

Report of the Members of the Board

The members of the Board have pleasure in submitting their Report and the summary financial statements for the financial year ended 31 December 2002.

Principal Activities of the Group

The principal activities of the Company and its subsidiaries are:

- A** the operation of a mass transit railway system with lines from Central to Tsuen Wan (Tsuen Wan Line), from Yau Ma Tei to Tiu Keng Leng (Kwun Tong Line), from Po Lam to North Point (Tseung Kwan O Line), from Chai Wan to Sheung Wan (Island Line), from Hong Kong to Tung Chung (Tung Chung Line) and from Hong Kong to the Hong Kong International Airport at Chek Lap Kok (Airport Express Line);
- B** property development at locations relating to the railway system including the Tseung Kwan O Extension;
- C** related commercial activities, including the letting of advertising and retail space, bandwidth services on the railway system, property management and leasing management of investment properties, property agency and Octopus Card Building Access System services;
- D** the construction of the Tseung Kwan O Extension;
- E** the design and construction of the Penny's Bay Rail Link;
- F** the design, construction and operation of the Tung Chung Cable Car Project and related tourist development;
- G** the planning and construction of future extensions to the railway system and other related infrastructure projects;
- H** consultancy services covering all areas of expertise required in the project management, planning, construction, operation, maintenance and up-grading of railways plus fare collection, property integration/development advice including other property related services and advice on generation of non-fare revenues; and
- I** the operation of a smart card system by Octopus Cards Limited, a subsidiary of the Company, for the collection of payments for both transport and non-transport applications.

Dividend

The Directors have recommended a final dividend of HK\$0.28 per Ordinary Share to be payable to shareholders whose names appear on the Register of Members of the Company on 2 April 2003. Subject to the passing of the necessary resolution at the forthcoming Annual General Meeting, such dividend will be payable on or about 12 June 2003, in cash in Hong Kong dollars, with a scrip dividend alternative.

Members of the Board

Members of the Board who served during the year were Jack So Chak-kwong (Chairman and Chief Executive), Cheung Yau-kai, Raymond Ch'ien Kuo-fung, David Gordon Eldon, David Wylie Gairns (resigned on 31 August 2002), T Brian Stevenson (appointed on 1 October 2002), Edward Ho Sing-tin, Lo Chung-hing, the Commissioner for Transport (Robert Charles Law Footman), the Secretary for Transport (Nicholas Ng Wing-fui until retirement on 2 April 2002) and Denise Yue Chung-ye. Following the reorganisation within the Government and with effect from 1 July 2002, the Secretary for Transport (acting by Paul Tang Kwok-wai) and Denise Yue Chung-ye were replaced by the Secretary for the Environment, Transport and Works (Dr. Sarah Liao Sau-tung) and Frederick Ma Si-hang respectively.

The Chairman informed the Board on 12 February 2003 that he would not seek to renew his contract as Chairman and Chief Executive of the Company when his current contract expires in September 2003.

Raymond Ch'ien Kuo-fung and Lo Chung-hing retired by rotation at the Annual General Meeting on 16 May 2002 and were re-elected as members of the Board.

Cheung Yau-kai, Edward Ho Sing-tin, T Brian Stevenson and Frederick Ma Si-hang will retire by rotation at the forthcoming Annual General Meeting (in accordance with the Company's Articles of Association) and offer themselves for re-election.

Brief biographical details for Board Members are set out on page 12.

Alternate Directors

The Alternate Directors in office during the year were (i) Martin Mckenzie Glass (for Denise Yue Chung-ye), (ii) the Deputy Secretary for Transport (for the Secretary for Transport), (iii) Martin Mckenzie Glass and Alan Lai-nin (both for Frederick Ma Si-hang with effect from 24 July 2002), (iv) both the Permanent Secretary for the Environment, Transport & Works (Rita Lau Ng Wai-lan) with effect from 8 August 2002 and the Deputy Secretary for the Environment, Transport & Works (Paul Tang Kwok-wai, Arthur Ho Kin-wah and Margaret Fong Shun-man) on 1 July 2002 (for the Secretary for the Environment, Transport & Works), and (v) Dorothy Chan [replaced by the Deputy Commissioner for Transport/Transport Services and Management (Judy Li Wu Wai-lok) on 30 September 2002] (for the Commissioner for Transport).

Martin Mckenzie Glass and the Deputy Secretary for Transport ceased to be Alternate Directors to Denise Yue Chung-ye and the Secretary for Transport respectively following their cessation as Members of the Board.

Executive Directorate

The members of the Executive Directorate who served during the year were Jack So Chak-kwong (Chairman and Chief Executive), a member of the Board of Directors, and Russell John Black, William Chan Fu-keung, Philip Gaffney, Thomas Ho Hang-kwong, Lincoln Leong Kwok-kuen and Leonard Bryan Turk.

