



Kowloon-Canton Railway Corporation  
Annual Report 2004



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## Our Commitment to You – Better connections; better services

In 2004 the Kowloon-Canton Railway Corporation completed and commissioned both Ma On Shan Rail and the Tsim Sha Tsui Extension, extending the reach of its railway network. The Ma On Shan area was served by rail for the first time in history, and the Tsim Sha Tsui Extension returned KCR trains to the heart of Tsim Sha Tsui. The two new extensions provide passengers with greater convenience and shorter journey times. Together with the other major projects that are either underway or about to commence, and the programmes to enhance West Rail's accessibility and convenience, they demonstrate the Corporation's commitment to offering the people of Hong Kong better connections and better services.



## 2 Corporate Profile, Mission and Vision

### Corporate Profile

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Established in 1982, the Kowloon-Canton Railway Corporation is a public corporation providing high quality mass transport services in the Hong Kong Special Administrative Region. In addition to its core rail services, the Corporation designs and develops new railways and is active in property development and related commercial activities.

The Corporation is one of the world's most successful railway operators: each day it carries about 1.5 million passengers. In recent years the Corporation has significantly expanded its network. West Rail, opened in 2003, extended rail service to the North West New Territories, and the completion of Ma On Shan Rail and the Tsim Sha Tsui Extension in 2004 further enhanced the network's reach and connectivity. The Corporation's 113-kilometre network now links much of the New Territories to Hong Kong's urban areas.

The KCRC also contributes significantly to Hong Kong's social and economic development by enhancing cross-boundary rail services, developing new railways, and extending rail service to growing areas of the New Territories.

The Corporation receives no government subsidies, is entirely self-financing, and has been consistently profitable since 1985.

### Mission and Vision

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The Corporation's mission is to provide a safe, reliable, profitable and integrated railway network that meets the increasing demand for territorial, cross-boundary and intercity railway services.

KCRC is dedicated to finding better ways to:

- Serve customers and meet performance pledges
- Fulfil both Government and corporate objectives
- Maintain financial strength
- Develop sound business partnerships
- Build teamwork and commitment in staff
- Encourage initiative and reward success

The Corporation's vision is to be a world leader in providing quality transport services on the basis of prudent commercial principles.

## Key Figures and Credit Ratings

### Financial Highlights

	<b>2004</b> (HK\$ million)	2003 (HK\$ million)
Revenue from operations	<b>4,976</b>	4,426
Operating profit before depreciation	<b>2,169</b>	2,297
Profit on property development	–	–
Net profit after tax	<b>429</b>	1,381
Capital expenditure	<b>9,022</b>	11,122
Return on average net fixed assets (%)		
Before property development and related profits tax	<b>1</b>	2
After property development	<b>1</b>	2
Interest-bearing borrowings (HK\$ million)	<b>19,748</b>	20,013
Debt/equity ratio	<b>1:3.0</b>	1:3.0
Interest cover (times)	<b>2.5</b>	2.9

### Credit Ratings

	<b>2004</b>	2003
<b>Standard &amp; Poor's</b>		
Short-term local currency corporate credit rating	A-1+	A-1+
Short-term foreign currency corporate credit rating	A-1	A-1
Long-term local currency corporate credit rating	AA-	AA-
Long-term foreign currency corporate credit rating	A+	A+
<b>Moody's</b>		
Short-term rating	P-1	P-1
Issuer rating - domestic currency	Aa3	Aa3
Issuer rating - foreign currency	A1	A1

The credit ratings for the Corporation assigned by Standard & Poor's and Moody's are at the same level as those of the Hong Kong SAR Government.

### Operating Highlights

	<b>2004</b>	2003
<b>Number of passengers (million)</b>		
East Rail (including Ma On Shan Rail)	<b>292</b>	278
Through Train	<b>3.0</b>	2.1
West Rail	<b>48</b>	–
Light Rail	<b>132</b>	106
Bus (excluding East Rail buses)	<b>20</b>	26
<b>Freight volume (million)</b>		
Southbound goods (tonnage)	<b>0.5</b>	0.6
Northbound goods (tonnage)	<b>0.3</b>	0.4
Livestock (heads)	<b>0.4</b>	0.7
Employees at year end (number)	<b>5,874</b>	5,871

## 2004 Highlights



### January

- **Environmentally friendly diesel locomotives handed over to KCRC**

Five new environmentally friendly diesel locomotives were delivered to Hong Kong after months of stringent testing. Costing HK\$130 million, they perform to the highest safety and environmental standards.

### February

- **Discussions on possible merger with the MTR Corporation Limited**

On 24 February the Government announced that it had invited KCRC and the MTR Corporation Limited to begin negotiations on a possible merger. On 16 September, the two corporations submitted a joint merger report. The Government will announce its decision in due course.

### March

- **Gazettal of Kowloon Southern Link**

The Kowloon Southern Link was first gazetted on 26 March, and the Corporation then began working on the amendments to the scheme, taking into consideration the views and concerns of the public. The Government gazetted the proposed amendments on 7 January 2005 for further public consultation.



- **West Rail promotions**

West Rail reached its 100th day of service on 28 March, and the occasion was celebrated with a series of promotional activities. To boost patronage, the "West Rail Fun All the Way" campaign was launched in June featuring weekend performances by many local artists while new initiatives including connectivity improvement schemes, a sightseeing bus and fare promotions were also implemented.

### April

- **25th anniversary of Guangzhou-Kowloon Through Train**

4 April marked the 25th anniversary of the Guangzhou-Kowloon Through Train. In its first quarter century the train has carried a total of 45 million passengers between Hong Kong and Guangzhou. Two additional pairs of through trains were introduced from 18 April to meet increasing demand, bringing the total to 12 pairs.



- Kowloon Tong Station expanded to improve passenger flow**  
 A 60-metre subway connecting the new southern concourse of the KCR Kowloon Tong Station with the nearby MTR station was opened on 15 April. The new facilities are more convenient for many passengers transferring between the two railways.
- Job fair popular**  
 On 30 April, the Corporation held a job fair at East Rail Tai Wai Station to recruit about 160 staff in preparation for the opening of Ma On Shan Rail and the Tsim Sha Tsui Extension. The event attracted 2,700 job seekers.

## May

- KCRC wins prestigious freight awards**  
 KCRC was named the "Best Rail Operator – Asia" at the Asian Freight and Supply Chain Awards in May, and in October was named the "Rail Freight Operator of the Year" at the Asia Logistics Awards for the third consecutive year.



- "Greening Ma On Shan Rail" campaign**  
 The Corporation planted 6,000 trees along the Ma On Shan Rail alignment, and about 1,000 residents, teachers and students joined KCRC volunteers to plant trees in the Greening Ma On Shan Rail campaign held in May, July and August.

- Locomotive donated to Railway Museum**  
 In May the Corporation donated Hong Kong's first diesel locomotive, the Sir Alexander, to the Hong Kong Railway Museum. The Sir Alexander, which entered service in 1955, was restored to its original appearance and is now on permanent display at the museum.

## June

- Launch of KCRC Corporate Volunteer Team**  
 In June, 200 KCRC staff signed up to help the community as members of the KCRC Corporate Volunteer Team. An inauguration ceremony held on 27 June got the volunteers off to a good start.



## August

- Completion of grade separation project at Tsing Lun Road**  
 The grade separation project at Tsing Lun Road was completed in August, relieving the busy traffic flow in the area, and enhancing the operational efficiency and safety standards of Light Rail, while saving passengers travelling time.



## 2004 Highlights



### September

- **KCRC signs HK\$8 billion syndicated loan**  
KCRC entered into a HK\$8 billion credit facilities agreement with 18 local and international banks on 28 September. It marked the Corporation's return to the local banking market, which is an essential source of funding in its long-term financing plans.

### October

- **West Rail project wins major UK awards**  
West Rail Mei Foo Station contract won the International Performance of the Year prize at the UK "Quality in Construction Awards" in March and the International Category prize at the "British Construction Industry Awards" in October, at which the Nam Cheong Station contract was also highly commended.
- **Opening of the Tsim Sha Tsui Extension**  
The Tsim Sha Tsui Extension, which cost HK\$4.1 billion, and took over three years to build, opened on 24 October. It extends East Rail from Hung Hom to East Tsim Sha Tsui, and provides an additional interchange with the MTR.



### November

- **Lok Ma Chau Spur Line milestones**  
The Lok Ma Chau Spur Line, Hong Kong's second railway boundary crossing, celebrated crucial milestones – the breakthrough of the down-track tunnel in June and the erection of the final viaduct segment in November.
- **Po Leung Kuk Sponsorship**  
On 6 November the Corporation became one of the first corporate sponsors in the Po Leung Kuk House Corporate Sponsorship Programme. Po Leung Kuk provides housing to children who cannot stay with their own families due to various family problems. The Corporation will sponsor 11 of the 26 dormitories for two years.



### December

- **Opening of Ma On Shan Rail**  
Ma On Shan Rail was opened on 21 December. The new railway extends rail service to the Ma On Shan district and will spur further development in the area. It also reinforces East Rail's strategic role as the territory's key north-south railway corridor.
- **Good People Management Award**  
In December the Corporation received a Good People Management Award from the Labour Department. The award recognises Hong Kong companies that embody the best practices in people management.

### Average Daily Ridership

	2004	2003	% Increase / (Decrease)
(passenger trips)			
East Rail domestic service	<b>566,300</b>	537,800	5.3
East Rail cross-boundary service (to Lo Wu)	<b>232,500</b>	224,500	3.6
Intercity Through Train service	<b>8,070</b>	5,870	37.5
West Rail service	<b>131,500</b>	–	–
Light Rail service	<b>359,800</b>	291,400	23.5
Bus service (excluding East Rail buses)	<b>56,660</b>	72,230	(21.6)

### Performance

	2004 (%)	2003 (%)
East Rail punctuality	<b>99.7</b>	99.7
East Rail ticketing equipment availability	<b>99.9</b>	99.8
West Rail punctuality	<b>99.5</b>	–
West Rail ticketing equipment availability	<b>99.9</b>	–
Light Rail punctuality	<b>99.6</b>	99.0
Light Rail ticketing equipment availability	<b>99.9</b>	99.9

### Passenger Safety

(injuries per million passenger trips)	2004	2003
East Rail	<b>0.74</b>	0.65
West Rail	<b>0.79</b>	–
Light Rail	<b>0.14</b>	0.25

### Cross-boundary (Lo Wu) Daily Average Passenger Trips

	Passenger trips	Year-on-year % Increase/ (Decrease)
1995	117,863	6.6
1996	130,157	10.4
1997	152,228	16.9
1998	178,802	17.4
1999	206,481	15.5
2000	229,120	10.9
2001	236,800	3.4
2002	251,600	6.3
2003	224,500	(10.8)
<b>2004</b>	<b>232,500</b>	<b>3.6</b>

## Managing Board



Michael Tien

BSc, MBA, BBS, JP

Chairman, Chairman of Strategic Human Resource Committee

Appointed Chairman in December 2001. Chairman of The G2000 Group since 1979. Chairman of the Standing Committee on Language Education and Research, Chairman of Working Group on Secondary School Places Allocation & Medium of Instruction, Chairman of the Employees Retraining Board, Member of Education Commission, Manpower Development Committee and Guangdong Chinese People's Political Consultative Conference.



Samuel M H Lai

BSc, MBA, CGA, CMILT

Chief Executive Officer (Acting), Member of Capital Projects Committee, Member of Property Committee, Member of Finance Committee, Member of Public Consultation Group on Railway Operations

Appointed Chief Executive Officer (Acting) in January 2004. Joined KCRC in 1983. Appointed Finance Director in 1991 and Senior Director-Finance and Management in 2000. Vice Chairman, UITP Asia-Pacific Division, International Association of Public Transport. Member, Membership Committee, The Hong Kong Management Association.



Vincent Lo Wing-sang

BA (Hons), JP

Board Member, Chairman of Property Committee, Member of Capital Projects Committee (up to May 2004), Chairman of Public Consultation Group on Railway Operations

Appointed in 1999. Senior Partner of Messrs Gallant Y T Ho & Co, Director of Shanghai Commercial Bank Trustee Ltd. Chairman of the Hong Kong Red Cross Blood Transfusion Service Governing Committee and Assistant Director of the Red Cross Council. Member of the Lotteries Fund Advisory Committee, the Social Welfare Advisory Committee, and Member of the Committee on Museums of the Leisure and Cultural Services Department.



Wan Man-ye

FHKIS, FRICS, RPS (GP), BBS, JP

Board Member, Chairman of Capital Projects Committee, Member of Audit Committee, Member of Property Committee, Member of Public Consultation Group on Railway Operations

Appointed in 2002. Registered Professional Surveyor (General Practice). Director of M Y Wan and Associates Limited. Panel Member of Municipal Services Appeals Board, President of Youth Outreach, Council Member of Hong Kong Federation of Youth Groups, Manager of Chi Lin Buddhist Secondary School (SOS), and Co-opt Member of Land, Rehousing & Compensation Committee of Urban Renewal Authority.



Patrick B Paul

MA, FCA, FHKICPA, CBE

Board Member, Chairman of Audit Committee, Member of Strategic Human Resource Committee

Appointed in 2002. Non-executive Director of The Hongkong and Shanghai Hotels Ltd, Johnson Electric Holdings Ltd, Kingsway International Holdings Ltd and Pacific Basin Shipping Ltd.



