

# Report of the Members of the Board

The members of the Board have pleasure in submitting their Report and the audited statement of Accounts for the financial year ended 31 December 2003.

## 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 (including shopping centres and offices), property agency and Octopus Card Building Access System services;
- D** the construction of the Penny's Bay Rail Link;
- E** the design, construction and operation of the Tung Chung Cable Car Project and related tourist development;
- F** the planning and construction of future extensions to the railway system and other related infrastructure projects;
- G** 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;
- H** 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; and
- I** equity investments and long term operation and maintenance contracts outside of Hong Kong.

## 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 2004. Subject to the passing of the necessary resolution at the forthcoming Annual General Meeting, such dividend will be payable on or about 30 June 2004, 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 Raymond Ch'ien Kuo-fung (appointed non-executive Chairman with effect from 21 July 2003), Jack So Chak-kwong (whose term of office as Chairman and Chief Executive expired on 20 July 2003 and who ceased to be a member of the Board with effect from the same date), Chow Chung-kong (appointed Chief Executive Officer and a member of the Board with effect from 1 December 2003), Cheung Yau-kai, David Gordon Eldon, T. Brian Stevenson, Edward Ho Sing-tin, Lo Chung-hing, Frederick Ma Si-hang, the Secretary for the Environment, Transport and Works (Dr. Sarah Liao Sau-tung) and the Commissioner for Transport (Robert Charles Law Footman).

Christine Fang Meng-sang was appointed a Member of the Board with effect from 1 January 2004.

At the Annual General Meeting on 15 May 2003 and pursuant to the Company's Articles of Association ("Articles"), Cheung Yau-kai, Edward Ho Sing-tin, T. Brian Stevenson and Frederick Ma Si-hang retired under the Company's Articles of Association and were re-elected as members of the Board.

At the forthcoming Annual General Meeting and in accordance with the Articles, Raymond Ch'ien Kuo-fung and David Gordon Eldon will retire by rotation. Chow Chung-kong and Christine Fang Meng-sang, who were appointed by the Board after the 2003 Annual General Meeting, will retire under Article 85 of the Articles. All these four Board members will offer themselves for re-election at the forthcoming Annual General Meeting.

Brief biographical details for Board members are set out on page 60.

Following the departure of Jack So Chak-kwong mentioned above, Philip Gaffney, Operations Director was appointed Acting Chief Executive Officer with effect from 21 July 2003. He ceased to be Acting Chief Executive Officer upon the appointment of Chow Chung-kong as Chief Executive Officer with effect from 1 December 2003.

## Alternate Directors

The Alternate Directors in office during the year were (i) Martin McKenzie Glass and Alan Lai-nin (both for Frederick Ma Si-hang), (ii) both the Permanent Secretary for the Environment, Transport & Works (Rita Lau Ng Wai-lan) and the Deputy Secretary for the Environment, Transport & Works (Paul Tang Kwok-wai [who ceased to be a Deputy Secretary for the Environment, Transport & Works after 31 October 2003], Arthur Ho Kin-wah, Margaret Fong Shun-man and Annie Choi Suk-han [who was appointed as a Deputy Secretary for the Environment, Transport & Works with effect from 24 November 2003]) (for the Secretary for the Environment, Transport & Works), and (iii) the Deputy Commissioner for Transport/Transport Services and Management (Judy Li Wu Wai-lok) (for the Commissioner for Transport).

### Executive Directorate

The members of the Executive Directorate who served during the year were Jack So Chak-kwong (whose term of office as Chairman and Chief Executive expired on 20 July 2003 and who also ceased to be a member of the Executive Directorate with effect from the same date), Chow Chung-kong (appointed Chief Executive Officer and a member of the Board with effect from 1 December 2003), Russell John Black, William Chan Fu-keung, Philip Gaffney, Thomas Ho Hang-kwong, Lincoln Leong Kwok-kuen and Leonard Bryan Turk.

Brief biographical details for members of the Executive Directorate during the year are set out on page 61.

### Corporate Governance

The Company has complied throughout the year ended 31 December 2003 with the Code of Best Practice as set out in Appendix 14 of the Listing Rules, 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 MTR 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. Dr. Raymond Ch'ien Kuo-fung has been a non-executive Director since 1998. He was also appointed non-executive Chairman in July 2003 for a term of three years. Details for corporate governance are set out on pages 45 to 47.

### 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 Chief Executive Officer and has direct access to the Audit Committee.

### Business Ethics

Please refer to page 47.

### 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.

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

### Bank Overdrafts, Bank Loans and Other Borrowings

The total borrowing of the Group as at 31 December 2003 amounted to HK\$32,025 million (2002: HK\$33,508 million). Particulars of borrowings including bank overdrafts and bank loans are set out in Note 26 to the Accounts.

### Accounts

The state of affairs of the Company and the Group as at 31 December 2003 and of the Group's results, changes in equity and cash flows for the year are set out in the Accounts on pages 75 to 131.

