CEO's Review of Operations and Outlook

"2007 also saw strong financial results for MTR Corporation as we continued to make steady progress in all our businesses"

Dear Stakeholders,

2007 was a successful year for the Company. Firstly, on 2 December, we completed the merger of our rail operations with those of the Kowloon-Canton Railway Corporation (KCRC) and acquired from KCRC a portfolio of properties (Rail Merger). Secondly, in Hong Kong, a number of new rail lines saw progress. The West Island Line was gazetted by the Hong Kong SAR Government, and good construction progress was made on the Kowloon Southern Link, which is part of the Rail Merger. Hong Kong SAR's Chief Executive highlighted in his Policy Address three additional rail lines as infrastructural priority projects, these being the South Island Line (East), the Shatin-to-Central Link and the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link). We welcome Government's latest decision for the Company to proceed with the further planning and design of Shatin-to-Central Link and the Kwun Tong Line extension to Whampoa. Thirdly, outside of Hong Kong, we won the London Overground concession together with our UK joint venture partner, Laing Rail, whilst work progressed in Beijing on the construction of Beijing Metro Line 4.

2007 also saw strong financial results for MTR Corporation as we continued to make steady progress in all our businesses. For the year, our revenue increased by 12.0% to HK$10,690 million, due to the continued growth in our recurring businesses and the effect of the Rail Merger. Operating profit from railway and related businesses before depreciation, amortisation and merger related expenses rose by 13.7% to HK$5,912 million. Property development profit recognised in the period was HK$8,304 million. Excluding investment property revaluation and the related deferred tax, net profit from underlying businesses attributable to equity shareholders was HK$8,571 million, 43.8% higher than 2006. This significant increase in underlying profits was primarily the result of the very significant property development profits recognised in 2007, in particular from Le Point at Tiu Keng Leng Station. Earnings per share were HK$1.54 before investment property revaluation and HK$2.72 after such revaluation. With the strong financial results, your Board has recommended a final dividend of HK$0.31, which when combined with the interim dividend of HK$0.14 per share, brings full year dividend to HK$0.45, an increase of 7.1% over 2006.

The Rail Merger

Following the Memorandum of Understanding between the Company and the Hong Kong SAR Government on 11 April 2006, the Rail Merger Bill was approved by the Legislative Council of Hong Kong (LegCo) on 8 June 2007. Formal transaction documents were entered into between the Government, the Company and KCRC in August 2007, and independent shareholders of the Company approved the Rail Merger on 9 October. The completion of the Rail Merger on 2 December marked a new era not only for the Company but also for public transportation in Hong Kong.

For our customers, the Rail Merger brought fare reductions as well as better integration of the rail network in Hong Kong. For the Company and our shareholders, the Rail Merger represents a significant increase in the size and scale of our rail and property portfolio as well as growth opportunities in the form of new railway lines throughout Hong Kong and connecting to the Mainland of China. The expansion of our rail and rail related businesses together with the Rail Merger transaction structure increases our recurrent profitability and enhances the long term sustainability of the Company. This will benefit all stakeholders of the Company and will provide a platform for the sustainable development of Hong Kong's public transportation services.

Operational Review

Hong Kong Railway Operations

For the year, total patronage on the Integrated MTR System, including the effect of the Rail Merger since 2 December, increased by 8.2% to 948.3 million. For the period before the Rail Merger, total patronage increased by 2.9% as compared to the same period in 2006.

Average weekday patronage on pre-Merger MTR Lines increased by 3.3% to 2.6 million as compared to the same period last year. After the Rail Merger, our Domestic Service, which now

"... the Rail Merger represents a significant increase in the size and scale of our rail and property portfolio as well as growth opportunities in the form of new railway lines throughout Hong Kong and connecting to the Mainland of China"

also includes the KCR Lines (comprising the East Rail excluding Cross–boundary Service, West Rail, and Ma On Shan lines), saw average weekday patronage increasing significantly to 3.5 million.

Patronage on the Airport Express rose 6.3% to 10.2 million in 2007, as the number of air travellers using Hong Kong International Airport continued to rise, and the number of exhibitions and other events at AsiaWorld-Expo increased.

