The Express Rail Link (XRL) Agreement – A Pragmatic and Viable Solution

Roadshow Presentation

January 2016

Expected Timetable

Latest time for lodging transfer forms in order to be entitled to attend and vote at General Meeting	4:30 p.m. 27 Jan 2016
Closure of the register of members of the Company for determination of entitlements to attend and vote at General Meeting	9:00 a.m. 28 Jan 2016 – 4:30 p.m. 1 Feb 2016
Latest time for lodging Proxy Forms for General Meeting	11:00 a.m. 29 Jan 2016
General Meeting	1 February 2016

Agenda

1. **Overview of the Proposed Arrangements**
2. **Rationale and Benefits of the Proposed Arrangements**
3. **Financing Plan**
4. **Financial Impact**
5. **IFA and IBC Recommendation**

1. Overview of the Proposed Arrangements

Overview of the Proposed Arrangements

1. MTR and the Government have jointly reviewed the project cost, and the estimated project cost has been reduced from HK$85.30bn to the Revised Cost Estimate of HK$84.42bn

2. The Government will finance the project cost up to the Revised Cost Estimate of HK$84.42bn

3. MTR will bear and finance the portion of project costs that exceed HK$84.42bn (if any)[1]

4. MTR will declare and pay a special dividend of HK$4.40 in aggregate per share in two equal tranches (of HK$2.20 in cash per share, in each tranche), amounting in total to a combined payment of approximately HK$25.76bn[2]

5. The Government reserves the right to refer to arbitration the question of MTR's liability for the Current Cost Overrun (if any)

Subject to the approval of MTR's independent Shareholders and Legislative Council in respect of the Government's additional funding.

[1] Except for certain agreed excluded costs (namely, additional costs arising from changes in law, force majeure events or any suspension of construction contracts).
[2] Based on 5,854,924,236 shares outstanding as of 31 October 2015. No scrip alternative for special dividend.

Overview of the Proposed Arrangements

1 **Revised Cost Estimate – Breakdown (1/3)**

HK$85.30bn
(30 Jun 2015)

HK$84.42bn
(30 Nov 2015)

Illustrative Approach to the Revised Cost Estimate

Revised Cost Estimate

	(HK$ billion)
30 June 2015 Cost Estimate	85.30
Scope of Works[1]	(0.544)
Reduction in Additional Project Management Cost	(0.186)
Net Reduction as a Result of Reduction in Project Contingency and Adjustments to a Small Number of Other Items	(0.150)
Revised Cost Estimate	**84.42**