### 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 58 to 59.

### Fixed Assets and Railway Construction in Progress

Movements in fixed assets and railway construction in progress during the year are set out in Notes 14 and 15 to the accounts respectively.

### Movements in Reserves

Movements in reserves during the year are set out in Notes 34 and 35 to the accounts.

### Share Capital

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. During the year, the Company issued a total of 129,946,738 Ordinary Shares. Of this number:

- A 10,489,500 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 (as referred in note 42A to the Accounts). In respect of each Ordinary Share issued, the relevant exercising share option holder paid HK\$8.44 to the Company;
- B 82,018,666 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 2002 (for which the cash dividend was HK\$0.28 per Ordinary Share); and
- C 37,438,572 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 2003 (for which the cash dividend was HK\$0.14 per Ordinary Share).

As at 31 December 2003, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,288,695,393 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 2003.

### Properties

Particulars of the principal investment properties and properties held for sale of the Company are shown on page 37.

## Donations

During the year, a total of HK\$579,912 was donated, of which HK\$429,912 went to the Community Chest Green Day of Hong Kong.

## 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 efficiency and effectiveness of operation, 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 bonds and notes during the year ended 31 December 2003, details of which are set out in Note 26D to the accounts. Such bonds and notes 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 9001:2000.

## 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), which subsisted at the end of the year or at any time during the year.

## Board Members' and Executive Directorate's Interests in Shares

As at 31 December 2003, the interests or short positions of the members of the Board of Directors and the Executive Directorate in the shares, underlying shares and debentures of the Company (within the meaning of Part XV of the Securities and Futures Ordinance ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the HKSE pursuant to the Model Code for Securities Transactions by the Directors of Listed Companies were as follows:

### Ordinary Shares

Member of the Board of Directors or Executive Directorate	Number of Ordinary Shares		Number of Share Options		Percentage of aggregate interests to total issued share capital
	Personal* interests	Family† interests	Personal* interests	Total interests	
T. Brian Stevenson	4,292	–	–	4,292	0.0001
Philip Gaffney	46,467	614	1,022,000 (Note 1)	1,069,081	0.0202
Russell John Black	49,384	–	–	49,384	0.0009
William Chan Fu-keung	46,233	–	822,000 (Note 1)	868,233	0.0164
Thomas Ho Hang-kwong	50,471	2,467	621,000 (Note 1)	673,938	0.0127
Lincoln Leong Kwok-kuen	–	–	1,066,000 (Note 2)	1,066,000	0.0202

## Bonds

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

\* Interests as beneficial owner

† Interests of spouse or child under 18 as beneficial owner

## Notes

1. Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the Pre-Global Offering Share Option Scheme.

2. Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the New Joiners Share Option Scheme.

## Options to subscribe for Ordinary Shares granted under the Pre-Global Offering Share Option Scheme, as referred to in Notes 5B (i) and 42A to the Accounts

Executive Directorate	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2003	Options vested during the year	Options lapsed during the year	Options exercised during the year	Price per share paid on exercise of options (HK\$)	Options outstanding as at 31 December 2003	Weighted average closing price of shares immediately before the date(s) on which options were exercised
Philip Gaffney	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	1,022,000	355,000	–	–	–	1,022,000	–
Russell John Black	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	1,022,000	355,000	–	1,022,000	8.44	–	10.48
William Chan Fu-keung	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	1,022,000	355,000	–	200,000	8.44	822,000	10.38
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	1,021,000	355,000	–	400,000	8.44	621,000	10.43
Leonard Bryan Turk	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	1,022,500	355,000	–	1,022,500	8.44	–	10.61
Other eligible employees	20/9/2000	40,343,000	5/4/2001 – 11/9/2010	30,055,000	10,087,500	1,044,500	6,246,000	8.44	22,764,500	10.03

## Notes

1. The Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") shall be valid and effective for a period of ten years after the adoption of the Pre-IPO Option Scheme on 12 September 2000. No option may be offered to be granted on or after the commencement of dealings in shares of the Company on HKSE on 5 October 2000.

2. The number of shares to which the option granted to each participant under the Pre-IPO Option Scheme does not exceed 25% of the number of the shares issued and issuable under the Pre-IPO Option Scheme.

## Options to subscribe for Ordinary Shares granted under the New Joiners Share Option Scheme, as referred to in Notes 5B (ii) and 42B to the Accounts

Executive Directorate	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2003	Options vested during the year	Options lapsed during the year	Options exercised during the year	Price per share paid on exercise of options (HK\$)	Options outstanding as at 31 December 2003	Weighted average closing price of shares immediately before the date(s) on which options were exercised
Lincoln Leong Kwok-kuen	1/8/2003	1,066,000	14/7/2004 – 14/7/2013	–	–	–	–	–	1,066,000	–
Other eligible employees	1/8/2003	495,200	14/7/2004 – 14/7/2013	–	–	–	–	–	495,200	–

## Notes

1. No option may be exercised later than ten years after its date of offer and no option may be offered to be granted more than five years after the adoption of the New Joiners Share Option Scheme ("New Option Scheme") on 12 April 2002.

