

## Chairman's statement

We opened the Tseung Kwan O Line in August, four months ahead of schedule, 47.5% below the original project budget, and were awarded both the Penny's Bay Rail Link and the Tung Chung Cable Car projects. We successfully tendered out three development packages along the Tseung Kwan O Line and continued to make good progress on development of other property projects along the Airport Railway. Despite the poor business environment, the Group achieved satisfactory profits of HK\$4,212 million, a slight decrease of 1.5% over 2001. Correspondingly, earnings per share were HK\$0.83 compared with HK\$0.85 in 2001.

The Board of Directors has proposed a final dividend of HK\$0.28 per share which, when combined with the interim dividend of HK\$0.14 per share, would result in total dividends for the year of HK\$0.42 per share. As in previous years, shareholders will be given an option to receive dividends in either cash or scrip. The Government has undertaken to elect to receive its entitlement in scrip form in such amount as to ensure that a maximum of 50% of the total dividend paid by the Company will be in the form of cash. Furthermore, under the project agreement for the Penny's Bay Rail Link, the Government has undertaken to waive all amounts of cash dividends payable to it up to an amount of HK\$798 million at net present value. Therefore, there will be no cash payment of the final dividend to the Government for the year.

### An eventful 2002

The key objectives for 2002, which I highlighted in our annual report last year, were achieved. Despite continued economic weakness and severe competition from buses, total patronage increased by 2.5% to 786 million as the new Tseung Kwan O Line increased our catchment area and helped reverse the recent declining trend. Indeed, on Christmas Eve 2002, MTR patronage reached a record 3.1 million.

One strategy to increase ridership included improvement of linkages with other modes of transport and to this end, we extended our trial intermodal fare discount scheme for passengers using feeder buses and installed "Fare Saver" machines in five shopping arcades near MTR stations to allow passengers with longer walks to stations to obtain fare discounts. We also increased patronage through other well-received discount initiatives such as the "Ride 10 Get One Free" scheme, group tickets and concession fares on the Airport Express Line (AEL).

During the year, MTR continued to maintain very high standards of service, which surpassed both the Government's requirements under the Operating Agreement and the Company's own more stringent Customer Service Pledges. We initiated a number of service enhancements, including a morning express service from Tsing Yi Station to Hong Kong Station using the rapid and comfortable AEL trains, while progress on the Platform Screen Door and Station Improvement programmes brought a more modern and pleasant look to more MTR stations. Our ability to raise service quality whilst keeping costs down is particularly noteworthy considering the Tseung Kwan O Line was opened without corresponding increase in staff levels.

The Tseung Kwan O Line marked another milestone for the Company. The early opening and savings of over HK\$14.5 billion against the original budget testify to the Company's track record of delivering new lines on time and within budget. Despite some initial "teething" problems with the new train control system immediately after commissioning, the extension is offering an excellent service to the residents of Tseung Kwan O and we are pleased with the resultant incremental patronage.

After carefully reviewing economic conditions in Hong Kong and in the overall interest of the Company, the Board of Directors decided not to implement a fare increase of 2.3% originally scheduled for April 2002.

Our non-fare revenues continued to grow. External consulting business experienced another year of strong growth in revenues and scope particularly in Mainland China, where we secured assignments in Tianjin, Shanghai, Nanjing and Shenzhen. While advertising was affected by the weak economy, station commercial revenues rose as floor space increased following the opening of the Tseung Kwan O Line and the completion of the project to increase the range and quality of retail outlets at Central and Kowloon Bay stations, including the introduction for the first time of food and beverage outlets. In telecommunications, increased mobile phone usage generated higher revenues and we established a new subsidiary, TraxComm Limited, to exploit the opportunities expected to arise from the recent liberalisation of the Hong Kong fixed line telephone market. Octopus Cards Limited achieved further penetration in the transport market and expansion in the non-transport sector, with the number of cards in circulation increasing to 9.3 million.

We were disappointed that the Government decided not to award MTR the Shatin-Central Link project despite our very competitive proposal, but were pleased to reach agreement with the Government on the Penny's Bay Rail Link and, on a provisional basis, the Tung Chung Cable Car project, which are planned for completion in 2005. With the reduced population forecast for Hong Kong and adequate capacity in our system serving the northern part of Hong Kong and cross harbour routes, we agreed with the Government's decision in early 2003 to defer completion of the North Island Link until after 2016.

