

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 2004.

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 telecommunication 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 Disneyland Resort Line (formerly known as 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 1 April 2005. Subject to the passing of the necessary resolution at the forthcoming Annual General Meeting, such dividend will be payable on or about 21 June 2005, in cash in Hong Kong dollars, with a scrip dividend alternative. The Company's majority shareholder, The Financial Secretary Incorporated, has agreed to elect to receive all or part of its entitlement to dividends in the form of scrip to the extent necessary to ensure that a maximum of 50% of the total dividend paid by the Company will be in the form of cash.

Members of the Board

Members of the Board who served during the year were Raymond Ch'ien Kuo-fung (non-executive Chairman), Chow Chung-kong (Chief Executive Officer), Cheung Yau-kai, David Gordon Eldon, Christine Fang Meng-sang (appointed on 1 January 2004), Edward Ho Sing-tin, Lo Chung-hing, T. Brian Stevenson, Frederick Ma Si-hang, the Secretary for the Environment, Transport and Works (Sarah Liao Sau-tung) and the Commissioner for Transport (Robert Charles Law Footman).

At the Annual General Meeting on 3 June 2004 and pursuant to the Articles of Association, Raymond Ch'ien Kuo-fung, Chow Chung-kong, David Gordon Eldon and Christine Fang Meng-sang retired under the Articles of Association and were re-elected as members of the Board.

At the forthcoming Annual General Meeting and in accordance with the Articles of Association, Cheung Yau-kai, Edward Ho Sing-tin and Lo Chung-hing will retire by rotation. All these three Board members will offer themselves for re-election at the forthcoming Annual General Meeting.

Brief biographical details for Board members are set out on pages 62 and 63.

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 [who ceased to be the Permanent Secretary for the Environment, Transport & Works with effect from 2 January 2004], Margaret Fong Shun-man [with effect from 1 July 2004 and ceased to be the Permanent Secretary for the Environment, Transport & Works with effect from 15 August 2004] and Joshua Law Chi-kong [with effect from 23 August 2004]) and the Deputy Secretary for the Environment, Transport & Works (Arthur Ho Kin-wah [who ceased to be a Deputy Secretary for the Environment, Transport & Works with effect from 15 November 2004], Margaret Fong Shun-man [who ceased to be a Deputy Secretary for the Environment, Transport & Works with effect from 1 July 2004], Patrick Ho Chung-kei [with effect from 1 July 2004], Thomas Chow Tat-ming [with effect from 1 July 2004], Cathy Chu Man-ling [with effect from 15 November 2004] and Annie Choi Suk-han) (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 Chow Chung-kong (Chief Executive Officer and a member of the Board), 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 64.

Corporate Governance

The Company has complied throughout the year ended 31 December 2004 with the Code of Best Practice set out in Appendix 14 to 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 Articles of Association. 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 59 to 61.

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 61.

Policies

The Board has adopted risk management 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.

Bank Overdrafts, Bank Loans and Other Borrowings

The total borrowing of the Group as at 31 December 2004 amounted to HK\$30,378 million (2003: HK\$32,025 million). Particulars of borrowings including bank overdrafts and bank loans are set out in note 27 to the accounts.

Accounts

The state of affairs of the Company and the Group as at 31 December 2004 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 135.

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 54 to 55.

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 35 and 36 to the accounts.

Share Capital

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. During the year, the Company issued a total of 101,304,581 Ordinary Shares. Of this number:

A 8,023,500 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 43A to the accounts). In respect of each Ordinary Share issued, the relevant exercising share option holder paid HK\$8.44 to the Company;

B 62,069,342 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 2003 (for which the cash dividend was HK\$0.28 per Ordinary Share); and

C 31,211,739 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 2004 (for which the cash dividend was HK\$0.14 per Ordinary Share).

As at 31 December 2004, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,389,999,974 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 2004.

Properties

Particulars of the principal investment properties and properties held for sale of the Company are shown on page 39.

Donations

During the year, the Company donated a total of HK\$581,724 to charitable organisations, out of which HK\$381,724 went to the Community Chest of Hong Kong for the Community Chest Green Day. The remaining HK\$200,000 raised from the launching ceremony of the Doraemon MTR Souvenir Ticket went to the Kelly Chen Children Education Fund Limited.

Internal Control

The Board 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. Monthly results of the Company's operations, businesses and projects are reported against the budget to the Board 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 with reference 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 2004, details of which are set out in note 27D 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. Disaster recovery rehearsal on critical applications is conducted annually.

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 2004, the interests or short positions of the members of the Board 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 Issuers were as follows:

Long Positions in Shares and Underlying Shares of the Company

Member of the Board or Executive Directorate	Number of Ordinary Shares held			Derivatives		Total interests	Percentage of aggregate interests to total issued share capital
	Personal* interests	Family† interests	Corporate interests	Share Options	Other		
Chow Chung-kong	-	-	-	-	700,000 (Note 1)	700,000	0.01299
T. Brian Stevenson	4,443	-	-	-	-	4,443	0.00008
Christine Fang Meng-sang	1,675	-	-	-	-	1,675	0.00003
Philip Gaffney	46,553	614	-	416,000 (Note 2)	-	463,167	0.00859
Russell John Black	51,132	-	-	-	-	51,132	0.00095
William Chan Fu-keung	46,233	-	-	317,500 (Note 2)	-	363,733	0.00675
Thomas Ho Hang-kwong	51,075	2,524	-	321,000 (Note 2)	-	374,599	0.00695
Lincoln Leong Kwok-kuen	-	-	23,000 (Note 3)	1,066,000 (Note 4)	-	1,089,000	0.02020

Notes

1. Chow Chung-kong has a derivative interest in respect of 700,000 shares in the Company within the meaning of Part XV of the SFO. That derivative interest represents Mr. Chow's entitlement to receive 700,000 shares in the Company (or their equivalent value in cash) on completion of his three-year contract (on 30 November 2006).
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 Pre-Global Offering Share Option Scheme.
3. The 23,000 shares are held by Linsan Investment Ltd., a private limited company beneficially wholly owned by Lincoln Leong Kwok-kuen.
4. 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.