2. Unless approved by shareholders in the manner as required by the Listing Rules, the total number of shares issued and issuable upon exercise of the options granted to any eligible employee under the New Option Scheme together with the total number of shares issued and issuable upon the exercise of any option granted to such eligible employee under any other share option scheme of the Company (including, in each case, both exercised and outstanding options) in any 12-month period must not exceed 1 per cent. of the shares of the Company in issue at the date of offer in respect of such option under the New Option Scheme.

Out of 1,599,000 options granted on 20 September 2000 under the Pre-Global Offering Share Option Scheme to Jack So Chak-kwong, former Chairman and Chief Executive, 1,066,000 vested options remained outstanding as at 1 January 2003. During the year ended 31 December 2003, the remaining 533,000 options were vested and the total 1,599,000 options were exercised and the weighted average closing price of shares immediately before the options were exercised was HK\$10.56.

On 1 August 2003, 1,561,200 options to subscribe for shares of the Company were granted to Lincoln Leong Kwok-kuen, a member of the Executive Directorate, and four other employees under the New Joiners Share Option Scheme. Pursuant to the terms of this Scheme, each grantee undertakes to pay HK\$1.00, on demand, to the Company, in consideration for the grant of the options (the closing market price per share immediately before the date on which the options were granted was HK\$9.25). The share options granted are not recognised in the accounts until they are exercised and the weighted average value per option granted, estimated at the date of grant using the Black-Scholes pricing model, was HK\$1.77 based on the following weighted average assumptions:

<i>Risk-free interest rate</i>	4.82%
<i>Expected life (in years)</i>	5
<i>Volatility</i>	0.24
<i>Expected dividend per share</i>	HK\$0.42

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options and requires input of highly subjective assumptions, including the expected life and stock price volatility. Because the Company's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, the Black-Scholes option pricing model does not necessarily provide a reliable measure of the fair value of the share options.

Save as disclosed above:

**A** none of the members of the Board of Directors or Executive Directorate of the Company had any interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO); and

**B** during the year ended 31 December 2003, 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 352 of the SFO or otherwise notified to the Company and the HKSE pursuant to the Model Code for Securities Transactions by Directors of Listed Companies.

### Directors' Service Contracts

No director proposed for re-election at the forthcoming annual general meeting has a service contract which is not determinable by the company or any of its subsidiaries within one year without

payment of compensation, other than statutory compensation.

### Substantial Shareholders' Interests

Set out below is the name of the party which was interested in 5 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 2003 as recorded in the register kept by the Company under section 336 of the SFO:

Name	No. of Ordinary Shares	Percentage of Ordinary Shares to total issued share capital
Financial Secretary Incorporated (in trust on behalf of the Government)	4,036,430,908	76.32

### Loan Agreements with Covenant Relating to Specific Performance of the Controlling Shareholder

As at 31 December 2003, the Group had borrowings of HK\$31,155 million with maturities ranging 2004 to 2018 and undrawn committed and uncommitted banking and other facilities of HK\$15,307 million, which were subject to the Government, being the Company's controlling shareholder, to own more than half in nominal value of the voting share capital of the Company during the lives of the borrowings and the undrawn facilities. Otherwise, immediate repayment of borrowings may be demanded and cancellation of undrawn facilities may result.

### 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 2003 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 2003 was attributable to the Company's five largest customers combined by value.

### Going Concern

The accounts on pages 75 to 131 have been prepared on a going concern basis. The Board of Directors has reviewed the Company's budget for 2004, 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.

### Connected Transactions

During the year under review the following transactions and arrangements described below have been entered into (or were ongoing) with persons who are "connected persons" for the purposes of the Listing Rules:

#### Entrustment Agreements

**A** The Company has entered into an entrustment agreement with Government dated 13 May 2003 in relation to the Lantau Airport Railway under which Government agreed to carry out construction work on behalf of the Company relating to an extension of the overrun tunnels at Hong Kong Station with a total value of HK\$58,600,000 in return for monthly payments based on the work completed.

Government is a substantial shareholder in the Company.

**B** The Company has entered into the following entrustment agreements with Government in relation to the Tung Chung Cable Car Project under which the Company agreed to carry out works on behalf of Government in return for monthly payments based on the work completed:

(1) Agreement dated 10 November 2003, for the Company to carry out design and construction of a landscaped piazza and associated works at Ngong Ping, with a total value of HK\$72,000,000.

(2) Agreement dated 28 November 2003, for the Company to carry out design and construction of a public transport interchange cum car and coach parks at Ngong Ping, with a total value of HK\$22,400,000.

Government is a substantial shareholder in the Company.