The Hon. Abraham Shek Lai-him

BA, Dip Ed, JP

Board Member, Member of Audit Committee, Member of Capital Projects Committee, Member of Strategic Human Resource Committee

Appointed in February 2004. Member of the Legislative Council representing the Real Estate and Construction Functional Constituency. Independent Non-executive Director and Audit Committee Member of Midas International Holdings Ltd, Paliburg Holdings Ltd, Lifestyle International Holdings Ltd, Chuang's Consortium International Ltd, New World TMT Ltd and NWS Holdings Ltd. Director of The Hong Kong Mortgage Corporation Ltd. Member of the Court of the University of Hong Kong and the Council of the Hong Kong University of Science and Technology.



Frederick Ma Si-hang

BA, JP

Board Member, Member of Capital Projects Committee, Member of Finance Committee, Member of Property Committee, Member of Strategic Human Resource Committee

Appointed in 2002. Secretary for Financial Services and the Treasury of the Hong Kong Special Administrative Region Government.



Dr. Sarah Liao Sau-tung

BSc, MSc, MPhil, PhD, R.P.E., FHKIE, FHKIEIA, FRSC, JP

Board Member, Member of Capital Projects Committee, Member of Strategic Human Resource Committee

Appointed in 2002. Secretary for the Environment, Transport and Works of the Hong Kong Special Administrative Region Government.



Prof. Richard Wong Yue-chim

AB, AM, PhD, SBS, JP

Board Member, Chairman of Finance Committee, Member of Property Committee. Appointed in February 2004. Deputy Vice-Chancellor and Chair of Economics at the University of Hong Kong, Director of the Hong Kong Centre for Economic Research, Director of the Hong Kong Institute of Economics and Business Strategy. Member of the Hong Kong Government's University Grants Committee, the Exchange Fund Advisory Committee, Land and Building Advisory Committee, and Economic and Employment Council. Non-executive Director of ICBC (Asia) Limited, CK Life Sciences International Holdings Limited, Orient Overseas (International) Ltd, Pacific Century Insurance (Holdings) Ltd and Great Eagle Holdings Ltd.



Ng Leung-sing

SBS, JP

Board Member, Member of Capital Projects Committee, Member of Finance Committee. Appointed in November 2004. Vice Chairman of Chiyu Banking Corporation, Independent Non-executive Director of Smartone Telephone Holdings Ltd, Member of the Mandatory Provident Fund Schemes Advisory Committee and the Fisheries Development Loan Fund Advisory Committee. Director of the Bank of China (Hong Kong) Charitable Foundation, Member of the Council and the Court of Lingnan University. Hong Kong Deputy to the 10th National People's Congress, PRC.

### Note:

Mr Patrick Wang Shui-chung and Mr Victor So Hing-woh resigned from the Managing Board in January 2004. Mr Vincent Cheng Hoi-chuen retired from the Managing Board in November 2004.

## Management Committee



Grace Lam

Ian M Thoms

Samuel M H Lai

Daniel C Lam

David Fleming

Lawrence Li

K K Lee

Y T Li

Mimi Cunningham

### Samuel M H Lai

BSc, MBA, CGA, CMILT  
Chief Executive Officer (Acting)

Appointed Chief Executive Officer (Acting) in January 2004. Joined KCRC in 1983. Appointed Finance Director in 1991 and Senior Director-Finance and Management in 2000. Vice Chairman, UITP Asia-Pacific Division, International Association of Public Transport. Member, Membership Committee, The Hong Kong Management Association.

### Y T Li

BSocSc, MPhil, FCHKPWS, CMILT, MIRSE (HON)  
Senior Director-Transport

Joined KCRC in 1984. Appointed Director-East Rail in 2001 and Senior Director-Transport in 2003. Member of the Transport Logistics Training Board of the Vocational Training Council, the Steering Committee on Principals' Professional Development, the Statistics Advisory Board and Users' Committee of the Immigration Department.

### K K Lee

BSc, MSc, MBA, CEng, MIEE, FHKIE  
Senior Director-Capital Projects

Joined KCR in 1981, prior to its corporatisation. Appointed Director-East Rail in 1997 and Director-East Rail Extensions in 1998. Appointed Senior Director-Capital Projects in January 2004. Member of the Committee on Apprenticeship and Trade Testing of the Vocational Training Council and the Construction Workers Registration Authority.

### Ian M Thoms

BSc, CEng, Eur Ing, RPE, FICE, FIHT, FHKIE  
Director-West Rail

Joined KCRC as Director-West Rail in 1998. Project management involvement with major railway projects in Hong Kong since 1976. Past Chairman of the Hong Kong Branch of the Institution of Highways and Transportation. Awarded the International Medal of the Institution of Civil Engineers for 2002 in recognition of his contribution to railway infrastructure development in Hong Kong.

### Daniel C Lam

FRICS, FHKIS, FHKI Arb, FCIArb, RPS, AP, BBS, JP  
Director-Property

Joined KCRC as Director-Property in 2000. Member of the Administrative Appeals Board. Council Member of the Hong Kong International Arbitration Centre. Chartered Surveyor, Chartered Arbitrator and Authorized Person.

### Lawrence Li

MBA, FCCA, FCPA, MBIM, MIIM  
Director-Finance

Joined KCRC in 1983. Positions held include Cash & Revenue Control Manager, Financial and Material Controller, Chief Accountant, General Manager-Finance, and Corporate Financial Controller. Appointed Director-Finance in January 2004.

### Mimi Cunningham

BA, MBA, MA  
Director-Human Resource

Joined KCRC in May 2004 after relocation from the UK. Previously worked for the Hong Kong Jockey Club and Cathay Pacific Airways as Head of Human Resources and Head of Training and Development respectively.

### Grace Lam

BA, MA  
General Manager-Corporate Affairs

Joined the Corporation in February 2004. Previously worked for the Hong Kong and China Gas Company Ltd. Council Member of the Hong Kong Academy for Performing Arts, Member of Advisory Council on Food and Environmental Hygiene, the Road Safety Campaign Committee and the Joint Committee on Student Finance.

### David Fleming

Company Secretary and General Counsel

A solicitor admitted to practice in Hong Kong, England and Wales, and Australia. Appointed Company Secretary in 1997. Principal Legal Advisor to the Corporation since 1993, having formerly served as a solicitor in private practice in Hong Kong and Australia and in the Legal Department of the Hong Kong Government.

#### Note:

Mr Kenneth Leung, Director-New Railway Projects, and Mr Jonathan Yu, Director-Operations, left the Corporation in June 2004 and December 2004 respectively.

## Chairman's Statement



**Michael Tien**  
Chairman

The theme of this year's annual report is the Corporation's commitment to provide better connections and better services. The successful opening of the Tsim Sha Tsui Extension and Ma On Shan Rail in 2004 reflects the Corporation's determination to honour this commitment.

Unlike 2003, 2004 started on a slightly less optimistic note with the disappointing West Rail patronage figures immediately following the line's opening on 20 December 2003.

However, as the year progressed, through the Corporation's determined efforts, the West Rail situation saw significant improvement. From an initial daily patronage of around 100,000, by the end of the year this had risen to about 173,000, and still continues to rise albeit more gradually than before.

October 2004 saw East Rail returning to its original terminus with the opening of the Tsim Sha Tsui Extension on the 24th of that month. On 21 December 2004, precisely one year and one day after the opening of West Rail, Ma On Shan Rail was successfully opened.

While both these new projects have extended the reach of the Corporation's rail network and brought added convenience to rail passengers, as with West Rail, the Corporation must endeavour to build patronage numbers, and this will be a major focus of the Corporation in 2005.

Although it is not unusual for a new railway to operate at a loss for the initial few years as patronage is

*"As the year progressed, through the Corporation's determined efforts, the West Rail situation saw significant improvement."*

built up to reach a critical mass, the Corporation has in the past been able to count on the profits generated from the cross-boundary market to subsidise its domestic rail services.

But 2004 saw the Corporation facing yet more competition from cross-boundary coaches. The Government introduced a quota system in respect of the operation of such coaches in August 2004. Since then statistics indicate that the number of coaches has reduced from that in the earlier part of the year. However, the Corporation's share of the cross-boundary market both in percentage terms and in actual numbers of passengers carried continued, and still continues, to fall almost every month despite the overall cross-boundary market having grown by some 18% in 2004 as compared to 2003.

Currently rail has about a 60% share of the cross-boundary market as against about a 30% to 40% share of the Hong Kong domestic public transport market. As the relationship between the SAR and the Mainland continues to grow closer and further road links are put in place, such as the Western Corridor which is due to open early next year, it would be reasonable to assume that rail's share of the cross-boundary market will gradually fall. A consequence of this might be that the Corporation could find itself increasingly less able to rely on profits from its cross-boundary services to subsidise its domestic services that have always operated at a loss.

However, the completion of the Shenzhen Metro and the Corporation's improvements at Lo Wu, both in December 2004, should assist the Corporation in competing more effectively in the cross-boundary market

**“The completion of the Shenzhen Metro and the Corporation's improvements at Lo Wu should assist the Corporation in competing more effectively in the cross-boundary market.”**

until the Lok Ma Chau Spur Line opens in 2007, at which time the Corporation would be able to offer its East Rail passengers a convenient rail link to the more westerly part of Shenzhen. The opening of the Disneyland theme park in September 2005 should also help in boosting cross-boundary patronage.

Against this background, in May 2004, I forecast that the Corporation's profit for 2004 would only amount to some HK\$300 million before tax. That the outturn for 2004 is now higher than then forecast at HK\$512 million is largely due to management's efforts in building West Rail patronage over the year and the improvement in the local economy resulting in a consequential increase in commercial revenue from tenants paying rent based on a fixed percentage of their turnover.

Nonetheless, the warning has to be sounded that the next few years will see a time of maximum stress on profits for the Corporation, although the Corporation should continue to make a cash operating profit.

### New Railway Projects

In September 2004, the Corporation submitted its final proposals for the Sha Tin to Central Link to the Government. We look forward to an early decision by the Government on this project.

Preparations to begin construction on the Kowloon Southern Link (KSL),

which will link West Rail with East Rail at Hung Hom, have proceeded well despite the fact that much time was taken to consider and discuss the feasibility of building a station at Canton Road. This matter was finally resolved in early December 2004, when the Corporation announced its decision to proceed with the KSL without providing a station at Canton Road. Nevertheless, the Corporation has agreed to provide a pedestrian connection from the East Tsim Sha Tsui Station to Canton Road.

Upon completion of the KSL, passengers wishing to go to Canton Road need only take a five-minute walk from the West Kowloon Station or about an eight to ten-minute walk if they choose to use the East Tsim Sha Tsui Station.

With the opening of the Tsim Sha Tsui Extension and Ma On Shan Rail, only the Lok Ma Chau Spur Line remains to be completed of the three East Rail Extensions. The Spur Line works are proceeding well, in accordance with both programme and cost.

### Railway Incidents

The wide reporting of a number of incidents during 2004 may have given rise to a public perception that there has been a dramatic increase in such incidents. One of the reasons for this can perhaps be put down to the Corporation trying to inform

## Chairman's Statement

passengers. Before the opening of West Rail, the Corporation only reported service delays to the media when the delay exceeded 20 minutes. In December 2003, following some delays on East Rail, I made the public commitment on behalf of the Corporation that any incident causing a delay of eight minutes or more would be reported.

“With the safety of passengers being of paramount importance, the Corporation adopts a fail-safe approach to the operation of its railways.”

Inevitably this resulted in an increase in the number of incidents being reported. In 2003, some 17 incidents involving a delay of 20 minutes or more were reported for East Rail and Light Rail combined. In 2004, some 72 delays of eight minutes or more were reported for the same two lines, plus a further 24 in respect of West Rail. In reality, however, the performance of East Rail and Light Rail combined improved significantly in 2004 as compared to 2003, in that the number of incidents in 2003 involving a delay of eight minutes was far larger at 97. But, when set against the over one million planned railway trips for 2003, the number of delays experienced by passengers was comparatively small.

With the safety of passengers being of paramount importance, the Corporation adopts a fail-safe approach to the operation of its railways. In the event of any fault, the system is designed to stop trains until checks can

be made to ensure that it is safe for them to proceed again.

By any objective yardstick, the Corporation's performance makes it one of the best railways in the world. Despite the media attention given to the West Rail incidents, such problems are commonly encountered on new railways. In fact, the latter half of 2004 saw West Rail achieving virtually the same standards of service performance as East Rail.

Even so, with a current standard of 99.9% for service delivery and 99.7% for punctuality on East Rail, it could still be argued that the Corporation should aim for 100% in both these areas. The Corporation pledges that it will continue to seek improvement in its service standards and to minimise the impact of any incidents, subject always to the condition that the safety of passengers must come first.

### Variable Pay

In response to the recommendations made in the Report of the Hay Group to the Government after studying the remuneration of the top three tiers of the management of statutory bodies in Hong Kong, the Corporation carried out a six-month trial in 2004 of a variable pay scheme for the top three tiers of management. The scheme was conducted in the last six months of the year and involved Executive Directors agreeing to contribute 20% of their total annual remuneration to a corporate pool, the payments from which at the end of the year depended on both the corporate and individual Directors' performance. Given the success of the trial scheme in 2004, the Managing Board has since decided to introduce this on a full year basis from 1 January 2005.

## The Merger

In February 2004 the Government invited the Corporation and the MTR Corporation Limited to commence negotiations on a possible merger of the two railway corporations.

Following six months of detailed negotiations examining every aspect of merging the two organisations, the two corporations submitted their joint report on the possible merger to the Government in September. The Government then announced it would study the report in detail, would discuss with the two corporations, and make a decision in due course on whether or not to proceed with the merger. At the date of drafting this report, the decision was still pending.