For Cross-boundary Service at Lo Wu and Lok Ma Chau, patronage for the full year recorded an increase of 4.7% to 92.1 million, of which 8.2 million was attributable to the Company from the Rail Merger for the period after 2 December. Light Rail, Bus and Intercity recorded patronage of 14.1 million for the period from 2 December to the end of 2007.

Our overall share of the franchised public transport market increased from 25.0% in 2006 to 25.3% in the period before the Rail Merger. After the Rail Merger including all rail and bus passenger services, our market share increased further to 41.6%.

In the period prior to the Rail Merger, average fare per passenger on the MTR Lines was HK$6.83, which was similar to the comparable period in 2006. After the Rail Merger, average fare per passenger on Domestic Service was HK$6.39 with the reduction in average fares being due to the fare reduction given as part of the Rail Merger and the lower average fares on KCR Lines as compared to the MTR Lines. Average fare per passenger for Airport Express was HK$64.34 in 2007, an increase of 0.8% over 2006. Average fare per passenger on Cross-boundary Service was HK$24.51 in 2007, similar to that of 2006. Total fare revenue from all passenger services for 2007 increased by 9.1% to HK$7,115 million.

The successful integration of the two networks on 2 December 2007 reflected the very high level of integration planning, service and operational performance that was demonstrated throughout the year. Passenger journeys on time performance on the pre-Merger MTR System achieved a level of 99.9%. A new Operating Agreement came into effect on 2 December 2007 as a result of the Rail Merger that will govern the performance levels of the Integrated MTR System.

To meet the constantly rising expectations of our customers, we invested not only in the expansion of the network but also in service and efficiency improvements. To enhance accessibility, we opened new pedestrian links and entrances at various stations including a pedestrian link at Admiralty Station connecting to Three Pacific Place, and two new entrances at Kowloon Station linking up to Elements shopping centre.

The new Airport Express platform serving SkyPlaza in Hong Kong International Airport Terminal 2 was put into operation. The noise enclosure project in the Tung Chung area to reduce noise impact for residents was completed and some rail sections along north Lantau were replaced for the same purpose. To improve passenger comfort, five new trains are being procured for the Tsuen Wan, Kwun Tong, Island and Tseung Kwan O lines.

To promote customer service and to help attract new patronage, various marketing programmes were launched, including the selection of a lucky couple to participate in the first MTR Hello Kitty Dream Wedding in Hong Kong Station, the MTR Hello Kitty Heroes Redemption Programme and the Ride 5 Get Free Breakfast Promotion. A tailor-made shopping guide entitled "MTR Easy Ride to Hong Kong Shopping Festival" was developed together with the Hong Kong Tourism Board for the use of overseas tourists in July and August.

On Airport Express, the popular "Ride to Rewards" programme was enhanced with new rewards. We also arranged same-day return trips on Airport Express as well as discounted prices for visitors travelling to private events or public concerts at AsiaWorld-Expo.

On the through train business to the Mainland of China, which we took on after the Rail Merger, the fare promotion on Intercity services to Beijing and Shanghai in non-peak periods continued. To promote the new Lok Ma Chau Station of the Cross-boundary Service, free ride promotions over the New Year and Lunar New Year holidays and weekly ticket promotions were provided to customers who used the new station.

Station Commercial and Rail Related Businesses

Revenue growth for our station commercial and rail related businesses benefited from a robust economy, rising patronage and the effect of the Rail Merger, resulting in revenue increasing 12.9% to HK$1,741 million despite decreases in telecommunications and consultancy revenues. Excluding the Rail Merger effect from 2 December to the year end, such revenues would have increased by 4.8% to HK$1,616 million.

Advertising revenue increased by 11.0% to HK$593 million (9.6% to HK$585 million excluding the Rail Merger effect), underpinned by higher passenger volumes, advertising innovations and station zone segmentation with the objectives of optimising revenue for the Company and advertising impact for our customers. Revenue also benefited from the replacement of seatback TV with the new multimedia system on the Airport Express, and the enhancement of the MTR Plasma TV network. With the Rail Merger, our advertising coverage now extends to an integrated network with larger patronage, including the cross-boundary market.

