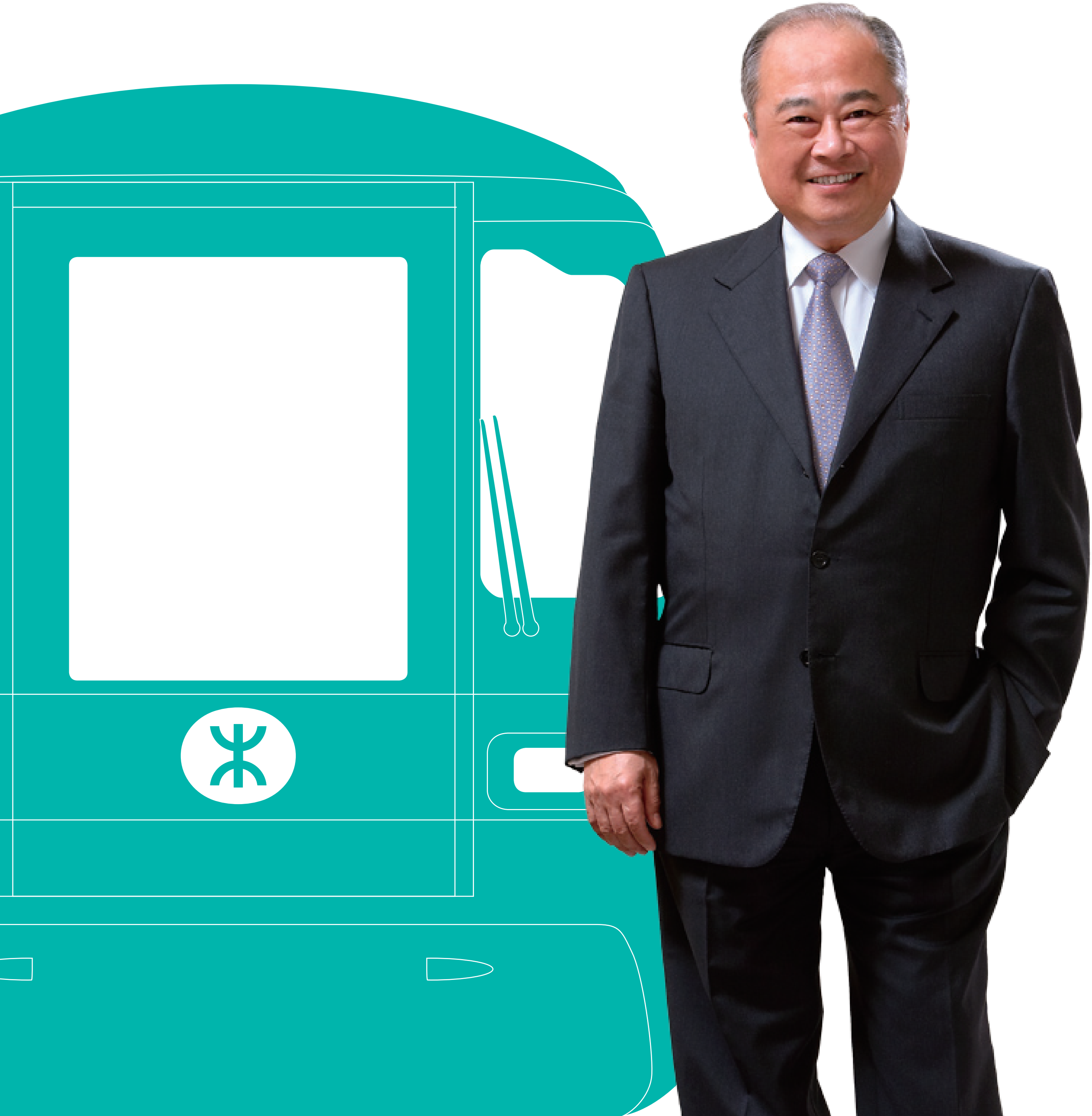
CEO's Review of Operations and Outlook

"The Rail Merger was successfully implemented, and we have delivered on all of the promises we made to our stakeholders."



"With the strong financial results from our recurrent businesses, your Board has recommended a final dividend... brings the full year dividend to HK$0.48, an increase of 6.7% over 2007."