## Members of the Managing Board

In addition to those changes in the Members of the Managing Board mentioned in the 2003 Annual Report, in November 2004, Mr Vincent Cheng Hoi-chuen retired from the Managing Board after seven years of service and was replaced by Mr Ng Leung-sing. Given his background of heading a major bank in Hong Kong, Vincent could always be counted on to contribute sound, pragmatic advice during the Board's discussions. As Chairman of the Finance Committee, his role was invaluable in assisting other Members to deal with the often complex issues arising from meeting the funding and investment requirements of the Corporation, and in concluding a number of leverage leases in respect of the Corporation's assets. On behalf of my fellow Board Members, I would like to thank Vincent for his contribution and wisdom over the years.

"I would give the reassurance to our passengers that, whatever its financial situation, the Corporation remains committed to doing its utmost to provide them with better connections and better services."

## Expert Members of the Committees of the Managing Board

With the exception of the Audit Committee, which may only comprise Non-executive Members of the Managing Board, the Corporation has appointed a number of Expert Members to each of its Committees to strengthen their role in advising the Managing Board. Details of these Expert Members may be found later in this Annual Report under the section dealing with the Report of the Members of the Managing Board. However, I would wish to express my personal thanks, and I am sure that of my fellow Board Members, for the effort and time put in by the Expert Members in helping the Corporation reach decisions on many major issues over the past two years.

## Management and Staff

As a provider of essential public transport services to over 1.5 million passengers each day, the Corporation is subject to constant public scrutiny; far more I would argue than is the case with any private sector company. Although we live in a technological age, machines and computers cannot yet wholly replace people. The image of the Corporation is heavily dependent on its employees, both those who make the management decisions

and those who execute them on a daily basis.

2004 has seen the Corporation face fresh challenges in opening new lines and building up their patronage, in responding effectively to competition from road-based modes of transport, and in positively contributing to the negotiations in respect of the merger of the two railway corporations. On behalf of the Managing Board, I would voice my gratitude to the management and staff for their sterling efforts in 2004.

## Commitment to Passengers

The Managing Board is extremely conscious of the fact that the Corporation exists only to serve the public transport needs of the community. I would thus give the reassurance to our passengers that, whatever its financial situation, the Corporation remains committed to doing its utmost to provide them with better connections and better services.

**Michael Tien**

*Chairman*

28 February 2005

## Statement of the Chief Executive Officer



**Samuel M H Lai**  
*Chief Executive Officer (Acting)*

The Corporation's financial situation in 2004 reflects the realities of operating a railway business in a competitive market. New railways are capital intensive, and they involve high fixed costs. With a design life of 100 years or more for the major infrastructure elements, they are planned on the basis of meeting long-term future, not first-day, passenger demand. In general, profitability comes with a railway's maturity, not in the initial years of operation.

### New Railway Lines

2004 saw the successful completion and commissioning, on schedule and within budget, of both the Tsim Sha Tsui Extension and Ma On Shan Rail. These two extensions to East Rail have strengthened East Rail's role as Hong Kong's primary north-south public transport artery.

Completing the Tsim Sha Tsui Extension was particularly gratifying as it marked the KCR's return to its historic roots in the Kowloon Peninsula. The new East

Tsim Sha Tsui Station and the associated underground pedestrian subway network provides rail passengers with convenient access to the MTR Tsim Sha Tsui Station for onward travel to Hong Kong Island, and to the major hotels, shopping centres, offices and tourist destinations in the Tsim Sha Tsui area. Currently the East Tsim Sha Tsui Station handles some 68,000 passengers a day.

Ma On Shan Rail, linking Tai Wai on East Rail to Wu Kai Sha, has been designed to serve the many residential and commercial centres that have

sprung up along its alignment as part of the new town development process. Four out of five residents of the area now live within a ten-minute walk of one of the nine stations. With a convenient interchange at Tai Wai, Ma On Shan is just a 30-minute rail journey to Tsim Sha Tsui. The line is now carrying an average of about 92,000 passengers a day.

I would like to take this opportunity to offer my thanks to the numerous consultants, contractors, suppliers and Government agencies and departments, and their staff, and my many KCRC colleagues, both past and present, who were involved in the successful completion of these projects over the years. Not least, I would express my appreciation for the understanding and forbearance of those members of the community who were exposed to disturbance and inconvenience during the construction period.

### Building Patronage

2004 was also the first full year of operations for West Rail. Ridership on opening was not quite as high as originally forecast, but grew steadily throughout the year. By December 2004 it had risen over 70% to about 173,000 passengers a day. This was achieved through focussed effort being put into developing ways to attract passengers to use the new railway.

West Rail's connectivity and accessibility were improved through the provision of additional Light Rail and KCR Bus feeder routes, as well as through cooperation with other public transport operators. Signage within and around the West Rail stations was also improved to assist passengers and

**“The successful completion and commissioning of the Tsim Sha Tsui Extension and Ma On Shan Rail have strengthened East Rail's role as Hong Kong's primary north-south public transport artery.”**

others to readily identify how best to get to and from West Rail stations.

Fare promotions were introduced, such as the introduction of a monthly pass, a festival pass during the Christmas and New Year period, and a \$2 concessionary fare for the elderly and children at weekends and on public holidays. A concerted publicity effort that culminated in the “West Rail Fun All the Way” campaign, which brought a range of entertainment and community service events to different West Rail stations every weekend from June to December, also helped to boost ridership.

Similar to West Rail, active marketing and promotional efforts must be deployed to attract passengers to move from their usual mode of transport to using the newly opened Tsim Sha Tsui Extension and Ma On Shan Rail. It should be recognised, however, that railways, which have a design life of over 100 years, are planned with the aim of meeting long-term passenger demand. It also takes time to change established passenger travel habits.

More gradual growth is expected for the KCRC network over the next few years until the Lok Ma Chau Spur Line and the Kowloon Southern Link are completed in 2007 and 2009 respectively. The Spur Line will provide a much needed more westerly boundary crossing point for rail passengers, while the Kowloon Southern Link will

extend West Rail into the heart of Tsim Sha Tsui and to the Corporation's East Rail network at Hung Hom. This, plus the rapid occupation of property developments along West Rail and Ma On Shan Rail, for which expressions of interest in bidding will be invited from developers over the coming year or two, should see the Corporation's patronage increased substantially by the end of this decade.

### Review of other Transport Operations

The Corporation's transport operations benefited from the further expansion of the Mainland's Frequent Individual Traveller Scheme, major station improvement projects at Lo Wu and Kowloon Tong, Light Rail's additional role as a feeder service for West Rail, and an increase in the number of intercity through trains.

On Christmas Eve, 24 December, the Corporation's lines carried a record 1.9 million passengers, and individual records were set on East Rail and West Rail.

East Rail's domestic patronage increased by 5.3% in 2004, to an average of 566,300 passengers a day, up from 537,800 in 2003. East Rail's share of the domestic market for North East New Territories to urban journeys remained relatively unchanged at around 40%.

## Statement of the Chief Executive Officer

The cross-boundary market fared less well because of increased competition from road-based modes of transport. At an average of 232,500 passengers per day, 2004 patronage was better than 2003 because of the impact of SARS in the first half of 2003. This was still below the average daily patronage of 251,600 achieved in 2002, even though the market as a whole increased by some 14% in 2004 compared to 2002 (18% compared to 2003). The Corporation's share of the cross-boundary market fell significantly, from 68.6% in 2003 to 61.2% in 2004.

The Corporation's Intercity Passenger Services continued to gain passengers and a greater share of the market in 2004. Increases in the number of trains and extended operating hours have made the services increasingly attractive for both business and recreational travellers. The daily patronage figure averaged 8,070, up 37.5% from 2003. The Guangzhou-Kowloon Through Train market share grew by 2.5% during the year to 25.4%.

*"West Rail's connectivity and accessibility were improved through the provision of additional Light Rail and KCR Bus feeder routes, as well as through cooperation with other public transport operators."*

The rationalisation and reorganisation of Light Rail to accommodate its new added role as a feeder service for West Rail resulted in a substantial increase in ridership during the year. Average daily ridership during the year was 359,800, an increase of 23.5% from 2003. On

28 September, Light Rail ridership exceeded 500,000 for the first time when the network carried 503,000 passengers.

Bus patronage, on the other hand, fell 21.6% during the year to a daily average of 56,660. Even so, the Corporation's buses also carried a record number of passengers, 79,000, on 28 September.

### Non-transport Commercial Operations

With the opening of West Rail, 235 station shops and 2,180 advertising panels were added to the Corporation's commercial portfolio. By the end of 2004, another 148 station shops and 845 advertising panels were added from the Tsim Sha Tsui Extension and Ma On Shan Rail. As with patronage build up, it will take time for these commercial assets to realise their full potential. With the recovery of Hong Kong's economy and the gradual growth in patronage on the new lines, non-transport revenues should increase steadily over the next few years.

### Financial Results

Net profit after tax in 2004 was HK\$429 million, a decrease of 68.9% compared with the net profit of HK\$1,381 million in 2003. The drop in net profit was primarily due to the substantial rise in depreciation and operating costs resulting from the full year operation of West Rail, and the opening of the Tsim Sha Tsui Extension and Ma On Shan Rail. Operating costs before depreciation increased by 31.8% to HK\$2,807 million, while depreciation rose by 118.2% to HK\$1,632 million. Total operating costs grew 54.3% during the year to HK\$4,439 million from HK\$2,877 million in 2003.

Transport revenues increased 12.1% to HK\$4,281 million, compared with HK\$3,819 million in 2003. Non-transport recurrent revenues, derived mainly from property rents, increased by 14.5% to HK\$695 million from HK\$607 million in 2003.

In 2004 the Corporation paid a dividend of HK\$620 million for the year ended 31 December 2003 to the Government, which is the sole shareholder of KCRC.

### New Railway Projects Move Ahead

The opening of the Tsim Sha Tsui Extension and Ma On Shan Rail were undoubtedly the highlights of 2004 for the Corporation, but notable progress was also made on other projects.

The Lok Ma Chau Spur Line achieved or bettered all of its programme milestones. The southbound tunnel, which is 3.2 kilometres long, was completed in 2004. By year end, construction of the 2.2 kilometre long viaduct and the Lok Ma Chau terminal building were 92% and 49% complete respectively. With tracklaying scheduled to commence in March 2005, the Spur Line is on track for opening for passenger operations in 2007.

The Kowloon Southern Link was gazetted under the Railways Ordinance in March. As a result of public comments, the Government gazetted amendments to the scheme in January 2005. The Environmental Impact Assessment was also completed and submitted for public consultation. During the year the scheme design and tender documents were finalised, and tendering commenced in December, to enable the design-and-build tender packages for the line to be awarded

once the Chief Executive in Council approves the project.

The Corporation's final proposals for the Sha Tin to Central Link were submitted to the Government in September 2004. The Government's decision on the project is currently awaited.

*“With the recovery of Hong Kong's economy and the gradual growth in patronage on the new lines, non-transport revenues should increase steadily over the next few years.”*

Work began on the preliminary project feasibility study for the Northern Link, which is intended to link West Rail to the boundary with the Mainland at Lok Ma Chau.

Investments amounting to some HK\$416 million were also made in improving the services and facilities provided by East Rail. This included major improvements at Lo Wu and at Kowloon Tong.

### Property Development Re-commences

The Government's two-year moratorium on property development was lifted at the end of 2004. The Corporation has used the moratorium to reassess its property development programme and will be inviting expressions of interest from developers for one to two projects per quarter over the next two years.

## Statement of the Chief Executive Officer

### Merger Discussions with MTRCL

In February 2004 the Government invited the Corporation and the MTR Corporation Limited (MTRCL) to commence negotiations on a possible merger of the two railway corporations based on the following key parameters: the adoption of a more transparent fare adjustment mechanism; the abolition of the second boarding charge and review of the fare structure with the objective of reducing fares; early resolution of interchange arrangements for rail projects under planning, notably the Sha Tin to Central Link; ensuring job security for front-line staff at the time of the merger; and provision of seamless interchange arrangements in the long run.

Six months of detailed negotiations then ensued to address in some detail the various parameters laid down by the Government. This was a major exercise for key staff of the Corporation and added considerably to their normal daily responsibility of managing the Corporation's railway operations and project construction works.

Since the beginning of the merger negotiations, the Corporation's staff have had entirely understandable concerns about the effects of a merger on their job security and benefits. At the outset I gave all staff my personal assurance that management would be as forthcoming as possible throughout the course of the negotiations, and that we would continually consult, seek, and value the opinions of staff. Subsequently, we honoured this commitment through a variety of channels, involving both face-to-face briefing sessions and written and electronic communications. At the conclusion of the negotiations, I was able to assure staff that addressing

their possible concerns had been a top priority during our discussions with the MTRCL and that we would continue to keep them informed of any new developments.

### Teamwork

The Corporation overcame a number of challenges and achieved a series of major goals in 2004. As in other years, this would not have been possible without the hard work and dedication of staff at all levels.

Since taking up my position on 1 January 2004, I have been conscious of the need to build teamwork and cooperation at all levels to respond to the many challenges faced by the Corporation. The need for a teamwork approach has also been strengthened by the Managing Board's decision to introduce a permanent element of variable pay in the remuneration of the top three tiers of management from 2005.

On 2 January 2004, under my chairmanship I established the Management Committee, comprising all the Executive Directors, the Company Secretary and General Counsel, and the General Manager—Corporate Affairs. This Committee meets at least once weekly to consider and agree how to deal with key issues requiring a corporate management view. My aim is to encourage Directors, and in turn their staff in preparing and presenting issues to the Committee, to "think out of the box" and to take a more comprehensive commercial view of corporate issues than would normally be asked of them in their individual positions. The Committee has proved itself to be a valuable forum for addressing issues and reaching

“With tracklaying scheduled to commence in March 2005, the Lok Ma Chau Spur Line is on track for opening for passenger operations in 2007.”

corporate-wide consensus on how best to tackle them.

