CEO's Review of Operations and Outlook

"...all of our businesses posted solid gains in 2010, taking full advantage of the active economies in Hong Kong and abroad."

Dear Shareholders and other Stakeholders,

I am pleased to report that all of our businesses posted solid gains in 2010, taking full advantage of the active economies in Hong Kong and abroad.

Growth in our recurrent businesses in Hong Kong was strong. Our Hong Kong rail business benefited from good patronage growth and an upward adjustment in fares, in accordance with the Fare Adjustment Mechanism. Higher rental reversions, as well as an increase in retail space positively impacted our property rental and station retail businesses. Our advertising business also saw a strong rebound. In property development, profit booking came mainly from Le Prestige in LOHAS Park.

Our businesses outside of Hong Kong also made good progress. Beijing Metro Line 4 (BJL4) celebrated its first anniversary in September 2010, with ridership exceeding 250 million passenger trips whilst achieving high service levels. The Daxing Line, an extension of BJL4, commenced service on 30 December 2010. In Shenzhen, our wholly owned subsidiary MTR Corporation (Shenzhen) Limited (SZMTR) took over the operations of the five-station 4.5-km Phase 1 of Shenzhen Metro Line 4 (SZL4) in July 2010. Our operations in the UK, Sweden and Australia, also made progress.

In Hong Kong construction is under way on the West Island Line and the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link). The planning, design and approval processes for the South Island Line (East), Kwun Tong Line Extension and Shatin to Central Link projects have all been advanced during the year.

Total revenue in 2010 rose by 57.0% to HK$29,518 million. Operating profit from railway and related businesses before depreciation, amortisation and variable annual payment increased by 14.7% to HK$10,917 million. Excluding our overseas railway subsidiaries, revenue was 9.1% higher and operating profit was 11.9% higher, while operating margin improved by 1.4 percentage points to 54.9%. Property development profit for the year was HK$4,034 million compared to HK$3,554 million in 2009. Excluding investment properties revaluation and the related deferred tax, net profit from underlying businesses attributable to equity shareholders increased by 18.5% to HK$8,657 million, representing earnings per share of HK$1.51. Gain on revaluation of investment properties was HK$4,074 million pre-tax (HK$3,402 million post-tax) as compared with HK$2,798 million pre-tax for 2009. Therefore net profit attributable to equity shareholders increased by 25.1% to HK$12,059 million, equivalent to earnings per share of HK$2.10 after such revaluation. Your Board has recommended a final dividend of HK$0.45 per share, resulting in a total dividend for the year of HK$0.59 per share as compared with HK$0.52 per share in 2009.

Hong Kong Passenger Services

Hong Kong fare revenue, which comprises our rail, light rail and bus services, reached HK$12,459 million in 2010, 8.4% higher than for 2009.

Patronage

Total patronage in Hong Kong increased by 6.8% over the previous year to 1,608.5 million.

Patronage on the Domestic Service rose by 6.6% over 2009 to 1,298.7 million. This growth was due to a combination of the full year effect of the opening of the Kowloon Southern Link and the LOHAS Park Station, both in the second half of 2009, strong tourist arrivals in Hong Kong as well as the economic recovery. Average weekday patronage was 3.8 million, an increase of 6.4% over the previous year.

The Cross-boundary Service at Lo Wu and Lok Ma Chau reported a 6.3% rise in patronage over 2009 to 100.0 million in 2010, due to the economic recovery and an increase in tourists from the Mainland of China.

Passenger traffic on the Airport Express in 2010 increased by 12.9% over 2009 to 11.1 million journeys, boosted by the revival in air travel as the global economy improved as well as the one-off "River of Wisdom – Animated Version of the Riverside Scene at Qingming Festival" exhibition at the AsiaWorld-Expo in November.

Passenger volume on Light Rail, Bus and Intercity services totalled 198.7 million in 2010, an increase of 8.0 % over 2009.

