

Report of the Members of the Board

The Members of the Board have pleasure in submitting their Report and the audited statement of Accounts for the financial year ended 31 December 2006.

Principal Activities of the Group

The principal activities of the Company and its subsidiaries are:

A the operation of a mass transit railway system with lines from Central to Tsuen Wan (Tsuen Wan Line), from Yau Ma Tei to Tiu Keng Leng (Kwun Tong Line), from Po Lam to North Point (Tseung Kwan O Line), from Chai Wan to Sheung Wan (Island Line), from Hong Kong to Tung Chung (Tung Chung Line), from Hong Kong to the Hong Kong International Airport and then AsiaWorld-Expo both at Chek Lap Kok (Airport Express Line) and from Sunny Bay to Disneyland Resort (Disneyland Resort Line);

B property development at locations relating to the railway system including the Tseung Kwan O Line Extension;

C related commercial activities, including the letting of advertising and retail space, bandwidth services on the railway telecommunication system, property management and leasing management of investment properties (including shopping centres and offices), property agency and Octopus Card Building Access System services;

D the design and construction of the Ngong Ping 360 tourism facilities and subsequent monitoring of the appointed operator;

E the design and construction of Tseung Kwan O South Station as an extension of the Tseung Kwan O Line;

F the planning and construction of future extensions to the railway system and other related infrastructure projects;

G consultancy services covering all areas of expertise required in the project management, planning, construction, operation, maintenance and up-grading of railways plus fare collection, property integration/development advice including other property related services and advice on generation of non-fare revenues;

H investment in Octopus Holdings Limited, a subsidiary of the Company, which has business activities both in Hong Kong and overseas including the operation of a smart card system by its subsidiary Octopus Cards Limited for the collection of payments for both transport and non-transport applications in Hong Kong;

I equity investments and long term operation and maintenance contracts outside of Hong Kong;

J property management, shopping centre investment and railway related property development business in the Mainland of China; and

K the investment in, and construction of, Beijing Metro Line 4, in which the Company has a 49% equity interest, for future operations under a 30 year concession agreement with the Beijing Municipal Government.

In addition to the above, a Feasibility Study Report for Shenzhen Line 4 has been submitted to National Development and Reform Commission for approval. The Company is waiting for the result.

Dividend

The Directors have recommended a final dividend of HK\$0.28 per Ordinary Share to be payable to shareholders whose names appear on the Register of Members of the Company on 17 April 2007. Subject to the passing of the necessary resolutions at the forthcoming Annual General Meeting, such dividend will be payable on or about 26 June 2007, in cash in Hong Kong dollars, with a scrip dividend alternative. The Company's majority shareholder, The Financial Secretary Incorporated, has agreed to elect to receive all or part of its entitlement to dividends in the form of scrip to the extent necessary to ensure that a maximum of 50% of the total dividend paid by the Company will be in the form of cash.

Members of the Board

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

In July 2006, Raymond Ch'ien Kuo-fung was re-appointed as the non-executive Chairman of the Company with effect from 21 July 2006 until 31 July 2007.

In November 2006, Chow Chung-kong renewed his contract as Chief Executive Officer of the Company for a further three years from 1 December 2006 to 30 November 2009.

At the Annual General Meeting on 8 June 2006 and pursuant to the Articles of Association, Raymond Ch'ien Kuo-fung, T. Brian Stevenson and Frederick Ma Si-hang retired under the Articles of Association and were re-elected as Members of the Board.

At the forthcoming Annual General Meeting and in accordance with the Articles of Association, Chow Chung-kong, David Gordon Eldon and Christine Fang Meng-sang will retire by rotation. All these three Board Members will offer themselves for re-election at that Meeting.

Biographical details for Board Members are set out on pages 70 to 72.

Alternate Directors

The Alternate Directors in office during the year were (i) Martin McKenzie Glass and Alan Lai Nin (both for Frederick Ma Si-hang), (ii) both the Permanent Secretary for the Environment, Transport & Works (Joshua Law Chi-kong) and the Deputy Secretary for the Environment, Transport & Works (Patrick Ho Chung-kei, Thomas Chow Tat-ming [who ceased to be the Deputy Secretary for the Environment, Transport & Works after 30 August 2006], Cathy Chu Man-ling, Annie Choi Suk-han and Yung Wai-hung [with effect from 31 August 2006]) (for the Secretary for the Environment, Transport & Works), and (iii) the Deputy Commissioner for Transport/Transport Services and Management (Carolina Yip Lai-ching) (for the Commissioner for Transport).

