Our recurrent businesses in Hong Kong saw higher revenues, as an improving economy led to good patronage growth and higher rental reversions in our property investment and station retail businesses, together with a rebound in our advertising business.

Dear Shareholders and other Stakeholders,

I am pleased to report that all of our businesses performed strongly in the first six months of 2010. Our recurrent businesses in Hong Kong saw higher revenues, as an improving economy led to good patronage growth and higher rental reversions in our property investment and station retail businesses, together with a rebound in our advertising business. Adjustment of fares under the Fair Adjustment Mechanism, which was adopted as part of the Rail Merger in 2007, took place on 13 June 2010 resulting in an upward adjustment, on a weighted average basis, of 2.05%. This was the first upward adjustment of the rail fares since 1997. Our property development business achieved good results as the Hong Kong property market continued to benefit from the low interest rate environment.

The Company's businesses outside Hong Kong contributed to our financial results. In the Mainland of China, Beijing Metro Line 4 (BJL4), our Public-Private-Partnership (PPP) project in the capital city, opened for passenger service in September 2009. Operating performance has been very good and the line already carries over 600,000 passengers per day. Overseas, we continued to drive service improvements at London Overground in the UK, the Stockholm Metro in Sweden and the Melbourne metropolitan train network in Australia. Improvement programmes in asset management and operating practices are being introduced in these franchises with the objective to raise service standards.

Our growth strategy also remains on track. In Hong Kong, we are engaged in five new railway projects. This network expansion is extending our connections throughout Hong Kong and to the new high speed rail network in the Mainland of China. This will enhance connectivity for our passengers and so strengthen the Company's market position. During the first six months, we made considerable headway in the construction of the West Island Line and the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link (Express Rail Link) as well as in the detailed design for the South Island Line (East), Kwun Tong Line Extension and Shatin to Central Link.

In the Mainland of China, our subsidiary, MTR Hangzhou Line 1 Investment Company Limited, together with a subsidiary of Hangzhou Metro Group Company Limited, entered into a concession agreement with the Hangzhou Municipal Government under a PPP project for the investment in, construction and operation of the Hangzhou Metro Line 1 (HZL1), and we are in the process of securing Government approvals. In Beijing, our BJL4 PPP Company is making good headway in preparing for the opening of the Daxing extension of BJL4 towards the end of the year. In Shenzhen, we took over operations of Phase 1 of Shenzhen Metro Line 4 (SZL4) on 1 July whilst construction works are progressing well on Phase 2.

The Company's results for the first half of 2010 reflected the continued recovery in the Hong Kong economy as well as results from our new railway businesses outside Hong Kong. Revenue, which now includes revenue from our overseas railway franchises, increased by 63.4% to HK$14,102 million while operating profit from railway and related businesses before depreciation and amortisation increased by 14.3% to HK$5,491 million. Excluding our overseas railway subsidiaries, revenue increased by 7.2%, operating profit increased by 9.9% and operating margin improved by 1.4 percentage points to 57.1%. Property development profit was HK$3,705 million compared to HK$2,147 million in the same period in 2009 with development profits coming mainly from Le Prestige at LOHAS Park as well as the sale of unsold units in The Palazzo at Fo Tan and Lake Silver at Wu Kai Sha. Excluding investment properties revaluation and the related deferred tax, net profit from underlying businesses attributable to equity shareholders increased by 46.6% to HK$5,720 million, due to the strong results from our recurrent businesses and the higher property development profits recognised in the period. Gain in revaluation of investment properties was HK$1,101 million pre-tax (HK$919 million post-tax) compared with HK$712 million pre-tax in 2009. As a result, net profit attributable to equity shareholders was HK$6,639 million, an increase of 47.6% from 2009. Reported earnings per share were HK$1.00 before investment property revaluation and HK$1.16 after such revaluation. Your Board has declared an interim dividend of HK$0.14 per share.

Hong Kong Passenger Services

■ **Our overall share of the franchised public transport market in Hong Kong rose to 43.7% in the first five months of 2010...** ■

Our Hong Kong fare revenue, including both rail and bus passenger services, was HK$5,933 million in the first half of 2010, an increase of 7.3% over the same period of 2009.

Patronage

In the first six months of 2010, total patronage for all of our rail and bus passenger services in Hong Kong increased by 6.5% to 773.4 million as compared to the same period last year.

Our Domestic Service, comprising the Kwun Tong, Tsuen Wan, Island, Tung Chung, Tseung Kwan O, Disneyland Resort, East Rail (excluding Cross-boundary Service), West Rail and Ma On Shan lines, recorded total patronage of 623.5 million, a 6.3% increase over the comparable period in 2009. This increase was due to the strong economic growth in Hong Kong as well as the opening of the LOHAS Park Station and the Kowloon Southern Link (including Austin Station) in the third quarter of last year.

The Cross-boundary Service at Lo Wu and Lok Ma Chau achieved patronage of 48.7 million in the first six months of 2010, representing an increase of 6.4%.

Passengers using the Airport Express in the first half of 2010 rose by 9.4% to 5.1 million, mainly due to a rebound in air travel that accompanied the economic recovery.

Passenger volume on Light Rail, Bus and Intercity was 96.1 million in the first six months of 2010, an increase of 7.7% compared with the same period of 2009.