Station retail revenue rose 27.6% to HK$499 million (9.7% to HK$429 million excluding the Rail Merger effect). Renovations and new layouts were completed in the retail zones of nine stations in 2007 and altogether, 41 stations in the MTR System have been renovated since 2001. During the year, 31 new trades/brands were added to the station retail network in the MTR System to enhance customer satisfaction. With the Rail Merger, the number of shops at stations totaled 1,230 at the end of the year, including nine Duty Free shops at Lo Wu, Lok Ma Chau and Hung Hom stations.

Revenue from telecommunications services decreased by 10.0% to HK$233 million as compared to 2006 due to the cannibalisation of the 2G service by the less profitable 3G service. However, our fixed network services provider TraxComm Limited achieved higher revenue and by the end of the year had sold more than 220 Gbps of bandwidth services to carrier customers. With the Rail Merger, we took over the telecoms business of the KCR System, which is similar to MTR Corporation's own telecoms business, and our fibre network coverage expanded from 156 kilometres to 324 kilometres.

As part of the Rail Merger, we also gained KCRC's relatively small freight transportation business, which generated revenue of HK$3 million from 2 December to the year end.

In external consultancy, we made progress on existing consultancy projects and the signing of new contracts. Project management consultancy work continued on Shanghai Metro Line 9 and Phase 1 (12 stations) opened on 29 December 2007. Overall, external consultancy activities generated a revenue of HK$193 million in 2007, a decrease of 3.0% compared to 2006, which was mainly due to programme delays of some projects caused by the changing requirements of our customers.

Property and Other Businesses

The Hong Kong property market was very active in 2007. The office and retail rental markets continued to enjoy good growth with supply being limited in the office market, and strong retail market driven by consumer and tourist spending.

The development rights for eight property development sites totalling 1.2 million square metres GFA were acquired as part of the Rail Merger. The Company will act as the Government's agent for property developments at West Rail sites. The Merger also increased our investment property portfolio by 40,957 square metres lettable, particularly in the New Territories.

Profit for the year from property developments increased significantly to HK$8,304 million. Amongst this, surplus proceeds contributed HK$7,077 million, particularly from the sale of residential flats from Le Point at Tiu Keng Leng Station and to a lesser extent from Harbour Green at Olympic Station. Deferred income contributed HK$1,224 million being profit recognition mainly from the newly opened Elements in Kowloon Station, and from Coastal Skyline and Caribbean Coast in Tung Chung.

In February 2007, the tender for Area 56 in Tseung Kwan O town centre was awarded to Lansmart Ltd, a subsidiary of Sun Hung Kai Properties Limited, with the plan to develop a hotel, residential, office and retail complex. In November, a subsidiary of Cheung Kong (Holdings) Limited, Wealth Pine Investment Limited, was awarded Tseung Kwan O Area 86 Package Three, a residential development with up to 1,648 units. Area 86 was formally named LOHAS Park in September.

Revenues from our property rental, management and other businesses benefited from additions to the portfolio, increasing by 24.3% to HK$1,834 million as compared to 2006; the Rail Merger effect from 2 December to the end of 2007 contributed HK$22 million to this total. Within this total, rental income rose by 25.2% over last year to HK$1,581 million (23.5% to HK$1,560 million excluding the Rail Merger effect), driven by positive rental renewals and new lettings, as well as contributions from Phase 1 of Elements with lettable area of 39,210 square metres and Ginza Mall in Beijing with lettable area of 19,307 square metres, both of which opened in 2007.

Our latest up-market flagship shopping centre, Elements on top of Kowloon Station, was successfully opened in October 2007. It quickly became a unique attraction for premier shopping and recreation both for Hong Kong residents and for visitors. Commercially, Elements was equally successful with 100% of its shops leased at the time of the opening.