**C** The Company has entered into the following entrustment agreements with Government in relation to the Lantau Airport Railway under which the Company agreed to carry out works on behalf of Government in return for monthly payments based on the work completed:

(1) Agreement dated 28 February 2001, for the Company to carry out design and construction of noise mitigation measures adjacent to Housing Sites No. 6 and 10 in the northern part of West Kowloon reclamation, with a total value of HK\$210,500,000.

(2) Agreement dated 4 June 2001, for the Company to carry out substructure work relating to the Kowloon Regional Education Resource Centre cum Public Transport Interchange at Kowloon Tong, with a total value of HK\$78,900,000.

(3) Agreement dated 14 May 2002, for the Company to carry out design and construction of modification and extension works to the southern concourse of Tsim Sha Tsui Station, the link to the Middle Road subway and the fitting out to the Mody Road subway, with a total value of HK\$270,000,000.

Government is a substantial shareholder in the Company.

**D** The Company has entered into the following entrustment agreement with the Housing Authority in relation to the Tseung Kwan O Extension, under which the Company agreed to carry out works on behalf of the Housing Authority in return for monthly payments based on the work completed:

Agreement dated 10 April 1999, for the Company to carry out site formation works and part foundations of housing blocks at Eastern Harbour Crossing and shopping spine above Yau Tong Station, with a total value of HK\$397,600,000.

The Housing Authority is a Governmental statutory body and Government is a substantial shareholder in the Company.

**E** The Company has entered into an entrustment agreement with the Airport Authority, dated 15 December 1995, for the Airport Authority to carry out construction work for the Company relating to the Airport Station at Chek Lap Kok, with a total value of HK\$854,000,000.

The Company entered into an Airport Automated People Mover Maintenance Agreement with the Airport Authority on 18 March

2002, for the Company to carry out preventive and corrective maintenance of the Airport Automated People Mover, with an estimated total value of HK\$48,540,000.

The Airport Authority is a Governmental statutory body and Government is a substantial shareholder in the Company.

**F** The Company has entered into an entrustment agreement with Kowloon-Canton Railway Corporation ("KCRC"), dated 18 January 2000, for KCRC to carry out design and construction work for the Company, at the cost of KCRC, relating to the Airport Railway element of Nam Cheong Station.

KCRC is wholly-owned by Government, which is a substantial shareholder in the Company.

**G** The Company has entered into an agreement with Territory Development Department dated 1 February 2002, under which the Company was entrusted to do certain works in relation to or adjacent to the Hong Kong Station Development at a total consideration of HK\$30,417,764. The scope of works include Footbridge FB4 including removal of Footbridge FB4A, the promenade works in between Pier 1 & Pier 3 including removal of existing barge loading facility and Road D1. The actual works are carried out by the Hong Kong Station Developer.

Territory Development Department is a department of Government. Government is a substantial shareholder in the Company.

#### Land Agreements

**A** The Company has entered into the following land grants with Government in relation to the Airport Railway, which provides for the Company to develop certain sites adjacent to the Airport Express and Tung Chung Lines. Upon payment of the relevant land premium, the Company may develop the relevant site within the building covenant period. All agreements except in respect of item (9) specified below, provide for the sites (once developed) to have a lease term up to 30 June 2047.

(1) Grant No. 12459, dated 21 May 1997, for Private Treaty Grant of IL No. 8898 for development at Hong Kong Station (building covenant period expiry date 30 September 2005) with a total consideration or value of HK\$5,834,000,000.

(2) Modification of Grant No. 12459, dated 1 February 2000, for development at Hong Kong Station (building covenant period expiry date 1 February 2006) with a total consideration or value of HK\$5,500,000,000.

(3) Grant of KIL No. 11080 to the Company, dated 8 July 1996, for development at Kowloon Station (building covenant period expiry date 30 March 2009) with a total consideration or value of: Site A – HK\$3,377,230,000; Sites B, C, D, E, F and G – to be assessed.

The total consideration or value for Sites B and D was subsequently assessed on 31 March 1999 and 24 March 1999 at HK\$4,725,500,000. The total consideration or value for Sites C, E, F and G are set out in the Modification Letters in paragraphs (4) and (5) immediately below.

(4) Modification, dated 15 May 2000, to amend and allow the Company to develop Site C at Kowloon Station under new user and gross floor area restrictions (building covenant period expiry date 14 June 2006) with a total consideration or value of HK\$2,400,000,000.

(5) Modification, dated 12 December 2000, to amend and allow the Company to develop Sites E, F and G at Kowloon Station under new user and gross floor area restrictions (building covenant period expiry dates 31 March 2007 for Sites E and F and 31 March 2009 for Site G) with a total consideration or value of HK\$5,562,710,000.

(6) Grant No. 12349 for Private Treaty Grant of KIL No. 11068, dated 8 May 1995, for development at Olympic Station (building covenant period expiry dated 7 November 1999) with a total consideration or value of HK\$1,530,000,000.

