

CHAIRMAN'S LETTER



Dear Shareholders and other Stakeholders,

“Challenging” is a word used too often in letters like this, but I find it a very appropriate adjective to describe the year 2018 for MTR. Being upfront, I have to admit that some situations have not turned out as expected. The Shatin to Central Link (“SCL”) is our final project under “Rail Gen 2.0” and, despite further construction progress, the issues at certain stations, especially Hung Hom Station, have caused concern not just for all of us at MTR, but also among the public. I will talk about this in more detail below but, suffice it to say we are working hard to rectify the issues.

In our Hong Kong operations, back in October 2018, a major service incident impacted a large number of passengers across four lines. Here too, prevention is always better than cure and we are actively taking steps to prevent a reoccurrence. Finally, two of our operations in Europe have been impacted by operational challenges, some of which are beyond our control, such

as industrial action, the introduction of more complex timetables and underperforming infrastructure provided by third parties, all of which have led to the underperformance of these businesses.

However, this should not overshadow our achievements in 2018, although there clearly is room for improvement in some aspects of our operations. After all, on 23 September, we began passenger service on the Hong Kong Section of the Guangzhou-Shenzhen-Hong Kong High Speed Rail ("HSR"). This is one of Hong Kong's most important infrastructure projects since the handover in 1997 and puts Hong Kong on the Mainland of China's vast high speed rail map.

MTR Corporation provides excellent railway services to the public in Hong Kong, whilst operating one of the busiest railway systems in the world. Serving 5.88 million people each weekday, it is inevitable that we will encounter challenges. I am confident that our operations teams will do their best to provide safe, reliable and efficient railway services for all. We are also making good progress in becoming a global operator of sustainable rail transport services that are admired by our peers.

In less than four months, I will hand over the baton to the next Chairman after three-and-a-half years as Chairman of MTR. I have to say that guiding the Company through this period of rapid expansion has been one of the most rewarding tasks I have ever undertaken, as the Company has largely met the goals set for it by the Board. In Hong Kong, we opened three new lines – HSR, the South Island Line and the Kwun Tong Line Extension – while expanding our presence in other markets in parallel. We have awarded seven property development packages that will provide around 6,000 much needed flats for the Hong Kong market, and completed our first property development in the Mainland of China, which was very well received. The MTR Academy ("MTRA") has been established to develop the railway talents of the future and contribute to China's "Belt and Road" initiative. All of these achievements were made possible because of the skill and dedication of our staff.

These rewards have not come easily though. Successfully balancing the needs of the public with those of shareholders is a really tough task. In 2017 we completed the early review of the Fare Adjustment Mechanism ("FAM"), which is paramount in underpinning MTR's financial sustainability, keeping fares at an affordable level for the public, and giving additional fare concessions to sectors of society that require extra relief or support. At the same time, we are committed to provide excellent and customer-oriented service.

All of the above has been achieved while providing our shareholders with a steady and rising stream of dividend payments, backed by a strong balance sheet and a diverse, resilient business model.

This year marks MTR's 40th anniversary. During this journey, MTR has gone from a local company operating a single railway line here at home in Hong Kong to a multinational company which is recognised as a world-class railway operator internationally. Last year, we carried 5.88 million passengers per weekday in Hong Kong along 256.6 km of track, and around 6.83 million passengers per weekday outside of Hong Kong along 2,008.7 km of track. Over the course of 2019, we will open a further three railway lines: Sydney Metro Northwest in Australia, the Light Rapid Transit Taipa Line in Macau and Hangzhou Metro Line 5 in the Mainland of China. These are important milestones in our strategy of continued expansion in the Mainland of China and internationally.

SHATIN TO CENTRAL LINK

Our current focus is the completion of the SCL. This project has become a focus for the whole of Hong Kong, mainly because of the issues regarding construction quality at three stations of the SCL, in particular the Hung Hom Station extension, which we are very concerned about.