Components of Revised Cost Estimate

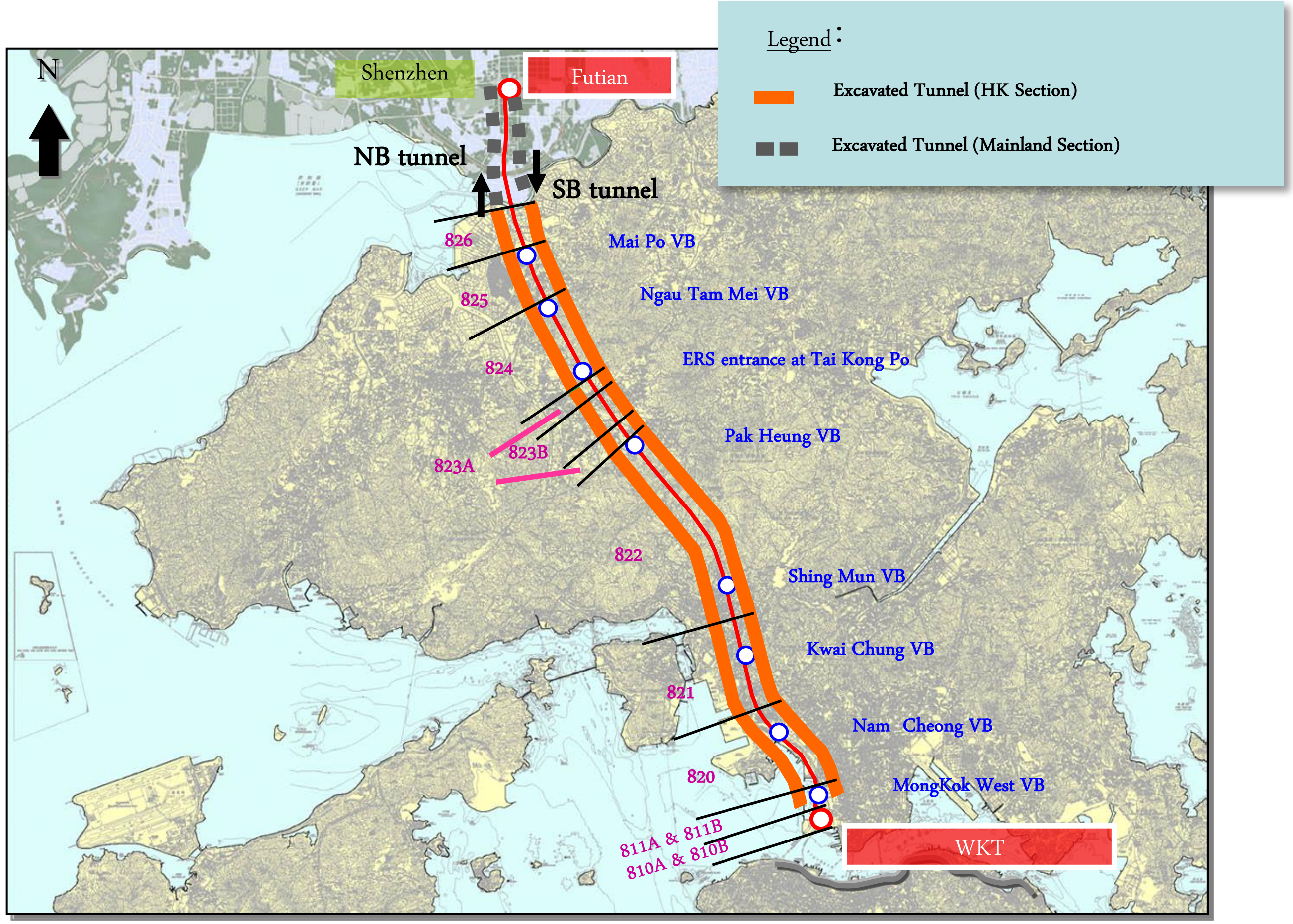
	(HK$ billion)
Construction Cost	76.47
Project Management Cost[2]	6.00
Contingency Reserve	1.95
Revised Cost Estimate	**84.42**

[1] Confirmation that 5 of the 15 tracks are not required in the initial period of operations and will only be fitted out at a later time.
[2] Increase of Project Management Cost of HK$1.75bn from EA2.

Overview of the Proposed Arrangements

1 Revised Cost Estimate – Project Progress (2/3)

Progress as of 30 Nov 2015	
■ **Excavation of tunnels**	**99.9%** *(Excavation completed on 12 Dec 2015)*
■ **West Kowloon Terminus**	**63.9%**
— Contract 810A (WKT North)	49.1%
— Contract 810B (WKT South)	88.9%
— Contract 811A (WKT Approach Tunnel North)	98.9%
— Contract 811B (WKT Approach Tunnel South)	70.5%
■ E&M works and installations	51.0%
■ **Overall**	**75.4%**



Construction work is currently on track in accordance with the Revised Programme to Complete.

Overview of the Proposed Arrangements

1 Revised Cost Estimate – Reviews (3/3)

MTR's Review

- Carried out a review to test the reasonableness of the revised cost estimate for the XRL project based on the agreed scope of the project, which suggested that the amount of the construction cost remains sufficient, although risks remain.

Independent Experts' Review

- The revised cost estimate has also been reviewed by:
  - Mr John Battersby of **Battersby Kingfield Limited (BKL)**, a quantity surveyor with 49 years' experience in the construction industry, 33 of which have been on major projects in Hong Kong and the Asia Pacific region.
    - *Conclusion: while the revised cost estimate is not without risk, the allowances generally appear to be sufficient and sufficient provisions have been made for uncertainties, provided that the Company adopts a proactive final account settlement strategy in respect of contractors' claims and the progress continues to be in line with the Express Rail Link revised timetable.*
  - Dr TC Kao and Professor Dr Bent Flyvbjerg who are **eminent academics** with extensive worldwide expertise in project management and as consultants and advisers on project related issues and who were independent experts to the board committee which was established in April 2014 in relation to the XRL project.
    - *Conclusion: the revised cost estimate for the XRL project is more likely than not to be adequate, although risks remain.*