Dear Stakeholders,

I am pleased to report that 2008 was a successful year for the Company. The Rail Merger was successfully implemented, and we have delivered on all of the promises we made to our stakeholders. For our passengers, we pledged fare reduction, which was implemented immediately upon the Rail Merger, benefiting 2.8 million passengers. We promised job security for all of our front-line staff and this objective was achieved under the spirit of "One Company, One Team". We laid out a plan to integrate the two rail networks within one year of the Rail Merger. We have completed this plan through the physical integration of the three interchange stations in Kowloon Tong, Mei Foo and Nam Cheong in September 2008, more than two months ahead of schedule. For our shareholders, the Company's financial results in 2008 clearly demonstrate the benefits of the Merger. In addition, we have achieved synergies of over HK$350 million in 2008, ahead of schedule. The Rail Merger has made MTR Corporation a stronger company with the confidence to face the future.

After the Rail Merger, we turn our attention to growth. We forged ahead both in Hong Kong and overseas. In Hong Kong, the Government gave approval in March and April for the planning and design of the Shatin to Central Link, the Kwun Tong Line Extension to Whampoa and the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link). These new lines together with the West Island Line and South Island Line (East), for which approval to proceed with planning and design had already been given, mean that in total the Company has five new lines in various stages of development. Our efforts in the Mainland of China and Europe continued to expand, with progress being made on our projects in Beijing and Shenzhen as well as in London. Elsewhere, we also made progress with potential projects in Hangzhou and Shenyang and we were awarded the Stockholm Metro operating concession.

The Company's financial results for 2008 reflect the significant impact of the Rail Merger as we made a step change in our recurrent businesses of rail, station commercial, investment property and property management. Despite the less than favourable economic climate caused by the global financial turmoil, our revenue increased by 64.9% to HK$17,628 million. Operating profit from railway and related businesses before depreciation and amortisation rose by 57.7% to HK$9,325 million. On the other hand, property development profits in 2008 of HK$4,670 million were lower than in 2007 by HK$3,634 million due to the very significant development profits realised relating to Le Point in Tseung Kwan O in 2007. Hence excluding the change in fair value of investment properties and related deferred tax, net profit from underlying businesses attributable to equity shareholders was HK$8,185 million, a slight decline of 4.5% from 2007. Reflecting the overall downturn in the Hong Kong property market, investment property revaluation deficit for the year was HK$146 million (HK$99 million surplus net of deferred tax after accounting for the reduction in Hong Kong Profits Tax rate) compared to a revaluation surplus of HK$8,011 million in 2007 (HK$6,609 million net of deferred tax). Therefore, net profit attributable to equity shareholders was HK$8,284 million. The reported earnings per share were HK$1.45 before investment property revaluation and HK$1.47 after such revaluation. With the strong financial results from our recurrent businesses, your Board has recommended a final dividend of HK$0.34, which when combined with the interim dividend of HK$0.14 per share, brings the full year dividend to HK$0.48, an increase of 6.7% over 2007.

"In 2008, total patronage for all of our rail and bus passenger services (Integrated MTR System) increased by 56.6% to 1,485.1 million as compared to last year mainly due to the Rail Merger."

Operational Review

Hong Kong Railway Operations

Patronage

In 2008, total patronage for all of our rail and bus passenger services (Integrated MTR System) increased by 56.6% to 1,485.1 million as compared to last year mainly due to the Rail Merger. On a "like for like" basis, such passenger numbers would have increased by 3.6% when compared with the combined rail and bus patronage numbers of MTR Corporation and pre-merger Kowloon Canton Railway Corporation (KCRC) (as adjusted for interchange passengers) in 2007 (Comparable Combined Patronage).

Our Domestic Service, which includes the MTR Lines (comprising the Kwun Tong, Tsuen Wan, Island, Tung Chung, Tseung Kwan O and Disneyland Resort lines) and the KCR Lines (comprising the East Rail excluding Cross-boundary Service, West Rail and Ma On Shan lines), recorded total patronage of 1,205.4 million. This represents an increase of 31.6% when compared with 2007 and 4.0% when compared with the equivalent Comparable Combined Patronage.

For the Cross-boundary Service at Lo Wu and Lok Ma Chau, patronage was 93.4 million for 2008, representing an increase of 1.4% when compared with 2007 as a result of the growth in cross-boundary traffic.