Lincoln Leong Kwok-kuen was appointed as the new Finance Director on 1 February 2002 following the resignation of Clement Kwok King-man who resigned as Finance Director on 31 January 2002.

Brief biographical details for members of the Executive Directorate during the year are set out on page 12.

Corporate Governance

The Company is committed to ensuring high standards of corporate governance in the interests of shareholders and devotes considerable effort to identifying and formalising best practices.

The overall management of the Company's business is vested in the Board of Directors. Pursuant to the Company's Articles of Association and the Protocol adopted by the Board of Directors, the Board of Directors has delegated the day-to-day management of the Company's business to the Executive Directorate, and focuses its attention on matters affecting the Company's finances and shareholders.

The Company takes care to ensure the Board is in a position to exercise its powers in an informed manner. The Board of Directors meets regularly and members of the Board receive information between meetings about developments in the Company's business. All members of the Board of Directors have full and timely access to relevant information and may take independent professional advice if necessary. The Board of Directors held 14 meetings in 2002 and the average attendance rate was 82.06%.

As an integral part of good corporate governance the following committees have been established. All the members of those committees are non-executive Directors.

Audit Committee

The Audit Committee meets four times each year to review the completeness, accuracy and fairness of the Group's financial statements and to consider the nature and scope of internal and external audit reviews. It also assesses the effectiveness of the systems of internal control. Internal control systems have been designed to allow the Board of Directors to monitor the Company's overall financial position and to protect its assets. The purpose is to guard against material financial misstatement or loss. The Board of Directors is responsible for these systems and appropriate authorisations and guidelines are in place. The Audit Committee Chairman also prepares an annual report to the Board of Directors covering its activities for the year and highlighting issues which the Chairman deems significant.

The members of the Audit Committee are T Brian Stevenson (chairman), Cheung Yau-kai and the Commissioner for Transport (Robert Charles Law Footman), two of whom are independent non-executive Directors. There were four meetings of the Audit Committee in year 2002 and the average attendance rate was 91.7%. The external auditors, the Finance Director and the Head of Internal Audit Department attended to answer questions on the reports or their work.

Remuneration Committee

The Remuneration Committee meets regularly to consider human resources issues, including the terms and conditions of employment, remuneration and retirement benefits of the Chairman and Chief Executive and members of the Executive Directorate. The members of the Remuneration Committee are Raymond Ch'ien Kuo-fung (chairman), Edward Ho Sing-tin and Frederick Ma Si-hang, two of whom are independent non-executive Directors. There were three meetings of the Remuneration Committee in year 2002 and the attendance rate was 100%.

Nominations Committee

The Nominations Committee carries out the process of recommending and nominating candidates to fill vacancies on the Board of Directors. A person may be appointed as a member of the Board of Directors at any time either by the shareholders in general meeting or by the Board of Directors upon the recommendation of the Nominations Committee. Directors who are appointed by the Board of Directors must retire at the first annual general meeting after their appointment. In either case, the Directors so elected and appointed are eligible for re-election and re-appointment. At each annual general meeting of the Company, one third of the Directors (or such number as is nearest to and less than one third) are required to retire from office by rotation (excluding the Directors appointed by the Chief Executive of the Hong Kong SAR under the Mass Transit Railway Ordinance).

The members of the Nominations Committee are David Gordon Eldon (chairman), Lo Chung-hing and the Secretary for the Environment, Transport and Works (Dr. Sarah Liao Sau-tung), two of whom are independent non-executive Directors. There was only one meeting of the Nominations Committee in year 2002 and the attendance rate was 66.67% (due to the absence of a Director who was away from Hong Kong).

Code of Best Practice

The Company has complied throughout the year with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, except that non-executive Directors of the Company are not appointed for a specific term but are subject (save for those appointed pursuant to Section 8 of the Mass Transit Railway Ordinance) to retirement by rotation and re-election at the Company's annual general meetings in accordance with Articles 87 and 88 of the Company's Articles of Association.

U.S. Sarbanes-Oxley Act 2002

This legislation which seeks to enhance the transparency and accountability of companies in the areas of corporate governance and financial reporting, was signed into law by the President of the United States on 30 July 2002.

As the Company is a U.S. Securities and Exchange Commission reporting company, it is generally bound by this new legislation.

The Company is in the process of reviewing the existing internal systems and practices and taking other steps to comply with the relevant provisions.

Internal Audit

The Company's Internal Audit Department provides independent, objective assurance and consulting services designed to add value and improve the Company's operations. Key responsibilities of the Department include:

- Assessments on the adequacy and effectiveness of the Company's system of internal control for controlling its activities and managing its risks.
- Identification of opportunities for improving management control, resources utilisation and profitability.
- Special reviews and/or investigations as commissioned by Company management.