### Senior Management Changes

2004 saw the retirement of three members of the senior management team, Mr Kenneth Leung, Director–New Railway Projects, in June, Mrs Irene Yau, General Manager–Corporate Affairs, in February and Mr Jonathan Yu, Director–Operations at the end of the year. I would like to record my personal thanks to these three individuals for their invaluable contributions to the work of the Corporation, particularly Mr Jonathan Yu who had been with the Corporation some 22 years.

Also during the year two new faces joined the senior management team, Mrs Mimi Cunningham, Director–Human Resource, and Mrs Grace Lam, General Manager–Corporate Affairs.

### Looking Ahead

2005 promises to be yet another eventful year. Our key focus will of necessity have to be on building patronage on the new lines. In the case of West Rail, the main aim must be to keep up the momentum so as to build on the solid passenger base that has developed after the first year of operation. For the two East Rail Extensions, the Corporation has to repeat the West Rail efforts in building the two lines’ patronage over the coming 12 months. We also need to see how East Rail can benefit

from the opening of Hong Kong Disneyland, which is scheduled for September 2005.

On the project side, the railway system works for the Lok Ma Chau Spur Line will enter their peak phase, the Kowloon Southern Link project will be tendered, and we will re-commence property development operations after a two-year moratorium. We stand ready to move ahead on the Sha Tin to Central Link and Northern Link projects pending various decisions by the Government.

We also look forward to the Government’s decision on the merger, so as to provide a firmer footing for our future planning.

**Samuel M H Lai**

*Chief Executive Officer (Acting)*

28 February 2005

## KCRC Rail Networks

-  East Rail
-  West Rail
-  Ma On Shan Rail
-  Light Rail
-  Intercity Through Train
  
-  **1** Lok Ma Chau Spur Line (under construction)
-  **2** Kowloon Southern Link (under planning)
-  **3** Sha Tin to Central Link (under planning)





# Transport

Ma On Shan Rail, the latest addition to the KCR network, joins East Rail at the newly expanded and renovated Tai Wai Station.





## Transport: East Rail

The Tsim Sha Tsui Extension and Ma On Shan Rail were integrated into the East Rail network in 2004. East Rail's return to Tsim Sha Tsui made travel faster and more efficient for many passengers, while Ma On Shan Rail extended the railway into the North East New Territories, meeting the transport needs of the growing population and contributing to the area's further development. The two additions also reinforced East Rail's role as Hong Kong's key north-south railway corridor.



*The Corporation continues to improve the station environment and arrangements for passenger flow at Lo Wu Station.*

The Corporation's railways operated as a single division during the year following their consolidation into the Transport Division in 2003. The new structure ensured the transfer and sharing of valuable experience and knowledge, created more uniform

service standards, and resulted in important synergies.

East Rail is the mass transit rail service connecting the Eastern New Territories and urban Kowloon. It is also Hong Kong's only rail link with the Mainland.

### East Rail (including the Tsim Sha Tsui Extension and Ma On Shan Rail)

<b>Route length (km)</b>	
- East Rail Main Line	35.1
- Ma On Shan Rail	11.4
<b>Number of stations</b>	
- East Rail Main Line	14
- Ma On Shan Rail (excluding Tai Wai Station)	8
<b>Number of rail cars</b>	
- East Rail Main Line	444
- Ma On Shan Rail	72
<b>Daily hours of operation</b>	19.5
<b>Minimum headway (minutes)</b>	
Peak hours	
- East Rail Main Line	2.7
- Ma On Shan Rail	3
Off peak hours	
- East Rail Main Line	5
- Ma On Shan Rail	6
<b>Average daily ridership</b>	
Domestic	566,300
Lo Wu	232,500
<b>Highest daily ridership in 2004</b>	
24 December	1,198,376
<b>Intercity Passenger Services</b>	
Destinations (number of Mainland cities)	6
Average daily passengers	8,070
<b>Freight</b>	
Containers (TEUs)	15,282
Breakbulk (wagons)	4,912
Livestock (wagons)	2,982

During the year under review two new extensions were added to the East Rail line, expanding its reach to the Ma On Shan area and returning the KCR to Tsim Sha Tsui for the first time since the 1970s. The 1.1 kilometre Tsim Sha Tsui Extension runs from Hung Hom to East Tsim Sha Tsui, and Ma On Shan Rail extends East Rail 11.4 kilometres from Tai Wai to Wu Kai Sha.

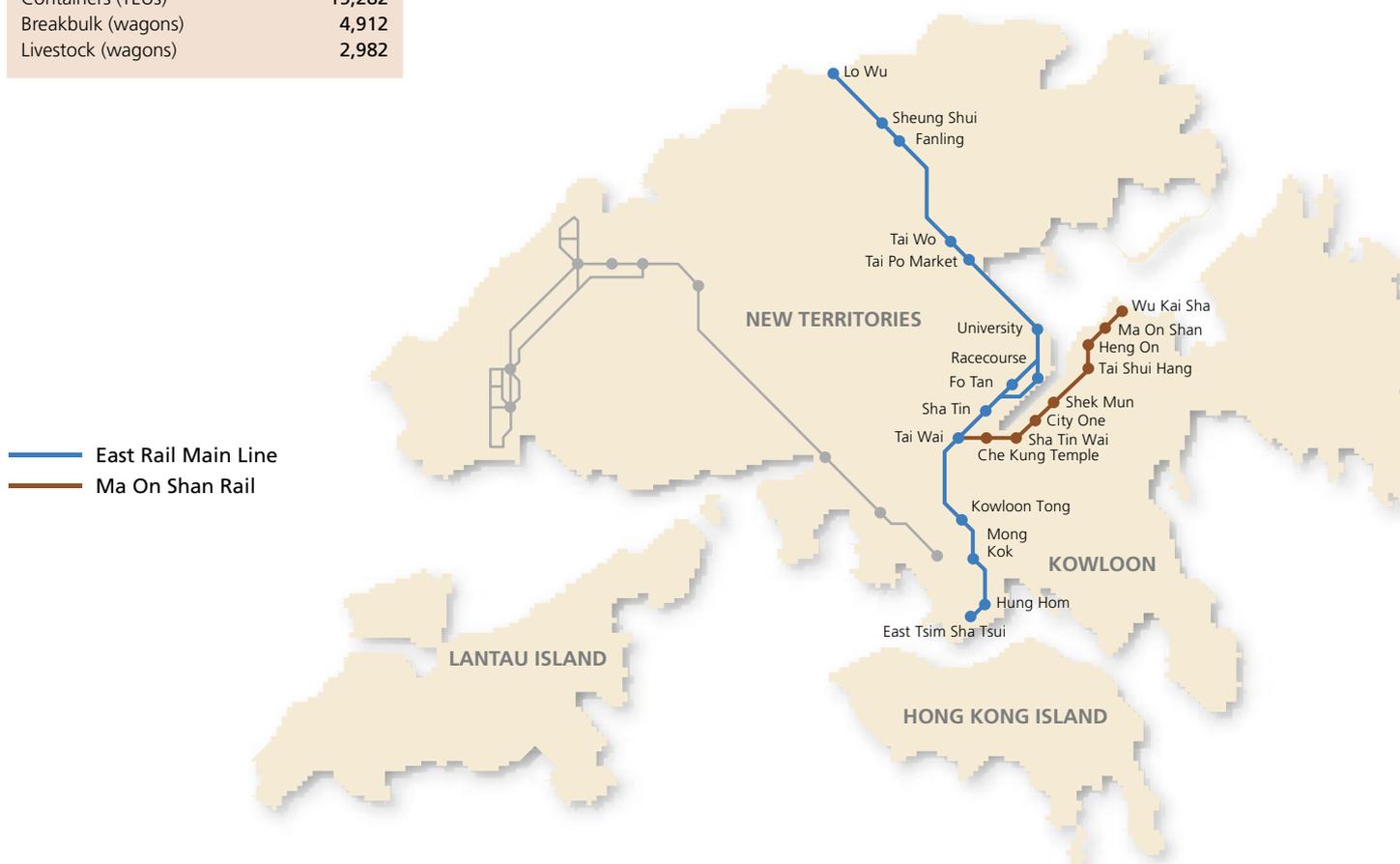
The East Rail network now has a total track length of 46.5 kilometres, and has 22 stations; it provides a mass transit electrified rail service connecting urban Kowloon with both the North East New Territories and the Mainland via Lo Wu.

The Corporation also operates an intercity passenger service to Guangzhou in the Mainland using its

own Ktt train and provides access for other intercity trains running to and from major cities in the Mainland, including Beijing, Shanghai and Guangzhou.

In addition to carrying passengers, East Rail provides daily container, general cargo and livestock rail freight services between Hong Kong and the Mainland.

The results of a 2002 benchmarking survey of 23 railway systems from around the world were released by Imperial College, London in 2004. East Rail ranked first in service quality in terms of on-time passenger journeys, and second in reliability and train punctuality. The Corporation's in-house statistics indicate that East Rail's performance in these categories has improved substantially since 2002.





*The East Rail Control Centre handles all traffic on the newly expanded East Rail network.*

### Domestic and Cross-boundary Passenger Service

In 2004 East Rail's gross revenue increased 4.6% to HK\$3,415 million, from HK\$3,266 million in 2003, mainly due to the recovery in patronage following the SARS outbreak and the opening of the Tsim Sha Tsui Extension. East Rail gross revenue accounted for 68.6% of the Corporation's total revenue.

Domestic patronage, at an average of 566,300 passengers a day, was 5.3% higher in 2004 than in 2003. Average cross-boundary patronage increased to 232,500 during 2004, up 3.6%

from 2003, but East Rail continued to lose market share to road based transportation. On 24 December, Christmas Eve, East Rail carried a record 1.198 million passengers. East Rail's domestic market share was 29.3% for intra-New Territories travel and 41.8% for travel between the New Territories and urban areas. Its cross-boundary market share was 61.2%.

To boost patronage and address public concern over fares, the Corporation extended the 20% second-trip fare discount offered to passengers who make a second trip on the East Rail domestic network on the same day.

The scheme, launched in April 2003, was due to expire in September 2004, but has been extended to 31 May 2005.

The fares for the Tsim Sha Tsui Extension and Ma On Shan Rail have been accepted as competitive and reasonable by the public. Various interchange discounts with mini-buses and the MTR have been launched for these two extensions.

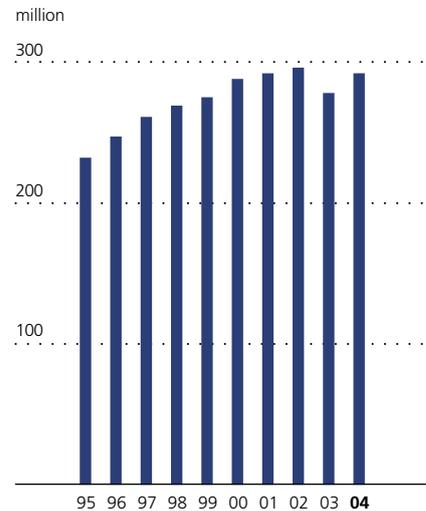
### Service Improvements

During the course of the year, East Rail continued to introduce service improvements to enhance passenger service. Chief among these were the two new extensions and additional interchange facilities with the MTR at Tsim Sha Tsui and Kowloon Tong.

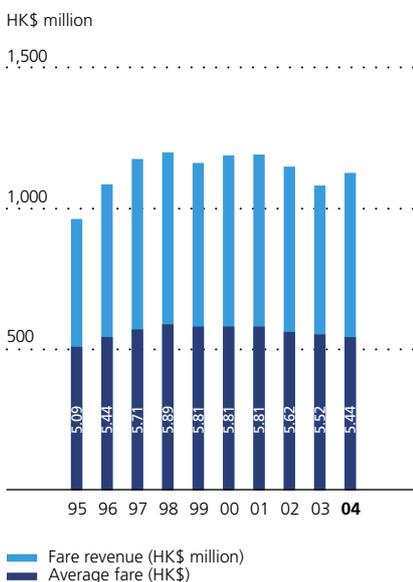
The Tsim Sha Tsui Extension was commissioned on 24 October. Ma On Shan Rail was commissioned on 21 December. Train frequency during morning peak hours was increased to 24 trains per hour per direction to tie in with the opening of Ma On Shan Rail.

The new underground southern concourse at Kowloon Tong Station opened in April, and the station's enhanced handling capacity is expected to meet passenger demand for the next 15 years. The new concourse is connected by subway to the MTR Kowloon Tong Station. Approximately one-fifth of the passengers interchanging between the two systems use the new subway. The improvement project also increased the station's street level accessibility by adding a new entrance and additional lifts, escalators and staircases.