The investment properties portfolio acquired as part of the Rail Merger comprises five shopping centres in the New Territories totalling 36,487 square metres lettable, 20 residential units at Royal Ascot and an office at Hung Hom of 1,686 square metres lettable.

Property management income rose by 12.8% to HK$168 million. During the year, 3,121 residential units were added to our property management portfolio at Coastal Skyline, Caribbean Coast and Harbour Green, which together with the 9,854 units under management acquired in the Rail Merger, brings the total number of residential units managed by the Company in Hong Kong to 71,851 units at the end of 2007.

Prior to the Rail Merger, total commercial properties managed by the Company increased by 81,457 square metres mainly due to the inclusion of Elements Phase 1. With the Rail Merger, an additional 93,026 square metres of commercial area was added to our property management portfolio to give a total of 756,556 square metres at year end.

Our managed property portfolio in the Mainland also increased in 2007, with a total new intake of 480,000 square metres. Altogether, total contracts in hand under management in the Mainland of China amounted to 820,254 square metres.

The Ngong Ping 360 cable car and associated theme village on Lantau Island, opened in September 2006. In June 2007, during the annual testing outside of operation hours, one of the gondolas dislodged from the cable. There were no injuries but operations were immediately suspended, followed by detailed investigations and a period of intensive testing of safety and operational procedures. In September, the Company took over the management and operation of the cable car system from the previous contractor through the acquisition of its Hong Kong subsidiary, with a senior management team of our experienced engineers and international cable car professionals. After extensive testing, the system was confirmed to be safe and reliable and the cable car service resumed on 31 December 2007. Patronage quickly returned to previous levels and we are optimistic about the future of this project. The revenue contributed for the year from Ngong Ping 360 was HK$85 million.

The Company's share of Octopus' net profit for 2007 was HK$97 million, a 42.6% increase over 2006. The increase was partly a result of an increase in average daily Octopus usage of 11.7% to HK$81.9 million per day in 2007, brought about by a rise in the number of service providers and improvements in the general economy. Cards in circulation rose to 16.5 million and average daily transaction volume rose to 10.2 million. By the end of 2007, the total number of service providers had risen to 490 from 431.

Hong Kong Network Expansion

With the completion of the Rail Merger, our key focus will be directed to the construction of new rail lines over the next decade, which will significantly contribute to Hong Kong's future growth.

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As the first of these new extension projects, the West Island Line (WIL) was gazetted under the Railways Ordinance in October 2007 followed by approval of design funding by Government in December 2007. WIL is a "community railway" that aims to rejuvenate the Western District of Hong Kong by enhancing connectivity for the community through rail service, station exits, lifts and escalators.

Works on the Kowloon Southern Link (KSL) connecting the existing East Rail Line's East Tsim Sha Tsui Station with West Rail Line's Nam Cheong Station, continued throughout the year. Completion is scheduled for late 2009. The Company took over the project management responsibility of KSL under the Rail Merger agreement. However, it will continue to be funded and owned by KCRC, and will form part of the Service Concession when it opens for service.

In his Policy Address in October 2007, the Chief Executive of Hong Kong SAR identified a number of new rail lines as priority infrastructure projects. These include the South Island Line (East), the Shatin-to-Central Link and the Hong Kong Section of the Express Rail Link.

A revised proposal for the South Island Line (East) with updated financial data and enhanced interchange arrangements at Admiralty Station was submitted to Government in June 2007. Government has since requested the Company to proceed with preliminary planning and design. In addition, feasibility studies were completed in 2007 for the Express Rail Link. The Express Rail Link will provide cross-boundary high speed train service connecting Hong Kong to the new high speed rail network in the Mainland of China.