Market Share

Our overall share of the franchised public transport market in Hong Kong rose to 43.7% in the first five months of 2010 as compared to 42.0% for the same period last year. Within this total, our share of cross-harbour traffic increased to 64.6% from 63.4%. As regards to the Cross-boundary business, our market share in the first half of 2010 declined to 54.8% from 55.4% in the same period in 2009 due to continued tough competition.

Fare Revenue

Of total Hong Kong fare revenue of HK$5,933 million in the first half of 2010, Domestic Service revenue accounted for HK$4,114 million, an increase of 7.4% when compared with the same period last year. Average fare per passenger on our Domestic Service increased by 1.1% to HK$6.60 mainly due to the opening of the Kowloon Southern Link that connects the West Rail Line with the East Rail Line, which has resulted in some passengers taking longer distance trips.

Fare revenue of the Cross-boundary Service was HK$1,203 million for the first six months of 2010, an increase of 6.2% when compared with the same period in 2009. Fare revenue of the Airport Express was HK$324 million in the first half of 2010, representing an increase of 12.1%.

On 13 June 2010, an adjustment was made to fares in accordance with the Fare Adjustment Mechanism, which was adopted as part of the Rail Merger in 2007. The weighted average adjustment of all applicable fares was +2.05%, calculated in accordance with the agreed methodology which is based on the change in the Composite Consumer Price Index and Transport Wage Index in 2009, plus the adjustment rate carried forward from 2009. For 83% of all passenger trips, the adjustment was 20 Hong Kong cents or less, including about 10% of passenger trips which experienced no change in fares.

Attracting Patronage

We launched a number of promotions designed to draw additional passengers to the network. These included a Valentine Promotion to promote leisure travel and MTR shop coupons for Octopus users who accumulated fares of HK$100 on weekdays. In May, we launched an iPhone application providing users with information for journey planning and facilities in our stations, which soon ranked as number one amongst App Store applications in Hong Kong. Enhanced fare promotions for the elderly were extended into 2011.

To attract more tourists to our network, a number of promotions were implemented throughout the period. A Tourist Ticket Value Pack was launched, providing tourists buying such tickets discount offers from six local major attractions or sightseeing services. A joint promotion with Asia Miles was launched in March to promote the purchase of Airport Express tickets

Operations Performance in First Half 2010

Service performance item	Performance Requirement	Customer Service Pledge target	**Actual Performance**
Train service delivery			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.5%	99.5%	**99.8%**
– East Rail Line (including Ma On Shan Line)	98.5%	99.5%	**99.9%**
– West Rail Line	98.5%	99.5%	**99.9%**
– Light Rail	98.5%	99.5%	**99.9%**
Passenger journeys on time			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line and Disneyland Resort Line	98.5%	99.5%	**99.9%**
– Airport Express	98.5%	99.0%	**99.9%**
– East Rail Line (including Ma On Shan Line)	98.5%	99.0%	**99.9%**
– West Rail Line	98.5%	99.0%	**99.9%**
Train punctuality			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line and Disneyland Resort Line	98.0%	99.0%	**99.7%**
– Airport Express	98.0%	99.0%	**99.9%**
– East Rail Line (including Ma On Shan Line)	98.0%	99.0%	**99.9%**
– West Rail Line	98.0%	99.0%	**99.7%**
– Light Rail	98.0%	99.0%	**99.9%**
Train reliability: train car-km per train failure causing delays ≥5 minutes			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	N/A	500,000	**2,449,986**
– East Rail Line (including Ma On Shan Line) and West Rail Line	N/A	500,000	**2,090,911**
Ticket reliability: magnetic ticket transactions per ticket failure			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line, Airport Express, East Rail Line (including Ma On Shan Line) and West Rail Line	N/A	8,000	**36,524**
Add value machine reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.0%	99.0%	**99.5%**
– East Rail Line (including Ma On Shan Line)	98.0%	99.0%	**99.9%**
– West Rail Line	98.0%	99.0%	**99.7%**
– Light Rail	N/A	99.0%	**99.6%**
Ticket machine reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	97.0%	99.0%	**99.5%**
– East Rail Line (including Ma On Shan Line)	97.0%	99.0%	**99.7%**
– West Rail Line	97.0%	99.0%	**99.7%**
– Light Rail	N/A	99.0%	**99.9%**
Ticket gate reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	97.0%	99.0%	**99.9%**
– East Rail Line (including Ma On Shan Line)	97.0%	99.0%	**99.9%**
– West Rail Line	97.0%	99.0%	**99.8%**
Light Rail platform Octopus processor reliability	N/A	99.0%	**99.9%**
Escalator reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.0%	99.0%	**99.9%**
– East Rail Line (including Ma On Shan Line)	98.0%	99.0%	**99.9%**
– West Rail Line	98.0%	99.0%	**99.9%**
Passenger lift reliability			
– Kwun Tong Line, Tsuen Wan Line, Island Line, Tseung Kwan O Line, Tung Chung Line, Disneyland Resort Line and Airport Express	98.5%	99.5%	**99.7%**
– East Rail Line (including Ma On Shan Line)	98.5%	99.5%	**99.9%**
– West Rail Line	98.5%	99.5%	**99.9%**
Temperature and ventilation			
– Trains, except Light Rail: to maintain a cool, pleasant and comfortable train environment generally at or below 26°C	N/A	97.0%	**99.9%**
– Light Rail: on-train air-conditioning failures per month	N/A	<3	**0**
– Stations: to maintain a cool, pleasant and comfortable environment generally at or below 27°C for platforms and 29°C for station concourses, except on very hot days	N/A	90.0%	**99.8%**
Cleanliness			
– Train compartment: cleaned daily	N/A	98.5%	**99.9%**
– Train exterior: washed every 2 days (on average)	N/A	99.0%	**100%**
Northwest Transit Service Area Bus Service			
– Service Delivery	N/A	99.0%	**99.8%**
– Cleanliness: washed daily	N/A	99.0%	**100%**
Passenger enquiry response time within 6 working days	N/A	99.0%	**99.9%**