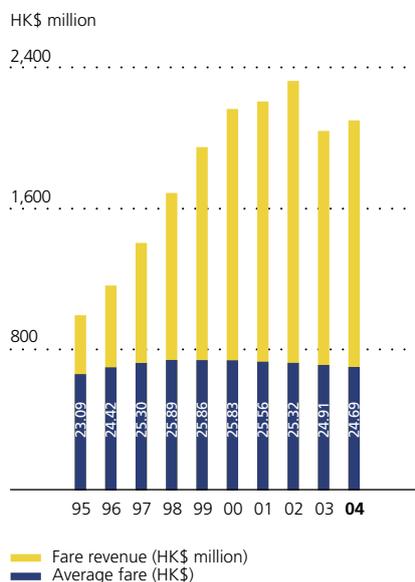
### East Rail Total Passengers



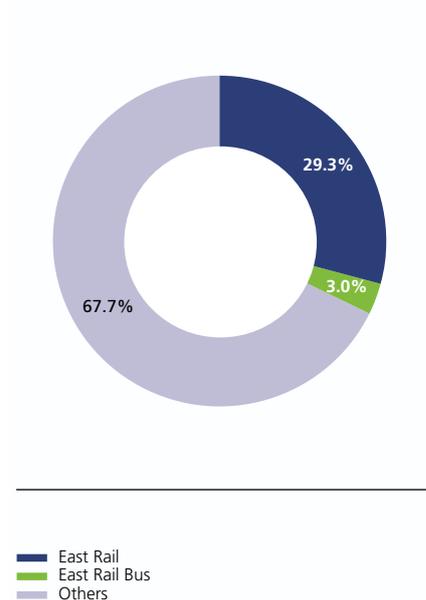
### East Rail Domestic Revenue



### East Rail Cross Boundary Revenue



### KCR's Market Share in the North East New Territories



Service Targets and Achievements

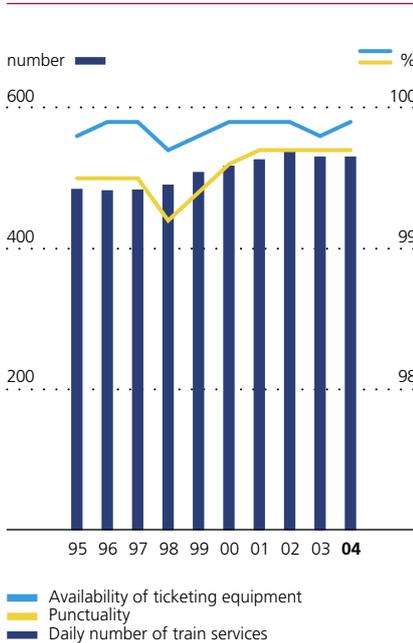
	2004 Yardstick	2004 Performance
<b>East Rail</b>		
Service delivery	99%	99.90%
Punctuality	99%	99.70%
Availability of ticket vending machines	99%	99.47%
Availability of Octopus equipment	99%	99.90%

More elements of the Lo Wu Station Improvement Project were completed during the year. In March the new Platforms 1 and 4 opened so that boarding and alighting passengers could be segregated to streamline passenger flow. The concourse renovation was completed in June and the extended concourse now provides ample waiting space for southbound travellers. New flap-type ticket gates, which are far easier for passengers with luggage to use, replaced the conventional tripod gates.

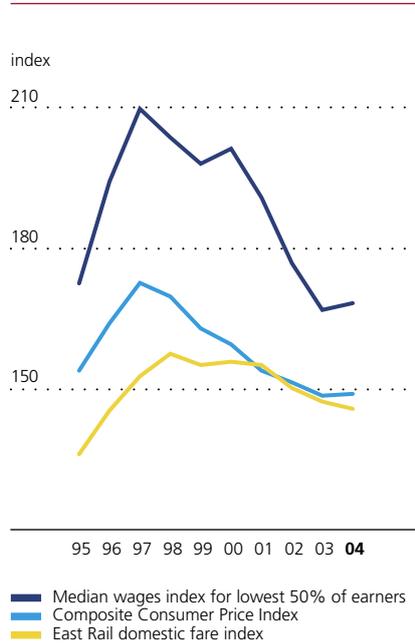
The Corporation continued to invest in upgrading its rolling stock fleet during the year. The Passenger Information Display System LCD terminals are being installed on refurbished trains, and all trains should be equipped by mid-2005. In June, Octopus card processors were installed in the gangways leading to first class compartments on all East Rail trains. Passengers may use these processors to access first class compartments after boarding trains.

In January, a new generation of environmentally friendly diesel

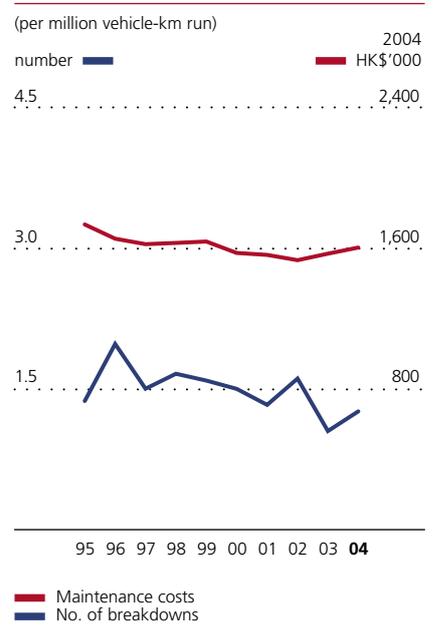
East Rail Operating Performance



Fares Relative to Income and Inflation



EMU Breakdown Vs Maintenance Costs



locomotives was handed over to the KCRC. The new locomotives entered service in May, replacing five older diesel locomotives. The new locomotives incorporate features that significantly reduce the noise produced by the locomotives, cut exhaust emissions by 20% and reduce fuel consumption by 40%. The Corporation restored one of the retired locomotives, the Sir Alexander, to its original appearance and donated it to the Hong Kong Railway Museum, where it is now on permanent display.

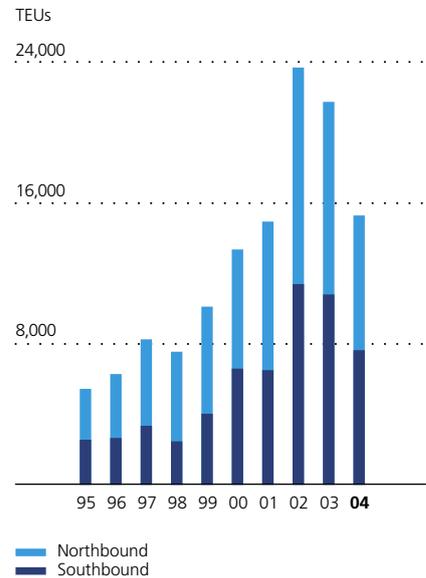
In February a new ticket vending machine with a voice response function for the visually impaired was installed at each station, and the tactile guide paths at all stations were modified to direct the visually impaired to these ticketing machines. Work on extending the tactile guide paths to cover four coaches at station platforms commenced in December and will be completed by mid-2005.

### Intercity Passenger Services

Seizing the opportunities presented by CEPA and further expansion of the Mainland's Frequent Individual Travellers (FIT) scheme, the Corporation secured the approval of the Mainland railway authorities and increased the frequency of the Guangzhou-Kowloon Through Train from ten to 12 pairs a day starting in April 2004. The additional pairs of through train extended the hours of operation for both northbound and southbound trains and enhanced the appeal of commuting by through trains. In 2004, the daily patronage of through trains averaged 8,070, an increase of 37.5% from the previous year.

The increased frequency and extended operating hours also generated growth in same day return trips by Hong Kong business travellers, along with growth in leisure trips by Mainland travellers. The Guangzhou-

### Container Traffic



*Two additional pairs of through trains were launched during the year to meet increasing demand.*



## Transport: East Rail

Kowloon Through Train's market share grew 2.5% during the year to 25.4% and its daily patronage reached a record high of 11,386 on 24 October, during the Autumn Trade Fair in Guangzhou.

A number of service enhancements and marketing initiatives were launched in 2004. On-board service was improved by expanding food and beverage offerings and the magazine selection. In order to fully tap the Mainland FIT market, several joint promotions were launched during the year. The Corporation reached agreements with

various partners in the travel industry such as travel agencies, the Hyatt Regency Hotel, the Hong Kong Jockey Club and Ocean Park on discounts and special packages that were then offered to through-train passengers.

### Freight

Management of the freight business and intercity passenger services was merged in May 2004 so that similar cross-boundary issues could be dealt with in a more unified and efficient manner. This also saved costs and created synergies.

## Relations with Mainland Railways

The growing social and economic ties between Hong Kong and the Mainland present new business opportunities for the Corporation, which operates the only Hong Kong railway that connects with the Mainland's rail network. The Corporation therefore devotes considerable effort to maintaining close relations with Mainland railways, boundary control authorities and other Mainland business entities.

In May 2004, the Corporation's Chairman and Chief Executive Officer (Acting) met with the Minister of Railways in Beijing. A decision was made to form a Joint Committee of the Ministry of Railways and the Corporation to provide a forum for the concerned parties to address cross-boundary rail passenger and freight transportation issues so as to contribute to the closer economic and trade relations between the Mainland and Hong Kong. It replaces the Four-way Joint Committee formed by the Corporation, the Beijing Railway Administration, the Shanghai Railway Administration and the Guangzhou Railway (Group) Corporation.

In December, a Corporation delegation led by the Chief Executive Officer (Acting) attended the first joint session with the Ministry of Railways to discuss various cross-boundary passenger and freight issues. The session also established working groups on passenger and freight issues and the initial timetable for the groups' meetings.

A Passenger and Freight Working Group meeting was also held with the Guangzhou Railway (Group) Corporation to resolve operational issues in respect of the passenger through train and freight services.

The Corporation also developed a cooperative relationship with the Shenzhen Metro. Convenient interchange connections between East Rail and the Shenzhen Metro at Lo Wu and Lok Ma Chau will greatly facilitate cross-boundary passenger flows.

In view of the highly competitive market, the Corporation continued to vigorously lobby the Ministry of Railways, local railway administrations and companies and business associates in the Mainland, for support in enhancing the scope and quality of our freight services. At the same time, efforts were made to improve the cost efficiency of our freight marketing and operations.

In 2004, the Corporation was named the Best Rail Operator – Asia, at the Asian Freight & Supply Chain Awards, and the Rail Freight Operator of the Year at the Asia Logistics Awards 2004. The KCRC won the latter award, decided by a vote among freight industry professionals, for the third year in a row.

## Looking Ahead

The major goals for East Rail during the coming year revolve around the two new extensions to the network: the Tsim Sha Tsui Extension and Ma On Shan Rail. The priorities for 2005 include ensuring that the new railways continue to operate smoothly and steadily increasing patronage by, among other things, continuously improving feeder connections.

The Shenzhen Metro opened on 28 December 2004 and the Corporation is exploring joint promotion opportunities in order to boost cross-boundary patronage. The opening of Hong Kong Disneyland in 2005 should also help contribute to growth in cross-boundary passenger traffic in coming years.

The Corporation plans to expand cooperation with travel agencies, hotels, airlines and theme park operators to offer more travel related services. New routes to other Mainland cities are also being explored. Given the increasing traffic crossing the boundary, through-train patronage and market share are expected to continue to grow in the short and medium terms.

A through-train customer database (Customer Relationship Management System) is being built to aid future marketing plans and increase the Corporation's knowledge of its customers.



## Transport: West Rail, Light Rail & Bus

Launched in late 2003, the West Rail network connects the North West New Territories to urban Kowloon and is the main component of an integrated transport network serving the North West New Territories.



*At Tuen Mun Station, passengers can quickly and conveniently interchange between West Rail and Light Rail.*

### West Rail

The 30.5 kilometre railway stretches from Nam Cheong to Tuen Mun, and includes nine stations. There are two interchanges with the MTR and four with Light Rail. West Rail has been designed to meet the transport needs of the growing population of the North West New Territories for many years to come.

### Passenger Services

The Corporation's efforts during the year focused on ensuring smooth operations and securing ridership for the new railway.

Teething problems are expected during the initial stage of operations of any project of West Rail's size and complexity, and the Corporation

## West Rail

Route length (km) Tuen Mun to Nam Cheong	30.5
Number of stations	9
Number of rail cars	154
Daily hours of operation	19
Minimum headway (minutes)	
Peak hours	3.5
Off peak hours	6
Average daily ridership	131,500
Highest daily ridership in 2004 24 December	229,283

worked to resolve such issues as quickly as possible in order to maximise public confidence in the new railway. The Corporation also engaged in coordinated efforts to enhance West Rail's connectivity and accessibility.