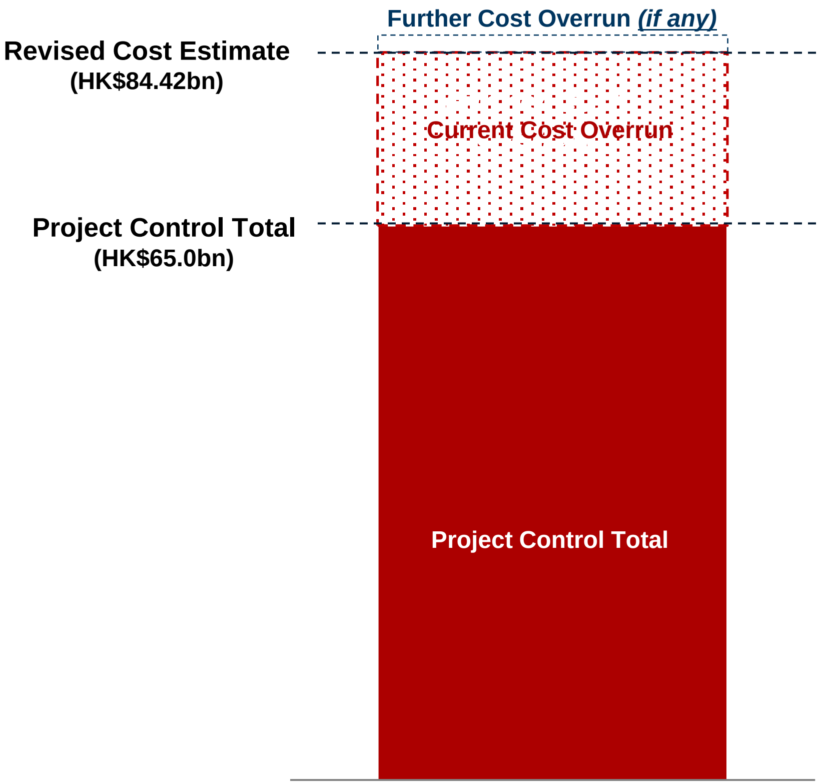
Arcadis' Review

- Arcadis, a leading global natural and built asset design and consultancy group, was engaged by IFA (Anglo Chinese) to independently review the Revised Cost Estimate.
  - *Conclusion: the Company has adopted a reasonable, consistent and logical approach to establishing the likely outturn cost*

MTR does not currently believe there is any need to revise further the Revised Programme or the Revised Cost Estimate for the agreed scope of the project.

Overview of the Proposed Arrangements

2 3 **Funding for Project Costs**



Who will Bear and Finance the Cost of the XRL?

MTR will bear and finance further cost overrun beyond the Revised Cost Estimate of HK$84.42bn (if any)[1]

Government will bear and finance the current cost overrun from the Project Control Total of HK$65.0bn up to the Revised Cost Estimate of HK$84.42bn (i.e. up to HK$19.42bn)

Government continues to fund XRL up to the Project Control Total (i.e. HK$65.0bn) as per the original Entrustment Agreement

Subject to the approval of MTR's independent Shareholders and Legislative Council in respect of the Government's additional funding.

[1] *Except for certain agreed excluded costs (namely, additional costs arising from changes in law, force majeure events or any suspension of construction contracts).*

Overview of the Proposed Arrangements

4 Special Dividend

- MTR will pay a special dividend of HK$4.40/share in aggregate, i.e. a total of approximately HK$25.76bn[1]
- Special dividend to be paid in two equal tranches (HK$2.20 in cash per share, in each tranche). No scrip alternative for special dividend.

First Tranche	Second Tranche
Special Dividend: HK$2.20/share *Estimated to be paid in 2H 2016*	**Special Dividend: HK$2.20/share** *Estimated to be paid in 2H 2017*

- MTR intends to maintain its **existing progressive dividend policy going forward**[2]

Putting the Special Dividend into Context

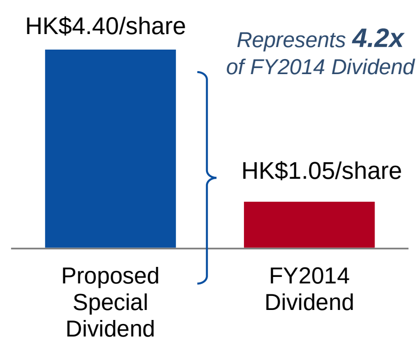
Financial Secretary Incorporated (FSI)
(75.7% shareholding)