Executive Directorate

The Members of the Executive Directorate who served during the year were Chow Chung-kong (Chief Executive Officer and a Member of the Board), Russell John Black, William Chan Fu-keung, Thomas Ho Hang-kwong, Lincoln Leong Kwok-kuen, Francois Lung Ka-kui, Andrew McCusker and Leonard Bryan Turk.

Biographical details for Members of the Executive Directorate during the year are set out on pages 73 and 74.

Internal Audit

The Company's Internal Audit Department provides independent, objective assurance and consulting services designed to add value and improve the Company's operations. Key responsibilities of the Department include:

- Assessments on the adequacy and effectiveness of the Company's system of internal control for controlling its activities and managing its risks.
- Identification of opportunities for improving management control, resources utilisation and profitability.
- Special reviews and/or investigations as commissioned by Company management.

The Company's Internal Auditor reports directly to the Chief Executive Officer and has direct access to the Audit Committee.

Business Ethics

Please refer to page 67.

Policies

The Board has adopted risk management strategies on construction and insurance, finance, treasury and safety.

During 2006 and in line with the business developments of the Company, the Board approved certain changes to the above strategies and the Environmental Risk Management Policy, and further established the Enterprise Risk Management Strategy. There was no change to Security Risk Management Policy.

Public Float

The Stock Exchange granted to the Company, at the time of its listing on the Main Board of the Stock Exchange in 2000, a waiver from strict compliance with Rule 8.08(1) of the Listing Rules ("Public Float Waiver"). Pursuant to the Public Float Waiver, the Company's prescribed minimum percentage of shares which must be in the hands of the public must not be less than 10% of the total issued share capital of the Company. Based on the information that is publicly available to the Company and within the knowledge of the Directors, the Company has maintained the prescribed amount of public float during the year and up to the date of this report as required by the Public Float Waiver.

Bank Overdrafts, Bank Loans and Other Borrowings

The total borrowings of the Group as at 31 December 2006 amounted to HK\$28,152 million (2005: HK\$28,264 million). Particulars of borrowings including bank overdrafts and bank loans are set out in note 33 to the accounts.

Accounts

The state of affairs of the Company and the Group as at 31 December 2006 and of the Group's results, changes in equity and cash flows for the year are set out in the accounts on pages 87 to 163.

Ten-Year Statistics

A summary of the results and of the assets and liabilities of the Group together with some major operational statistics for the last ten years are set out on pages 56 to 57.

Fixed Assets and Railway Construction in Progress

Movements in fixed assets and railway construction in progress during the year are set out in notes 16 and 17 to the accounts respectively.

Movements in Reserves

Movements in reserves during the year are set out in notes 39 and 40 to the accounts.

Share Capital

As at 31 December 2005, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,481,856,439 of which were issued and credited as fully paid. During the year, the Company issued a total of 66,757,512 Ordinary Shares. Of this number:

A 4,094,000 Ordinary Shares were issued by the Company pursuant to the exercise of share options which had been granted under the Company's Pre-Global Offering Share Option Scheme (as referred in note 39 to the accounts). In respect of each Ordinary Share issued, the relevant exercise price per share of options is HK\$8.44 to the Company;

B 132,500 Ordinary Shares were issued by the Company pursuant to the exercise of share options which had been granted under the Company's New Joiners Share Option Scheme (as referred in note 39 to the accounts). In respect of each Ordinary Share issued, the relevant exercise price per share of options is HK\$9.75 to the Company;

C 43,101,387 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the final dividend of the Company for the year ended 31 December 2005 (for which the cash dividend was HK\$0.28 per Ordinary Share); and

D 19,429,625 Ordinary Shares were issued by the Company in order to satisfy shareholders' scrip dividend elections in respect of the interim dividend of the Company for the six months ended 30 June 2006 (for which the cash dividend was HK\$0.14 per Ordinary Share).