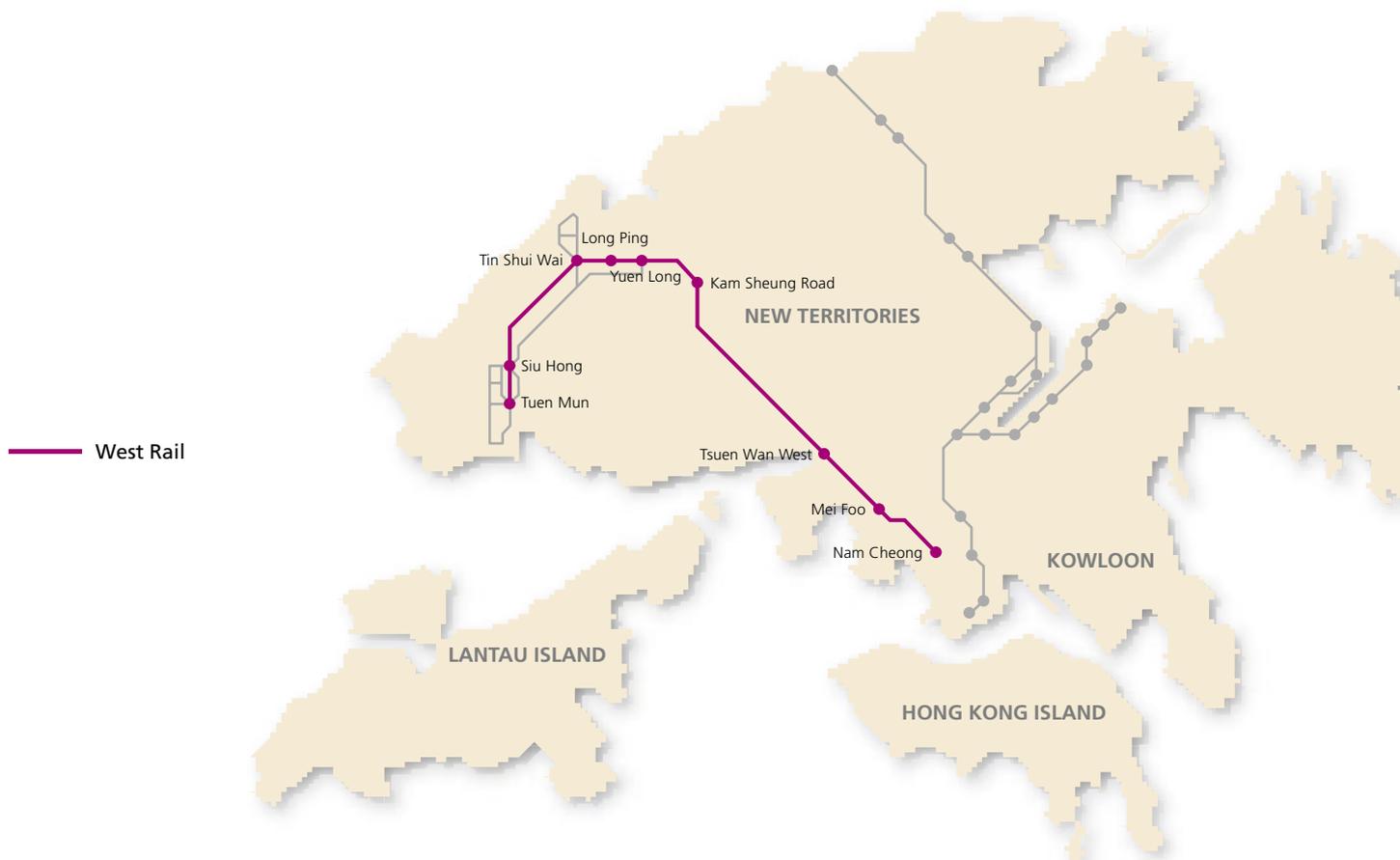
These efforts, along with concerted publicity and promotional campaigns and innovative fare offers, steadily attracted passengers, and the railway achieved a 72% growth in patronage during the year. Ridership increased from a daily average of 100,500 in January to 172,900 in December. The patronage record, set on 24 December 2004, was 229,283.

The "West Rail Fun All the Way" promotional campaign turned West Rail stations into venues for innovative events and performances on weekends during the second half of the year.

The campaign will continue during 2005.

In September the Corporation launched the West Rail Sightseeing Bus, which departed from West Rail Kam Sheung Road Station and toured areas of scenic and cultural interest in the North West New Territories. Over 4,000 people used the service on each of the 13 Sundays and public holidays on which it ran.

Numerous fare promotions and special offers, including interchange discounts with other public transport providers, also attracted new riders. The West Rail One-Month Pass received an overwhelming response when it was introduced in August 2004, and the original month-long offer was extended to the end of 2004 and further until June 2005. The West Rail Student



## Transport: West Rail, Light Rail & Bus

### Service Targets and Achievements

	2004 Yardstick	2004 Performance
<b>West Rail</b>		
Service delivery	99%	99.60%
Punctuality	99%	99.50%
Availability of ticket machines	99%	99.85%
Availability of Octopus equipment	99%	99.89%

One-Day Pass was introduced during the 2004 school summer holidays, and an average of about 500 passes were sold each day.

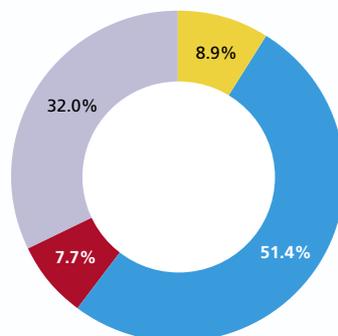
The Corporation worked closely with other transport operators, including bus and mini-bus companies, to enhance West Rail's connectivity to other forms of public transport. These efforts proved extremely popular. For example a green mini-bus feeder to Tsuen Wan West Station attracted about 100 passengers a day when it was introduced in May, but by December

it carried an average of 2,700 passengers a day.

### Service Improvements

In addition to reliability of train operations, connectivity, accessibility and station facilities were also key elements in West Rail's drive to improve services. A total of 132 pedestrian signs and 51 traffic signs were added, relocated or modified in the vicinity of West Rail stations to increase accessibility. Additional directional signage was also erected at stations, and some entry and exit gates were relocated to improve passenger flow.

### KCR's Market Share in the North West New Territories



■ West Rail  
■ Light Rail  
■ KCR Bus  
■ Others

An extensive study was conducted on energy saving opportunities at all stations. The resulting initiatives included optimising interior temperatures, shutting off some escalators during non-peak periods, and switching off some lighting in aboveground stations during daylight hours. The study was part of an on-going effort to utilise energy as efficiently as possible.

## Light Rail

Total route length (km)	36.2
Number of Light Rail vehicles	119
Number of stops	68
Daily hours of operation	19
Minimum headway (minutes)	
Peak hours	1.4
Off peak hours	1.6
Total km run	11,288,284
Average daily ridership	359,800
Highest daily ridership in 2004 28 September	503,247

## Light Rail

In 2004 Light Rail completed its first year as both a feeder service for West Rail and a provider of rail services in the North West New Territories. Light Rail ridership rose significantly during the year as residents of the area used it to connect to West Rail services.

The Light Rail network is an important element of the integrated public transport system in the North West New Territories. Its efficient, high-frequency services help the more than one million residents of the region connect to West Rail and the other forms of transport that link them to urban Kowloon and Hong Kong.

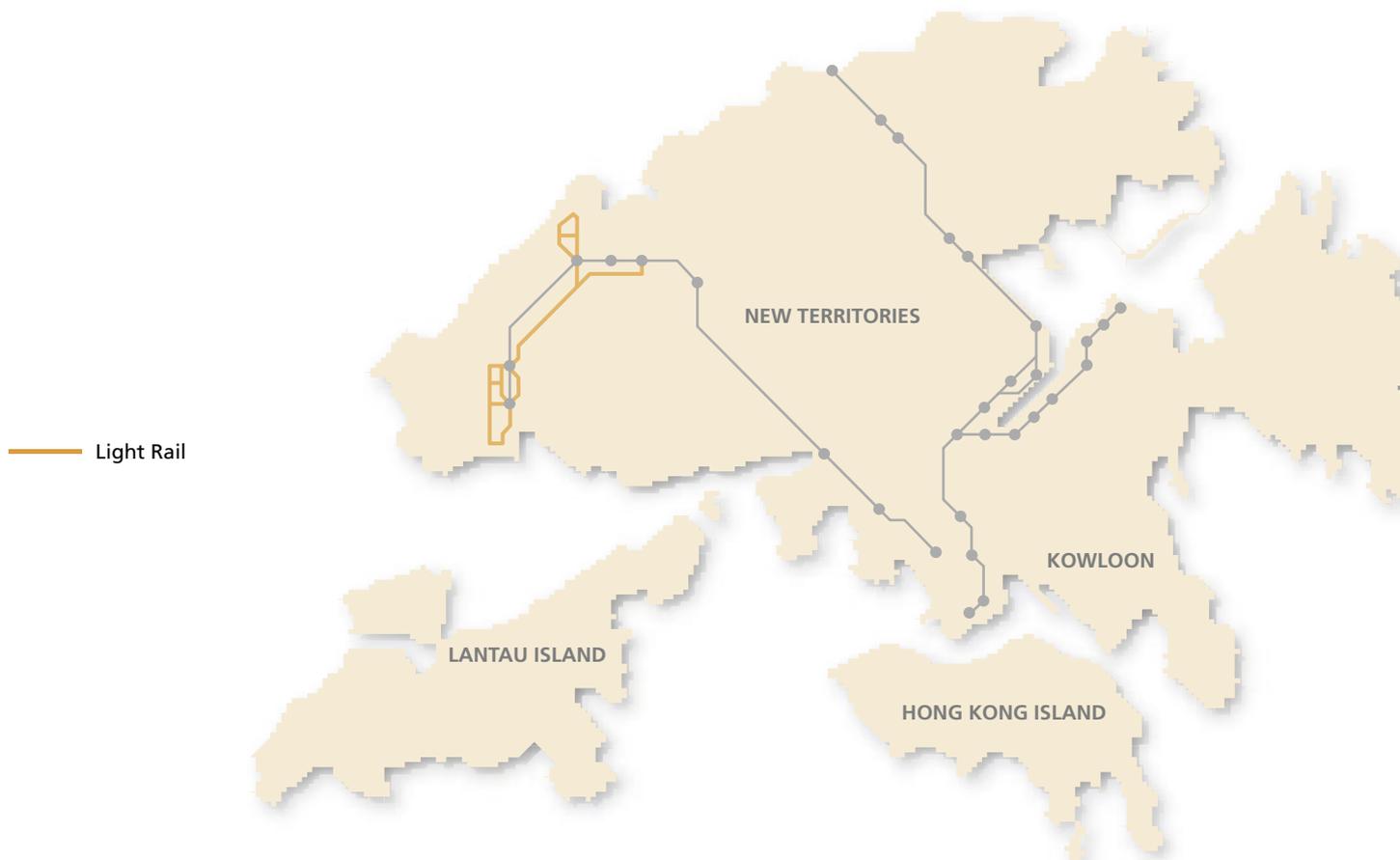
The Light Rail service restructuring and rationalisation continued to make good progress during the course of the year.

The process includes reorganising routes, expanding the network, better utilising Light Rail vehicles, and making it an effective West Rail feeder system.

The Corporation also operates feeder bus services in support of West Rail, East Rail and Light Rail services. There are 16 such routes, including feeder services, residential and express routes. Six East Rail feeder routes are managed under a KMB franchise through an operating agreement between the two companies.

## Passenger Services

Light Rail patronage increased significantly during the year, from an average of 330,900 passengers a day in January, to 382,800 in December. For the year as a whole there was a daily average of 359,800 passenger trips on



# Transport: West Rail, Light Rail & Bus

## Service Targets and Achievements

	2004 Yardstick	2004 Performance
<b>Light Rail</b>		
Service delivery	99%	100%
Punctuality	99%	99.60%
Availability of ticket machines	99%	99.86%
Availability of Octopus equipment	99%	99.96%

Light Rail, representing an increase of 23.5% over the previous year. Light Rail ridership exceeded 500,000 for the first time in history during the Mid-Autumn Festival; the network carried 503,247 passengers on 28 September 2004.

Light Rail revenue decreased 11.1% during the year, to HK\$416 million, mainly due to lower Light Rail feeder bus revenue as a result of the rationalisation of feeder bus service routes that followed West Rail's opening in 2003.

## Improvement Projects

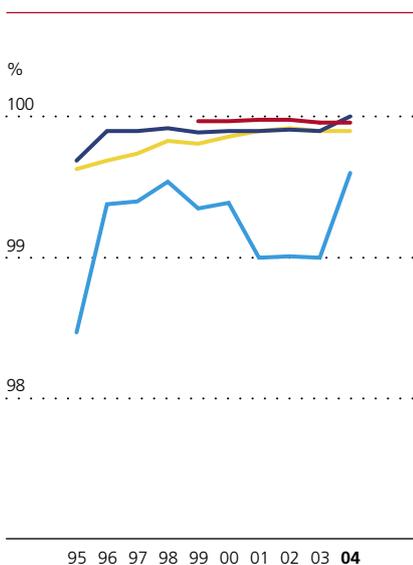
In August the Corporation completed the HK\$150 million grade separation/ viaduct project at Tsing Lun Road. The new viaduct, which crosses over Tsing Lun Road, saves passengers travelling time, enhances operating safety and increases the capacity of the junctions along Tsing Lun Road.

The Bay Management System at Tin Yat was completed in June. The installation of the new signalling system for the existing network is continuing and will be completed by late 2005.

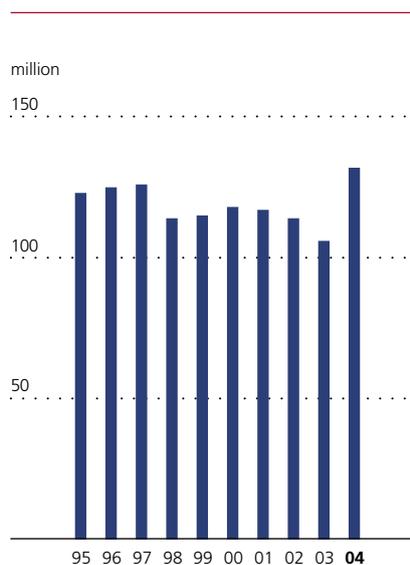
A total of 75 entry and exit Octopus Card processors were relocated on Light Rail platforms during the year in order to better serve the changed passenger flows resulting from the rationalisation of Light Rail routes.

To further enhance passenger service, 32 additional Octopus Card enquiry processors were installed on Light Rail platforms. All Light Rail platforms are now equipped with enquiry processors, enabling passengers to check the status of their Octopus Cards at their convenience.