Passengers using the Airport Express in 2008 rose 4.2% to 10.6 million when compared with the same period last year due to an increase in the market share of Airport Express despite a drop in number of travelers using Hong Kong International Airport, coupled with an increase in passengers going to and from AsiaWorld-Expo.

Passenger volume on Light Rail, Bus and Intercity was 175.6 million in 2008, an increase of 2.5% when compared with full year patronage of such services in 2007.

Market Share

Our overall share of the franchised public transport market rose to 42.7% in December 2008 as compared to 41.6% in the same month last year. Our share of cross-harbour traffic rose to 63.6% from 62.5% in 2007, and our share of traffic to and from the airport rose to 24% from 23% in 2007. However our market share in the Cross-boundary business declined to 56.2% from 57.0% in 2007 due to continued strong competition.

Fare Revenue

Total fare revenue was HK$11,467 million in 2008, which represents an increase of 61.2% over last year. Such fare revenue represents a slight decrease of 0.3% over the combined fare revenue of the rail and bus services of MTR Corporation and pre-merger KCRC in 2007 due to fare reductions given at the time of the Rail Merger.

Fare revenue of the Domestic Service was HK$7,930 million in 2008, which represents an increase of 27.6% over last year. However, compared with the combined fare revenue of MTR Lines and KCR Lines in 2007 (Combined Fare Revenue), there was a slight decline of 1.0% mainly as a result of the fare reduction implemented on the Rail Merger Day and the extension of student concession fares to the KCR Lines, which was partly offset by the increased patronage mentioned above.

Fare revenue of the Cross-boundary Service was HK$2,283 million in 2008, which represents an increase of 1.2% when compared with the equivalent 12-month revenue for such service in 2007. Fare revenue of the Airport Express was HK$673 million in 2008, which represents an increase of 2.7% over 2007.

Average fare per passenger for the Domestic Service in 2008 was HK$6.58, a decrease of 3.0% compared with that of 2007 due to the one-off fare reduction implemented on the Rail Merger Day. For Cross-boundary Service, average fare per passenger in 2008 was HK$24.45, a slight decrease of 0.2% when compared with 2007. For the Airport Express, average fare per passenger in 2008 decreased marginally by 1.4% to HK$63.47.

Attracting Patronage

In order to underpin patronage growth and to meet the high service levels expected by our customers, we continued to offer targeted promotions, as well as investing in service and efficiency improvements. Fare promotions included reduced fares for interchanging passengers from outlying island ferries as well as the extension of the student Concessionary Fare to cover the domestic services of East Rail, West Rail, Ma On Shan lines, Light Rail and MTR Bus. Special promotions were also offered to increase ridership for Cross-boundary Service and the Airport Express. To further enhance service, we brought into operation five 7-car new trains on the West Rail Line in the fourth quarter of 2008 as well as ordering an additional 10 new trains, to be delivered between 2011 to 2012, to increase train frequency on the existing Island, Kwun Tong, Tsuen Wan and Tseung Kwan O lines. Our intercity passengers also benefitted from the replacement of diesel-powered locomotives by electric-powered rolling stock on the Beijing/Shanghai-Kowloon Through Trains. We have renovated East Rail stations with the introduction of inspiring colours and graphics containing local heritage with better signage. This provides a refreshing ambience for our East Rail passengers.

Connectivity to our network was enhanced with additional pedestrian links and footbridges at Kowloon Bay and Sheung Wan stations. We also added seven more popular fare saver machines, bringing the total to 26 by the end of 2008.

Service Performance

With the Rail Merger, a new Operating Agreement was established to include the East Rail Line, West Rail Line, Ma On Shan Line and Light Rail. For the period from the Merger Date of 2 December 2007 to 31 December 2008, we exceeded all the performance levels required by Government and our own more stringent Customer Service Pledges targets. Train service delivery, passenger journeys on time and train punctuality were 99.7% or above. The high standard of our service performance levels delivered by our dedicated staff was again recognised in a large number of awards, including the Best Metro Asia Pacific Award at The Metro Rail 2008, Sing Tao Daily's Excellent Services Brand Award 2007 – Public Transportation Category, Next Magazine's "Top Service Award – Transportation Category" for the 10th consecutive year and the Bronze Award in the Customer Service Excellence Awards 2007 organised by the Hong Kong Association for Customer Service Excellence Limited. Ktt, which provides intercity passenger service between Hong Kong and Guangzhou, won the 2008 Prime Award for Brand Excellence in Cross Boundary Transportation Services organised by Prime Magazine.