As at 31 December 2006, the authorised share capital of the Company was HK\$6.5 billion, divided into 6.5 billion Ordinary Shares, 5,548,613,951 of which were issued and credited as fully paid.

Redemption of Listed Securities

Neither the Company nor any of its subsidiaries purchased, sold or redeemed any of its listed securities during the financial year 2006.

Properties

Particulars of the principal investment properties and properties held for sale of the Company are shown on page 37.

Donations

During the year, the Company donated a total of HK\$78,280 to charitable organisations.

The MTR HONG KONG Race Walking 2006 raised over HK\$1.2 million for the Hospital Authority Health InfoWorld's "Better Health for a Better Hong Kong" health education campaign.

The Company was honoured with the President's Award in recognition of its contribution to the Community Chest with a total of cash donation of over HK\$2.5 million, including the participation of different activities such as CARE Scheme, The Community Chest Green Day and Dress Casual Day.

Reporting and Monitoring

There is a comprehensive budgeting system for all operational and business activities, with an annual budget approved by the Board. Monthly results of the Company's operations, businesses and projects are reported against the budget to the Board and updated forecasts for the year are prepared regularly.

Treasury Management

The Company's Treasury Department operates within approved guidelines from the Board. It manages the Company's debt profile with reference to the Preferred Financing Model which defines the preferred mix of financing instruments, fixed and floating rate debts, maturities, interest rate risks, currency exposure and financing horizon. The model is reviewed and refined periodically to reflect changes in the Company's financing requirements and market environment. Derivative financial instruments such as interest rate swaps and cross currency swaps are used only as hedging tools to manage the Group's exposure to interest rate and currency risks. Prudent guidelines and procedures are in place to control the Company's derivatives activities, including a comprehensive credit risk management system for monitoring counterparty credit exposure using the Value-at-Risk approach. There is also appropriate segregation of duties within the Company's Treasury Department.

Major financing transactions and guidelines for derivatives transactions including credit risk management framework are approved at the Board level.

Capital and Revenue Expenditure

There are defined procedures for the appraisal, review and approval of major capital and revenue expenditures. All project expenditure over 0.2% of the net assets of the Company and the employment of consultancy services over 0.1% of the net assets of the Company require the approval of the Board.

Bonds and Notes Issued

The Group issued bonds and notes during the year ended 31 December 2006, details of which are set out in note 33D to the accounts. Such bonds and notes were issued in order to meet the Group's general corporate funding requirements, including the financing of new capital expenditure and the refinancing of maturing debts.

Computer Processing

There are defined procedures and regular quality reviews on the operation of computer systems to ensure the accuracy and completeness of financial records and efficiency of data processing. The Company's computer centre operation and support, help desk operation and support services, and also software development and maintenance, have been certified under ISO 9001:2000. Disaster recovery rehearsal on critical applications is conducted annually.

Interests in Contracts of Members of the Board and the Executive Directorate

There was no contract of significance, to which the Company or any of its subsidiaries was a party and in which a Member of the Board or a Member of the Executive Directorate had a material interest (whether direct or indirect), which subsisted at the end of the year or at any time during the year.

Board Members' and Executive Directorate's Interests in Shares

As at 31 December 2006, the interests or short positions of the Members of the Board and the Executive Directorate in the shares, underlying shares and debentures of the Company (within the meaning of Part XV of the Securities and Futures Ordinance (Cap. 571 of the Laws of Hong Kong) ("SFO")) as recorded in the register required to be kept under section 352 of the SFO or as otherwise notified to the Company and the Stock Exchange pursuant to the Model Code were as follows:

Long Positions in Shares and Underlying Shares of the Company

Member of the Board or Executive Directorate	Number of Ordinary Shares held			Derivatives		Total interests	Percentage of aggregate interests to total issued share capital
	Personal* interests	Family [†] interests	Corporate interests	Share Options	Other		
Chow Chung-kong	–	–	–	–	418,017 (Note 1)	418,017	0.00753
T. Brian Stevenson	4,689	–	–	–	–	4,689	0.00008
Christine Fang Meng-sang	1,712	–	–	–	–	1,712	0.00003
Russell John Black	53,985	–	–	–	–	53,985	0.00097
William Chan Fu-keung	46,960	–	–	217,500 (Note 2)	–	264,460	0.00477
Thomas Ho Hang-kwong	53,889	2,541	–	321,000 (Note 2)	–	377,430	0.00680
Lincoln Leong Kwok-kuen	23,000	–	23,000 (Note 3)	1,043,000 (Note 4)	–	1,089,000	0.01963