Both I and my fellow Board Members have taken the matter very seriously since we became aware of it. Since June 2018, three special Board meetings, in addition to regular Board and Capital Works Committee meetings, have been held to consider and review the issues, as well as to ensure that appropriate steps are being taken to understand the matter fully and to manage it properly. From the outset, I have stressed that public safety is always our first priority. I have also reiterated the need to be transparent about our fact finding and actions. The Company has been and remains committed to honouring this pledge of transparency throughout the course of the matter. It was unfortunate, therefore, that the report relating to the platform slab at the Hung Hom Station extension which we submitted to Government on 15 June 2018 contained inaccuracies, regarding which both I, personally, and the Board have expressed deep disappointment. I would be less than honest if I said that we have done a good job in this matter. Our project management performance has fallen short of public expectations and tarnished the reputation of the Corporation.

In addition to our internal investigations and improvement actions, we have co-operated fully with the Commission of Inquiry ("COI") appointed by the HKSAR Chief Executive in Council and will continue to work with Government to bring the matter to a close. Taking into consideration the views of Government, its Expert Adviser Panel and the Company's appointed external engineering consultants, a holistic proposal for verification and assurance of the as-constructed conditions and workmanship quality of the Hung Hom Station extension was formulated by the Company and approved by Government. Verification and assurance works

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are being carried out according to the agreed protocol, with findings published by Government on a regular basis for the public's information.

In February 2019, Government announced that the terms of reference of the COI had been expanded to cover issues relating to the North Approach Tunnels ("NAT"), the South Approach Tunnels ("SAT") and the Hung Hom Stabling Sidings ("HHS"), having stated that it has recently come to light that, in respect of the NAT, SAT and HHS, some works-related documentation has been found to be missing and some construction works involving deviations from the designs, plans or drawings accepted by the Highways Department or the Building Authority might have been carried out. In view of the expanded scope of the COI, the Chief Executive in Council has approved a further extension of time for the COI to submit its report to the Chief Executive to 30 August 2019, or such time as the Chief Executive in Council may allow. The COI submitted an interim report to the Chief Executive on 25 February 2019, and Government has yet to publish the interim report up to the date of this annual report. In the meantime, our management team has been asked to strengthen its monitoring and supervision of all project management works, in particular those related to the SCL. Furthermore, we have updated the Terms of Reference of the Company's Capital Works Committee to enhance its oversight of the quality of all major capital works projects.

The opening date of the new line is therefore dependent on a number of factors, and we are looking into the feasibility of the phased opening of the Tuen Ma Line.

Throughout the 40-year history of MTR, we have successfully delivered many projects for Hong Kong, all of the highest quality, including most recently the HSR, which has been well received by the public. MTR is a great organisation, but there is always room for improvement. While we need to move forward, it is also imperative for us to learn from our painful lessons, so that we are geared up to serve Hong Kong for another 40 years and many more years ahead, and we need to continue to strive for excellence for the community.

FINANCIAL PERFORMANCE

Our financial results in 2018 were solid, as the decent economic growth in Hong Kong has provided a good platform for our business expansion.

Looking at the numbers, profit attributable to equity shareholders from recurrent businesses increased by 5.1% to HK\$9,020 million. Property development profit for the year increased by 15.9% to HK\$2,243 million. As a result, profit attributable to shareholders from underlying businesses was 7.1% higher at HK\$11,263 million. Including the gain arising from investment property revaluation which was lower than

that in 2017, net profit attributable to shareholders of the Company fell by 4.9% to HK\$16,008 million, representing earnings per share after revaluation of HK\$2.64. Your Board has proposed a final ordinary dividend of HK\$0.95 per share, which together with the interim dividend of HK\$0.25 per share, brings the full year dividend to HK\$1.20 per share.

Despite the issues associated with the SCL, in 2018, the MTR share price outperformed the Hang Seng Index on a one-year total return basis, and I take this opportunity to thank our shareholders for their confidence and continued support of the Company.

OPERATIONS AND FARES

One of the highlights of my time at MTR fell on 22 September 2018 with the ceremony to mark the opening of HSR, when I joined Mrs Carrie Lam, HKSAR Chief Executive, and Mr Ma Xingrui, Governor of Guangdong Province, and over 400 other guests. Together, we passed through the co-located immigration and customs checkpoints in Hong Kong's award-winning Hong Kong West Kowloon Station and boarded an MTR Vibrant Express high-speed train for a round-trip journey to Guangzhounan station.