The Company's Internal Auditor reports directly to the Chairman and has direct access to the Audit Committee.

Ethical Culture

The Company is committed to high standard of business ethics and integrity.

Following the publication of the MTR's Code of Conduct in 2002, the Company has carried out an extensive training and communication campaign to ensure all levels of staff understand the content of the Code and the philosophy behind an ethical working culture. All employees were issued a personal copy of the Code of Conduct and in addition, each manager was issued a Corporate Guidebook for Managers containing illustrative examples for better communication with employees.

To promote similar practices with contractors and make the Code available for interested shareholders, customers and other interested parties, the Company has placed the Code of Conduct on the MTR website for public access.

Policies

The Board has adopted risk strategies on the following matters:

- A** Construction and insurance;
- B** Finance;
- C** Treasury risk management;
- D** Safety risk management;
- E** Security management;
- F** Environmental management.

No changes to such policies may be made without the approval of the Board of Directors.

Summary Financial Statements

The state of affairs of the Group as at 31 December 2002 and of its results for the year are set out in the summary financial statements on pages 18 to 23.

Ten-Year Statistics

A summary of the results and of the assets and liabilities of the Group together with some major operational statistics for the last ten years are set out on pages 10 to 11.

Fixed Assets and Railway Construction in Progress

Movements in fixed assets and railway construction in progress during the year are set out in Note 4 to the summary financial statements.

Movements in Reserves

Movements in reserves during the year are set out in Note 6 to the summary financial statements.

Share Capital

As at 31 December 2001, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,055,229,742 of which were issued and credited as fully paid. During the year, the Company issued a total of 103,518,913 Ordinary Shares. Of this number:

- A** 4,362,000 Ordinary Shares were issued by the Company pursuant to the exercise of share options which had been granted under the Company's Pre-Global Offering Share Option Scheme. In respect of each Ordinary Share issued, the relevant exercising share option holder paid HK\$8.44 to the Company;
- B** 63,322,970 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the final dividend of the Company for the year ended 31 December 2001 (for which the cash dividend was HK\$0.28 per Ordinary Share); and
- C** 35,833,943 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the interim dividend of the Company for the six months ended 30 June 2002 (for which the cash dividend was HK\$0.14 per Ordinary Share).

As at 31 December 2002, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,158,748,655 of which were issued and credited as fully paid.

Redemption of Listed Securities

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of its listed securities during the financial year 2002.

Donations

During the year, a total of HK\$273,650 was donated, of which HK\$245,650 went to the Community Chest of Hong Kong.

To demonstrate our commitment to supporting charitable causes and promoting 'Green' initiatives, the Company provided 30,000 free tickets for the Community Chest Green Day in 2002.

Internal Control

The Board of Directors is responsible for ensuring that there is in place a satisfactory system of internal control. The main objectives are to ensure adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

A function of the Audit Committee is to review the effectiveness of the system of internal control from information provided by the Executive Directorate and management of the Company and by the auditors.

Reporting and Monitoring

There is a comprehensive budgeting system for all operational and business activities, with an annual budget approved by the Board of Directors. Monthly results of the Company's operations, businesses and projects are reported against the budget to the Board of Directors and updated forecasts for the year are prepared regularly.

Treasury Management

The Company's Treasury Department operates within approved guidelines from the Board. It manages the Company's debt profile according to the Preferred Financing Model which defines the preferred mix of financing instruments, fixed and floating rate debts, maturities, interest rate risks, currency exposure and financing horizon. The model is reviewed and refined periodically to reflect changes in the Company's financing requirements and market environment. Derivative financial instruments such as interest rate swaps and cross currency swaps are used only as hedging tools to manage the Group's interest rate and currency risks. Prudent guidelines and procedures are in place to control the Company's derivatives activities, including a comprehensive credit risk management system for monitoring counterparty credit exposure using the Value-at-Risk approach. There is also appropriate segregation of duties within the Company's Treasury Department.

Major financing transactions and guidelines for derivatives transactions including credit risk management framework are approved at the Board level.

Capital and Revenue Expenditure

There are defined procedures for the appraisal, review and approval of major capital and revenue expenditures. All project expenditure over 0.2% of the net assets of the Company and the employment of consultancy services over 0.1% of the net assets of the Company require the approval of the Board.

Bonds and Notes Issued

The Group issued retail bonds during the year ended 31 December 2002, details of which are set out in Note 5 to the summary financial statements.

Such bonds were issued in order to meet the Group's general corporate funding requirements, including the financing of new capital expenditure and the refinancing of maturing debts.

Computer Processing

There are defined procedures and regular quality reviews on the operation of computer systems to ensure the accuracy and completeness of financial records and efficiency of data processing. The Company's computer centre operation and support has been certified under ISO 9002.