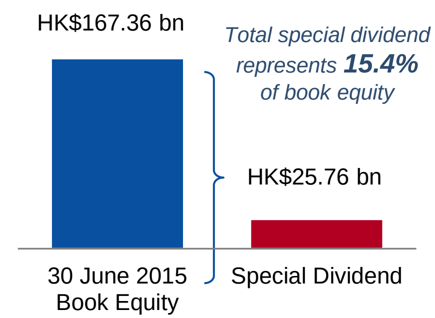
Entitled to ***HK$19.51bn[1]*** *of special dividends in aggregate*

Other Shareholders
(24.3% shareholding)

Entitled to ***HK$6.25bn[1]*** *of special dividends in aggregate*

MTR





[1] *Based on the number of shares outstanding as of 31 October 2015.*
[2] *Subject to, among other things, the financial performance and trading results of the Company and general economic conditions in Hong Kong and globally.*

Overview of the Proposed Arrangements

5 **Liability Assessment Process**

- Government reserves the right to refer to arbitration the question of the Company's liability for the Current Cost Overrun (if any) (including any question Government may have regarding the validity of the Liability Cap)
- The liability cap is currently up to HK$4.94bn and will increase to up to HK$6.69bn when the Project Management Cost is increased
- If the Government chooses to initiate an arbitration claim, it will only proceed after commencement of commercial operations on the XRL
- If the Arbitrator determines MTR's liability would exceed the liability cap, MTR will bear such amount up to the liability cap and seek Independent Shareholders' approval at a second EGM for MTR to bear the amount exceeding the liability cap

2. Rationale and Benefits of the Proposed Arrangements

Key Benefits

1

Pragmatic and viable solution to take forward and complete the Express Rail Link Project, which is an important project for the Company and Hong Kong

MTR

Important project for the Company

- Maintain its successful track record of constructing and / or operating railway projects in HK, China and overseas
- Demonstrate ongoing commitment to the XRL project, as the Company undertook the XRL Agreement with the understanding that it would be invited to operate the XRL under concession approach following the completion of the project

Important project for Hong Kong

- Express Rail Link Project is expected to bring direct benefits in terms of time savings and enhanced ease of travel
- Enhance Hong Kong's status as a gateway to China, bringing benefits in terms of fostering trade, professional services and other economic activities for the benefit of Hong Kong
- Enhance Hong Kong's connectivity which is one of the vital factors for achieving growth and development; failure to improve Hong Kong's infrastructural connectivity may reduce Hong Kong's long term competitiveness

Key Benefits

2 **Sizable one-off return to Shareholders without affecting the Company's ability to continue its progressive regular dividend policy**

- Opportunity for a sizable one-time special dividend
- Will not affect intention to continue MTR's progressive regular dividend policy[1]

3 **Proposed financing plan improves Company's capital structure while preserving financial flexibility**

- Opportunity to improve capital structure by utilizing its ample leverage capacity
- Higher efficiency of capital
- Maintain full financial flexibility for long term growth plans

4 **Preserves relationship with its stakeholders**

- The XRL Agreement removes uncertainty around the XRL project and sets a clear roadmap for project completion
- Preserves and further strengthens the relationship with its largest shareholder, the Government
- Offers certainty of project to the contractors
- Preserves goodwill with various stakeholders, including the general public

[1] *Subject to, among other things, the financial performance and trading results of the Company and general economic conditions in Hong Kong and globally.*

3. Financing Plan

Financing the Special Dividend

Reserves	■ Sufficient distributable reserves available: — HK$68.3bn as of 30 June 2015
Funding	■ Tapping the debt market for the necessary funding of c.HK$26bn in cash: — Financing facilities with attractive funding terms available to MTR — Meaningful leverage capacity on MTR's balance sheet — Opportunity to improve existing capital structure
Credit Ratings	■ Current sovereign ceiling credit rating remained unchanged[1]: **AAA (S&P) / Aa1 (Moody's) / AA+ (R&I)**

1. **Improving its capital structure while preserving financial flexibility**
2. **Capex projects and longer-term growth plans will continue to be pursued**
3. **Intends to maintain progressive regular dividend policy[2]**

[1] *Following the Company's announcement regarding the XRL Agreement on 30 November 2015.*
[2] *Subject to, among other things, the financial performance and trading results of the Company and general economic conditions in Hong Kong and globally.*

Credit Ratings Confirmed to Remain Unchanged

***Standard & Poor's Ratings Services** confirmed that it expects the Company's current credit rating of AAA/Stable/A-1+ will not be immediately affected by the XRL Agreement, based on its current expectation that the Company will continue to receive "almost certain" extraordinary support from Government in the event of financial distress although it stated that the significant debt-funded Special Dividend could result in a weakening of the Company's standalone credit profile*