and tourists passes through Online Ticketing. In addition, we partnered with Hong Kong Tourism Board to launch a “Hong Kong Child Goes Free” campaign targeted at travellers from the Mainland and other short haul destinations such as Korea, Japan and the Philippines. We also organised themed tours on our Intercity Through Trains together with local travel agencies and revamped the Intercity website. We are pleased that “Ktt”, the Intercity train managed by the Company that runs between Hong Kong and Guangzhou, was appointed an official carrier for the Asian Games in Guangzhou which will take place in November this year.

We continue our work on improving service connectivity, including new entrances and walkways. The most notable addition during the first six months was at Tsim Sha Tsui Station, where the recent opening of the Middle Road Subway Extension and two new exits has enhanced connectivity to shops, businesses and points of interest in the area, allowing passengers comfortable all-weather access. The installation of wide gates was completed at Kwai Fong, Kwai Hing, Kowloon Tong, University, Racecourse and Sheung Shui stations.

Following the opening of the Kowloon Southern Link, connecting the West Rail Line to Hung Hom Station, six new Light Rail vehicles have entered service to cater for the increased demand on the light rail system feeding passengers into the West Rail Line. In anticipation of growing passenger demand for the Shanghai-Kowloon Through Train services arising from the Shanghai World Expo, one additional coach with 66 hard sleepers was added starting from May 2010.

Service and Performance

We continue to exceed all the performance standards as stipulated in the Operating Agreement and our own more stringent Customer Service Pledges. Train service delivery, passenger journeys on time and train punctuality were at 99.7% or above. Cleanliness targets were at or exceeded 99.9%.

The service excellence which the Company continually provides gained us a wide array of awards, including the Hong Kong Service Award in the Public Transportation Category presented by East Week magazine. The Company was also a category award winner in the Public Transportation Category of the Sing Tao Excellent Services Brand Award 2009 organised by Sing Tao Daily, and in the Top Service Awards 2010 organised by Next Magazine.

Station Commercial and Rail Related Businesses

■ Revenue from our station commercial and rail related businesses increased by 4.8% over the first half of 2009 to HK$1,732 million. ■

Revenue from our station commercial and rail related businesses increased by 4.8% over the first half of 2009 to HK$1,732 million. The increase was due mainly to a recovery in the advertising business as well as good rental reversions and increase in area for our station shops.

Station retail revenue in the first six months of 2010 was HK$849 million, 7.1% higher than the first half of 2009. The rise in revenue reflects the increase in the area and number of shops, together with increased rental rates resulting from a refinement of trade mix and favourable renewal rates.

During the six months, the total number of station shops increased by 18 from 1,228 at the end of 2009 to 1,246 at the end of June this year, as renovations were completed at Tsing Yi, Tsim Sha Tsui and Sheung Shui stations. The total area of station retail space increased by 684 square metres to 53,472 square metres following completion of the renovations.

Advertising revenue in the first half of 2010 was HK$322 million, an increase of 19.3% over the comparable period in 2009. However, this is still lower than the 2008 level. During the first half of the year, we revamped 587 advertising panels on the East Rail Line, modernising their appearance and enabling a higher quality of presentation.

Revenue from our telecommunications business in the first six months of 2010 rose by 3.0% to HK$136 million, due to incremental income from mobile networks at new stations, as well as rentals from new rooftop sites as operators expanded their network coverage. In May this year, the Company concluded an agreement with two telecom operators to participate in a 3G Capacity Enhancement Project to double 3G capacity in 15 stations in prime locations. To improve mobile phone services further, the Company signed an agreement in June 2010 with another telecom operator to upgrade all its 3G mobile phone equipment along the railway.

Revenue from external consultancy in the first half of 2010 was HK$60 million, a decrease of 29.4% over the first half of 2009, following completion of the Airport Authority Hong Kong Automatic People Mover Modification Works project in June last year.

Property and Other Businesses

The Hong Kong property market remained generally well supported for the first half of 2010, as interest rates remained low and market sentiment generally positive.

Property Development

Profit from property development for the first six months of 2010 was HK$3,705 million, with the major contribution coming from Le Prestige at LOHAS Park as well as the sale of certain units at The Palazzo in Fo Tan and Lake Silver in Wu Kai Sha.