Olympic Equestrian Event

A noteworthy event in the year was MTR Corporation's participation in the transportation of athletes, supporting personnel and spectators to the Equestrian Olympic venues in Hong Kong at Beas River and Shatin in August. Drawing on resources from across the Company, we ensured that passengers arrived at their venues safely, on time and in comfort.

Station Commercial and Rail Related Businesses

Revenue for our station commercial and rail related businesses in 2008 was HK$3,449 million, representing an increase of 98.1% over 2007. The increase would have been 33.4% over the comparable combined revenue of MTR Corporation and pre-merger KCRC for such businesses in 2007 (Combined Non-fare Revenue).

Revenue for our station retail business in 2008, comprising duty free shops and kiosk rental, was HK$1,546 million, representing an increase of 209.8% over 2007 (42.3% increase over the equivalent Combined Non-fare Revenue). This increase was mainly due to the inclusion of retail shops along the KCR Lines, particularly the 10 duty free shops serving Cross-boundary customers. Further growth was provided by increased new retail area and new rental contracts being awarded at higher rents. Although there were repossession of shops to facilitate renovation works, 45 renovated shops were completed at 9 stations and 18 new trades were added. The total number of shops as at 31 December 2008 was 1,186. Total area of station retail space at 31 December 2008 was 51,539 square metres.

Advertising revenue in 2008 was HK$741 million, representing an increase of 25.0% when compared with 2007 (11.3% increase over the equivalent Combined Non-fare Revenue). In addition to the merger benefits, there were higher advertising rates and more innovative advertising formats. New advertising formats included "The Galleria" launched in the lower adit of Causeway Bay Station in May and the Digital Escalator Crown Bank at Causeway Bay, Tsim Sha Tsui and Central stations, which is the first of its kind in Asia's metro.

Revenue from telecommunications services in 2008 was HK$356 million representing an increase of 49.0% when compared with 2007 (an increase of 27.6% over the equivalent Combined Non-fare Revenue). This increase was mainly due to a one-off payment received on termination of a telecommunication license. Excluding this one-off income, revenue would have increased by 13.0% to HK$270 million as compared to 2007 (3.2% decline compared with the equivalent Combined Non-fare Revenue).

Revenue from consultancy was HK$158 million during 2008, a decrease of 18.1% when compared with 2007, due to the more focused strategy on consulting services and the completion of the majority of works on Shanghai Metro Line 9 Phase 1, which opened in December 2007.

Property and Other Businesses

The Hong Kong property market performed strongly in the first half of 2008. Both office and retail markets enjoyed steady growth. However, with global credit market uncertainties developing into a global economic downturn, market activities slowed noticeably in the second half. Sale prices for residential units declined, and commercial rents started to consolidate.

Property Development

Profit on property development for 2008 was HK$4,670 million, a decrease of 43.8% when compared with that of HK$8,304 million in 2007. This is mainly due to the very significant development profits booking in 2007, particularly for Le Point in Tseung Kwan O. The major contributors to property development profit were from profit recognition relating to The Capitol at LOHAS Park and The Palazzo in Shatin as well as the sale of units from inventory at Harbour Green and The Arch. In addition, there was deferred income recognition, mainly from properties along the Airport Railway, such as Coastal Skyline and Caribbean Coast in Tung Chung Station, and Elements in Kowloon Station.

Property sales in the year included the pre-sale of all 2,096 units of The Capitol at LOHAS Park, about 80% or 1,100 units of the 1,375 units available at The Palazzo in Shatin and over 470 units at Le Bleu Deux in Tung Chung.

In our property tendering activities, the development package for Che Kung Temple on the Ma On Shan Line was awarded to a subsidiary of New World Development Company Limited (Deluxe Sign Limited) in April. Similar to LOHAS Park Package 1, The Capitol, we paid half of the land premium for this development in return for a larger share of profits. As agent for the West Rail Line property development, we awarded Tsuen Wan West Station TW7 Property Development to a subsidiary of Cheung Kong (Holdings) Limited (Queensway Investments Limited) in September.

"Total revenue from property rental, property management and other businesses in 2008 was HK$2,712 million, an increase of 47.9% over 2007."