Market Share

The Company's overall share of the franchised public transport market in Hong Kong rose from 42.6% in 2009 to 44.3% in 2010. Within this total, our share of the cross-harbour traffic increased from 64% to 65.3%. Our Cross-boundary business market share was 55.0% in 2010.

Fare Revenue

Domestic Service fare revenue increased by 8.5% in 2010 to HK$8,668 million, accounting for 69.6% of the total Hong Kong fare revenue of HK$12,459 million. Average fare per passenger on our Domestic Service increased by 1.9% to HK$6.67, mainly due to an adjustment to fares in June 2010 as well as longer passenger trips after the opening of the Kowloon Southern Link, which connected the East Rail Line and West Rail Line.

Fare revenue from the Cross-boundary Service in 2010 was HK$2,487 million, an increase of 6.9% over 2009. Airport Express fare revenue reached HK$694 million in 2010, a rise of 12.5% as compared with 2009. Fare revenue from Light Rail, Bus and Intercity services was HK$610 million in 2010, a rise of 7.4% over 2009.

Service and Performance

As in previous years, we exceeded all our performance standards, including both those stipulated in the Operating Agreement and our own more demanding Customer Service Pledges.

The Company's service performance was widely recognised in Hong Kong, including the Hong Kong Service Awards in the Public Transportation Category presented by East Week magazine and as the category award winner in the Public Transportation Category of the Sing Tao Excellent Services Brand Award 2009 organised by Sing Tao Daily.

To seek continuous service improvement, we continue to upgrade our stations and rolling stock. During 2010, renovations were completed in five stations, with work under way in three more. Installation of automatic platform gates at eight above ground stations on the Island, Kwun Tong and Tsuen Wan lines have commenced. Platform queuing tiles have been installed at ten West Rail Line stations. A new noise enclosure was constructed for the tracks at Wo Liu Hang in Fo Tan in March 2010.

Eight new light rail vehicles were put into operation in 2010. Ten new underground trains are targeted for delivery in 2011. We have also modified train compartments to make them more accessible for the disabled and added more ramps and wide gates at stations.

Station Commercial and Rail Related Businesses

Revenue from our station commercial and rail related businesses rose by 11.6% over 2009 to HK$3,715 million. The increase was mainly due to a strong recovery in the advertising business, good rental reversion and an increase in the rental area of station shops. Project management on behalf of Government in relation to the Express Rail Link also added to revenue and, in similar amount, to expenses.

Station retail revenue in 2010 was HK$1,716 million, an increase of 6.9% as compared with 2009. The rise in revenue reflects the increased rental rates resulting from a refinement of trade mix and an active economy, as well as an increase in the number of shops.

The total number of station shops increased from 1,228 at the end of 2009 to 1,254 at the end of 2010, and the total area of station retail space increased from 52,788 square metres at the end of 2009 to 53,880 square metres.

Advertising revenue in 2010 increased by 22.9% over 2009 to HK$734 million, reflecting an improving economy, and the timely launch of new advertising packages.

Revenue from our telecommunications business in 2010 was 6.2% higher than in 2009 at HK$290 million. The increase was due to incremental income from mobile phone networks at new stations, the strong growth of 3G data transmission as well as rentals from new rooftop sites as mobile phone operators expanded their outdoor network coverage.

Revenue from external consultancy in 2010 was HK$113 million. This decline of 28.9% over 2009 reflects completion of the Airport Authority Hong Kong Automatic People Mover Modification Works project in June 2009.

The small and unprofitable freight business was wound down in June 2010.

Property and Other Businesses

The Hong Kong property market was buoyant throughout most of 2010, due to a combination of low interest rates, the economic recovery and increased purchases by Mainland Chinese buyers.