Pre-sales commenced for Phase 1 of Festival City at Tai Wai Maintenance Centre on 26 March 2010 and saw a strong response from the market. Up to now, approximately 78% of the 1,360 units in Phase 1 have been sold.

Occupation Permits were issued during the first half of the year for the remaining projects at Kowloon Station, namely the International Commerce Centre (ICC), Ritz Carlton Hotel, the Observation Deck on level 100 of ICC and the final phase of Elements. In addition, Occupation Permits were issued for Le Prestige, Phase 2a of LOHAS Park in January 2010 and Festival City Phase 1 at Tai Wai Maintenance Centre in February 2010.

In our property tendering activity, we awarded Austin Station Sites C and D to Fast New Limited, a consortium formed by New World Development Company Limited and Wheelock Properties Limited, on 2 March 2010. We have contributed approximately HK$3.9 billion to this development as part of the land premium payments for the sites.

■ The Hong Kong property market remained generally well supported for the first half of 2010, as interest rates remained low and market sentiment generally positive. ■

Property Rental, Property Management and Other Businesses

The combined revenue of our property rental, property management and other businesses in the first six months of 2010 was HK$1,585 million, 9.3% higher than the same period last year.

Total property rental income in Hong Kong and the Mainland of China increased by 10.1% to HK$1,375 million. For our retail shopping mall portfolio in Hong Kong, an average 10% increase in rental reversion was achieved. At the end of June 2010, the occupancy of our 12 shopping malls in Hong Kong remained close to 100%, while the Company's 18 floors at Two International Finance Centre were fully leased out.

Property rentals and occupancy were supported by strong marketing efforts. Our shopping malls won a Gold Prime Award for Eco-Business 2010 given by Prime Magazine and the Business Environment Council, and a 2010 Outstanding Strategic

Property Development Packages Awarded and to be Completed

Location	Developers	Type	Gross floor area *(sq. m.)*	No. of parking spaces	Period of package tenders	Expected completion date
Tseung Kwan O Station						
Area 56	Sun Hung Kai Properties Ltd.	Residential Hotel Retail Office Car park	80,000 58,130 20,000 5,000	360	Awarded in February 2007	By phases from 2010 – 2011
LOHAS Park Station						
Package Two (Le Prestige)	Cheung Kong (Holdings) Ltd.	Residential Kindergarten Car park	309,696 800	905	Awarded in January 2006	By phases from 2010 – 2013
Package Three	Cheung Kong (Holdings) Ltd.	Residential Kindergarten Car park	128,544 1,000	350	Awarded in November 2007	2013
Tai Wai Maintenance Centre	Cheung Kong (Holdings) Ltd.	Residential Car park	313,955	745	Awarded in April 2006	By phases from 2010 – 2011
Che Kung Temple Station	New World Development Co. Ltd.	Residential Retail Kindergarten Car park	89,792 193 670	232	Awarded in April 2008	2012
Austin Station						
Sites C and D	New World Development Co. Ltd. and Wheelock Properties Limited	Residential Car park	119,116	450	Awarded in March 2010	2014
Tuen Mun Station#	Sun Hung Kai Properties Ltd.	Residential Retail Car park	119,512 25,000	349	Awarded in August 2006	By phases from 2012 – 2013
Tsuen Wan West Station TW7#	Cheung Kong (Holdings) Ltd.	Residential Car park	113,064	444	Awarded in September 2008	2013

\# as development agent for the Government of HKSAR

Property Development Packages to be Awarded Notes 1 and 2

Location	No. of packages envisaged	Type	Gross floor area *(sq. m.)*	Expected no. of parking spaces	Period of package tenders	Expected completion date
LOHAS Park Station	6 – 10	Residential Retail Car park	1,025,220 – 1,035,220 39,500 – 49,500	3,303 (max)	2011-2015	2019
Tai Wai Station	1 – 2	Residential Retail Car park	190,480 62,000	801	Under review	Under review
Tin Shui Wai Light Rail Terminus	1	Residential Retail Car park	91,051 205	267	Under review	Under review

Notes
1 Property development packages for which we are acting as development agent for the Government of HKSAR are not included.
2 These property development packages are subject to review in accordance with planning approval, land grant conditions and completion of statutory processes.

Performance Award from "Capital" and "Capital Weekly" magazines.

Elements, our premium shopping mall in Hong Kong, continued to lead the market in innovative marketing campaigns. These included the Lang Lang Charity Concert in support of UNICEF and other various promotions. Elements was also listed among the top 30 in the Gunn Report, an independent report on creativity for advertising, and won The Best Creative Buy Award in METRO CREATIVE AWARDS 2010. Telford Plaza won a Hong Kong Service Award from East Week magazine.

Ginza Mall in Beijing, was 96% let at the end of June.

At the end of June 2010, the Company's attributable share of investment properties in Hong Kong was 225,374 square metres of lettable floor area of retail properties, 41,090 square metres of lettable floor area of offices, and 11,604 square metres of real estate for other usage.

Property management revenue in the first half of 2010 was HK$106 million. As at the end of June 2010, the number of residential units under our management in Hong Kong was 80,274, while commercial space under management was 742,816 square metres. Our managed property portfolio in the Mainland of China stood at 733,254 square metres.