(7) Grant No. 12375 for Private Treaty Grant of KIL No. 11074, dated 31 January 1996, for development at Olympic Station (building covenant period expiry date 30 January 2002) with a total consideration or value of HK\$3,777,860,000.

(8) Grant No. 12434 for Private Treaty Grant of KIL No. 11090, dated 10 January 1997, for development at Olympic Station (building covenant period expiry date 9 January 2003) with a total consideration or value of HK\$6,118,000,000.

(9) Conditions of Exchange No. 12620 dated 4 March 2002 in respect of Kowloon Inland Lot No. 11151 for development at Olympic Station (building covenant period expiry date 31 March 2007) with a total consideration or value of HK\$815,050,000 and a lease term of 50 years from date of grant.

(10) New Grant No. 6993 for Private Treaty Grant of TYTL No. 132, dated 7 March 1996, for development at Tsing Yi Station (building covenant period expiry date 30 September 2001) with a total consideration or value of HK\$4,343,500,000.

(11) New Grant No. 7973 for Private Treaty Grant of Tung Chung Town Lot No. 1, dated 16 August 1995, for development at Tung Chung Station (building covenant period expiry date 30 September 2000) with a total consideration or value of HK\$1,730,550,000.

(12) New Grant No. 7984 for Private Treaty Grant of Tung Chung Town Lot No. 2, dated 27 September 1995, for development at Tung Chung Station (building covenant period expiry date 30 September 2003) with a total consideration or value of HK\$724,010,000.

(13) New Grant No. 8015 for Private Treaty Grant of Tung Chung Town Lot No. 3, dated 1 May 1996, for development at Tung Chung Station (building covenant period expiry date 31 March 2001) with a total consideration or value of HK\$873,030,000.

(14) Modification of New Grant No. 8015, dated 29 August 2001, for additional gross floor area at Tung Chung Station (building covenant expiry date 31 March 2003) with a total consideration or value of HK\$116,000,000.

(15) Modification for New Grant No. 8082, dated 3 May 2000, for additional gross floor area and some other amendments at Tung Chung Station (building covenant period expiry date 31 March 2005) with a total consideration or value of HK\$493,570,000.

(16) New Grant No. 8102 for Private Treaty Grant, dated 26 June 1997, of Tung Chung Town Lot No. 5 for development at Tung Chung Station (building covenant period expiry date 30 June 2003) with a total consideration or value of HK\$4,150,000,000. The

building covenant period was extended to 30 June 2004 by a letter from Lands Department dated 5 February 2003 for a consideration or value of HK\$22,258,000.

(17) Modification for New Grant No. 8102, dated 16 August 1999, for additional gross floor area and some other amendments for development at Tung Chung Station (building covenant period expiry date 30 June 2005) with a total consideration or value of HK\$660,000,000.

(18) New Grant No. 8082, dated 26 March 1997, of Tung Chung Town Lot No. 4 for development at Tung Chung Station (building covenant period expiry date 31 March 2002) with a total consideration or value of HK\$2,510,000,000. The building covenant period was extended to 31 December 2002 by a letter from Lands Department dated 30 November 2001.

**B** The Company has entered into a land grant relating to NKIL No. 6179 for development rights near Choi Hung Station in order for the Company to develop the lot in accordance with the terms and conditions stipulated in the Conditions of Grant No. 12611 dated 12 November 2001 (building covenant period expiry date 30 June 2006), with a total value of HK\$207,000,000 and a lease term of 50 years from date of grant.

**C** The Company has entered into the following land grants with Government in relation to the Tseung Kwan O Line, which provides for the Company to develop certain sites above or adjacent to the Tseung Kwan O Line. Upon payment of the relevant land premium, the Company may develop the relevant site within the building covenant period. All land grants provide for the sites to have a lease term of 50 years from the date of the land grant.

(1) New Grant No. 9687 for Private Treaty Grant, dated 28 March 2002, of TKOTL No. 75 for development at Area 55b Tseung Kwan O (building covenant period expiry date 31 March 2007) with a total consideration or value of HK\$600,000,000 subject to a Deed of Surrender dated 28 December 2002 for surrender of a stratum of the lot.

(2) New Grant No. 9686 for Private Treaty Grant, dated 28 March 2002, of TKOTL No. 74 for development at 57a Tseung Kwan O (building covenant period expiry date 31 March 2007) with a total consideration or value of HK\$202,800,000 subject to a Deed of Surrender dated 28 December 2002 for surrender of a stratum of the lot.

(3) New Grant No. 9689 for Private Treaty Grant, dated 16 May 2002, of TKOTL No. 70 for development at Area 86 Tseung Kwan O (building covenant period expiry date 31 December 2015 or 60 months from the due date for payment of land premium of Site O, whichever is the later) with a consideration or value of HK\$150,000,000 for Site M1 and the consideration or value for the other sites to be assessed.

