This was mainly due to (i) the continuous challenges being faced in operational and financial performances of Stockholms pendeltåg and Mälartåg regional traffic; and (ii) the depletion of the government subsidy in late 2022 for Shenzhen Metro Line 4, which resulted in no government subsidy being booked in profit or loss during the six months ended 30 June 2023. These factors were partially mitigated by recovery in patronage as the pandemic subsided.

Other businesses, project study and business development expenses: EBIT loss from these businesses was HK$146 million for the six months ended 30 June 2023 compared to an EBIT loss of HK$317 million for the same period in 2022. The reduction in loss of HK$171 million, or 53.9%, was due to increased visitor numbers and improved financial performance of Ngong Ping 360.

Share of Profit of Associates and Joint Ventures

Share of profit of associates and joint ventures increased by HK$142 million, or 29.0%, to HK$632 million for the six months ended 30 June 2023. This was mainly due to (i) higher profit sharing in Octopus Holdings Limited as a result of boundary reopening, improved consumer sentiment following the relaxation of social distancing policies and the spill-over effect from the Government's Consumption Voucher Scheme; and (ii) improved performance of our operations in Mainland China.

Total Recurrent EBIT

Total recurrent EBIT before impairment loss increased by HK$2,638 million, or 229.0%, to HK$3,790 million. Including the impairment loss on Shenzhen Metro Line 4 of HK$962 million for the six months ended 30 June 2022, total recurrent EBIT increased by HK$3,600 million to HK$3,790 million.

Income Tax

Income tax increased by HK$398 million, or 232.7%, to HK$569 million for the six months ended 30 June 2023. This was mainly due to the increase in recurrent business profit in Hong Kong.

Since the Rail Merger in 2007, the Company has claimed annual Hong Kong Profits Tax deductions in respect of certain payments relating to the Rail Merger (collectively "the Sums"). The total tax amount in respect of the Sums for the years of tax assessment from 2007/2008 to the first six months of 2023/2024 amounted to HK$4.9 billion. On 20 May 2022, the Commissioner of Inland Revenue issued a determination to the Company disagreeing that the Sums are tax deductible. The Company lodged a notice of appeal to the Inland Revenue Board of Review on 16 June 2022. The hearing before the Board of Review is scheduled to be held in early 2024. Further details are set out in Note 8 "Income Tax" to the Unaudited Interim Financial Report.

Property Development Profit (Post-tax)

Property development profit (post-tax) was HK$732 million for the six months ended 30 June 2023, which was mainly derived from initial profit recognition from LOHAS Park Package 11 and residual profits from various completed projects. The decrease was HK$7,054 million when comparing to HK$7,786 million when three of our development projects having profits booked during the same period last year.

Gain/(Loss) from Fair Value Measurement of Investment Properties (Post-tax)

Gain from fair value measurement of investment properties in Hong Kong and Mainland China was HK$1,026 million during the six months ended 30 June 2023. This comprised (i) a portion of gain of HK$1,005 million recognised from the initial fair value measurement of our sharing-in-kind property (i.e. THE SOUTHSIDE shopping mall); and (ii) a marginal gain of HK$21 million from investment property fair value remeasurement after tax.

Net Profit Attributable to Shareholders of the Company

Taking into account the Group's recurrent businesses, property development businesses and fair value measurement of investment properties, the Group reported a net profit attributable to shareholders of the Company of HK$4,178 million for the six months ended 30 June 2023 compared to a net profit of HK$4,732 million for the same period in 2022.

CONSOLIDATED FINANCIAL POSITION

HK$ million	**At 30 June 2023**	At 31 December 2022	Inc./(Dec.) HK$ million	Inc./(Dec.) %
Net Assets	**177,661**	179,912	(2,251)	(1.3)
Total Assets	**341,726**	327,081	14,645	4.5
Total Liabilities	**164,065**	147,169	16,896	11.5
Gross Debt^	**53,330**	47,846	5,484	11.5
Net Debt-to-equity Ratio$^{\delta}$	**22.3%**	23.3%		(1.0)% pt.

^ : *Gross debt represents loans and other obligations, and short-term loans*

δ : *Net debt-to-equity ratio represents net debt of HK$39,601 million (31 December 2022: HK$41,994 million), which comprises loans and other obligations, short-term loans, obligations under service concession and loans from holders of non-controlling interests net of cash, bank balances and deposits in the consolidated statement of financial position, as a percentage of the total equity of HK$177,661 million (31 December 2022: HK$179,912 million)*

Net Assets

Our financial position remains strong. The Group's net assets decreased slightly by 1.3% to HK$177,661 million as at 30 June 2023. This was mainly due to the accrual for the 2022 final ordinary dividend for payment in July 2023, which was partly mitigated by the net profit recognised for the six months ended 30 June 2023.

Total Assets

Total assets increased slightly by 4.5% to HK$341,726 million. This was mainly due to the increase in cash, bank balances and deposits as well as the receipt of our shopping mall THE SOUTHSIDE as an investment property.