To increase transparency in the sales process of primary residential units, Government introduced a number of measures, such as more detailed listing of the composition of saleable floor area, and the disclosure of price lists three days in advance of sale, all of which we welcome and support. To promote sustainable development, Government also announced measures which made conditions to obtain additional developable floor area for environmental features more restrictive. We are taking steps to comply with these new requirements while mitigating any potential impact on the Company.

In November, Government introduced special stamp duty on properties sold within two years of purchase, with the aim of discouraging speculative purchases. This action led to a reduction in sales volumes, although prices remained relatively firm. Sales volume in the secondary market saw a recovery starting in early 2011.

Property Development

Profit from property development in 2010 was HK$4,034 million, with the major contribution from Le Prestige at LOHAS Park. The sale of units in inventory at The Palazzo in Fo Tan and Lake Silver in Wu Kai Sha also added to this result.

Pre-sales commenced for Phase 1 and Phase 2 of Festival City at Tai Wai Maintenance Centre in March and November 2010 respectively. By the end of 2010, approximately 47% of the 2,728 units in the two phases had been sold.

Occupation Permits were issued for Le Prestige, Phase 2a of LOHAS Park in January 2010 and Festival City Phase 1 and Phase 2 at Tai Wai Maintenance Centre in February 2010 and November 2010 respectively.

In our property tendering activity, we awarded Austin Station Sites C and D to Fast New Limited, a consortium of New World Development Company Limited and Wheelock Properties Limited, in March 2010. We contributed HK$3.9 billion to this development as part of the land premium payments for the sites.

In the second half of 2010, Government introduced a number of new measures relating to property development as discussed above, which has resulted in some adjustments to our property development plans.

Property Rental, Property Management and Other Businesses

The combined revenue of our property rental, property management and other businesses increased by 9.3% in 2010, as compared with 2009, to HK$3,200 million.

Total property rental income from Hong Kong and the Mainland of China rose by 8.2%, to HK$2,758 million. Our shopping mall portfolio in Hong Kong reported an average rental reversion of 14% for the year. At 31 December 2010, our 12 shopping malls in Hong Kong and the Company's 18 floors at Two International Finance Centre remained close to 100% let. Our shopping malls in Hong Kong continued to receive recognition, winning over ten international and local awards.

In Hong Kong, at the end December 2010, the Company's attributable share of investment properties comprised of 225,650 square metres of lettable floor area of retail properties and 41,090 square metres of lettable floor area of offices.

Property management revenue in 2010 was 1.9% lower, as compared with 2009, at HK$203 million. The number of residential units under our management in Hong Kong rose from 79,449 to 81,962 units.

Ngong Ping 360

The Ngong Ping cable car and associated theme village on Lantau Island saw revenue increase by 38.2% to HK$239 million in 2010, as visitor numbers rose from about 1.4 million in 2009 to 1.7 million in 2010. The improved performance was the result of smooth operations, increased sales of the premium "crystal cabin ride", active promotional programmes and the success of our new travel agency, "360 Holidays" in promoting Lantau as a tourist destination.

Octopus

Octopus continued its expansion in the retail sector by recruiting more small to medium-sized retail merchants and introducing new applications to provide greater convenience to consumers and businesses. By the end of December, there were over 3,000 Octopus service providers in Hong Kong, including those served by Octopus-appointed acquirers. Cards in circulation were 23.1 million and average daily transaction volume and value were 11.5 million and HK$106.6 million respectively. The Company's share of Octopus' net profit for 2010 was HK$126 million, a decrease of 15.4% from 2009 mainly due to one-off expenses incurred by Octopus relating to the data privacy incident.

Mainland of China and Overseas Businesses

The Company's operating railway franchises outside of Hong Kong in 2010 comprised of our 49% interest in Beijing MTR Corporation Limited (BJMTR), which operates the BJL4 and our 100% interest in SZMTR, which operates the SZL4, both in the Mainland of China, our 60% interest in Metro Trains Melbourne

Pty. Ltd. (MTM) in Australia, our 100% interest in MTR Stockholm AB (MTRS) in Sweden, our 50% interest in Tunnelbanan Teknik Stockholm AB (TBT), which maintains rolling stock for MTRS, and our 50% interest in London Overground Rail Operations Limited (LOROL) in the UK.