Notes

1. Chow Chung-kong has a derivative interest in respect of 418,017 shares in the Company within the meaning of Part XV of the SFO. That derivative interest represents Mr. Chow's entitlement to receive an equivalent value in cash of 418,017 shares in the Company on completion of his three-year contract (on 30 November 2009).

2. Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the Pre-Global Offering Share Option Scheme.

3. The 23,000 shares are held by Linsan Investment Ltd., a private limited company beneficially wholly owned by Lincoln Leong Kwok-kuen.

4. Further details of the above share options are set out in the table below showing details of the options to subscribe for ordinary shares granted under the New Joiners Share Option Scheme.

5. The 1,066,000 share options held by Francois Lung Ka-kui lapsed on 17 October 2006.

* Interests as beneficial owner

† Interests of spouse or child under 18 as beneficial owner

Options to subscribe for Ordinary Shares granted under the Pre-Global Offering Share Option Scheme, as referred to in Notes 6B(i) and 41A(i) to the Accounts

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2006	Options vested during the year	Options lapsed during the year	Options exercised during the year	Exercise price per share of options (HK\$)	Options outstanding as at 31 December 2006	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
William Chan Fu-keung	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	317,500	–	–	100,000	8.44	217,500	20.75
Thomas Ho Hang-kwong	20/9/2000	1,066,000	5/4/2001 – 11/9/2010	321,000	–	–	–	8.44	321,000	–
Other eligible employees	20/9/2000	41,409,000	5/4/2001 – 11/9/2010	11,285,000	–	–	3,994,000	8.44	7,291,000	19.91

Notes

1. The Pre-Global Offering Share Option Scheme ("Pre-IPO Option Scheme") is valid and effective for a period of ten years after 12 September 2000. No option may be offered to be granted under the Pre-IPO Option Scheme on or after the commencement of dealings in shares of the Company on Stock Exchange on 5 October 2000.

2. The number of shares to which the option granted to each participant under the Pre-IPO Option Scheme does not exceed 25% of the number of the shares issued and issuable under the Pre-IPO Option Scheme.

Options to subscribe for Ordinary Shares granted under the New Joiners Share Option Scheme, as referred to in Notes 6B(ii) and 41A(ii) to the Accounts

Executive Directorate and eligible employees	Date granted	No. of options granted	Period during which rights exercisable (day/month/year)	Options outstanding as at 1 January 2006	Options granted during the year	Options vested during the year	Options lapsed during the year	Options exercised during the year	Exercise price per share of options (HK\$)	Options outstanding as at 31 December 2006	Weighted average closing price of shares immediately before the date(s) on which options were exercised (HK\$)
Lincoln Leong Kwok-kuen	1/8/2003	1,066,000	14/7/2004 – 14/7/2013	1,043,000	–	355,000	–	–	9.75	1,043,000	–
Francois Lung Ka-kui	27/9/2005	1,066,000	26/9/2006 – 26/9/2015	1,066,000	–	355,500	1,066,000	–	15.75	–	–
Other eligible employees	1/8/2003	495,200	14/7/2004 – 14/7/2013	400,700	–	164,200	–	132,500	9.75	268,200	20.48
	12/1/2006	94,000	9/1/2007 – 9/1/2016	–	94,000	–	–	–	15.45	94,000	–
	13/9/2005	94,000	9/9/2006 – 9/9/2015	94,000	–	31,500	–	–	15.97	94,000	–
	23/9/2005	213,000	9/9/2006 – 9/9/2015	213,000	–	71,000	–	–	15.97	213,000	–
	17/10/2005	94,000	6/10/2006 – 6/10/2015	94,000	–	–	94,000	–	16.05	–	–
	23/3/2006	94,000	20/3/2007 – 20/3/2016	–	94,000	–	94,000	–	18.05	–	–
	31/3/2006	94,000	20/3/2007 – 20/3/2016	–	94,000	–	–	–	18.05	94,000	–
	4/7/2006	94,000	19/6/2007 – 19/6/2016	–	94,000	–	–	–	18.30	94,000	–
	17/11/2006	94,000	13/11/2007 – 13/11/2016	–	94,000	–	–	–	19.104	94,000	–
	5/10/2006	94,000	29/9/2007 – 29/9/2016	–	94,000	–	–	–	19.732	94,000	–
	12/5/2006	266,500	25/4/2007 – 25/4/2016	–	266,500	–	–	–	20.66	266,500	–
	15/5/2006	213,000	25/4/2007 – 25/4/2016	–	213,000	–	–	–	20.66	213,000	–
	12/5/2006	213,000	2/5/2007 – 2/5/2016	–	213,000	–	–	–	21.00	213,000	–