Since passenger service began on 23 September 2018, HSR has performed satisfactorily, clocking up more than 5 million passenger journeys by the end of the year. On behalf of the Board, I would like to thank all our staff at MTR who have been involved in HSR for their hard work that has made it such a success. As a company, we are delighted to have been part of this project and to have been awarded a ten-year operating concession. HSR is a new chapter in the history of Hong Kong and will generate immense opportunities for the years to come. We are committed to providing safe, reliable and comfortable high-speed rail services.

Our existing operations, meanwhile, performed well. Our passenger journeys on-time performance for heavy rail train services was maintained at 99.9% over the year. As I have said, this is no easy task and it requires heavy investment by the Company every year, not only in new lines and stations, but also in upgrading and maintaining those that are already operating. The major projects we are undertaking under "Rail Gen 2.0", which signifies the next generation of rail services in Hong Kong, are now taking shape.

But you can only invest if you have the capital required and this is why the FAM is so important to MTR and Hong Kong, because it enables MTR to strike a good balance between addressing the concern of affordability for our customers and maintaining our financial sustainability.

The fare structure underpinned by the FAM allows us to invest not only in new rail projects, but in major improvements to our existing network, with the replacement of trains, signalling systems and air conditioning systems well underway. It also

helps fund many smaller scale additions and refurbishments, such as new lifts, gates and seating, which make the everyday experience of our passengers more pleasant and comfortable.

There were no fare increases in 2017 on the MTR lines, in accordance with the FAM, but fares saw an overall upward adjustment of +3.14% from June 2018. This, however, is much lower than the 11.89% aggregated average increase in household incomes in Hong Kong over the last two years, so our fares have actually become more affordable. What's more, our 2018/2019 fare promotions package amounted to HK\$500 million and, if you add this to the over HK\$2.7 billion on-going MTR fare concessions and discounts, it means that we're bringing to our customers over HK\$3 billion worth of fare concessions in the 12 months up to June 2019.

I am very pleased to see that my suggestion to Government of using the dividend it receives from the Company to subsidise passenger fares has been taken up in some form. The 2017 Policy Address introduced a non-means tested Public Transport Fare Subsidy Scheme to provide a 25% fare subsidy for commuters on their monthly public transport expenses in excess of HK\$400, subject to a cap of HK\$300 a month. Over 2 million commuters are expected to benefit from the scheme, which has been implemented since 1 January 2019.

GROWTH

Despite the challenges of the past few months, we remain focused, as we must be, on the future of MTR and on our role in serving the Hong Kong community. Rail transport is a very long term business. Working with Government, we need to plan decades ahead to make sure Hong Kong has the sustainable railway network that it needs. Government reaffirmed its commitment for railways to be the backbone of

Hong Kong's transport system in the HKSAR Chief Executive's 2018 Policy Address and we have already submitted proposals for five new railway lines under the Railway Development Strategy 2014. These are now at various stages of discussion with Government. In the even longer term, Government's "Hong Kong 2030+: Towards a Planning Vision and Strategy Transcending 2030" and "Lantau Tomorrow Vision" plans are proposing additional transport corridors and we are looking forward to playing our part in shaping the future of transportation in Hong Kong by participating in the "Strategic Study on Railways beyond 2030 – Feasibility Study" that Government is planning to kick off in 2019.

A substantial portion of our growth in recent years has come from the various franchises we've been awarded outside of Hong Kong, as we leverage our skills and reputation to move into new markets. During the year, we were awarded the operations and maintenance contract for Macau's first railway, the Macau Light Rapid Transit Taipa Line. In the Mainland of China, we signed a series of agreements with local parties that will open up new railway and property opportunities in the cities of Beijing, Hangzhou, Chengdu, Shunde and at provincial level in Zhejiang. Further afield, in the UK we have submitted our bid for the West Coast Partnership rail franchise, which will include the HS2 high speed rail services. In Australia, we are pursuing opportunities in phase two of Sydney Metro, Sydney Metro City and Southwest, and, in Canada, a rail system upgrade and expansion project in the Toronto and Hamilton corridor.

OUR PEOPLE

Our experienced and committed staff are our greatest asset and the key to what makes MTR a world-class company year after year. We strive to provide our people with

「廣州－深圳－香港」高速鐵路(香港段) 開通儀式

Opening Ceremony for "Guangzhou – Shenzhen – Hong Kong" High Speed Rail (Hong Kong Section)





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competitive remuneration and continuous growth and development opportunities in a collaborative and harmonious work environment.