Revenue from railway subsidiaries outside of Hong Kong, MTM, MTRS and SZMTR, was HK$10,144 million. Operating costs were HK$9,865 million, yielding an operating profit of HK$279 million and an operating profit margin of 2.8%. As operation and maintenance franchises, MTM and MTRS require modest capital investment and hence operating margins will typically be much lower than for more capital intensive projects. SZMTR, which commenced operations on 1 July 2010, made a small operating loss, as expected, in 2010. Although the financial performance for MTM has been encouraging, MTRS has not met expectations financially and measures have been implemented to enhance operating efficiency. BJMTR, LOROL and TBT are accounted for as associates, and contributed a total of HK$22 million in post-tax profit in 2010, better than expectations.

Total passengers carried by our rail subsidiaries and associates outside of Hong Kong was close to 850 million in 2010.

BJL4's total ridership in 2010 exceeded 250 million passenger trips, with a daily average of 750,000 trips. On 1 May 2010, the line reported a record ridership of 1 million passenger trips. Performance in terms of average train service availability and punctuality have exceeded targets. On 30 December 2010, the 22-km Daxing Line extension of BJL4 opened for passenger service. BJMTR has an operation and maintenance contract only for the Daxing Line.

In Shenzhen, SZMTR took over the operations of the five-station 4.5-km Phase 1 SZL4 on 1 July 2010. Performance has been good, with average train service delivery and punctuality both exceeding targets. Work progresses well on the ten-station 16-km Phase 2 of SZL4, which is expected to open in the middle of 2011.

With key personnel changes at major stakeholders in Shenyang, including its municipal Government, our 49% owned Shenyang operation and maintenance joint venture has been presented with serious obstacles and is prevented from delivering on the proposed scope of its contract. We are in discussions with the relevant Shenyang parties to resolve this matter, which will lead to our withdrawal from Shenyang. Our investment relating to the joint venture comprises mainly staff costs employed by or supporting the joint venture company and is written off in the 2010 accounts.

In the UK, the introduction of new trains during the year contributed to further service improvements by LOROL. In May 2010, LOROL started full passenger services on the refurbished and extended East London Line, increasing the overall route length from 85 km to 110 km.

In Stockholm, MTRS has returned satisfactory operational performance since the start of operations in November 2009. Performance in terms of average train service punctuality exceeded target.

In Melbourne, MTM encountered a number of operational issues in the first half of the year. Remedial measures were introduced, resulting in improved performance in the second half of the year. MTM has continued to implement asset reliability and operational initiatives aimed at improving performance.

Future Growth

Growth in Hong Kong

We made good progress during the year on the five major projects now under way to extend the railway network in Hong Kong, namely the West Island Line, South Island Line (East), Kwun Tong Line Extension, Express Rail Link and Shatin to Central Link.

All of the Government financial grants for the 3-km West Island Line have been received and construction work is progressing on schedule. All civil works contracts for this project were awarded by April 2010. The civil infrastructure works for the Kennedy Town Swimming Pool (Phase 1) and the David Trench Rehabilitation Centre were substantially completed by the end of 2010. This project has carefully integrated community aspirations to preserve local heritage and create opportunities for urban renewal.

The Government published the gazette amendment for the 7-km South Island Line (East) railway scheme on 4 June 2010 and the project was authorised by the Executive Council on 30 November 2010. The detailed design for the project has been substantially completed. The proposal to zone the Wong Chuk Hang site, which will be used for the depot, into a Comprehensive Development Area for integrated property development, was agreed by the Town Planning Board in June

2010. Formal approval under the Town Planning Ordinance is expected later in 2011. Financial viability for the South Island Line (East) is expected to be achieved using the "Rail plus Property" model.