Notes

- No option may be exercised later than ten years after its date of offer and no option may be offered to be granted more than five years after the adoption of the New Joiners Share Option Scheme ("New Option Scheme") on 16 May 2002.
- Unless approved by shareholders in the manner as required by the Listing Rules, the total number of shares issued and issuable upon exercise of the options granted to any eligible employee under the New Option Scheme together with the total number of shares issued and issuable upon the exercise of any option granted to such eligible employee under any other share option scheme of the Company (including, in each case, both exercised and outstanding options) in any 12-month period must not exceed 1% of the shares of the Company in issue at the date of offer in respect of such option under the New Option Scheme.
- The 1,066,000 share options held by Francois Lung Ka-kui under the New Option Scheme lapsed on 17 October 2006.

During the year ended 31 December 2006, 1,256,500 options to subscribe for shares of the Company were granted to 9 employees under the New Joiners Share Option Scheme and the respective closing price per share immediately before the respective date of grant of the options are set out below. Pursuant to the terms of this Scheme, each grantee undertakes to pay HK\$1.00, on demand, to the Company, in consideration for the grant of the options. The share options granted are recognised on an accrued vesting basis in the accounts. The weighted average value per option granted, estimated at the respective date of grant using the Black-Scholes pricing model is as follows:

Date granted	Closing price per share immediately before the date of grant (HK\$)	Estimated risk-free interest rate (%)	Expected life (Years)	Estimated Volatility	Expected dividend per share (HK\$)	Weighted average value per option granted (HK\$)
12/1/2006	16.05	4.00	5	0.20	0.42	3.17
23/3/2006	17.60	4.40	5	0.20	0.42	3.25
31/3/2006	17.65	4.47	5	0.20	0.42	3.28
4/7/2006	18.70	4.73	5	0.21	0.42	4.19
17/11/2006	19.12	3.81	5	0.21	0.42	3.70
5/10/2006	19.22	3.83	5	0.20	0.42	3.51
12/5/2006	20.10	4.62	5	0.21	0.42	4.11
15/5/2006	20.10	4.67	5	0.21	0.42	4.13
12/5/2006	20.10	4.62	5	0.21	0.42	3.99

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options and requires input of highly subjective assumptions, including the expected life and stock price volatility. Since the Company's share options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimates, the Black-Scholes option pricing model does not necessarily provide a reliable measure of the fair value of the share options.

Save as disclosed above:

A none of the Members of the Board or the Executive Directorate of the Company had any interest or short position in the shares, underlying shares or debentures of the Company or any of its associated corporations (within the meaning of Part XV of the SFO); and

B during the year ended 31 December 2006, no Member of the Board or the Executive Directorate nor any of their spouses or children under 18 years of age held any rights to subscribe for equity or debt securities of the Company nor had there been any exercises of any such rights by any of them,

as recorded in the register kept by the Company under section 352 of the SFO or otherwise notified to the Company and the HKSE pursuant to the Model Code.

Directors' Service Contracts

No director proposed for re-election at the forthcoming Annual General Meeting has a service contract which is not determinable by the Company or any of its subsidiaries within one year without payment of compensation, other than statutory compensation.