In 2018, many of our human resources activities centred on the campaign to “Strengthen Our Culture for Excellence and Growth”, with four cultural focuses – Participative Communication, Effectiveness and Innovation, Collaboration and Agility to Change. Innovation is the holy grail of business in our fast-changing world and one of the new initiatives in this area during the year was the #propUP programme, which focused on innovative ideas for shopping malls. The programme was a platform to crowdsource ideas and it followed on from the success of 2017's Innovation Bootcamp, launched for our property business, which was held again in 2018. Over 100 startups enrolled in the #propUP programme and the five winning startups were able to test their products and services in four MTR malls, with mentors and on-site support sponsored by MTR.

MTRA is also contributing increasingly to the railway industry globally. More and more railway professionals are enrolling and, during the year, MTRA engaged with local schools to give young people a taste of the railway industry, which they might one day consider as a career. Internationally, MTRA now has agreements with organisations in the Mainland of China, Thailand, Indonesia, the Philippines and the UK covering various kinds of collaboration.

CONTRIBUTIONS TO THE COMMUNITY

Our rail services and related businesses play an important role in connecting people and stimulating economic growth, but our “Community Connect” platform tries to help in other ways, especially in relation to young people as they move through life, which can be a rough journey at times.

In July 2018, we launched a new youth initiative, “Uth Live Saturdays”, providing a platform for tertiary students to showcase their talents at Hong Kong Station. The second year of the “STEM Challenge” programme, which engages secondary-school students in real-world engineering challenges, has gone from strength to strength, now reaching more than 12,000 students. Our long-running youth summer programme “Train’ for life’s journeys” celebrated its 10th anniversary with a record number of young people spending eight days in July challenging themselves, learning about our operations and sampling various roles.

Culture is part of what moves any city from good to great, and this is why we also put out efforts into enriching the cultural life of Hong Kong through our “Art in MTR” programme. Apart from the 82 artworks in the MTR network, the programme also puts on a variety of events in our stations during the year.

MTR cares about the community and our “More Time Reaching Community” Scheme organised 292 volunteering activities involving a participating volunteer headcount of over 5,600 in 2018 to serve those in need. The MTR Volunteering Month in late 2018 demonstrated our commitment to environmental protection. We again received the “10 Years Plus Caring Company Logo” from The Hong Kong Council of Social Service. The Community Chest, meanwhile, gave MTR the “President’s Award”, the “Diamond Award” and the “10th Top Fundraiser Award” in its Corporate and Employee Contribution Programme 2017/2018 in recognition of our efforts in various charity events and fundraising initiatives for good causes.

An electrified railway system is one of the most environmentally friendly ways to travel and MTR is making a positive contribution to our planet every day by taking people off fossil fuel based road transport. We also strive to go beyond this through a range of programmes aimed at making a positive impact, such as those targeting energy efficiency. We raised a total of around HK\$3.5 billion through green finance initiatives in 2018, including the signing of our first green loan, and such funds have been assigned to different green projects. We are proud when these efforts are recognised and, in 2018, our achievements were acknowledged in a number of ways, including through several awards given under the Energy Saving Championship Scheme organised by the Environment Bureau and the Electrical and Mechanical Services Department.

BOARD

A good company also needs to be backed by a strong Board and I am pleased that MTR is able to attract the high calibre Directors it needs. There were a few important changes from 2018 to date.

I would like to welcome Mr Rex Auyeung Pak-kuen, who joins the Board today as a Non-Executive Director. Following the Board’s appointment, the Financial Secretary Incorporated notified the Corporation that, subject to his election as a Director of the Corporation at the Corporation’s Annual General Meeting in 2019, Mr Auyeung will be appointed as Chairman of the Corporation with effect from 1 July 2019 until 31 December 2021. I congratulate Rex on his appointment and wish him all the very best in his new role. Without doubt, the Corporation will be taken to new heights under Rex’s leadership. As for myself, I will be retiring from the position of Chairman when my tenure ends on 30 June 2019.