***Moody's Investors Service** stated that while the XRL Agreement is credit negative, there is no immediate impact on the Company's current credit rating of Aa1 and its stable ratings outlook, noting the Company's credit profile remains supported by its solid business fundamentals, strong access to the capital markets and the expectation of the very high level of support the Company will receive from Government in times of need*

***Rating and Investment Information, Inc.** confirmed that there is no need to change the Company's current credit rating of AA+, noting the Company has a very strong financial base for a railway company*

4. Financial Impact

Summary Financial Impact

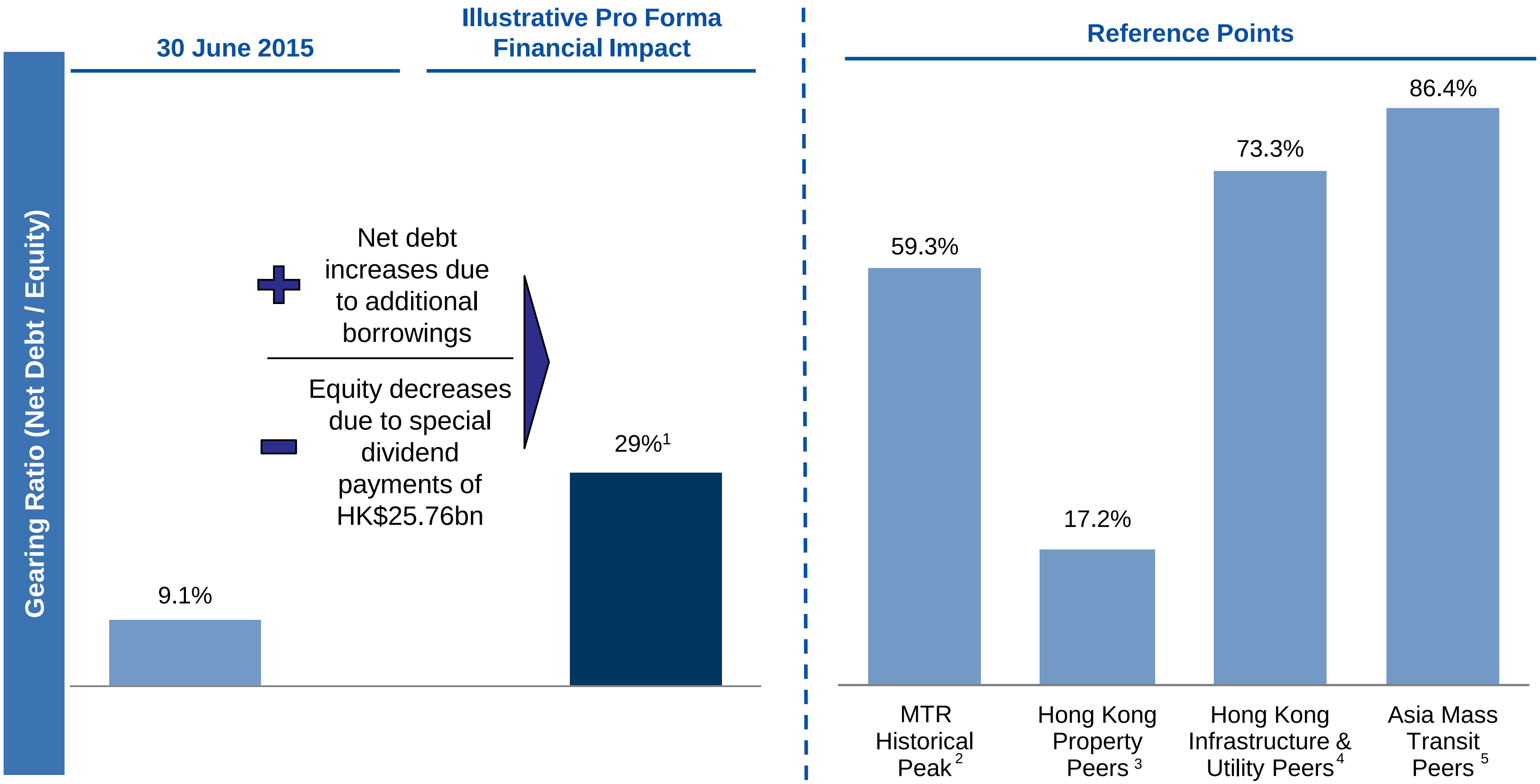
1	Healthy gearing ratio despite additional borrowing	→	Maintain current sovereign ceiling credit rating
2	Manageable incremental interest expense	→	Impact on earnings and EPS (EPS: HK$1.99 to HK$1.86)[2]
3	Enhance capital efficiency with higher weight of debt in the capital structure	→	Lower cost of capital
4	Special dividend to shareholders	→	Intends to maintain progressive regular dividend policy going forward[1]
5	Higher Proforma Return-On-Equity (ROE) following lower equity balance	→	Higher efficiency of capital