Light Rail Operating Performance



Light Rail Total Passengers

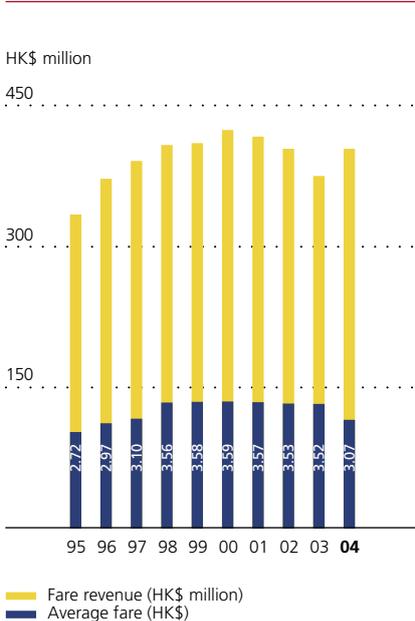


■ Service delivery  
■ Punctuality  
■ Availability of ticket machines  
■ Availability of Octopus equipment (first introduced in 1999)

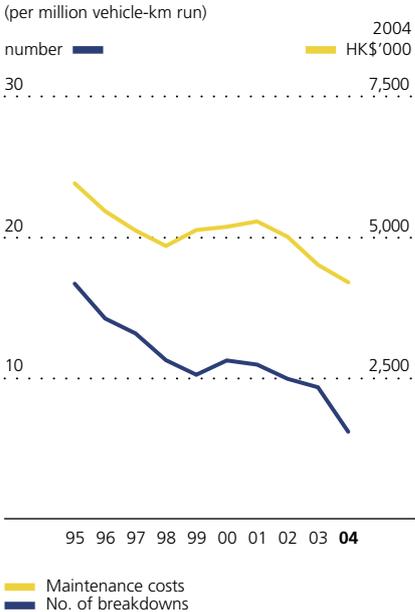


With average daily ridership of about 360,000, Light Rail is one of the world's busiest light rail systems.

**Light Rail Revenue**



**Light Rail Vehicle Breakdowns vs Maintenance Costs**



## Transport: West Rail, Light Rail & Bus



*KCR Bus' strategic routes provide access to and between many KCR stations for thousands of passengers each day.*

## Bus

Total number of buses	129
Total number of bus routes (the operating right of East Rail's feeder routes was transferred to KMB in 1999)	16
Total km run (West Rail feeder buses and residential / express routes only)	6,952,761
Daily hours of operation	19
Minimum headway (minutes)	5
Average daily ridership (West Rail feeder buses and residential / express routes only)	56,660

## Bus

The average daily bus ridership during 2004 was 56,660, a decrease of 21.6% from the average of 72,230 recorded in 2003.

There were a total of 16 routes, excluding East Rail feeder services, at the end of 2004. A number of bus routes were cancelled or introduced during the year as part of the Light Rail and Bus rationalisation plan. Feeder buses in the North West New Territories, which formerly served Light Rail, have been re-positioned to provide feeder service to West Rail.

All "K" feeder buses now provide free interchange service with both Light Rail and West Rail. To supplement the expanded Light Rail service, the Corporation introduced two permanent feeder service routes in Tin Shui Wai in September 2004.

The Corporation decided to purchase 53 second-hand air-conditioned buses with low-floor facilities during the year. Most of the new buses will replace non air-conditioned buses, while the others will be used to open new West Rail feeder bus routes. The new buses,

which will be delivered during the first quarter of 2005, will increase the Corporation's bus fleet to 143.

## Looking Ahead

As West Rail enters its second year of operations the Corporation will continue to focus on increasing ridership by enhancing connectivity and accessibility and continually improving service standards.

Consultations with the public will be undertaken to determine how the Corporation can best strengthen and tailor the feeder services provided by Light Rail and Bus to meet the needs of the increasing population of the North West New Territories.

Proactive and innovative marketing programmes will be carried out to attract passengers to West Rail from within the area, and encourage people from other parts of Hong Kong to use West Rail to explore the region's natural beauty and extensive cultural heritage.

## Service Targets and Achievements

	2004 Yardstick	2004 Performance
<b>Bus</b>		
Service delivery	99%	99.98%
Reliability: number of trips per failure	1,300	1,996.8

An aerial, long-exposure photograph of a complex road interchange at night. The image shows multiple levels of roads, including a large roundabout and several overpasses. Light trails from cars and trucks create vibrant streaks of yellow, white, and red across the road surfaces. The surrounding area includes some greenery and streetlights. The overall scene is illuminated by the warm glow of the city lights.

# New Extensions and Future Projects

Ma On Shan Rail, which crosses the Sai Sha Road roundabout near Heng On Station, provides fast, convenient and environmentally friendly mass transportation between the North East New Territories and Kowloon.



## 44 New Extensions and Future Projects

The completion and successful opening of both the Tsim Sha Tsui Extension and Ma On Shan Rail in 2004 were major achievements for the Corporation and major steps forward for Hong Kong's transportation network: they extended railway service to many communities and enhanced convenience for the travelling public. The achievements also demonstrate that the Corporation has built up a world-class project implementation team.



*An extensive pedestrian subway network links East Tsim Sha Tsui Station to the nearby MTR station and major hotels and shopping centres.*

The two projects, which were both completed within budget and on schedule, also represent the culmination of the vision laid out in the Government's 1994 Railway Development Strategy.

The Corporation's railway projects are designed with the needs and perspectives of passengers and operators first and foremost. The Corporation's philosophy of Continuous Public Involvement in all new railway projects helps it build railways that best serve the Hong Kong community by taking these needs into consideration at every stage of development.

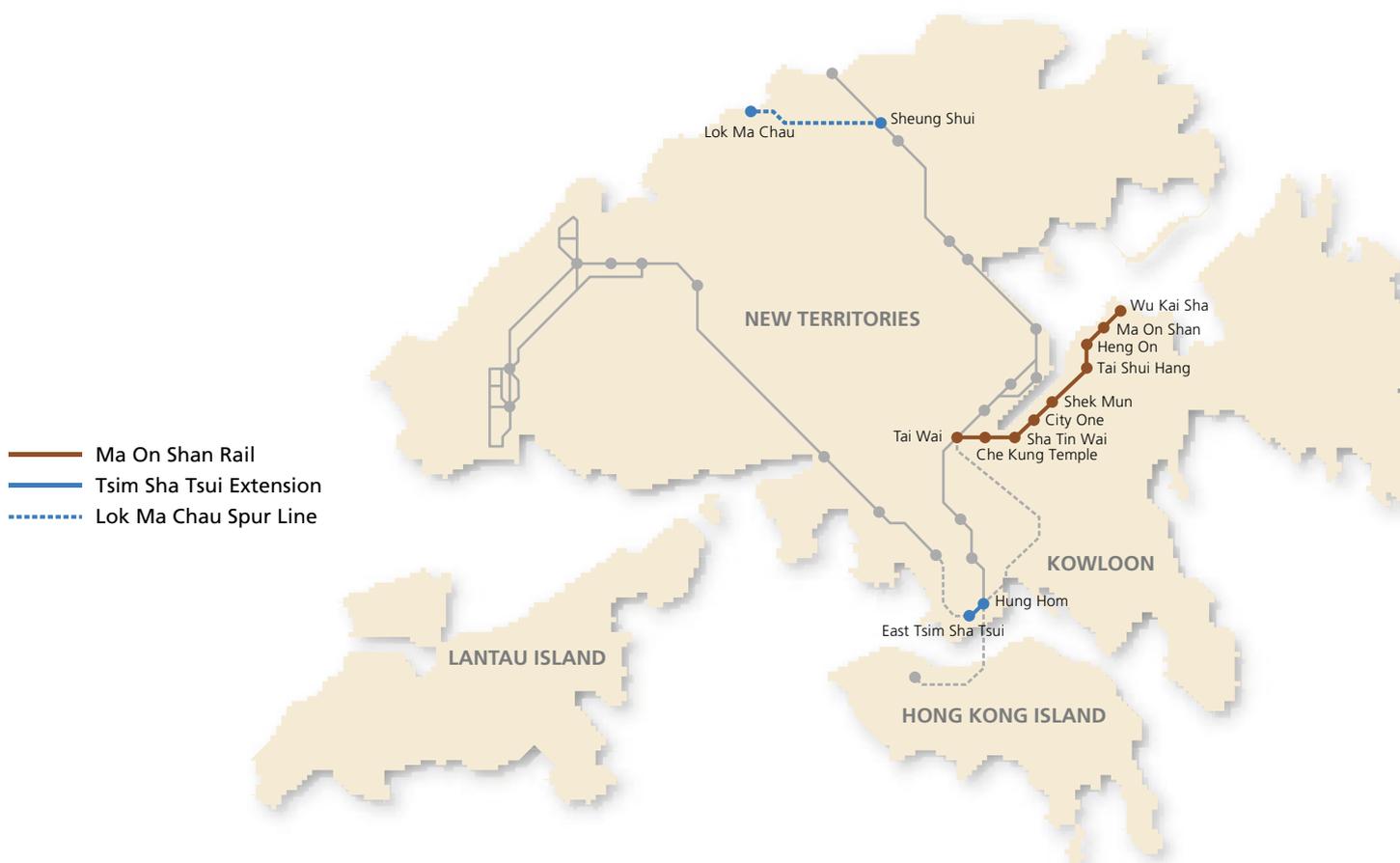
Now that the Tsim Sha Tsui Extension and Ma On Shan Rail have made the transition from construction projects to operating railways, the Lok Ma Chau Spur Line is the only one of the East

Rail Extensions still in the construction phase. The project is making excellent progress and is well on the way towards its scheduled completion.

### The Tsim Sha Tsui Extension and Ma On Shan Rail

The Tsim Sha Tsui Extension and Ma On Shan Rail were opened for public service on 24 October 2004 and 21 December 2004 respectively. The coordination and dedicated efforts of many parties over the course of the year were instrumental to the successful launch of both railways.

By early 2004, following the completion of major structural works for the Tsim Sha Tsui Extension, attention was focused on the building services installations and architectural finishing works for East Tsim Sha Tsui



## 46 New Extensions and Future Projects



*Travellers in East Tsim Sha Tsui Station's pedestrian subway make travel more pleasant for passengers.*

Station. Architectural finishing and building services installation works on the pedestrian subway were completed in June. Statutory inspections were carried out successfully between May and July 2004.

On Ma On Shan Rail, all architectural finishing works and building services installation at the nine stations were substantially completed in mid-2004. All building services systems were rigorously tested from the second quarter of 2004.

Meanwhile the railway systems works on both railways were also proceeding according to schedule.

Both tracklaying and overhead line installation on the Tsim Sha Tsui Extension were completed in the first quarter of 2004. The overhead line system was energized on 15 March to support testing of the train control and signalling system. The system was thoroughly tested from April to July.

Ma On Shan Rail's overhead line system was energized on 1 April, and trains

began running to test the signalling and train control system later that month. Railway systems, including the signalling and train control systems, lifts and escalators, automatic revenue collection system, and integrated control and communication systems were completed by the end of July. System Acceptance Tests were then carried out to ensure that all systems met performance standards.

In May, the last three of the 18 sets of four-car EMU trains for Ma On Shan Rail were delivered to Hong Kong, completing its fleet of 72 cars.

### **Trial Operations and Final Inspection**

Formal trial operations on the Tsim Sha Tsui Extension started on 1 August and were successfully completed on 27 August. The average punctuality and service delivery levels attained substantially exceeded the Corporation's stringent performance targets. The trial operations also provided an opportunity for operations

staff to familiarise themselves with the new systems and station facilities.

For Ma On Shan Rail, formal trial operations began on 28 September and continued for two months. The results again substantially exceeded the Corporation's rigorous performance standards. In addition to thoroughly testing the railway systems, the comprehensive tests also familiarised operations and maintenance staff with the new systems and drilled them in troubleshooting skills.

During the trial operations, a series of emergency drills and exercises at both extensions including major joint exercises were conducted with the Fire Services Department, Transport Department, Hong Kong Police Force

and the MTR Corporation Limited. Through participation in the exercises operations staff obtained hands-on experience with operational procedures and contingency plans for various emergency scenarios.

### Public Involvement

The Corporation had made public consultation and involvement in both projects a priority since the design stage. Community Liaison Groups, composed of local residents, members of estate management committees and District Councillors, were formed in Tsim Sha Tsui and Ma On Shan. The groups met regularly with the Corporation's staff and were briefed on the progress of the works and matters such as temporary traffic arrangements.

The Corporation and the contractors found the opportunity to consult with members of the public helpful in fostering cooperation and support, and the local members of the groups welcomed the opportunity to provide suggestions and become better informed.

Community Liaison Offices were established to answer questions from residents of the communities, resolve complaints and address concerns. A customer service hotline also enhanced communication with local residents. The Corporation also published a bi-monthly Projects Update, describing the latest progress on both projects, which was distributed in the communities.

*Ma On Shan Rail makes it more convenient for worshippers to reach Che Kung Temple, one of Hong Kong's busiest temples.*



## 48 New Extensions and Future Projects



*The expanded and renovated Tai Wai Station links Ma On Shan Rail and East Rail.*

The Corporation made extensive efforts to keep Legislative and District Councillors, and community leaders informed throughout the construction and commissioning process. The Legislative Council, relevant District Councils, the Transport Advisory Committee and community leaders were briefed and consulted on the principles by which the fares for the new railways were determined. A passenger survey was also conducted on the new fares.

Another issue that aroused much public concern, particularly among those who live near Ma On Shan Rail, was noise of trains running on the tracks. To ensure that the noise levels of the new railway complied with the Noise Control Ordinance, the Corporation adopted a host of noise mitigation measures for both the train cars and





*Ma On Shan Rail's passenger-friendly stations are within easy walking distance for most of the area's residents.*

the tracks to minimise the noise at source. These included: installing noise absorbing lining under the train cars, beneath the walkways along the tracks and on the inside of the parapets; adding "skirts" to train vehicles; and installing floating slab track and rubber bearings. Additional measures were implemented for some sections that lie close to residential blocks. These included adding noise absorbers, and extending the walkways and the parapets.