Ngong Ping 360

The Ngong Ping cable car and associated theme village on Lantau Island achieved a 19.5% increase in revenue for the first six months of 2010 to HK$104 million, while visitor numbers rose to 0.78 million. These increases reflect the success of an active promotional programme. Demand for the Crystal Cabins continued to increase, with 26.3% of passengers opting for this ride. The cable car system achieved a reliability rate of over 99% during the six months. In April 2010, Ngong Ping 360 Limited received ISO 9001:2008 certification.

A new travel agency, "360 Holidays", which is a subsidiary of the Company, started its operations in March 2010. This travel agency provides a wide range of tour products for our customers including guided tours to the Giant Buddha, eco-tours to the Tai O Fishing Village, educational tours through the country park, and trips to the beaches of southern Lantau Island.

Awards garnered during the period included the Certificate of Quality Tourism Service Scheme award from the Hong Kong Tourism Board, the Environmental Performance Award Certificate of Merit given by the Business Environment Council, a Bronze Award for the Outstanding Customer Service Programme and a Gold Award for Internal Support Service from the Hong Kong Association for Customer Service Excellence.

Mainland of China and Overseas Businesses

■ Railway franchise revenue outside Hong Kong from our two rail subsidiaries, namely MTM and MTRS, was HK$4,852 million. ■

The Company's operating railway businesses outside Hong Kong in the first half of 2010 comprised our 49% interest in the BJL4 PPP Company in the Mainland of China, our 60% interest in Metro Trains Melbourne (MTM), our 100% interest in MTR Stockholm (MTRS), our 50% interest in Tunnelbanan Teknik Stockholm (TBT), the rolling stock maintenance company in Stockholm, and our 50% interest in London Overground Rail Operations Limited (LOROL).

Railway franchise revenue outside Hong Kong from our two rail subsidiaries, namely MTM and MTRS, was HK$4,852 million. Operating costs were HK$4,645 million, resulting in an operating profit of HK$207 million and an operating profit margin of 4.3%. The business models of MTM and MTRS, which are operation and maintenance franchises, require only modest capital investment and hence operating margins are typically lower than those rail projects requiring significant capital outlays. BJL4, LOROL and TBT are accounted for as associates, and contributed a total of HK$5 million in post-tax profit in the first half of 2010. Our share of the post-tax profits from LOROL was HK$11 million, while BJL4 and TBT made losses of HK$1 million and HK$5 million respectively. The BJL4 loss was expected as investment projects of this nature, with relatively large depreciation and interest cost, do not normally achieve profit in their early years.

Octopus

Octopus continued its expansion in the retail sector, thanks to the ongoing support of major acquirers, which has helped extend the Octopus payment service to more small-to medium-sized retailers. By the end of June 2010, over 3,000 service providers in Hong Kong have adopted the Octopus service.

Cards in circulation stood at 21.7 million and average daily transaction volume and value were 11.2 million and HK$102.4 million respectively. The Company's share of Octopus' net profit for the first half of 2010 was HK$77 million, an increase of 13.2% from the same period last year.

Future Growth

Hong Kong

The five major projects to extend our 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 made solid progress during the period.

In designing the West Island Line, we have drawn extensively on the views of the local community, with the aim of preserving local heritage and creating opportunities for urban renewal. This 3-km extension of the Island Line is targeted to open in 2014, and will reduce travel time from Kennedy Town to Sheung Wan to eight minutes.

All civil works contracts for this project have been awarded. The re-provisioning works for the Kennedy Town Swimming Pool (Phase 1) and the David Trench Rehabilitation Centre are both half-way through their construction programmes.

Government published the gazette amendment for the 7-km South Island Line (East) railway scheme on 4 June 2010. The detailed design has been substantially completed and the Environmental Impact Assessment (EIA) Report was submitted to the Environmental Protection Department in June this year. The proposal to rezone the former Wong Chuk Hang Estate into a Comprehensive Development Area to facilitate integrated property development above the depot for the South Island Line (East) was agreed by the Town Planning Board in June 2010 and was exhibited on 16 July 2010 to seek public views. Discussions continue with Government on the Project Agreement for the South Island Line (East), including the financial terms of the project.

The 3-km Kwun Tong Line Extension will run from Yau Ma Tei Station on the Kwun Tong Line to Whampoa Station via Ho Man Tin Station which will become an interchange station with the Shatin to Central Link. The scheme was first gazetted on 27 November 2009, and an amendment of the scheme was

■ **The five major projects to extend our 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 made solid progress during the period.** ■

gazetted on 25 June 2010. The detailed design is making good progress, following a further period of public consultation that began in January this year with the local communities, district councils and other stakeholders to integrate their needs into the design.

The Express Rail Link is a new 26-km line which will provide high speed cross-boundary rail services connecting Hong Kong to Shenzhen, Guangzhou and the new high speed intercity rail network in the Mainland of China. The Hong Kong Government has entrusted the Company to design and build the line, but will fund the construction, and has also agreed to invite the Company to operate this service on a concessionary basis when completed. Services are expected to start in 2015. Construction on site has begun and 11 major civil contracts had been awarded as at the end of June 2010.