The 3-km Kwun Tong Line Extension scheme was authorised by the Executive Council on 30 November 2010. The detailed design has been substantially completed. It is proposed to use property development rights above Ho Man Tin Station to achieve financial viability for this line under the "Rail plus Property" model.

The Hong Kong Government will fund the costs for construction of the 26-km Express Rail Link, but has entrusted the design and construction of the line to the Company and has agreed to invite the Company to operate the service on a concession basis upon completion. The Entrustment Agreement for construction was signed on 26 January 2010. Construction started in January 2010 and is making good progress.

Station designs and construction planning for the 17-km Shatin to Central Link are being progressed in parallel with further consultation with local communities and other stakeholders. The scheme was gazetted on 26 November 2010. On 18 February 2011, the advanced funding for the construction of the Shatin to Central Link's share of Admiralty Station and Ho Man Tin Station was approved by the Finance Committee of Legislative Council. This will facilitate further progress for the South Island Line (East) and Kwun Tong Line Extension in the first half of 2011.

Growth in Mainland of China and Overseas

Construction work on SZL4 Phase 2 has made good progress with rolling stock manufacturing well advanced. Full line operation, encompassing Phase 1 and Phase 2, is expected to commence in the middle of 2011.

The Public-Private-Partnership project for the investment in, construction and operation of the 48-km Hangzhou Metro Line 1, for which we entered into a Concession Agreement in March 2010, is awaiting regulatory approval from the Central Government.

Financial Review

Total turnover of the Group in 2010 increased by 57.0% from 2009 to HK$29,518 million as a result of the strong economic rebound in Hong Kong as well as the full-year operation of the international railway subsidiaries. Hong Kong fare revenue grew by 8.4% to HK$12,459 million while non-fare revenue increased by 10.5% to HK$6,915 million. With the full year of operating results from our subsidiaries in Stockholm and Melbourne as well as six months of results from SZL4 Phase 1, which we took over in mid-2010, revenue of HK$10,144 million was generated from these subsidiaries. Including railway subsidiaries outside of Hong Kong, total operating costs in 2010 increased by 100.4% to HK$18,601 million. Excluding these subsidiaries, operating costs grew by 5.9% compared with a 9.1% increase in revenues. The resulting operating profit before depreciation, amortisation and variable annual payment to KCRC for the service concession increased by 14.7% to HK$10,917 million, with operating profit margin decreasing by 13.6 percentage points to 37.0%. Excluding the railway subsidiaries outside of Hong Kong, operating profit margin would have increased by 1.4 percentage points to 54.9% with operating profit increasing by 11.9% to HK$10,638 million. Property development profits in 2010 were HK$4,034 million, mainly from Le Prestige. The one-month provision of variable annual payment to KCRC in 2010 was HK$45 million. After accounting for depreciation and amortisation of HK$3,120 million, interest and finance charges of HK$1,237 million, investment property revaluation gains of HK$4,074 million, share of profits of non-controlled subsidiaries and associates of HK$139 million and income tax of HK$2,590 million, net profit attributable to equity shareholders of the Company in 2010 increased by 25.1% to HK$12,059 million, or HK$2.10 per share. Excluding investment property revaluation, net profit attributable to shareholders increased by 18.5% to HK$8,657 million, or HK$1.51 per share.

As at 31 December 2010, the Group's net assets increased by 10.2% to HK$117,293 million with a 2.9% increase in total assets and a 8.1% decrease in total liabilities. The increase in assets was mainly due to investment property revaluation gains, construction progress of SZL4 and land premium payment for Austin Station Sites C and D. The receipt of West Island Line Government funding support of HK$12,252 million in 2010 led to the decrease in the amounts due from Government and other related parties while this receipt, together with strong cash flow, increased the investments in securities and cash balance. The reductions in liabilities were mainly attributable to the utilisation of West Island Line Government funding support and repayment of debts from surplus cash. With the share capital, share premium and capital reserves increasing by HK$1,237 million and retained earnings and other reserves increasing by

HK$9,526 million, total equity attributable to shareholders of the Company grew by 10.1% to HK$117,150 million. The net debt-to-equity ratio decreased from 25.8% at 2009 year end to 12.8% at 2010 year end.