(4) New Grant No. 9694 for Private Treaty Grant, dated 22 October 2002, of TKOTL No. 24 for development at Area 38b Tseung Kwan O (building covenant period expiry date 31 December 2007) with a total consideration or value of HK\$1,276,000,000.

(5) New Grant No. 9700 for Private Treaty Grant of TKOTL No. 73, dated 11 February 2003, for development at Area 73b Tseung

Kwan O (building covenant period expiry date 31 March 2008 for Site A and 31 March 2009 or 60 months from the due date for payment of the land premium, whichever is the later, for Site B) with a consideration or value of HK\$1,028,000,000 for Site A. The consideration or value for Site B was not assessed as at 31 December 2003.

**D** The Company has entered into an agreement for sale and purchase on 5 October 2001 with The Financial Secretary Incorporated for the sale of levels 55, 56 and 77 to 88 of the office building on Site R of Hong Kong Station Development (IL No. 8898) for a total value of HK\$3,699,000,000, a supplemental agreement dated 8 October 2003 with the total value adjusted to HK\$3,697,358,837 and an assignment dated 8 October 2003 to the Financial Secretary Incorporated of the said levels pursuant to the said agreement for sale and purchase and supplemental agreement.

**E** In respect of the Remaining Portion of Mass Transit Railway Lot No. 1:

A Supplemental Lease was signed on the 11 February 2002 between Government and the Company in which the Government leased to the Company land occupied by the Quarry Bay Congestion Relief Works or the Quarry Bay Relief Works connecting Quarry Bay Station to North Point Station at an annual rent of 3% of the rateable value of the leased area for a term commencing 1 October 2001 to 29 June 2050 on terms and conditions substantially similar to the lease for the Mass Transit Railway Lot No. 1.

By a Modification Letter dated 13 May 2002 entered into between Government and the Company, the lease for the Remaining Portion of Mass Transit Railway Lot No. 1 was modified in areas indicated in the lease plans attached to the Modification Letter.

**F** A lease was signed on the 29 October 1993 between Government and the Company in which the Government leased to the Company Mass Transit Railway Lot No. 1 (now known as the Remaining Portion of Mass Transit Railway Lot No. 1) at HK\$3,000 per annum in respect of the portion in Hong Kong and Kowloon, and in respect of the portion in New Kowloon and New Territories from 1 July 1997 at annual rent of 3% of the rateable value of the leased area for a term commencing from 29 October 1993 to 29 June 2047 as varied or modified by modification letters dated 5 May 1995, 29 June 2000, 31 July 2000 and as supplemented and modified by a supplemental agreement dated 29 October 1993 subject to and with the benefit of terms and conditions stated therein.

**G** A lease was executed by the Government and the Company dated 27 June 1997 in respect of Mass Transit Railway Lot No. 2 at HK\$3,000 and an annual rent of 3% of the rateable value of the leased area per year from 1 July 1997 for a term commencing from 27 June 1997 to 29 June 2047 which lease was supplemented and modified by a supplemental agreement dated 27 June 1997 and a modification letter dated 29 June 2000 on terms and conditions substantially similar to the lease for the Mass Transit Railway Lot No. 1.

**H** A Deed of Surrender of a portion of Mass Transit Railway Lot No. 2 located inside the site of the Nam Cheong Station was executed by the Company in favour of Government dated 20 December 2003.

Consideration: The release of the Company from all obligations imposed upon it by the Lease in respect of the Premises.

**I** A Modification Letter was executed by the Government and the Company dated 20 December 2003 in respect of the Remaining Portion of Mass Transit Railway Lot No. 1 for the diversion of cooling water mains and cables to facilitate land grant arrangements for Nam Cheong Station.

Consideration: Payment of a premium of \$1,000 and an administrative fee of \$16,200.

**J** An Assignment dated 20 December 2003 to assign 30/100th equal undivided parts or shares of and in New Kowloon Inland Lot No. 6436 and the buildings and erections constructed and to be constructed therein known as Nam Cheong Station, was signed by Kowloon-Canton Railway Corporation as assignor and the Company as assignee.

**K** A Lease and Supplemental Agreement in respect of Mass Transit Railway Lot No. 3 for operation of the Tseung Kwan O Line dated 14 August 2003 was signed by the Government and the Company at an annual rent of 3% of the rateable value of the leased area for a term commencing from the respective dates of 4 August 2002, 18 August 2002 and 29 December 2002 in respect of respective portions of the said lot to 29 June 2050 in all cases on terms and conditions substantially similar to the Lease for the Mass Transit Railway Lot No. 2.

The consideration is annual rent at 3% of rateable value of leased area.

#### Transactions between the Company and KCRC

**1** An agreement signed dated 3 June 2003 between the Company and Kowloon-Canton Railway Corporation in respect of certain operations and maintenance arrangements relating to Nam Cheong Station.

Consideration: The consideration for each party's obligations is the obligations of the other party.