MTR intends to continue its capital expenditure and long term growth plans in Hong Kong, the Mainland of China and overseas.

[1] Subject to, among other things, the financial performance and trading results of the Company and general economic conditions in Hong Kong and globally.
[2] Based on the Company's basic earnings per share arising from underlying businesses for the year ended 31 December 2014 of HK$1.99. For further details, please refer to page 20.

Illustrative Financial Impact

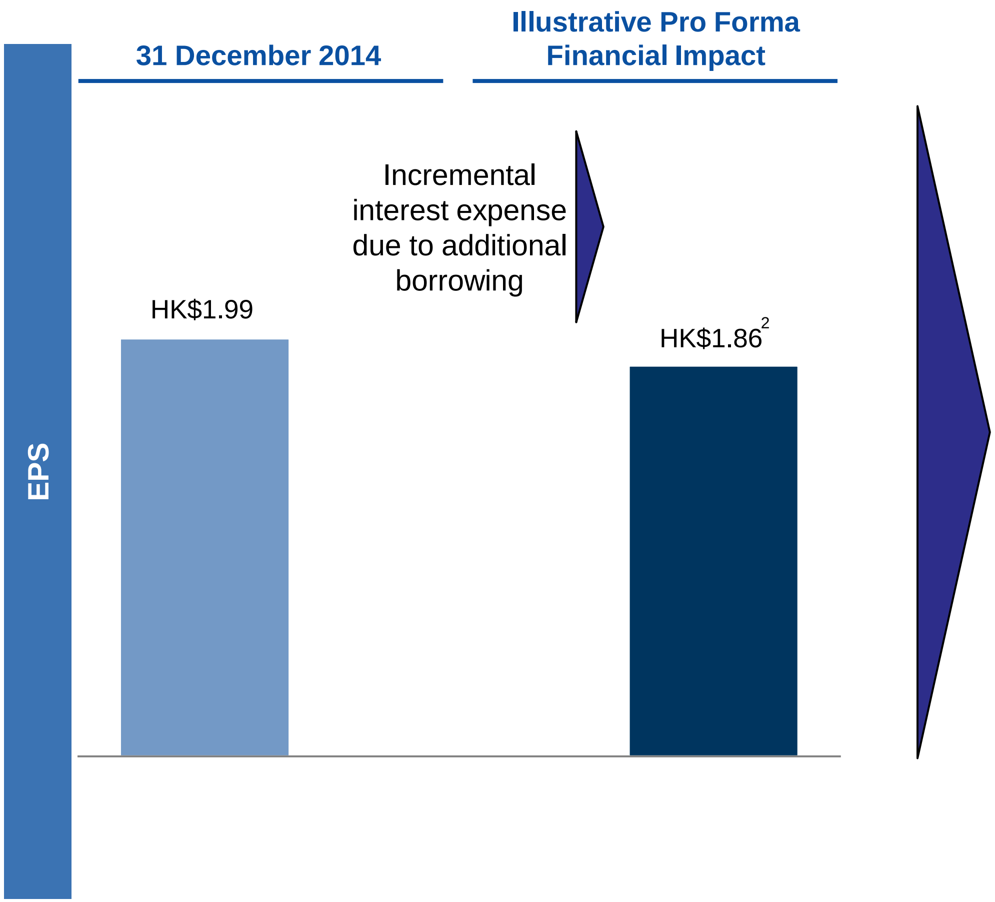
1 Gearing Ratio



[1] Calculated as if the payment of Special Dividend and the drawdown of additional borrowing were effective as on 30 June 2015, for illustrative purposes only.
[2] Historical peak since the privatization in 2000.
[3] Hong Kong Property Peers include Sun Hung Kai Properties, Cheung Kong Property, Henderson Land Development, Link REIT and New World Development, data as of 22 December 2015.
[4] Hong Kong Infrastructure and Utility Peers include CLP Holdings, Hong Kong Electric and Hutchison Ports Holdings Trust, data as of 22 December 2015.
[5] Asia Mass Transit Peers include BTS Group, SMRT Corp., Bangkok Metro (BMCL) and SBS Transit, data as of 22 December 2015.