Property Rental, Property Management and Other Businesses

Total revenue from property rental, property management and other businesses in 2008 was HK$2,712 million, an increase of 47.9% over 2007 (29.8% increase over the equivalent Combined Non-fare Revenue).

Demand for both office and retail space was strong in the first half of the year, but the rate of growth began to slow in the second half. Property rental income was HK$2,346 million, an increase of 48.4% over 2007 (28.8% increase over the equivalent Combined Non-fare Revenue). Visitors to the Company's retail centres remained strong throughout this year. The average increase in rental income of retail properties on renewal of leases or re-letting was 20% as compared to rental income achieved in the previous lettings.

We maintained close to 100% occupancy of our shopping centres. The Company's 18 floors at Two International Finance Centre were fully rented out.

At the end of December 2008, the Company's attributable share of investment properties was 221,661 square metres of lettable floor area of retail properties, and 41,059 square metres of lettable floor area of offices.

During the year, we continued to renovate our shopping centres to enhance their market appeal and competitiveness. Renovation works included the redevelopment of the cinema complex at Telford Plaza I. Our shopping centres were honoured with a variety of local and international awards. Elements, above Kowloon Station, won an international MIPIM award at the world's premier real estate summit in Cannes, France and the Urban Land Institute's 2008 Award for Excellence: Asia Pacific. The development was also named Project of the Year (Retail) in the Asia Pacific Real Estate Awards. Telford Plaza won the Prime Award for Eco-Business 2008 sponsored by Prime Magazine and the Hong Kong Service Award sponsored by East Weekly.

Ginza Mall, which opened in January 2007, continued to set new benchmarks for service and quality amongst shopping centres in Beijing. Average rental income increment for lease renewal and re-letting was 15% compared to 2007 and occupancy was 100%. The shopping centre received many awards and honours in its first full year of operation. These included being ranked No. 2 amongst the 156 major shopping centres and department stores in Beijing in a Customer Satisfaction Survey conducted by the Beijing Municipal Commerce Bureau.

Property management revenue in 2008 was HK$210 million, an increase of 25.0% over 2007 (a 15.4% increase over the equivalent Combined Non-fare Revenue). The number of residential units under our management totalled 73,947 as at the end of December, whilst commercial space under management was 770,556 square metres. Our managed property portfolio in the Mainland of China amounted to 1,158,254 square metres.

"Planning and design are underway for five new rail projects in Hong Kong, which together with the substantially completed Kowloon Southern Link, will extend our network by approximately 60 kilometres when they are all completed."

Octopus and Ngong Ping 360

Octopus performed strongly in 2008 with our share of Octopus' net profits increasing 40.2% to HK$136 million. The growth in profit was mainly due to continued increases in non-transport retail payments.

The Ngong Ping cable car and associated theme village on Lantau Island contributed HK$156 million of revenue in 2008, with visitor numbers reaching more than 1.6 million.

Future Growth

Hong Kong

Planning and design are underway for five new rail projects in Hong Kong, which together with the substantially completed Kowloon Southern Link, will extend our network by approximately 60 kilometres when they are all completed. These five new lines represent the most significant network expansion in the Company's history and will make a considerable contribution to our growth.

In March, the Government gave approval for the planning and design of the Shatin to Central Link and the Kwun Tong Line Extension. The Shatin to Central Link comprises two sections. The 11-km East West Corridor, expected to complete in 2015, will extend the Ma On Shan Line from Tai Wai to Hung Hom, via Diamond Hill, and will connect with the West Rail Line. The 6-km North South Corridor, expected to be completed in 2019, will form Hong Kong's fourth rail harbour crossing, extending the East Rail Line from Hung Hom to Hong Kong Island. The preliminary design started in September 2008 with a view to developing a scheme to be gazetted under the Railways Ordinance in late 2009.

The 3-km Kwun Tong Line Extension will run from the existing Yau Ma Tei Station of Kwun Tong Line to Whampoa via Ho Man Tin, which will be an interchange station with the East West Corridor of the Shatin to Central Link. The preliminary design started in June, and will be finished in early 2009. The project is expected to be completed in 2015.