Work on the detailed design of the Shatin to Central Link began in January this year. This two-part project comprises an 11-km extension of the Ma On Shan Line from Tai Wai to Hung Hom. Here it will connect with the West Rail Line to form the East West Corridor and a 6-km extension of the East Rail Line from Hung Hom to Hong Kong Island, which will be Hong Kong's fourth rail harbour crossing to form the North South Corridor. To ensure that the needs of the community are addressed, further extensive consultations are being held.

Hong Kong Project Funding

The funding model for our new Hong Kong rail projects will take different forms, each appropriately designed for the project.

Under the capital grant model used for the West Island Line, an initial HK$400 million was received in 2008 from the Government and the balance of HK$12,252 million was received in March 2010.

The South Island Line (East) and Kwun Tong Line Extension projects will likely use our traditional "Rail plus Property" model. Discussions continue with Government on how the property developments should be taken forward to ensure project viability.

The Service Concession model will be adopted for the Express Rail Link and Shatin to Central Link. Under the Entrustment Agreement signed with Government in January 2010, we are responsible for the construction and commissioning of the Express Rail Link on the understanding that the Government will invite the Company to undertake the operations of the railway after its completion. The operational requirements and operational business model are under active discussion with the Government and Mainland entities.

Mainland China

In the Mainland of China, a concession agreement was signed in December 2009 for the operation and maintenance of the 22-km Daxing Line, the extension of BJL4 to the district of Daxing. Preparation works to commence operations are well advanced and we are on schedule for the opening of this extension by the end of 2010.

In Shenzhen, the concession agreement for the SZL4 project was signed in March 2009. We took over the operations of the 4.5-km Phase 1 of SZL4 on 1 July 2010. Most of the main line structures for Phase 2 of SZL4 have been substantially completed with 92% of the railway tracks laid. Production of the rolling stock is also well underway. Full line operation, encompassing Phase 2, is expected to commence in the middle of 2011.

On 4 March 2010, our subsidiary, MTR Hangzhou Line 1 Investment Company Limited, together with a subsidiary of Hangzhou Metro Group Company Limited, signed a concession agreement with the Hangzhou Municipal Government under a PPP project for the investment in, construction and operation of the 48-km HZL1 for a term of 25 years. This PPP project requires a total investment of RMB22 billion, 37% of which will be provided by a joint venture company in which MTR Corporation has an effective interest of 49% with the balance owned by a subsidiary of the Hangzhou Metro Group Company Limited. MTR Corporation's equity investment is estimated to be RMB2.2 billion.

Civil construction works by Hangzhou Metro Group Company Limited on HZL1 commenced in March 2007 and the line is expected to open in 2012.

Financial Review

The Group delivered good financial results for the first half of 2010, with strong growth in the Hong Kong recurrent businesses and incremental contributions from new rail businesses overseas. Hong Kong fare revenue increased by 7.3% to HK$5,933 million when compared with the same period last year as a result of patronage growth brought about by the economic rebound and the opening of the Kowloon Southern Link and LOHAS Park Station in the second half of 2009. Station commercial and rail related revenue increased by 4.8% to HK$1,732 million due to a recovery in the advertising business and good rental reversions as well as increased shop area for our station retail business. These increases were off-set by significantly lower revenues from project management of Kowloon Southern Link for Kowloon Canton Railway Corporation following the completion of that project in the second half of 2009. Rental, management and other revenue also increased by 9.3% to HK$1,585 million mainly due to positive rental reversions. As a result, total revenue from recurrent businesses increased by 7.2% to HK$9,250 million. Including revenues of HK$4,852 million from railway franchises outside Hong Kong from our two rail subsidiaries, namely MTRS and MTM, total Group revenue increased by 63.4% over the same period in 2009 to HK$14,102 million.

Operating expenses before depreciation and amortisation for the first half of 2010 increased by 125.2% to HK$8,611 million when compared with the same period last year. The significant increase was mainly due to expenses of HK$4,645 million relating to the two railway franchises outside Hong Kong. Excluding these overseas franchises, the increase in operating expenses would have been 3.7% mainly due to the incremental costs from operating the Kowloon Southern Link and LOHAS Park Station, which opened in the second half of 2009. As a result, operating profit from railway and related businesses before depreciation and amortisation increased by 14.3% to HK$5,491 million, and if the new overseas railway franchises are excluded, operating profit would have increased by 9.9% to HK$5,284 million. Operating margin excluding the overseas rail franchises increased by 1.4 percentage points to 57.1% whilst including such overseas franchises operating margins would be 38.9%. We have noted previously that the "asset light" overseas operation and maintenance franchises require little investment and hence have lower margins than rail systems requiring significant investment.

Property development profit for the first half of 2010 was HK$3,705 million mainly from the profits relating to Le Prestige at LOHAS Park and, to a lesser extent, profits from the sale of units in inventory at The Palazzo in Fo Tan and Lake Silver in Wu Kai Sha. As a result, operating profit before depreciation and amortisation increased by 32.3% to HK$9,196 million.

Depreciation and amortisation charge for the first half of 2010 increased by 4.5% to HK$1,537 million mainly due to the commencement of operation of LOHAS Park Station. Net interest and finance charges decreased by 23.2% to HK$656 million mainly due to reduced debt outstanding. The increase in fair value of investment properties since the end of 2009 was HK$1,101 million pre-tax and HK$919 million post-tax as compared with HK$712 million pre-tax and HK$595 million post-tax for the same period last year.