Despite the weak property market, we achieved a 15.6% increase in profits from property development to HK\$3,755 million in 2002, the bulk of which was derived from transfers from deferred income and the recognition of profit sharing in kind from Kowloon Station Package Two. During the year, we awarded to developers three more residential property development projects on the Tseung Kwan O Line at Area 55b in Tseung Kwan O Station, Hang Hau Station and Tiu Keng Leng Station. Good progress was made in the development and sale of Airport Railway property projects, including construction of the 88-storey Two International Finance Centre (Two IFC), which is due for completion in mid 2003. Our portfolio of investment properties also delivered increased revenues of 9.8% and enjoyed 100%

occupancy levels. The property management division was awarded the first management contracts in Mainland China. In November, the Government announced new measures to stabilise the housing market, including a suspension of land auctions in 2003. The Company, as a significant developer of residential properties in joint venture with our partners, supports these initiatives and has agreed in consultation with the Government to postpone property development tenders until after 2003.

Despite the challenging operating environment, MTR achieved satisfactory financial results. While total fare revenues for the MTR Lines increased only marginally, to HK\$5,167 million, and those of AEL declined by 2.0% to HK\$553 million, station commercial and other revenues rose 0.6% to HK\$979 million, resulting in revenues from railway operations being virtually unchanged from 2001 at HK\$6,699 million. Combined with higher rental and property management income, total revenue increased by 1.2% to HK\$7,686 million. Cost savings and productivity gains continued. Excluding a one-time write-off largely relating to project study and deferred expenditures for the Shatin-Central Link and North Island Link, operating costs decreased by 2.0% to HK\$3,454 million, despite the opening of the new Tseung Kwan O Line. As a result, operating margin before depreciation, interest and write-offs increased to 55.1% from 53.6% (as restated). Correspondingly, after taking into account of the write-offs, operating profit before depreciation and interest decreased marginally to HK\$4,014 million from HK\$4,053 million last year. However, with the increased property development profits, operating profit before depreciation increased by 6.4% to HK\$7,769 million.

After the opening of the Tseung Kwan O Line, depreciation and interest charges increased significantly by 13.4% and 28.7% respectively. The year-end profit after depreciation and interest reduced slightly to HK\$4,212 million, almost the same as 2001. However, we continued to take advantage of the low interest rate environment to launch an extremely successful HK\$3.5 billion retail bond, which attracted subscriptions of more than HK\$5.6 billion from over 18,000 investors.

### Wider horizons

Although outlook for 2003 remains uncertain, the Company foresees a number of opportunities for business and revenue growth.

With the opening of the Tseung Kwan O Line and a larger catchment area, we look forward to a further rise in patronage. We also expect a further passenger increase when the Kowloon-Canton Railway Corporation's West Rail opens in late 2003 and begins feeding passengers from the western New Territories into our system via our new Nam Cheong interchange station and pedestrian link at Mei Foo Station. The attractiveness of travelling on MTR will be enhanced with the progress of both our Platform Screen Door and Station Improvement projects.

Construction of the Penny's Bay Rail Link and, subject to formalisation of a project agreement, the Tung Chung Cable Car project, will proceed in earnest during 2003. Presently, all major contracts have been awarded for the Penny's Bay Rail Link, which when completed in 2005 will provide a convenient and

swift access to the future Hong Kong Disney Theme Park via a new station at Yam O on the Tung Chung Line. The Tung Chung Cable Car project together with a theme village will transform travel to the Big Buddha on Lantau Island, creating a new tourist attraction. In early 2003, the Government requested the Company to proceed with the planning of the South Island Line and West Island Line Phase I. We welcome the Government's request and will work closely with the Government to pursue the most cost effective transport solution for the western and southern districts of Hong Kong Island.

On the property side, Two IFC is on target to be available for occupation in the third quarter of 2003 and we expect increasing momentum in tenant leasing as the year progresses. Anchor tenant marketing will begin for MTR's fifth shopping centre at Union Square in Kowloon Station whilst our existing shopping centres are expected to continue to perform well. Property management business will grow as more properties come under management, particularly along the Airport Railway, and as we provide other value-added services and expand further into Mainland China.

Mainland China will be a major focus in our rapidly expanding rail consulting business, given the country's substantial need for urban rail networks. In telecommunications, TraxComm Limited positions the Company well to capture the opportunities in the fixed line telephone market. In advertising, we will continue to examine new formats of station and in-train advertising to enhance our revenue. Renovation work on five more stations will be completed in 2003 and this will enable us to maximise station commercial revenue through better trade mix and retail environments. We expect Octopus Cards to penetrate further into the transport and non-transport markets, with increasing card circulation and transaction volumes.