In April, the Government asked the Company to proceed with the planning and design of the Express Rail Link, which will further enhance the strategic position of Hong Kong as the southern gateway to the Mainland of China. The 26-km Express Rail Link will provide cross-boundary high speed rail services connecting Hong Kong to Shenzhen, Guangzhou and the Mainland of China's new high speed intercity rail network. Trips to Futian in Shenzhen will take 14 minutes and to Guangzhou 48 minutes. The project was gazetted on 28 November 2008 and it is anticipated that construction will commence in late 2009 for completion by 2015.

Following the announcement of the Government's support for the planning and design of the South Island Line (East) in December 2007, preliminary design commenced in February 2008 and will be completed in early 2009. The final plan will be issued to Government for review and gazetting later in 2009.

The West Island Line was gazetted under the Railways Ordinance in October 2007. Frequent dialogue with, and input from local communities have led to a design that is sensitive to both local heritage and urban renewal opportunities for creating a "Community Railway". Detailed design commenced in early 2008, and construction is planned to commence in 2009 for completion in 2014.

In addition to the foregoing five new lines, satisfactory progress was made during 2008 on the Kowloon Southern Link, which incorporates the new Austin Station that will connect the existing East Rail Line's East Tsim Sha Tsui Station with West Rail Line's Nam Cheong Station. The main civil works, including the tunnel boring works, were substantially completed and the fitting out of the new Austin Station is rapidly approaching completion. The line is expected to open in the second half of 2009.

Phase 2 of the Tseung Kwan O Line is also on schedule for completion in the second quarter of 2009 to coincide with occupancy of The Capitol at LOHAS Park.

Hong Kong Project Funding

As noted previously, the funding model for all these new rail projects will take different forms, each appropriately designed for the project. For the West Island Line, which will use the capital grant model, we received the initial part of this grant of HK$400 million in February 2008 while the amount of the remaining portion, which forms the bulk of the total capital grant, is being discussed with Government.

The South Island Line (East) and the Kwun Tong Line Extension will likely follow the Company's traditional "Rail and Property" approach whereby property development rights will be granted to us. Suitable sites have been identified and negotiations with the Government on the development rights are continuing.

The Service Concession model used in the Rail Merger will be adopted for Kowloon Southern Link, Shatin to Central Link and the Express Rail Link. On this basis, the Finance Committee of the Legislative Council of Hong Kong (LegCo) approved an amount of HK$2.4 billion in May to be used for design and site investigation works for the Shatin to Central Link, and an amount of HK$2.8 billion in July for similar works for the Express Rail Link. On 24 November 2008, we entered into Entrustment Agreements with Government entrusting the Company to design the Shatin to Central Link and Express Rail Link with costs to be borne by Government. Further funding arrangements for construction of these two lines will be made by Government at the appropriate time. The construction of the Kowloon Southern Link is being funded by KCRC as part of the Rail Merger agreement.

Mainland of China and Overseas

Our projects in the Mainland of China and overseas continued to make good progress.

Mainland of China

In Beijing, the Public-Private-Partnership (PPP) company comprising MTR Corporation (49%), Beijing Infrastructure Investment Co. Ltd. (2%) and Beijing Capital Group (49%) is making steady progress with construction work on the Beijing Metro Line 4 (BJL4) project. BJL4 is expected to commence operation in the fourth quarter of 2009. The Company, together with our PPP company partners, also signed a Memorandum of Understanding (MOU) on 27 November 2008 with Beijing Metro Daxing Line Investment Company Limited, a wholly owned subsidiary of Beijing Municipal Government, for the operation and maintenance of the 22-km Daxing Line of the Beijing Metro Network. Discussions are ongoing on the Concession Agreement for Daxing Line.

In Shenzhen, approval for the Shenzhen Metro Line 4 (SZL4) project has been obtained from the National Development and Reform Commission. We are now completing final regulatory procedures for signing the Concession Agreement in the near future. Project works will be expanded to cover the whole line. Meanwhile, preparation works for taking over SZL4 Phase 1 are also underway.

We continue to seek investment opportunities in other cities in the Mainland of China.