Share of profits from non-controlled subsidiaries and associates increased by 10.8% to HK$82 million mainly due to profit increases at Octopus Holdings Limited and LOROL, which contributed HK$77 million and HK$11 million respectively to the Group's profits during the first half of 2010. Beijing MTR Corporation Limited and TBT reported losses, with the Group sharing losses of HK$1 million and HK$5 million respectively. Income tax increased in line with the profit growth to HK$1,482 million. Net profit attributable to shareholders for the first half of 2010 was HK$6,639 million, an increase of 47.6% over the same period last year. Reported earnings per share increased from HK$0.79 to HK$1.16. Excluding investment property revaluation and the related deferred tax, net profit from underlying business increased by 46.6% to HK$5,720 million, with earnings per share on the same basis increasing from HK$0.69 to HK$1.00. On a pre-tax basis, net pre-tax profit from underlying business increased by 49.5% from HK$4,696 million to HK$7,020 million.

The Board has declared an interim dividend of HK$0.14 per share. As with previous dividend payments, a scrip dividend option will be offered to all shareholders except those with registered addresses in the United States of America or any of its territories or possessions. As mentioned previously, subject to the financial condition of the Company, the Board intends to follow a progressive dividend policy.

The Group's balance sheet strengthened further, with net assets increasing by 5.3% from HK$106,453 million as at 31 December 2009 to HK$112,138 million as at 30 June 2010. Total assets decreased slightly by 0.8% to HK$175,008 million as a result of utilising surplus cash to reduce debt. During the period, fixed assets increased by 0.7% to HK$139,187 million mainly due to investment property revaluation gains and capital expenditure for SZL4. Property development in progress increased by 34.1% to HK$9,006 million mainly due to the contribution of land premium for Austin Station Sites C and D. Debtors, deposits and payments in advance increased by 83.3% to HK$4,451 million mainly due to receivables from property purchasers of Le Prestige at LOHAS Park. With the receipt of Government funding support of HK$12,252 million for the West Island Line in March 2010, the Group used some of the surplus cash to repay loans and placed the remaining cash balance in medium term notes and bank deposits. As a result, investment in securities increased from HK$227 million to HK$3,485 million while cash and cash equivalents increased by 44.6% to HK$10,287 million. Total borrowings decreased from HK$23,868 million to HK$19,597 million. The resulting net debt-to-equity ratio including obligations under the service concession as a component of debt decreased from 25.8% as at 31 December 2009 to 15.0% as at 30 June 2010.

The Group maintained a strong cash flow position during the first half of 2010 as a result of the receipt of HK$12,252 million of Government funding support for the West Island Line in March 2010 as well as growth in operating profits. During the period, net cash inflow generated from operating activities increased by 22.4% to HK$5,600 million when compared with the same period last year. Cash receipts from property development were HK$2,097 million mainly from The Palazzo and Festival City, as well as upfront payment in respect of Austin Station Sites C and D. Including dividend distribution from Octopus Holdings Limited, net cash receipts for the entrustment works of the Shatin to Central Link and the Express Rail Link as well as proceeds from fixed assets disposal totalling HK$153 million, total cash inflows during the first half of 2010 increased by 180.9% to HK$20,102 million. Total cash outflows during the period increased from HK$2,678 million for the same period last year to HK$8,198 million mainly due to land premium payment of HK$3,900 million for Austin Station Sites C and D and increase in expenditures for new railway extensions from HK$676 million to HK$2,797 million mainly for the West Island Line and SZL4. After deducting the dividend payment of HK$1,089 million, net cash inflow generated in the first half of 2010 was HK$10,815 million, of which HK$4,474 million was used to repay debt and HK$3,197 million was invested in bank floating rate notes.

Financing Activities

Financial markets conditions stabilised and market confidence continued to improve in the first half of 2010, supported by accommodative government fiscal and monetary policies and renewed economic growth. During the period, the Hong Kong market saw a number of sizeable syndicated loans and bond issues completed at favourable credit spreads on the back of strong liquidity and investor demand. Although market sentiment weakened slightly towards the end of the period due to concerns over sovereign risk in Europe and tightening credit conditions in the Mainland of China, liquidity has generally remained strong and the credit market highly accessible to top rated borrowers.

The Group had no funding requirements during the six months. We did not need to tap the debt markets during the period due to our strong operating cash flows and cash surplus. We used part of this surplus to pay down our debts and also cancelled a significant portion of our undrawn committed banking facilities that we no longer require.

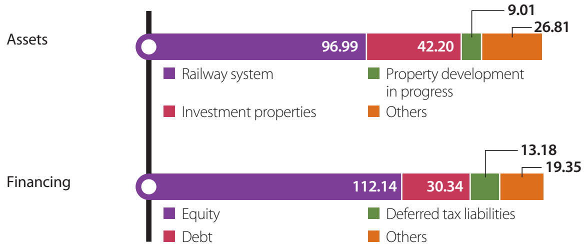
As a result, the Group's consolidated debt position has significantly improved from HK$23,868 million at the end of December 2009 to HK$19,597 million at the end of June, with total undrawn committed banking facilities of HK$7 billion (excluding the undrawn committed RMB project loan for SZL4). These undrawn committed facilities, together with the existing cash surplus and projected operating cash flows, are expected to be sufficient to cover all of the Group's cash requirement up to the early part of 2012, including debt repayment and capital expenditures.