The Government announced on 11 March 2008 its decision for the Company to proceed with the further planning and design of Shatin-to-Central Link and the Kwun Tong Line extension to Whampoa. The 17-km Shatin-to-Central Link, which will be based on the scheme proposed by the Company under the Rail Merger, will run from Tai Wai to Hong Kong Island connecting a number of rail lines to provide more convenient rail services to passengers. The section from Tai Wai to Hung Hom connecting Ma On Shan Line to West Rail Line is expected to be completed in 2015. The other section, which will extend the existing East Rail Line from Hung Hom across the harbour to Hong Kong Island, is expected to be completed in 2019. The Company will continue discussions with Government on the operation of Shatin-to-Central Link by way of a Service Concession. The 3-km Kwun Tong Line extension will run from the existing Yau Ma Tei Station via Ho Man Tin to Whampoa and is expected to be completed by 2015. The Company will discuss the implementation details of this project with Government based on the ownership approach and has proposed to use property development rights relating to a site at the former Valley Road Estate site to bridge the funding gap.

The funding model for these new rail projects will take different forms, each appropriately designed for the project. As always, the Company will seek to create a commercial return on its investments above its cost of capital and at rates commensurate with the risk of the projects. For the West Island Line, the Government has indicated that it would consider a capital grant model whereby Government grants to the Company a sum of money, currently estimated at HK$6 billion, to establish the financial viability of the project. The South Island Line (East)

"Our overseas expansion took a step forward with the award of the London Overground concession to London Overground Rail Operations Ltd (LOROL), our 50:50 joint venture with UK's Laing Rail"

will likely follow the Company's traditional "Rail and Property" approach, whereby property development rights will be granted to us. A third model that could be used for future rail lines would be the Service Concession model used in the Rail Merger, whereby Government (or KCRC, which is wholly owned by the Government) pays for the initial capital costs of the rail line and the Company operates the line by paying an annual concession payment as well as being responsible for maintenance and upgrades; KSL has adopted this approach.

For the new station at LOHAS Park (in Tseung Kwan O South), civil and structural works were substantially completed in October 2007, and track installation was substantially completed in December 2007. Design of the railway electrical and mechanical systems has been completed, manufacturing of major plant and equipment is in progress, and installation works are on schedule for completion of the station in 2009.

Construction work for the pedestrian subway at Cheung Lai Street connecting Lai Chi Kok Station with the new developments to the south of Lai Chi Kok Road began in August 2007.

Overseas Expansion

Our overseas expansion took a step forward with the award of the London Overground concession to London Overground Rail Operations Ltd (LOROL), our 50:50 joint venture with UK's Laing Rail (now being acquired by Deutsche Bahn group). Works on the Beijing Metro Line 4 (BJL4) project made steady progress and the process to gain approval of the Shenzhen Metro Line 4 (SZL4) project continued.

In Beijing, tendering for the Electrical & Mechanical (E&M) Works Contracts of BJL4 was substantially completed. Design works and manufacturing for E&M equipment advanced smoothly. Testing and commissioning works of the first two trains commenced in December 2007.

In Shenzhen, we continued to support the Shenzhen Municipal Government in obtaining approval on the SZL4 project from the National Development and Reform Commission. Preparatory work and expanded trial section work continue with undertakings from the Shenzhen Municipal Government to reimburse certain of the costs incurred if the project is not approved. Under the current policy relating to property development in China, the public sector funding support to this project is likely to take other forms than the grant of property development rights. The Company will ensure that the project, if approved, will provide satisfactory returns to its shareholders. We continue to pursue other projects in the Mainland of China, such as the BJL4 Extension to Daxing District, as well as the development of new lines in Hangzhou, Suzhou, Tianjin and Wuhan.

In Europe, our joint venture with Laing Rail, LOROL, was awarded the London Overground concession on 19 June 2007. On 11 November, LOROL successfully took over the concession, which allows it to operate services on five existing lines in Greater London for seven years.