After being selected as the "preferred bidder" in July 2008, the Company entered into a non-binding Principle Agreement in January 2009 for a PPP project with Hangzhou Municipal Government and Hangzhou Metro Group Company Limited for the investment, construction and operation of Hangzhou Metro Line 1 for 25 years. At the same time we also entered into a strategic agreement with the same parties to explore property development opportunities along the Hangzhou Metro lines. We moved forward in our discussions with the Shenyang Government on cooperation in the operation of the 50-km Shenyang Metro Lines 1 and 2 and possible investment in future lines by entering into non-binding Agreements in Principle with Shenyang Municipal Government and Shenyang Metro Group Company Limited in November 2008. In addition, a further non-binding agreement was entered into to plan and explore property development opportunities along the Lines 1 and 2 alignment. Discussions in Hangzhou and Shenyang on Concession Agreements are now progressing.

Europe

In the UK, our 50:50 joint venture London Overground Rail Operations Limited (LOROL) brought steady improvements to London Overground following the takeover of the concession in November 2007. Operational performance has been enhanced and 31 stations have undergone station upgrading works.

In Sweden, we submitted our bid for the Stockholm Metro concession in August 2008 and in January 2009, we were awarded the eight-year concession rights to operate the 108–km long, 100-station system.

Financial Review

With the full-year effect of the Rail Merger, the Group achieved strong growth in revenue and operating profits from recurrent businesses in 2008. Total fare revenue increased by 61.2% to HK$11,467 million, comprising HK$7,930 million from Domestic Service, HK$2,283 million from Cross-boundary Service, HK$673 million from the Airport Express and HK$581 million from Light Rail, Intercity and Bus. Non-fare revenue increased by 72.3% to HK$6,161 million with HK$3,449 million from station commercial and rail related businesses and HK$2,712 million from property rental, management and other businesses. Total revenue for 2008 therefore increased by 64.9% to HK$17,628 million, and total operating costs for 2008 rose by 73.8% to HK$8,303 million. Operating profit from railway and related businesses before depreciation and amortisation increased by 57.7% to HK$9,325 million whilst operating margin decreased from 55.3% in 2007 to 52.9% in 2008 due to fare reduction at the time of the Rail Merger as well as the lower margin of the pre-merger KCRC businesses.

Owing to the significant property profit recognition from Le Point in Tseung Kwan O in 2007 and the decline in property prices in the latter part of 2008, property development profits decreased by 43.8% to HK$4,670 million in 2008, mainly comprising profits from The Capitol and The Palazzo. Operating profit before depreciation and amortisation therefore decreased slightly by 1.6% to HK$13,995 million. Depreciation and amortisation increased by 7% to HK$2,930 million mainly due to the Rail Merger while merger related expenses decreased by 72.5% to HK$53 million. Interest and finance charges increased by 51.8% to HK$1,998 million, mainly due to interest on debt taken on for the Rail Merger and the notional interest expense on the capitalised fixed annual payments for the Rail Merger. MTR's share of profits from Octopus Holdings Limited and London Overground Rail Operations Ltd totalled HK$159 million. A non-cash revaluation deficit of HK$146 million was recorded for investment property versus a large gain of HK$8,011 million in 2007. Including the above, the reported profit before tax decreased by 50.6% from 2007 to HK$9,027 million.

With the decrease in profits and the deferred tax impact from the reduction in profits tax rate from 17.5% to 16.5%, income tax decreased by 75.8% to HK$747 million. Reported profit attributable to shareholders of the Company in 2008 therefore decreased by 45.4% to HK$8,284 million, or HK$1.47 per share as compared with HK$2.72 in 2007.

“Cash flow of the Group in 2008 was strengthened by the Rail Merger with net cash inflow from railway and related businesses increasing by 49.3% to HK$8,921 million.”

Excluding investment property revaluation, the more representative net profit from underlying business attributable to shareholders of the Company decreased by 4.5% to HK$8,185 million, or HK$1.45 per share as compared with HK$1.54 in 2007. As stated earlier, this is the result of strong growth of profit from our recurrent businesses but lower property development profit when compared with the previous year.

The Group’s balance sheet showed a 7.5% increase in net assets from HK$91,037 million as at 31 December 2007 to HK$97,822 million as at 31 December 2008. Total assets increased from HK$155,668 million to HK$159,338 million mainly attributable to increases in accounts receivable and properties held for sale relating to property development as well as investments in new railway projects both in Hong Kong and the Mainland of China. Total liabilities decreased from HK$64,631 million in 2007 to HK$61,516 million mainly due to reduced loans outstanding and deferred income. Including obligations under the service concession as a component of debt, the Group’s net debt-to-equity ratio improved from 48.5% at 2007 year end to 42.1% at 2008 year end.