**2** An agreement signed dated 20 December 2003 between the Company and Kowloon-Canton Railway Corporation in respect of ownership, commercial and other aspects of Nam Cheong Station.

Consideration: The consideration for each party's obligations is the obligations of the other party.

**3** A Deed of Mutual Rights and Obligations dated 20 December 2003 was executed between the Company and Kowloon-Canton Railway Corporation concerning land rights for use of Nam Cheong Station erected in New Kowloon Inland Lot No. 6436 by the 2 railway corporations.

KCRC is wholly-owned by Government which is a substantial shareholder in the Company.

#### Transactions between the Company and Octopus Cards

On 17 January 2001, the Company entered into an Octopus Card Services Agreement (the "MTR Octopus Services Agreement") with Octopus Cards, in order to formalise the arrangements that already existed between them with respect to services provided to each other relating to Octopus cards. Under the terms of the MTR Octopus Services Agreement, the Company will accept use of Octopus cards as payment for its fares and will provide add-value

services, refund handling and other services to Octopus Cards for an indefinite period terminable on six months' notice (not to be given before 1 July 2010).

A supplemental agreement dated 9 December 2003 to amend the terms of the MTR Octopus Services Agreement was entered into between the Company and Octopus Cards pursuant to which the applicable rates of the transactions fees and the percentage fees in respect of the central clearing services provided by Octopus Cards which are payable by the Company to Octopus Cards were revised with retrospective effect from 1 July 2003.

During the year ended 31 December 2003, the Company paid Octopus Cards a total amount of HK\$46.2 million in respect of central clearing services provided by Octopus Cards. During the same period, load agent fees and fees for handling Octopus card issuance and refund amounting to HK\$9.9 million and HK\$5 million respectively were received by the Company from Octopus Cards in respect of services and facilities provided by the Company at various MTR stations.

In connection with the listing of the Company's shares on the HKSE in October 2000, the HKSE granted the Company a waiver (the "Waiver") from strict compliance with Chapter 14 of the Listing Rules in relation to the connected transactions (as defined in the Listing Rules) to be entered into between the Company and Octopus Cards following completion of the Global Offering (as defined in the prospectus dated 25 September 2000 issued by the Company). The Company confirms that the provision of the central clearing services by Octopus Cards to the Company and the provision of the load agent services by the Company contemplated under the MTR Octopus Services Agreement (as supplemented by the supplemental agreement dated 9 December 2003) were: (i) transactions entered into by the Company in the ordinary and usual course of its business; (ii) entered into on normal commercial terms (by reference to transactions of a similar nature made by similar entities within Hong Kong); and (iii) entered into on terms no less favourable than terms available to the other shareholders of Octopus Cards.

#### **Transactions between the Company and KCRC in relation to Octopus Cards**

(1) On 17 January 2001, the then shareholders in Octopus Cards, the Company, KCRC, Kowloon Motor Bus Company (1933) Limited, Citybus Limited, New World First Bus Services Limited and New World First Ferry Services Limited, entered into a replacement shareholders' agreement (the "Shareholders' Agreement") in respect of Octopus Cards, under which, inter alia, Octopus Cards was converted to profit making status. In connection with this agreement, the Company's shareholding in Octopus Cards was reduced to 57.4% and KCRC's shareholding was reduced to 22.1%. Further details of the replacement shareholders' agreement are set out in Note 18 to the Accounts.

(2) On 17 January 2001, KCRC entered into an Octopus Card Services Agreement (the "KCRC Octopus Services Agreement") with Octopus Cards in order to formalise the arrangements that already existed between them with respect to services provided to each other relating to Octopus cards. Under the terms of the KCRC Octopus Services Agreement, KCRC will accept use of Octopus cards as payment for its fares and will provide add-value services, refund handling and other services to Octopus Cards for

an indefinite period terminable on six months' notice (not to be given before 1 July 2010).

(3) A supplemental shareholders' agreement dated 16 January 2003 was entered into between the Company, KCRC, Citybus Limited, KMB Public Bus Services Holdings Limited, New World First Bus Services Limited and New World First Ferry Services Limited, the existing shareholders of Octopus Cards, to amend the Shareholders' Agreement pursuant to which the existing shareholders of Octopus Cards give a non-competition undertaking in relation to the card business carrying on by Octopus Cards.

(4) A supplemental agreement dated 9 December 2003 to amend the terms of the KCRC Octopus Services Agreement was entered into between Octopus Cards and KCRC pursuant to which the applicable rates of the transaction fees and the percentage fees in respect of the central clearing services provided by Octopus Cards which are payable by KCRC to Octopus Cards were revised with retrospective effect from 1 July 2003.

During the year ended 31 December 2003, KCRC paid Octopus Cards a total amount of HK\$29.0 million in respect of the transaction fees and percentage fees for the handling of Octopus cards. During the same period, load agent fees and fees for handling Octopus card issuance and refund amounting to HK\$5.2 million and HK\$2.1 million respectively were received by KCRC from Octopus Cards in respect of services and facilities provided by KCRC at various KCR stations.