Interests in Contracts of Members of the Board and the Executive Directorate

There was no contract of significance, to which the Company or any of its subsidiaries was a party and in which a member of the Board or a member of the Executive Directorate had a material interest (whether direct or indirect), subsisted at the end of the year or at any time during the year.

Board Members' and Executive Directorate's Interests in Shares

At 31 December 2002, the interests of the members of the Board of Directors and the Executive Directorate in the equity securities of the Company as recorded in the register required to be kept under section 29 of the Securities (Disclosure of Interests) Ordinance ("SDI") or as otherwise notified to the Company and The Stock Exchange of Hong Kong Limited ("SEHK") pursuant to the Model Code for Securities Transactions by Directors of Listed Companies were as follows:-

Ordinary Shares

Member of the Board of Directors or Executive Directorate	Number of Ordinary Shares		
	Personal interests	Family interests	Total interests
Jack So Chak-kwong	80,358	–	80,358
T Brian Stevenson	4,102	–	4,102
Russell John Black	47,187	–	47,187
William Chan Fu-keung	46,233	–	46,233
Philip Gaffney	46,358	588	46,946
Thomas Ho Hang-kwong	48,226	2,358	50,584
Leonard Bryan Turk	46,554	2,329	48,883

Bond

Member of the Executive Directorate	Personal interests
William Chan Fu-keung	HK\$101,010 MTR 201 3.75 per cent. Notes due 2004
	HK\$50,740 MTR 301 4.50 per cent. Notes due 2005

Options to subscribe for Ordinary Shares granted under the Share Option Scheme, as referred to in Note 2B to the summary financial statements

Member of Board of Directors or Executive Directorate	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2002	Options vested during the year	Options lapsed during the year	Options exercised during the year	Price per share paid on exercise of options	Options outstanding as at 31 Dec 2002	Weighted average closing price of shares immediately before options were exercised
Jack So Chak-kwong	20/9/2000	1,599,000	5/4/01 – 11/9/10	1,599,000	533,000	–	–	–	1,599,000	–
Russell John Black	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	23,000	\$8.44	1,022,000	\$9.20
William Chan Fu-keung	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	23,000	\$8.44	1,022,000	\$9.15
Philip Gaffney	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	23,000	\$8.44	1,022,000	\$9.15
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,044,000	355,500	–	23,000	\$8.44	1,021,000	\$9.05
Leonard Bryan Turk	20/9/2000	1,066,000	5/4/01 – 11/9/10	1,045,000	355,500	–	22,500	\$8.44	1,022,500	\$9.20
Other eligible employees	20/9/2000	40,343,000	5/4/01 – 11/9/10	36,324,500	12,341,000	2,104,500	4,165,000	\$8.44	30,055,000	\$10.36

Save as disclosed above:

A there were no interests held as at 31 December 2002 by any members of the Board of Directors or Executive Directorate of the Company in securities of the Company and its associated corporations (within the meaning of the SDI);

B during the year ended 31 December 2002, no member of the Board of Directors or Executive Directorate nor any of their spouses or children under 18 years of age held any rights to subscribe for equity or debt securities of the Company nor had there been any exercises of any such rights by any of them, as recorded in the register kept by the Company under section 29 of the SDI or otherwise notified to the Company and the HKSE pursuant to the Model Code for Securities Transactions by Directors of Listed Companies; and

C out of 1,066,000 options granted on 20 September 2000 to Clement Kwok King-man, Finance Director (resigned on 31 January 2002), 793,000 options remained outstanding as at 1 January 2002. During the year ended 31 December 2002, 82,500 options were exercised and 710,500 options lapsed. The weighted average closing price of shares immediately before those options were exercised was HK\$10.20 per share.

Substantial Shareholders' Interests

Set out below is the name of the party which was interested in 10 per cent. or more of the nominal value of the share capital of the Company and the respective relevant numbers of shares in which it was interested as at 31 December 2002 as recorded in the register kept by the Company under Section 16 (1) of the SDI:

Name	No. of Ordinary Shares
Financial Secretary Incorporated (in trust on behalf of the Government)	3,928,221,249

Major Suppliers and Customers

Less than 30% in value of supplies (which were not of a capital nature) purchased during the year ended 31 December 2002 was attributable to the Company's five largest suppliers. Less than 30% in value of the Company's turnover during the year ended 31 December 2002 was attributable to the Company's five largest customers combined by value.

Going Concern

The summary financial statements on pages 18 to 23 have been prepared on a going concern basis. The Board of Directors has reviewed the Company's budget for 2003, together with the longer-term forecast for the following five years and is satisfied that the Company has sufficient resources to continue as a going concern for the foreseeable future.

By order of the Board

Leonard Bryan Turk
Secretary to the Board
Hong Kong, 6 March 2003