Cash flow of the Group in 2008 was strengthened by the Rail Merger with net cash inflow from railway and related businesses increasing by 49.3% to HK$8,921 million. Receipts from our property development business were HK$4,448 million. The Group also received HK$400 million of government grant for the West Island Line project as well as HK$132 million of loan repayments and dividend distribution from its non-controlled subsidiaries and associates. Total cash outflows, excluding the non-recurrent merger-related payments, increased by 88% to HK$9,887 million primarily due to new railway projects, increases in capital expenditures on the expanded railway network after the Rail Merger, payment for the half land premium for the Che Kung Temple property development as well as the fixed annual payment for the service concession. Therefore net cash inflow of HK$3,698 million was generated in 2008, which was used mainly to reduce debt.

The Board has recommended a final dividend of HK$0.34 per share, which, when added to the interim dividend of HK$0.14, will give a total dividend of HK$0.48 per share for the year, representing an increase of HK$0.03 or 6.7% 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 success of the Company is based on the commitment, professionalism and caring services of our staff. In the post-Rail Merger era, our goal is to create a culture of “One Company, One Team”, so the new grading and salary structure together with aligned terms and conditions of our 12,000 Hong Kong staff were implemented across the entire organisation on 1 March 2008. The entire selection and appointment process was completed in April.

To meet post-Rail Merger challenges, a broad range of training and development programmes was undertaken throughout the year, particularly in the areas of railway safety, railway operations and maintenance, multi-skilling, redeployment and new recruits. In addition, Mainland local recruits for BJL4 and SZL4 were given comprehensive training with job attachment in Hong Kong to ensure operational readiness of these two key new projects. We continued to develop management and leadership quality for the future of the Company with major ongoing programmes such as our Executive Associate Scheme and a Graduate Trainee Programme with graduates from both Hong Kong SAR and the Mainland of China.

With the expansion of the railway network in Hong Kong, substantial manpower resources are required for the planning, construction and operations of these new lines. An intensive Human Resources planning and recruitment programme has commenced in 2008 to address these needs and is making good progress.

Outlook

Economic conditions globally and in Hong Kong remain uncertain with forecasts of negative economic growth in Hong Kong for 2009. Given these conditions, we are taking a cautious approach to 2009.

Our rail business is by nature defensive. It is, however, sensitive to the level of unemployment. We will benefit from incremental increase in passengers with the opening of Kowloon Southern Link and the Tseung Kwan O Line extension to LOHAS Park. Review of fares will be subject to the provisions of the Fare Adjustment Mechanism in July 2009. It should be noted that according to the agreed mechanism, if the calculated adjustment percentage is within ± 1.5%, no adjustment will take place in that year but the adjustment percentage will be carried forward to the next year. Our advertising business is more sensitive to economic conditions and together with the non-recurrence in 2009 of the one-off telecommunication termination revenue in 2008, will make 2009 a more challenging year for these two businesses.

Our station commercial and property rental businesses will be affected by rental renewals and reversions, which will be market dependent.

In our property development business, the second half of 2009 should see the issuance of the Occupation Permit for Phase 1 of LOHAS Park Package 2 comprising 1,688 units. As profit sharing for this property is based on "sharing in kind" , irrespective of sales, it will be accounted for based on the market value of those Phase 1 units due to MTR Corporation on the date of issuance of the Occupation Permit less the deemed interest subsidy on the interest free loan to the developer.

The launch of sales at Lake Silver at Wu Kai Sha and Tai Wai Maintenance Centre will be subject to a commercially driven decision dependent on the market and other considerations.

Our growth business will see a number of milestones in 2009. In Hong Kong, the Tseung Kwan O Line extension opens in mid-2009 and Kowloon Southern Link opens in the second half. In the Mainland of China, BJL4 will commence operations in the fourth quarter of 2009 while in Stockholm, we expect to take over the franchise in November 2009.

Given all the economic uncertainties we continue our focus on cost containment, and maintaining a strong cash flow.

Finally, I would like to take this opportunity to thank my fellow directors and all my 14,000 colleagues for their energy and dedication over the past year. They are the heroes of MTR.

C K Chow, *Chief Executive Officer*
Hong Kong, 10 March 2009