On 7 August 2018, our CEO, Mr Lincoln Leong Kwok-kuen, notified the Company of his wish to take early retirement. Following a global search, the Board has appointed Dr Jacob Kam, currently Managing Director – Operations and Mainland Business of MTR Corporation, to be the new CEO, with effect

from 1 April 2019. I am confident that, with Dr Jacob Kam's extensive experience in operations, engineering and other businesses of the Corporation, fuelled by his passion for the industry, he will lead the Corporation in overcoming the difficulties it is facing. Mr Lincoln Leong will retire from the Corporation after 31 March 2019. I wish once again to thank Lincoln for his leadership and the tremendous contributions he has made since joining the Company in 2002 as Finance Director. Under Lincoln's leadership, the Corporation has continued to deliver world-class performance in its operations, and successfully completed and opened the Kwun Tong Line Extension, the South Island Line and the HSR. In addition, Lincoln has also driven significant growth in our Hong Kong station commercial, property development and rental businesses, as well as contributed significantly to the Corporation's growth in the Mainland of China and international markets.

Mr Alasdair George Morrison retired as an Independent Non-executive Director with effect from the conclusion of the Company's Annual General Meeting on 16 May 2018. Alasdair served on the Board for more than seven years and I thank him for his advice and support during all these years. Filling his place, Ms Rose Lee Wai-mun joined as an Independent Non-executive Director on the same date.

I also wish to formally welcome Mr Lam Sai-hung who, by virtue of his appointment to the post of Permanent Secretary for Development (Works) with effect from 13 October 2018, became a Non-executive Director of the Board on the same day. He succeeded Mr Hon Chi-keung, who retired from the Board on the same date, and I thank Mr Hon for his contributions during his tenure as a Board Member.

I thank all my fellow Directors for the time they have put in, and all of our staff for their hard work and commitment throughout the year.

SOME FINAL THOUGHTS

I feel privileged and honoured to have served MTR for close to six years, starting off as an Independent Non-executive Director in July 2013, and serving as Non-executive Chairman since 1 January 2016. My time at MTR has surely been busy and fulfilling. MTR is a Hong Kong institution, one that should be treasured for the contributions it makes each and every day to the community's well-being.

The construction issues relating to certain stations on the SCL, particularly the Hung Hom Station extension, have distressed me. Yet, I believe that every company or individual inevitably encounters setbacks at some point. The situation reminds me of an incident involving Ngong Ping 360 in 2007, when an empty cable car fell to the ground, causing a collapse in the public confidence in the operating company.

As Secretary for Commerce and Economic Development at that time, I had to restore public trust in the Ngong Ping 360 cable car service as soon as possible. Through a joint effort of Government and MTR, we eventually succeeded in doing so. Today, Ngong Ping 360 is highly successful and has been named as one of "The World's 10 Best Cable Cars".

Likewise, in the case of the SCL project, I am confident that with the concerted efforts of MTR staff and their "can-do" spirit, the Corporation will be able to overcome the recent challenges and regain the public's trust. Over the next 40 years and for even more decades to come, I have no doubt the Corporation will continue to weather any challenges and embrace new opportunities so as to achieve new heights.



Professor Frederick Ma Si-hang
Chairman
Hong Kong, 7 March 2019

SUPPLEMENTARY UPDATE UP TO 26 MARCH 2019

On 18 March 2019, during non-traffic hours drill tests for the new signalling system for the Tsuen Wan Line, two trains collided near Central Station. Both I and my fellow Board Members are very concerned about the incident and, at a special Board Meeting held on 19 March 2019, requested the management team to (i) resume the service between Admiralty Station and Central Station on the Tsuen Wan Line as soon as possible (the service was resumed on 20 March 2019), (ii) set up an expert panel to conduct a detailed investigation into the incident, and (iii) reserve the Company's position against the relevant contractor. Safety is of utmost importance to MTR Corporation and the Board will continue to oversee the follow up to this unacceptable incident.

On 26 March 2019, the interim report of the COI was made public by Government. The COI has made a clear determination that the diaphragm wall and platform slab construction works of the Hung Hom Station extension are safe and finds no rebuilding or strengthening of the works to be necessary. The Company welcomes and recognises the findings and recommendations in the interim report of the COI. We will continue to work with Government to bring forward the SCL project to better serve the community.