No Director has a service contract with the Company or any of its subsidiaries which is for a duration which may exceed three years or which requires the Company to, in order to terminate such contract, give a notice period in excess of one year or pay or make other payments equivalent to more than one year's emoluments.

Substantial Shareholders' Interests

Set out below is the name of the party which was interested in 5% or more of the nominal value of the share capital of the Company and the respective relevant numbers of shares in which it was interested as at 31 December 2006 as recorded in the register kept by the Company under section 336 of the SFO:

Name	No. of Ordinary Shares	Percentage of Ordinary Shares to total issued share capital
The Financial Secretary Incorporated (in trust on behalf of the Government)	4,249,276,330	76.58

The Company has been informed by the Government that, as at 31 December 2006, approximately 1.46% of the shares of the Company were held for the account of the Exchange Fund. The Exchange Fund is a fund established under the Exchange Fund Ordinance (Cap. 66 of the Laws of Hong Kong) under the control of the Financial Secretary.

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

As at 31 December 2006, the Group had borrowings of HK\$27,508 million with maturities ranging 2007 to 2020 and undrawn committed and uncommitted banking and other facilities of HK\$17,288 million, which were subject to the condition that the Government, being the Company's controlling shareholder, owns more than half in nominal value of the voting share capital of the Company during the lives of the borrowings and the undrawn facilities. Otherwise, immediate repayment of borrowings may be demanded and cancellation of the undrawn facilities may result.

Major Suppliers and Customers

Less than 30% in value of supplies (which were not of a capital nature) purchased during the year ended 31 December 2006 was attributable to the Company's five largest suppliers. Less than 30% in value of the Company's turnover during the year ended 31 December 2006 was attributable to the Company's five largest customers combined by value.

Going Concern

The accounts on pages 87 to 163 have been prepared on a going concern basis. The Board has reviewed the Company's budget for 2007, together with the longer-term forecast for the following five years and is satisfied that the Company has sufficient resources to continue as a going concern for the foreseeable future.

Connected Transactions

During the year under review the following transactions and arrangements described below have been entered into (or were ongoing) with persons who are "connected persons" for the purposes of the Listing Rules:

Land Agreements

A (a) New Grant No. 9689 dated 16 May 2002, of Tseung Kwan O Town Lot No. 70 for development at Tseung Kwan O Area 86 (building covenant period expiry date 31 December 2015 or 60 months from the due date for payment of land premium of Site O, whichever is the later, which was extended to 31 December 2018 or 66 months from the due date for payment of land premium of Site O, whichever is the later, pursuant to the Further Modification Letter described in (b) below) with a total consideration or value of HK\$150,000,000 for site M1 and the consideration for the other sites to be assessed.

(b) The Company entered into a Further Modification Letter dated 13 April 2006 (the "Further Modification Letter") with Government to fix the boundary of Site AB, defer the expiry dates of the building covenant periods, revise the requirements relating to the Government accommodation, require the Company to make payments in respect of noise mitigation measures and set out the development parameters, with the premium for Site AB assessed at HK\$8,061,470,000.

B Following the end of the year under review, the Company accepted on 26 February 2007 an offer from the Government to proceed with the proposed development of Tseung Kwan O Town Lot No.72, Area 56, Tseung Kwan O, Sai Kung, New Territories ("Area 56"), subject to the Company's acceptance of Government's assessment of the premium for Area 56 (the "Land Premium") and of the particulars and conditions of the land grant by private treaty of Area 56 to be entered into between the Company and the Government (the "Land Grant"). The offer was made by the Government on 15 January 2007. The Company delivered the acceptance to the Government on 26 February 2007 and the Land Grant is expected to be executed within three calendar months from that date.

It is proposed that the development in Area 56 will be a mixed-use development comprising hotel, office, residential, commercial and car parking accommodations with a total gross floor area of not more than 168,537 square metres. The Company is required to pay to the Government the Land Premium, which has been assessed by the Government to be HK\$3,345,230,000, by reference to the full market value of Area 56, ignoring the presence of the railway. The Company is required to pay (a) a deposit equal to 10% of the Land Premium on 26 February 2007 and (b) the remaining balance of the Land Premium when the Land Grant is executed. The payment of the Land Premium will be funded by Lansmart Limited, which was the successful tenderer in the tender to develop Area 56.