Financial Review

The Group achieved strong financial results in 2007. Total fare revenues increased by 9.1% from HK$6,523 million to HK$7,115 million with fare revenue from Domestic Service (including KCR Lines after the Rail Merger) increasing by 5.1% in 2007 to HK$6,213 million. Fare revenues from Airport Express increased by 7.0% to HK$655 million whilst Cross-boundary, Light Rail, Bus and Intercity services contributed total revenue of HK$247 million for the period after the Rail Merger. Non-fare revenues increased by 18.5% in 2007 to HK$3,575 million comprising HK$1,741 million of station commercial and rail related business incomes and HK$1,834 million of property rental, management and other incomes. Total revenues for 2007 therefore increased by 12.0% to HK$10,690 million. Total operating costs, excluding merger related expenses, increased by 10.1% in 2007 to HK$4,778 million after accounting for the incremental operating costs following the Rail Merger in December. Operating profit from railway and related businesses before depreciation and amortisation therefore increased by 13.7% to HK$5,912 million before accounting for merger related expenses. We estimate that the Rail Merger contributed approximately HK$284 million to such operating profit from 2 December to the year end before merger related costs. Operating margin also increased from 54.5% in 2006 to 55.3%.

Property development profits for 2007 increased significantly from HK$5,817 million to HK$8,304 million mainly due to profit recognition from Le Point at Tiu Keng Leng Station. As noted in the 2006 Annual Report, costs relating to the Le Point property development had been accounted for in 2006 and hence profit recognition for Le Point in 2007 was based predominantly on our share of the revenue from sales of units at the development, leading to significant profit booking in 2007. Depreciation and amortisation charges for 2007 increased by 2.4% to HK$2,739 million while interest and finance charges declined by 5.9% to HK$1,316 million as a result of substantial cash inflows during the early part of the year. With the Rail Merger, merger related expenses charged to the 2007 profit and loss account were HK$193 million. Acquisitions of assets in 2007 included investment property subsidiaries from KCRC as part of the Rail Merger and the Ngong Ping 360 operation management company from the previous contractor; fair market adjustments for such assets produced a net gain of HK$187 million.

Excluding investment property revaluation, net profit attributable to shareholders of the Company from underlying businesses for 2007 increased by 43.8% to HK$8,571 million, or HK$1.54 per share as compared with HK$1.08 in 2006. After accounting for the revaluation of investment properties, reported earnings attributable to shareholders of the Company were HK$15,180 million with earnings per share of HK$2.72.

The Company's balance sheet showed an 18.6% increase in net assets from HK$76,786 million as at 31 December 2006 to HK$91,037 million as at 31 December 2007. Total assets increased from HK$120,421 million in 2006 to HK$155,668 million as at 31 December 2007 mainly attributable to the addition of the Service Concession assets and property package acquired in the Rail Merger as well as the appreciation in market values of investment properties. Total liabilities increased from HK$43,635 million in 2006 to HK$64,631 million at 2007 year end mainly due to the additional borrowings, obligations under the Service Concession and other liabilities arising from the Rail Merger. Including the obligations under the Service Concession of HK$10,685 million as a component of debt, the Group's net debt-to-equity ratio increased from 36.3% at 2006 year end to 48.5% at 2007 year end.

Cash flow of the Company remained strong during the year with net cash inflow of HK$5,965 million generated from railway and related activities and HK$5,824 million of cash receipts from our property development business. After payments for capital projects, interest expense, working capital and dividends, a net cash inflow of HK$6,122 million was generated before payments for the Rail Merger. Upfront payments of HK$12,040 million were incurred while reimbursement of HK$786 million was received in respect of the assumption of certain KCRC assets and liabilities for the Rail Merger, resulting in a cash deficit of HK$5,132 million for the year, which was financed by an increase in debt of HK$5,401 million.

In view of the strong financial performance in 2007, the Board has recommended a final dividend of HK$0.31 per share which, when added to the interim dividend of HK$0.14, will give a total dividend of HK$0.45 per share for the year, representing an increase of HK$0.03 or 7.1% as compared to last year. As in previous years, the Financial Secretary Incorporated has agreed to receive its entitlement to dividends in the form of shares to the extent necessary to ensure that a maximum of 50% of the Company's total dividend will be paid in cash.

Human Resources

The commitment, loyalty and professionalism of our staff have long been the foundation of our success. In the preparations for the Rail Merger, we consistently followed the principle of "One Company, One Team", and consulted our colleagues on all matters that affected their future. The Rail Merger was not simply a financial transaction involving physical assets and operational integration; it was a process that involved people. To help our colleagues to learn about the merger process, and to provide an opportunity for them to interact with each other, 99 Cultural Integration workshops were held. Every one of our colleagues attended at least one of these workshops. Their views were sought and they were kept abreast of developments through many different channels, including publications, newsletters and communication sessions. These programmes were designed to make the merger process more transparent and to reduce uncertainties.