Total Liabilities

Total liabilities increased by 11.5% to HK$164,065 million. This was mainly due to the accrual for the 2022 final ordinary dividend and the net drawdown of loans, as well as deferred income retained regarding a portion of the gain from the initial fair value measurement of THE SOUTHSIDE shopping mall after considering the outstanding risks and obligations relating to THE SOUTHSIDE Package 3 property development project.

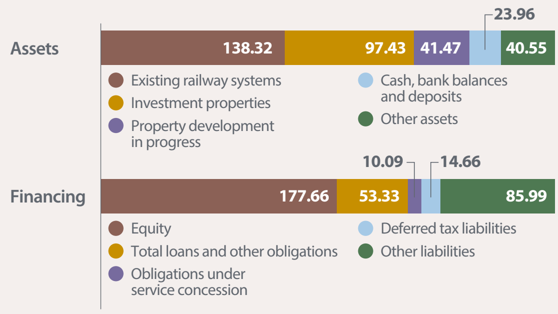
Gross Debt and Cost of Borrowing

As at 30 June 2023, gross debt of the Group (being loans and other obligations, and short-term loans) increased by 11.5% or HK$5,484 million from 31 December 2022. Weighted average borrowing cost of the Group's interest-bearing borrowings for the six months ended 30 June 2023 was at 3.3% p.a., an increase of 1.1% points over the same period in 2022.

Simplified Consolidated Financial Position

As at 30 June 2023

(HK$ billion)



Net Debt-to-equity Ratio and Interest Cover

Net debt-to-equity ratio decreased by 1.0% point to 22.3% as at 30 June 2023 from 23.3% as at 31 December 2022. This was mainly due to the decrease of net debt. The Group's interest cover for the six months ended 30 June 2023 was 9.2 times, compared to 19.8 times during the same period in 2022.

CONSOLIDATED CASH FLOWS

	Six months ended 30 June	
HK$ million	**2023**	2022
Net Cash Generated from Operating Activities	**3,870**	**3,775**
Net Receipts from Property Development	**4,533**	11,152
Variable Annual Payment	**(323)**	(260)
Other Net Cash Outflow from Investing Activities	**(4,995)**	(4,270)
Net Cash (Used in)/Generated from Investing Activities	**(785)**	**6,622**
Net Drawdown/(Repayment) of Debts, Net of Lease Rental and Interest Payments	**5,223**	(4,362)
Other Net Cash Outflow from Financing Activities	**(376)**	(109)
Net Cash Generated from/(Used in) Financing Activities	**4,847**	**(4,471)**
Effect of Exchange Rate Changes	**(110)**	(475)
Increase in Cash, Bank Balances and Deposits, Net of Bank Overdraft	**7,822**	**5,451**

Net Cash Generated from Operating Activities

Net cash generated from operating activities was HK$3,870 million for the six months ended 30 June 2023 compared to HK$3,775 million for the same period in 2022. This was mainly due to the increase in operating profit as discussed above, offset by the higher tax payment made during the period.

Net Receipts from Property Development

Net receipts from property development were HK$4,533 million, comprising mainly cash receipts from THE PAVILIA FARM.

Other Net Cash Outflow from Investing Activities

Other net cash outflow from investing activities was HK$4,995 million, which mainly included capital expenditure of HK$5,200 million comprising HK$3,744 million for investments in additional assets such as station renovation works, new trains and signalling systems for existing Hong Kong railways and related operations; HK$770 million for Hong Kong railway extension projects, primarily initial works for RDS 2014 projects; HK$512 million for Hong Kong investment properties, in particular the fitting-out works for The Wai; and HK$174 million for Mainland China and overseas subsidiaries such as Shenzhen Metro Line 13.

FINANCING ACTIVITIES

The United States Federal Reserve continued to hike interest rates in the first half of 2023, bringing the Federal Funds Target Rate to a range of 5%-5.25% p.a. as core inflation rates remained elevated.

The 3-month USD Libor increased from 4.77% p.a. at the beginning of the year to 5.55% p.a. by the end of June, whereas the 3-month HKD Hibor started the year at 4.99% p.a. and fell to a low of 3.42% p.a. in February before rising again to 4.97% p.a. The 10-year US Treasury yield fell from 3.87% p.a. to 3.84% p.a., and the 10-year HKD swap rate fell from 3.88% p.a. to 3.87% p.a.

In the first half of 2023, the Company arranged HK$8.5 billion worth of debt financing, including HK$7.5 billion from MTN issuances with maturities ranging between two to three years and a HK$1 billion three-year bank loan. Approximately HK$930 million of the financing was arranged under our Sustainable Finance Framework, with proceeds earmarked for eligible investments.

The Group's consolidated gross debt position at the end of June 2023 was HK$53.3 billion, with a cash and deposit balance of HK$24.0 billion and undrawn committed facilities of over HK$13 billion.

The weighted average cost of the Group's interest-bearing borrowings over the first six months was 3.3% p.a. as compared to 2.2% p.a. for the same period in 2022. As at the end of June 2023, around 68% of the Group's borrowings were fixed-rate borrowings with an average interest rate of 2.8% p.a. and maturity of 9.9 years.

Preferred Financing Model and Debt Profile

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

(Preferred Financing Model) vs. **Actual debt profile** as at 30 June 2023