As the Government is a controlling shareholder of the Company and therefore a connected person of the Company, the transaction is a connected transaction for the Company under Rule 14A.13 of the Listing Rules. As disclosed in the announcement of the Company dated 13 January 2005, the Stock Exchange has granted a waiver to the Company from strict compliance with the requirements under Chapter 14A of the Listing Rules which would otherwise apply to connected transactions between the Company and the Government, subject to certain conditions (the "Waiver").

Entrustment Agreement

On 22 June 2006 the Company executed an Entrustment Agreement (“Entrustment Agreement”) with the Government under which the Company would construct road L861 and associated services as part of the Tseung Kwan O South Station and Approaches Project. The works are scheduled for completion in 2009. The Entrustment Agreement was executed in the sum of HK\$111.1 million.

The above disclosure relating to the Entrustment Agreement is made in accordance with paragraph B(l)(i) of the Waiver and Rule 14A.45 of the Listing Rules.

Continuing Connected Transactions

On 30 June 2005, the Company entered into a supplemental agreement with The Hong Kong Airport Authority (“AA”) (“Supplemental Agreement”) for the renewal for a further three-year period of the existing maintenance agreement for the Automated People Mover at Hong Kong International Airport (the “Airport”).

The Company entered into the original maintenance agreement (the “Maintenance Agreement”) with the AA on 18 March 2002. The Maintenance Agreement was for a term of three years, which expired on 6 July 2005. However, the Maintenance Agreement also included an option, exercisable at the discretion of the AA, to extend the term of the agreement at pre-agreed rates and prices for another three years until 6 July 2008.

Since entering into the Maintenance Agreement, the AA has decided to modify and extend the Automated People Mover in order to serve the new Sky Plaza and Sky Pier terminal buildings which are being built at the Airport. This has correspondingly extended the scope of maintenance work for the Automated People Mover. As a result, the price for the option to extend the Maintenance Agreement for a further three-year period has been re-negotiated and reflected in the Supplemental Agreement. Otherwise, the basic terms and conditions of the Maintenance Agreement have not been changed.

The AA, being an associate (as defined in the Listing Rules) of Government, a substantial shareholder of the Company, is a connected person of the Company. As the Supplemental Agreement is a transaction between the Company and a connected person (i.e. the AA) (the “Transaction”), it constitutes a connected transaction for the Company. In addition, on the basis that the agreement involves the provision of services on an ongoing basis, the Supplemental Agreement constitutes a continuing connected transaction for the Company. The transaction is subject to the terms of the Waiver.

The above disclosure relating to the Transaction is made in accordance with paragraph (B)(l)(i) of the Waiver and Rule 14A.46 of the Listing Rules.

In accordance with paragraph (B)(l)(iii)(a) of the Waiver, all the Independent Non-executive Directors of the Company have reviewed the Transaction and confirmed that the Transaction was entered into:

- (1) in the ordinary and usual course of the business of the Company;
- (2) on normal commercial terms which are no less favourable to the Company than terms available from independent third parties; and
- (3) in accordance with the Maintenance Agreement and the Supplemental Agreement on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

The Company has engaged the auditors of the Company to carry out a review of the Transaction in accordance with Hong Kong Standard on Related Services 4400 “Engagements to Perform Agreed-Upon Procedures Regarding Financial Information” issued by the Hong Kong Institute of Certified Public Accountants. In accordance with paragraph (B)(l)(iii)(b) of the Waiver, the auditors have confirmed to the Board of Directors that the Transaction:

- (i) has been approved by the Members of the Board of the Company; and
- (ii) has been entered into in accordance with the terms of the Maintenance Agreement, as amended by the Supplemental Agreement.

Government is a substantial shareholder in the Company.

Auditors

The retiring auditors, KPMG, have signified their willingness to continue in office. A resolution will be proposed at the Annual General Meeting to reappoint them and to authorise the Directors to fix their remuneration.

By order of the Board

Leonard Bryan Turk
Secretary to the Board
Hong Kong, 13 March 2007