During the year, the Group generated net cash inflow from operating activities after tax payments of HK$10,907 million, an increase of 34.5%. Cash receipts from property developments were HK$5,249 million, while other cash receipts amounted to HK$166 million. After netting off total cash outflows of HK$15,711 million, mainly for capital projects, property developments, fixed annual payment as well as interest and dividend payments, net cash inflow of HK$611 million was generated. Including the West Island Line Government funding support of HK$12,252 million, total net cash inflow of the Group in 2010 was HK$12,863 million, of which HK$3,015 million was used to reduce debt while HK$3,624 million was invested in bank medium term notes.

Following our progressive dividend policy, the Board has recommended a final dividend of HK$0.45 per share, which, when added to the interim dividend of HK$0.14 per share, gives a total dividend of HK$0.59 per share for the year, an increase of HK$0.07 per share or 13.5% from last year.

Human Resources

The Company has expanded its businesses rapidly in recent years and now employs some 13,829 people in Hong Kong and 6,672 outside of Hong Kong, including those employed by our subsidiaries.

Proactive recruitment planning, appropriate training and open communication have helped the Company to attract and retain the people we need and have underpinned harmonious staff relations. In Hong Kong, over 1,000 vacancies for operating railway staff were filled and 430 new recruits were hired in the Projects Division during the year. Recruitment for our graduate and apprentice schemes was also increased to support our business expansion. Staff retention continues to be effective through reinforcing career advancement for high calibre staff, competitive employment terms and conditions, and staff consultation programmes and motivational schemes.

We strive to develop our colleagues to ensure that they are fully equipped to meet the challenges and opportunities ahead and align their personal goals with the Company's goals. We have also put in place effective programmes to groom future leaders for the Company.

Outlook

In spite of some uncertainties, global economic recovery should continue in 2011.

In this environment our rail business should see continued patronage growth whilst any fare adjustment will be implemented in June 2011 in accordance with the Fare Adjustment Mechanism. Our station commercial and property rental businesses will benefit from a more promising market whilst we expect further recovery in our advertising business.

The year 2011 will see the first full year of variable annual payment to KCRC in line with the Rail Merger.

In our railway franchises outside of Hong Kong, we expect to open Phase 2 of SZL4 in the middle of 2011.

In our property development business, recognition of profit from Festival City in Tai Wai is based on the later of the date when Occupation Permit for the third Phase is issued or the date when sales proceeds exceed the cost of development. Currently, Occupation Permit for Phase 3 is expected by December 2011. At Area 56 in Tseung Kwan O where we have a share in the 20,000 square metre shopping mall, Occupation Permit was issued in January 2011. Hence we will book profits on this mall in the first half of 2011 based on the assessed value of our share of the mall. The mall will open for business in early 2012. Apart from our share of the mall, we have no further financial interest in the Area 56 development.

In our property tendering activities, from now until the end of 2011, we may tender out the Tai Wai Station and the smaller Tin Shui Wai sites, subject to market conditions. The Tai Wai Station site is above East Rail Line Tai Wai Station, whilst our Tin Shui Wai site is above a Light Rail stop. For West Rail development sites, where we only act as agent for Government, we may tender out the Nam Cheong Station site and the Tsuen Wan West (TW5) site in the second half of 2011.

Finally, I take this opportunity to thank my fellow directors and all of my over 20,000 colleagues for their dedication and hard work. They are the heroes of MTR.

C K Chow, *Chief Executive Officer*
Hong Kong, 3 March 2011