Notes of MTR Corporation (C.I.) Limited

Member of the Executive Directorate

Personal interests*

William Chan Fu-keung	HK\$50,000 MTR 301 4.50% Notes due 2005
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* Interests as beneficial owner

† Interests of spouse or child under 18 as beneficial owner

Options to subscribe for Ordinary Shares granted under the Pre-Global Offering Share Option Scheme, as referred to in Notes 5B (i) and 43A to the Accounts

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2004	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 2004	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
Philip Gaffney	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	1,022,000	–	–	606,000	8.44	416,000	11.80
William Chan Fu-keung	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	822,000	–	–	504,500	8.44	317,500	12.14
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	621,000	–	–	300,000	8.44	321,000	12.25
Other eligible employees	20/9/2000	40,343,000	5/4/2001 – 11/9/2010	22,764,500	–	–	6,613,000	8.44	16,151,500	12.00

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 43B to the Accounts

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2004	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 2004	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
Lincoln Leong Kwok-kuen	1/8/2003	1,066,000	14/7/2004 – 14/7/2013	1,066,000	355,500	–	–	–	1,066,000	–
Other eligible employees	1/8/2003	495,200	14/7/2004 – 14/7/2013	495,200	165,500	–	–	–	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 16 May 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% of the shares of the Company in issue at the date of offer in respect of such option under the New Option Scheme.

Save as disclosed above:

A none of the members of the Board 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 2004, no member of the Board 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 Issuers.

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% 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 2004 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
The Financial Secretary Incorporated (in trust on behalf of the Government)	4,121,262,921	76.46

The Company has been informed by the Government that, as at 31 December 2004, approximately 1.37% of the shares of the Company were held for the account of the Exchange Fund. The Exchange Fund is a fund established under the Exchange Fund Ordinance (Cap. 66 of the laws of Hong Kong) under the control of the Financial Secretary.

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

As at 31 December 2004, the Group had borrowings of HK\$29,974 million with maturities ranging 2005 to 2019 and undrawn committed and uncommitted banking and other

facilities of HK\$11,590 million, which were subject to the Government, being the Company's controlling shareholder, owning 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 2004 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 2004 was attributable to the Company's five largest customers combined by value.

Going Concern

The accounts on pages 75 to 135 have been prepared on a going concern basis. The Board has reviewed the Company's budget for 2005, 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:

Land Agreements

A The Company has entered into the following land grant 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. The agreement provides for the site (once developed) to have a lease term up to 30 June 2047.

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 September 2004 by a letter dated 9 June 2004 from Government with a total consideration or value of HK\$15,936,000. By a letter dated 14 July 2004, Government excluded balconies and utility platforms from the calculation of gross floor area of the development with a total consideration or value of HK\$30,561,000.

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. The Company has entered into a Modification Letter dated 26 June 2004 with Government for additional gross floor area and other amendments in respect of the development with a total consideration or value of HK\$95,190,000.

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. By a letter dated 30 June 2004, Government excluded balconies and utility platforms from the calculation of gross floor area of the development at Tseung Kwan O Town Lot No. 75 with a total consideration or value of HK\$32,560,640.

(2) 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 assessed on 10 January 2004 at HK\$1,227,840,000. By a letter dated 3 August 2004, Government excluded balconies and utility platforms from calculation of gross floor area of the development at Site A with a total consideration or value of HK\$36,915,120.

Following the end of the year under review, the Company accepted on 24 January 2005 the land premium offer from Government under New Grant No. 9689 dated 16 May 2002 for the development rights of Site F of Tseung Kwan O Town Lot No. 70 (building covenant period expiry date: 72 months from the date of payment of Site F premium) with a total consideration or value of HK\$2,319,290,000. An undertaking regarding a lease modification of TKOTL No. 70 to reflect the master layout plan approved on 13 August 2004 was given to Government on 24 January 2005. A Modification Letter for Site F is to be executed pursuant to the said undertaking on or before 23 April 2005.

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

A Supplemental Lease was signed on 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 at an administration fee of HK\$16,200. By a Modification Letter executed by the Government and the Company dated 31 May 2004, 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 in the consideration of a premium of HK\$1,000 and an administrative fee of HK\$16,200.

Project Agreement

On 17 March 2004, the Company entered into an agreement with Hong Kong IEC Limited for the design, construction, financing and operation of a new Airport Express Line station to serve the new International Exhibition Centre, known as AsiaWorld-Expo, which is being built at Chek Lap Kok. Hong Kong IEC Limited is a joint venture company between IEC Holdings Limited (wholly owned by the Government and the Airport Authority) and IEC Investment Limited (wholly owned by Dragages et Travaux Publics (HK) Limited, Yu Ming Investments Limited and Yu Ming Investment Management Limited). The total capital cost of the new station is about HK\$274 million.

Government 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, 1 March 2005