As at 31 December 2003, the Company held 57.4% of the issued share capital in Octopus Cards and KCRC held 22.1% of the issued share capital in Octopus Cards. Octopus Cards is a subsidiary of the Company and KCRC is a substantial shareholder of Octopus Cards. Furthermore, the Government is a substantial shareholder of the Company and KCRC is wholly owned by the Government.

#### **Project Agreements**

The Company and the Deputy Secretary for the Environment, Transport and Works, for and on behalf of Government, entered into a Project Agreement for the Penny's Bay Rail Link project on 24 July 2002. This agreement sets out the obligations of the Company in respect of design, construction and operation of the Penny's Bay Rail Link, including the need for compliance with relevant terms of the agreement between the Government and the Walt Disney Company. The Agreement also sets out the obligations of Government in respect of making land and access available. It provides remedies to the Company for delay or failure by Government in making land available or in completing the Disney Theme Park. In order to provide financial support in respect of the Penny's Bay Rail Link project, provision is made for the waiver (as against the Company) of any entitlement to dividends representing Government's beneficial entitlement to cash dividends for the financial year 2002 and (to the extent necessary) 2003 and for subsequent financial years, as it is equivalent to a net present value amount (as at the end of 2001) of HK\$798 million as at the relevant date (as more particularly described in the Project Agreement).

Government is a substantial shareholder in the Company.

The Company and the Commissioner for Tourism on behalf of Government entered into a Project Agreement for the Tung

Chung to Ngong Ping Cable Car Franchise on 19 November 2003. The Agreement sets out the obligations of the Company in respect of the design, construction, operation and transfer of the System. The Franchise for the operation of the Tung Chung Cable Car was granted and regulated by the Tung Chung Cable Car Ordinance (Cap. 577). The franchise period will extend for 30 years from the date of signing the Project Agreement following which the System will be transferred to the Government. The Company has in parallel entered into an agreement with Government on the terms of a Private Treaty Grant for the land upon which the associated Ngong Ping tourism facilities will be constructed.

The Company has, in relation to the Tung Chung Cable Car Franchise, also entered into a Licence Agreement on 19 November 2003 with the Government whereby the Company is granted a licence over a parcel of land in Tung Chung for the purposes of constructing, operating, managing and maintaining a coach park.

Government is a substantial shareholder in the Company.

#### Land Comfort Letter

The Company has received a letter from Government, dated 14 July 2000, pursuant to which Government agreed to extend the period of certain of the Company's land interests so that they are coterminous with the Company's initial 50-year franchise and, for certain other interests, Government has agreed to render assistance to the Company to facilitate the smooth operation of the railway during the Company's franchise period. If the Company's initial 50-year franchise is extended, Government has agreed that, subject to certain conditions (including the prevailing land policy at the time of extension of the franchise), Government will amend certain documents, including the Running Lines Leases, to make them coterminous with the extended franchise period.

Government is a substantial shareholder in the Company.

#### Eastern Harbour Crossing Agreement

The Company and the Secretary for the Treasury, for and on behalf of Government, entered into an agreement on 30 June 2000 in respect of the vesting of certain assets comprised in the Eastern Harbour Crossing by Government into the Company in 2008 for nominal consideration (the "EHC Agreement"). Under the EHC Agreement, the Company agreed to indemnify Government for certain amounts which are expected to be nominal.

Government is a substantial shareholder in the Company.

#### Transactions in connection with the Privatisation Share Offer of the Company

(1) The Company entered into a deed of indemnity dated 22 September 2000, with the members of the Board and members of the Executive Directorate and the FSI, under which, inter alia, the FSI agreed to indemnify the Company, the members of the Board and members of the Executive Directorate in certain circumstances and in respect of certain liabilities in respect of the global offering of the shares in the Company by the FSI. The FSI is a substantial shareholder in the Company and the members of the Board and members of the Executive Directorate are also connected persons of the Company.

(2) The Company, the FSI, Goldman Sachs (Asia) L.L.C., HSBC Investment Bank Asia Limited and UBS AG entered into the following underwriting agreements in relation to the underwriting of the Privatisation Share Offer of the Company, details of which were disclosed in the prospectus issued by the Company in connection with the Privatisation Share Offer of the Company dated 25 September 2000:

- (i) the Hong Kong Underwriting Agreement, with the Hong Kong Underwriters (as defined therein), dated 22 September 2000; and
- (ii) the International Underwriting Agreement, with the International Underwriters (as defined therein), dated 1 October 2000.

The FSI is a substantial shareholder in the Company.

#### Auditors

The retiring auditors, KPMG, have signified their willingness to continue in office. A resolution will be proposed at the Annual General Meeting to reappoint them and to authorise the Directors to fix their remuneration.

By order of the Board

Leonard Bryan Turk  
Secretary to the Board  
Hong Kong, 2 March 2004