The Company's financial position remains strong. We will continue our policy of cost control, increase productivity and improve efficiency, thereby further strengthening our financial position. With capital expenditures projected to be modest in the coming years, our financial health and substantial financing capacity will enable us to take advantage of new business opportunities.

The Government announced in June 2002 that it is undertaking a study on the possible merger of MTR and the Kowloon-Canton Railway Corporation. Although the results of this study are still not yet known, at this preliminary stage, the Company's position is that, if properly structured and implemented on acceptable terms, a merger would be beneficial to all our stakeholders including our investors, our passengers, our employees and the overall Hong Kong rail transport system. We recognise the importance that financial terms of any possible merger must be value enhancing to the Company. We look forward to the conclusion of the Government's study on this matter. We will ensure that the Company will comply with all relevant requirements under the Rules Governing the Listing of Securities on the Exchange.

I would stress that if terms acceptable to the Company cannot be reached, MTR will continue to succeed as a "standalone" company without the merger.

### Sustainable development

MTR is helping to deliver the vision of sustainable development by providing equitable access to affordable, safe, reliable and highly energy efficient transportation. We play a significant role in reducing the environmental impacts of moving millions of people, as road traffic produces vastly more atmospheric pollution per passenger than MTR. By establishing new communities along railways, MTR also maximises the use of Hong Kong's scarce land resources, improves its quality of life and allows its passengers to enjoy more time for life.

In 2002, we became the first Hong Kong company to publish a Sustainability Report, which detailed performance against targets on sustainability criteria. Our efforts in this area were rewarded by recognition from the international investment community and inclusion in both the Dow Jones Sustainability World Index and the FTSE4Good Global Index, making MTR one of the few Asian companies to meet the globally recognised standards required.

### Commitment to high standards of corporate governance and disclosure practices

The Company is committed to high standards of corporate governance, and disclosure and transparency in the interests of shareholders and lenders. In recognition of our success in this area, we were voted the "Best in Corporate Governance" in the Hong Kong transportation industry by *Asiamoney* Magazine. Our 2001 Annual Report also won the Gold Award under the General Category in the Hong Kong Management Association's 2002 Best Annual Reports Competition, the fourteenth consecutive time since 1988 that our annual report has been recognised by the Association.

### Well positioned for 2003

The world is facing political and economic uncertainties, and Hong Kong its own structural adjustments, and 2003 will be a challenging year. With a strong platform of tightly integrated businesses, sound finances and a highly skilled and motivated workforce, MTR is well positioned to meet these challenges and to capture opportunities that will arise in Hong Kong and other markets.

Our key objectives for 2003 will be to:

- Maintain tight control on costs, so as to further improve productivity and efficiency.
- Increase patronage by taking advantage of our expanded network and tighter linkage with other modes of transport, as well as through enhanced service quality and other value-added products and services.
- Achieve the published customer pledges for the railway.
- Progress work on the Penny's Bay Rail Link and Tung Chung Cable Car projects to ensure timely completion within budget.
- Work closely with the Government to plan for the design, construction and finance of the South Island Line and West Island Line Phase I.
- Forge ahead with sales and construction work of tendered property projects on the Airport Railway and Tseung Kwan O Line.

- Await and respond promptly to Government's decision on the possible merger between the Company and the Kowloon-Canton Railway Corporation.
- Continue to expand consultancy services and project operations into Mainland China.
- Continue to grow non-fare revenue from businesses such as Octopus Cards, advertising, station retail and telecommunications.

I informed the Board of Directors in February this year that I will not seek to renew my contract as Chairman and Chief Executive Officer of MTR when my contract expires in September 2003. This decision was made for personal reasons. In the last eight years during my tenure as Chairman and Chief Executive Officer, the Company has made a lot of progress, which I would attribute to the dedication and hard work of all the employees of MTR and the support of our business partners. The Board of Directors is in the process of finalising a course of action on succession.

Finally, I would like to take this opportunity to express my gratitude once again to my fellow directors, senior managers and all staff for their hard work and commitment during this challenging period. I also thank our shareholders, financiers and business partners for their invaluable support.



Jack So Chak-kwong, *Chairman*  
Hong Kong, 6 March 2003