Illustrative Financial Impact (Cont'd)

2 Basic Earnings Per Share[1] (EPS)

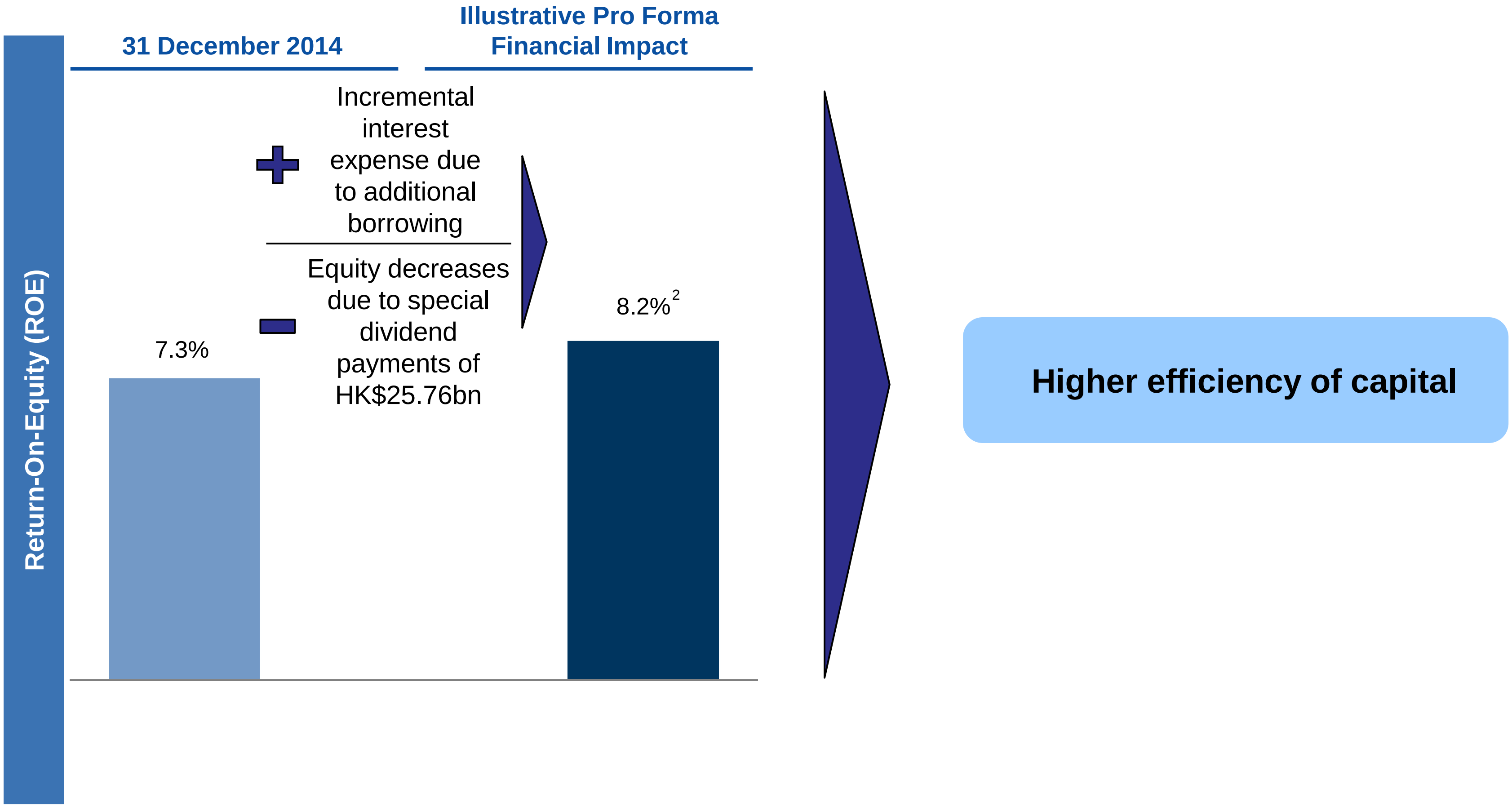


~6.5% Impact on Earnings and EPS

[1] Represents basic earnings per share calculated based on profit attributable to equity shareholders arising from underlying businesses.
[2] Calculated as if the payment of Special Dividend and the drawdown of additional borrowing were effective as on 31 December 2013 and the interest expense on additional borrowing had been calculated based on the Company's weighted average borrowing rate for the half year ended 30 June 2015, for illustrative purposes only.