Our numerous training and development programmes to enhance skills and maintain motivation continued throughout the year, with courses covering issues such as empathetic listening, empowerment and railway safety. In order to meet the future requirements of the Company, several major initiatives were undertaken to develop management and leadership talents, including an Executive Associate Scheme and a graduate trainee programme with graduates from both Hong Kong SAR and the Mainland of China. We also continued to devote resources to developing and resourcing staff for our expanding overseas business and to create our culture at our operations offshore.

Outlook

Uncertainties in the global economy continued in the latter part of 2007 and into 2008, with the risk of a slowdown in the U.S.. However, with continued growth in the Mainland of China and barring any further major external shocks, we hold a positive view on the economic prospects of Hong Kong in 2008.

The Rail Merger will have a positive full-year impact on our businesses in 2008. We remain confident of achieving the HK$450 million per year in merger synergies over three years. In 2008, we are of the view that approximately HK$130 million of such synergies could be achieved through energy optimisation, combined procurements and revenue enhancements through the enlarged network.

However rail operating margin is expected to be lower in 2008 as a result of the fare reduction and also the lower margin of the KCR System. Station commercial and rail related businesses will benefit from economic growth in Hong Kong as well as the full year impact of the Duty Free shop tenancies in Hung Hom, Lo Wu and Lok Ma Chau. However, we will continue to see pressure on our telecommunications business with further cannibalisation of 2G service by 3G.

In our property and other businesses, our property investment and management business will benefit from the full year effect of Elements Phase 1 as well as the expected opening of Elements Phase 2 of around 7,609 square metres gross towards the end of 2008. We should also benefit from the full year effect of the re-opening of Ngong Ping 360 and the acquired investment property portfolio under the Rail Merger.

In our property development business, depending on the progress of constructions and pre-sale, we expect to recognise most of our remaining property deferred income balance (before deduction of related cost) of HK$400 million in the next 18 months, which mainly relates to properties along the Airport Railway, such as Elements in Kowloon Station, Coastal Skyline and Caribbean Coast in Tung Chung Station. In Tseung Kwan O, pre-sales have been successfully completed for The Capitol, LOHAS Park Package 1, and depending on the issuance of the Occupation Permit, we may be able to recognise surplus proceeds from this development in the second half of 2008. Pre-sales should also commence this year for Ho Tung Lau, one of the eight property development projects acquired in the Rail Merger. Once again depending on the progress of pre-sales and with the Occupation Permit expected to be received before the year end, there is a possibility of profit recognition from this development in 2008. From an accounting perspective, our acquisition costs for the property developments (such as Ho Tung Lau) acquired under the Rail Merger will have to be accounted for before profits can be recognised. Another of the eight projects acquired in the Rail Merger, Wu Kai Sha, will likely start pre-sales in 2008 but as the Occupation Permit is not expected until after 2008, it is unlikely that profits will be recognised on the project in 2008. The magnitude of property development profits in 2007 were mainly the result of the profit accounting of Le Point in Tiu Keng Leng, whereby the costs for that project were already accounted for in 2006. Hence, we do not expect the magnitude of development profits in 2007 to be repeated in 2008. In our property tender activities, we are likely to tender the Che Kung Temple site in 2008, for which the Expression of Interest was launched in early March 2008. Meanwhile, as the development agent for West Rail property developments, we will recommend the sites at Tsuen Wan West (TW5 and TW7) for tender invitation within the next 12 months, subject to market conditions. These three railway related property development sites are planned to provide a total of about 6,200 flats.

Finally, I would like to take this opportunity to thank my fellow directors and all my colleagues for their tremendous energy and dedication in a truly memorable year for the Company.

C K Chow, *Chief Executive Officer*
Hong Kong, 11 March 2008