During the period, we continued to manage our debt portfolio in a prudent manner in accordance with the Preferred Financing Model. As at the end of June 2010, 34% of debt outstanding will mature within 2 years, 46% between 2 and 5 years, and 20% beyond 5 years indicating a well balanced portfolio. Risk was well managed, with more than 99% of debt outstanding either borrowed in or hedged into HK dollars, or hedged by foreign currency cash flows from underlying businesses. Approximately 76% of our debt outstanding was at fixed rates.

The Group's average borrowing cost during the period was higher at 4.4%, compared with 3.6% during the same period last year due to a higher portion of debt being in fixed interest rate following prepayment of a substantial portion of our floating rate bank loans with surplus cash.

Simplified Balance Sheet

As at 30 June 2010
(HK$ billion)

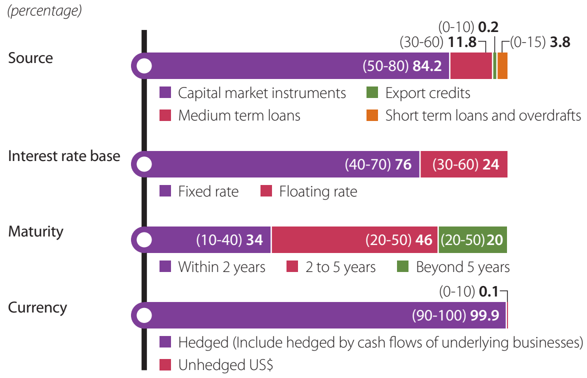


Preferred Financing Model and Debt Profile

The Preferred Financing Model exemplifies the Company's prudent approach to debt management and helps ensure a well balanced debt portfolio.

(Preferred Financing Model) vs. **Actual debt profile**
As at 30 June 2010

(percentage)



Human Resources

The Company's continued success relies on our ability to employ, retain and motivate staff to achieve our strategic goals.

The Company's continued success relies on our ability to employ, retain and motivate staff to achieve our strategic goals. Given the anticipated business growth in Hong Kong, we have conducted a 5-year comprehensive manpower resourcing plan. There will be attractive promotion and career opportunities for our colleagues and for the local community.

To prepare our colleagues for career advancement, we have developed a number of initiatives such as the Integrated Staff Development Programme and Skill Progression Scheme to enhance their competence. Over 2,500 training courses were delivered across the Company covering approximately 45,000 trainee man-days during the first half of 2010. More high calibre young graduates and apprentices are being nurtured through comprehensive training in support of business growth.

To meet the manpower requirement of the Company's expansion projects, we have adopted pro-active resourcing strategies, such as the Employer Branding Programme, to early identify candidates in Hong Kong and overseas countries.

The Company has developed effective communication mechanisms over the years. We have further enhanced direct two-way communication by implementing "Enhanced Staff Communication" Programme in Operations Division starting from January 2010. Over 2,200 communication sessions involving more than 22,000 participants were conducted during the first half of 2010. Through this programme, we are able to identify and resolve any staff concerns at an early stage and at a personal level.

To groom the leaders of the future, we continue to provide career development opportunities to staff through the Executive Associate Scheme and the People Development Initiative. These schemes help identify and develop staff with the potential for higher level responsibilities.

Outlook

The first half of 2010 has seen a recovery from the financial crisis. While there are a number of uncertainties surrounding the developed economies, we are cautiously optimistic that the recovery in Hong Kong and the Mainland of China will continue for the remainder of the year.

Economic growth will benefit patronage in our Hong Kong rail system, although the rate of growth will moderate in the second half of 2010 due to the higher base of second half of 2009. Implementation of the fare increases under the Fare Adjustment Mechanism will have a positive impact on average fares.

Our station and property investment businesses should continue to benefit from the economic recovery.

In our Mainland of China and overseas businesses, we took over the operations of Phase 1 of SZL4 on 1 July this year. We do not expect SZL4 to make positive contributions to our operating profit until shortly after the opening of Phase 2 of SZL4, which is expected to be in 2011.

In our property development business, the Occupation Permit for the 20,000 square metres shopping centre in Area 56 in Tseung Kwan O may be issued at the end of 2010, depending on construction progress. Once issued, we can recognise development profit for our share of the project, based on assessed market value at that time. Apart from our share in this centre we have no other financial interest in the Area 56 development. As mentioned previously, although sales of Phase 1 of Festival City in the Tai Wai Maintenance Centre have progressed well, we do not expect to start profit recognition before 2011.

In our property tendering activity, depending on market conditions, we expect to tender the Tai Wai Station and Nam Cheong Station sites over the next six months. The Nam Cheong Station Site is a West Rail Development site where we only act as agent.

Finally, I would like to take this opportunity to thank my fellow directors and all my colleagues for their hard work and dedication.

C K Chow, *Chief Executive Officer*
Hong Kong, 12 August 2010