Illustrative Financial Impact (Cont'd)

3 Return-On-Equity[1] (ROE)



[1] Represents return on average equity attributable to equity shareholders arising from underlying businesses.
[2] Calculated as if the payment of Special Dividend and the drawdown of additional borrowing were effective as on 31 December 2013 and the interest expense on additional borrowing had been calculated based on the Company's weighted average borrowing rate for the half year ended 30 June 2015, for illustrative purposes only.

5. IFA and IBC Recommendations

IFA Recommendation

IFA: Anglo Chinese (or "AC")

- ***IFA's work scope:*** To determine whether the terms of the XRL Agreement are fair and reasonable and in the interests of the Company and its Shareholders (including Independent Shareholders) as a whole, and whether the XRL Agreement is on normal commercial terms and in the ordinary and usual course of the Company's business

- In formulating its opinion, AC considers it has reviewed sufficient and relevant information based on documents supplied and explanations provided by the Company to them

- **Reasonableness of Revised Cost Estimate**

  — As part of its analysis, AC engaged EC Harris, a member of the Arcadis NV group ("Arcadis"), a leading global natural and built asset design and consultancy group, to act as an independent expert and undertake an independent review of the Revised Cost Estimate of HK$84.42 billion for completion of the XRL Project:

  - Included and tested the assumptions, methodology and process used to arrive at the Revised Cost Estimate of HK$84.42 billion
  - Undertook a high level review of the quantitative assessments that have been developed and applied by the Company
  - Reviewed the Company's strategy in general and the suitability of the Company's assessments

Arcadis concluded that the Company has adopted a reasonable, consistent and logical approach to establishing the likely outturn cost.

IFA Recommendation

IFA: Anglo Chinese (or "AC")

The IFA also considered other factors that should be taken into account in determining whether the terms of the XRL Agreement are fair and reasonable:

- The **Revised Cost Estimate has been determined after careful review** by the Company and Government
- **Reasons for and Benefits of the XRL Agreement**: Set out in the Letter from the Board are the reasons for and the benefits of the XRL Agreement, to which the Independent Shareholders are referred
- **Company's reputation**: Should the Express Rail Link not proceed or be further delayed by reasons of lack of funding, the Company's reputation as a world class manager of railway projects and its success in being awarded projects locally and internationally will be impaired
- **Relationship with Government**: The support of Government has assisted the Company in pioneering the rail and property model under which Government has granted land to the Company on terms which have been critical in financing the capex required for the development of its railway work
- **Additional project management cost**: Company will receive an increased project management cost of HK$6.34 billion compared to the original project management cost of HK$4.59 billion if the XRL Agreement is implemented
- **Benefits to Hong Kong**: The Express Rail Link is expected to bring direct benefits to Hong Kong as a whole
- **Additional control methods**: Various measures have already been implemented to enhance project delivery in a more transparent and timely manner

IFA Recommendation

XRL Agreement is on **normal commercial terms** as part of **the usual course of business**

The terms are **fair and reasonable** and to be **in the interests of the Company and its Shareholders** as a whole

Recommends the Independent Shareholders to **vote in favour** of the resolution to approve the XRL Agreement

Board Process and IBC Recommendation

As a matter of good corporate governance, the Board established and maintained a framework for its decision making processes in relation to the XRL Agreement to protect the interests of the Independent Shareholders. The framework included measures such as:

- Updates relating to the XRL Arrangements being provided to the Board
- Directors who had a conflict of interest either not attending the relevant part of or the entire Board meetings at which the XRL Arrangements and the Circular were discussed, and did not vote on the XRL Agreement
- Establishment of the IBC, comprising only independent non-executive Directors, which has taken into account the recommendations of the IFA (AC)
- The IFA being selected by the IBC to make recommendations to the IBC and the Independent Shareholders and to advise the Independent Shareholders on how to vote
  - The IFA, in making its recommendations and in giving its advice, has also acted at all times independently and without influence from the Company

IBC Recommendation

Taking into account IFA's recommendations, XRL Agreement is **fair and reasonable** and **in the interests of the Shareholders (including the Independent Shareholders)** as a whole

Recommends the Independent Shareholders to **vote in favour** of the resolution to approve the XRL Agreement