### Pre-launch Publicity

The Corporation launched a major publicity campaign to inform the public about the new railways well before they opened. Starting in April, roving exhibitions were held in major shopping malls throughout Hong Kong. A number of school talks and visits also helped raise public awareness.

Information leaflets, updated route maps, fare charts and passenger guide books were distributed at East Rail stations to familiarise the public with the new facilities and extended East Rail services.

The 19 September opening of the Mody Road section of the Tsim Sha Tsui Extension's pedestrian subway, which

links East Tsim Sha Tsui Station to the MTR Tsim Sha Tsui Station and major hotels and shopping centres, also drew public attention to the forthcoming commissioning of the Tsim Sha Tsui Extension.

The East Tsim Sha Tsui Station Open Day and Public Trial Ride held on 17 October, and the Ma On Shan Rail Charity Ride Day, held on 19 December, attracted thousands of visitors to the new facilities, and the new extensions received extensive coverage in all local media.

# New Extensions and Future Projects

## Lok Ma Chau Spur Line

The Corporation has adopted a combined tunnel/viaduct approach for the 7.4 kilometre Lok Ma Chau Spur Line, Hong Kong's second railway boundary crossing. The Spur Line will consist of 5.2 kilometres of tunnels and 2.2 kilometres of viaducts.

The Spur Line will branch off the existing East Rail alignment north of Sheung Shui Station, run in tunnels from Sheung Shui to Chau Tau, and then rise gradually onto viaducts until it reaches the new station at Lok Ma Chau.

By providing a second railway boundary crossing between Hong Kong and the Mainland, the Spur Line will relieve congestion at Lo Wu and facilitate growth in cross-boundary rail passenger traffic.

The Corporation has worked closely with the rail, municipal and immigration authorities in the

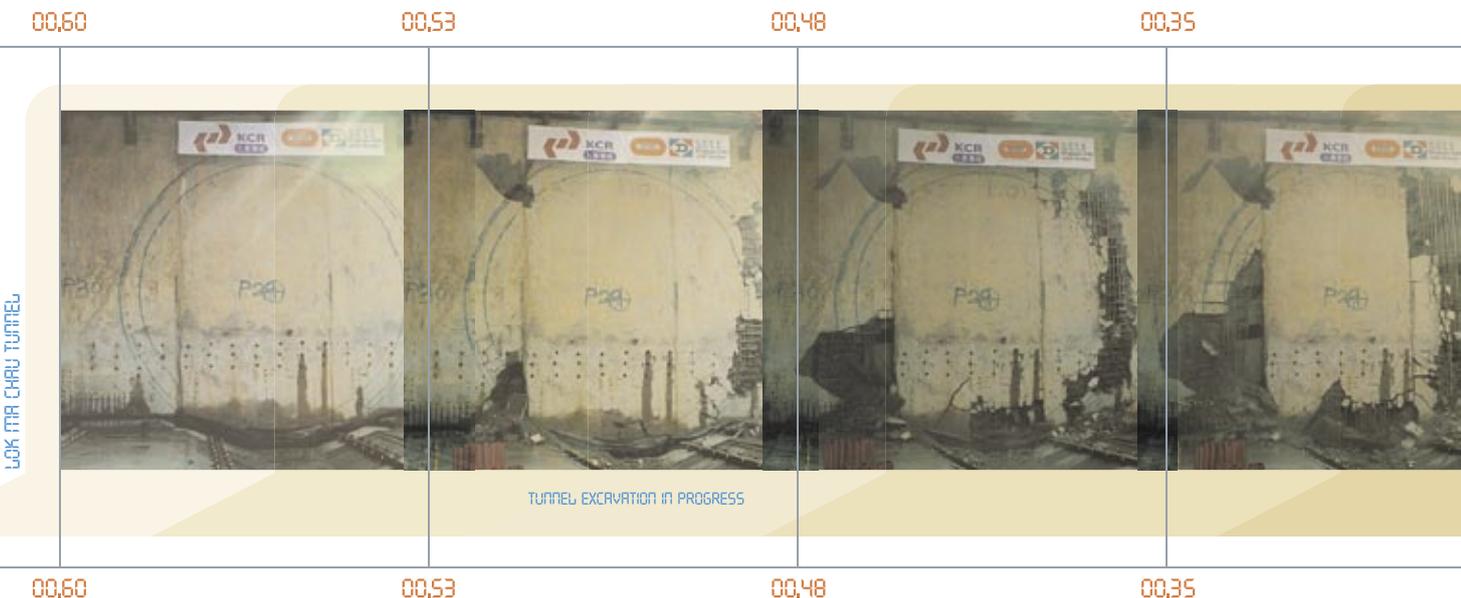
Mainland to ensure that the Spur Line will be seamlessly integrated into the transportation and immigration facilities on the Mainland side of the boundary. The Spur Line Terminus will be linked to the Huanggang Station of the new Shenzhen Metro by a double-deck Passenger Bridge being built in conjunction with the Shenzhen Municipal People's Government.

Construction commenced in January 2003 and by the end of 2004 the civil construction works were 67% complete.

### Tunnel Section

The southbound tunnel, running from Sheung Shui to Chau Tau, was broken through on 21 June. The northbound tunnel is progressing well and should be completed in April 2005. In both tunnel drives the tunnel-boring machine passed through the ecologically sensitive Long Valley area without much difficulty.

*Construction of the Lok Ma Chau Spur Line is on schedule; here, the tunnel boring machine Mulan breaks through on the southbound tunnel.*





## 52 New Extensions and Future Projects

The Corporation has begun preparations for commencement of construction on the next generation of Hong Kong's transportation infrastructure. As work continues on the Lok Ma Chau Spur Line, construction on the Kowloon Southern Link will get underway in 2005. This project and the others outlined in the Government's Railway Development Strategy 2000 signal a new era of railway development.



*An artist's impression of the Kowloon Southern Link's West Kowloon Station.*

### **Kowloon Southern Link**

The Kowloon Southern Link took several major steps forward in 2004.

In March, the Corporation's plan for the 3.8 kilometre link, which will connect the overrun tunnels of West Rail Nam Cheong Station to East Rail East Tsim

Sha Tsui Station, was gazetted under the Railways Ordinance.

The Corporation has completed the scheme design and tender documents for the design and build tender packages for the link. The Environmental Impact Assessment has also been completed and submitted for public consultation.

The proposed bored tunnel design, running under Canton Road, will minimise disruption to the environment and the surrounding area, which is a bustling commercial and tourist district.

The Corporation amended the Railway Scheme in response to views received during the gazettal period, and the Government gazetted these proposed amendments on 7 January 2005. Subject to the approval of the Chief Executive in Council, contracts will be awarded in mid-2005 and construction will begin soon thereafter. The forecast completion date is 2009.

### The Northern Link

The Corporation also made significant progress on the planning of the Northern Link during the course of the year. The Northern Link, which will join the northern sections of East Rail and West Rail, is the next natural extension of the KCR network, complementing the southern link achieved by the Kowloon Southern Link.

The Northern Link will also provide a second cross-boundary rail link, connecting West Rail from Kam Tin to Lok Ma Chau.

In February 2004 the Corporation submitted a preliminary in-house study report on the Northern Link to the Government. Having reviewed the study report, the Government provided the Study Brief and invited the Corporation to conduct a Preliminary Project Feasibility Study. Consultants were engaged in September to undertake the study, which will be completed in April 2005.

### Express Rail Link

The Government's Railway Development Strategy 2000 included

an Express Rail Link to facilitate the flow of people between Hong Kong and the Mainland. This Express Rail Link will meet passenger demands arising from the closer social and economic ties that have developed with the Mainland.

In 2004 the Government invited the Corporation to study the feasibility of operating express rail services using West Rail and the proposed Northern Link, with a short section branching out to connect with the Mainland railway.

The preliminary findings of this feasibility study are expected in April 2005.

### Sha Tin to Central Link

The Corporation won the bid to plan, build and operate the Sha Tin to Central Link in 2002. In 2004, the Corporation completed the scheme design for the link, and in September it submitted the final proposal to the Government.

The railway scheme and implementation programme of the Sha Tin to Central Link are subject to the Government's final decision.

# Safety

The new Tai Wai depot keeps Ma On Shan Rail's trains running safely and on schedule.





## Safety

Safety is of paramount concern in railway operations, and the Corporation has adopted the most stringent standards in the design, operation and maintenance of its railway systems in order to ensure the safety of its passengers and staff. Regular safety drills with emergency service agencies ensure that the KCRC is fully prepared to act quickly and efficiently in the event of any emergency. The Corporation also works to educate the public about the safe use of its trains and station facilities.



*The Corporation's comprehensive inspection and maintenance system is a key element of its safety programme.*

### Safety Audit System

The Corporation has adopted a comprehensive safety audit system to proactively and systematically manage the safety of assets, systems, people and the environment. The Corporation regularly conducts quality audits, risk assessments and statutory safety audits.

Its safety management is overseen by senior management, which closely monitors all safety-related procedures.

The Corporation is also a member of the Rail Safety Audit Program of the American Public Transportation Association (APTA), which features in-depth audits conducted in a three-year cycle by independent experts. In August railway safety experts from APTA carried out the first stage of the audit programme on the Corporation's safety and security management systems. The audit confirmed that the Corporation had adequate systems and practices in place, as well as a sound system of command and control over safety critical procedures and practices.

APTA will conduct a full-scale safety audit in March 2005. The audit team will review the Corporation's safety and security management system, safety culture, operational rules and procedures, accident investigation, training, equipment maintenance and repair, security efforts and station operations.

## Maintenance

The Corporation has established a comprehensive inspection and maintenance system based on modern maintenance strategies that ensures that the safety and reliability of its railway systems are maintained at a high level. The inspection and maintenance regime is in line with international standards.

Maintenance strategies include preventive maintenance, reliability-centred maintenance, and constant monitoring of the performance of components and equipment and analysis of their life cycles. The repair and maintenance system ensures that the highest levels of safety, reliability, service delivery, durability and productivity of equipment are maintained.

The Corporation constantly reviews and improves its maintenance system, including the scope and frequency of maintenance, to further enhance the safety and reliability of railway systems.

## East Rail

East Rail maintained a high safety performance in 2004. The number of passengers and members of the public injured per million passengers was 0.74.

Efforts to further increase safety levels included new regulations limiting the size of luggage that can be carried on all KCR trains and the deployment of 80 Safety Assistants in East Rail stations from July to September to promote, advise and assist passengers in the safe use of escalators and lifts and the proper boarding and alighting procedures. Flashing signs reminding passengers to hold the handrail were installed at Kowloon Tong Station.

The Corporation conducted a series of drills and joint exercises in conjunction with the Police, the Fire Services Department and other emergency service agencies to maintain the maximum level of emergency preparedness, and to promote coordination and communication during rescue operations. Exercises were conducted on both the operating lines and the new extensions.

Members of the public were invited to participate in a safety drill held in the East Rail Beacon Hill Tunnel in October. Over 300 members of the public took part in the successful drill, which also helped the public become more familiar with emergency preparedness and procedures.

## West Rail

The number of passengers and members of the public injured per million passengers was 0.79. Measures to enhance passenger safety included the deployment of additional staff to advise passengers on the correct use of escalators and the posting of warning labels on lift and platform screen doors.

## Light Rail and Bus

Service and safety standards for both Light Rail and Bus were maintained in 2004. The number of passengers and members of the public injured per million passengers carried was 0.14, 44% lower than the rate of 0.25 recorded in 2003.

Efforts to further reduce accidents included the application of anti-slip paste and "Mind the Platform Gap" markings at every door location on Light Rail platforms and a quarterly road safety campaign conducted jointly with the Police to raise the

safety awareness of pedestrians when crossing Light Rail tracks.

The Corporation also installed bollards or railings at 34 Light Rail junctions to encourage pedestrians, and particularly cyclists, to stop and look both ways before crossing.

## Education

In addition to the efforts described above, the Corporation also held its annual passenger safety campaign, and its biennial Safety, Health and Environment Week, which is designed to raise staff awareness and enhance work practices in these three areas during the year.

Safety Campaign 2004 focused on educating passengers on the safe use of escalators and enhancing the safety awareness of elderly passengers. Safety messages were broadcast at all stations, advertisements were placed in newspapers, and safety leaflets were distributed to passengers.

The campaign also included several elements aimed at Mainland visitors, many of whom use East Rail. Safety games and messages were broadcast on Radio Guangdong – Voice of The City and the Corporation prepared and distributed a safety leaflet in simplified Chinese characters.

# Property Development and Other Businesses

The Corporation's growing network has enhanced its property business by adding properties such as these West Rail Mei Foo Station shops to its commercial property portfolio.





## 60 Property Development and Other Businesses

During the Government's moratorium on land sales in 2003 and 2004, the Corporation took stock of its property development portfolio and advanced the planning and design process for priority property development projects along West Rail and Ma On Shan Rail. Tenders will be invited from developers during and after 2005 under a five-year property development programme.



*The Ho Tung Lau (Site A) development in Fo Tan will provide about 1,400 residential units.*



Sentiment regarding the property market is improving along with Hong Kong's general economic situation and the Corporation believes its return to the property market is well timed.

The Corporation has embraced the public's new emphasis on hygiene, health and quality-of-life issues and stands ready to incorporate such features into its next generation of developments, which will be tendered beginning in 2005.

The multi-disciplinary Linear City Research Project examining the "linear city" running along railway alignments is scheduled for completion in 2005, and the results of this innovative multi-disciplinary study will also influence the design of these new developments.

After two years of analysing its property development portfolio and the latest trends in the public's expectations and desires regarding their living environment, the Corporation will move forward with an ambitious schedule, inviting expressions of interest on one to two projects per quarter over the next two years.

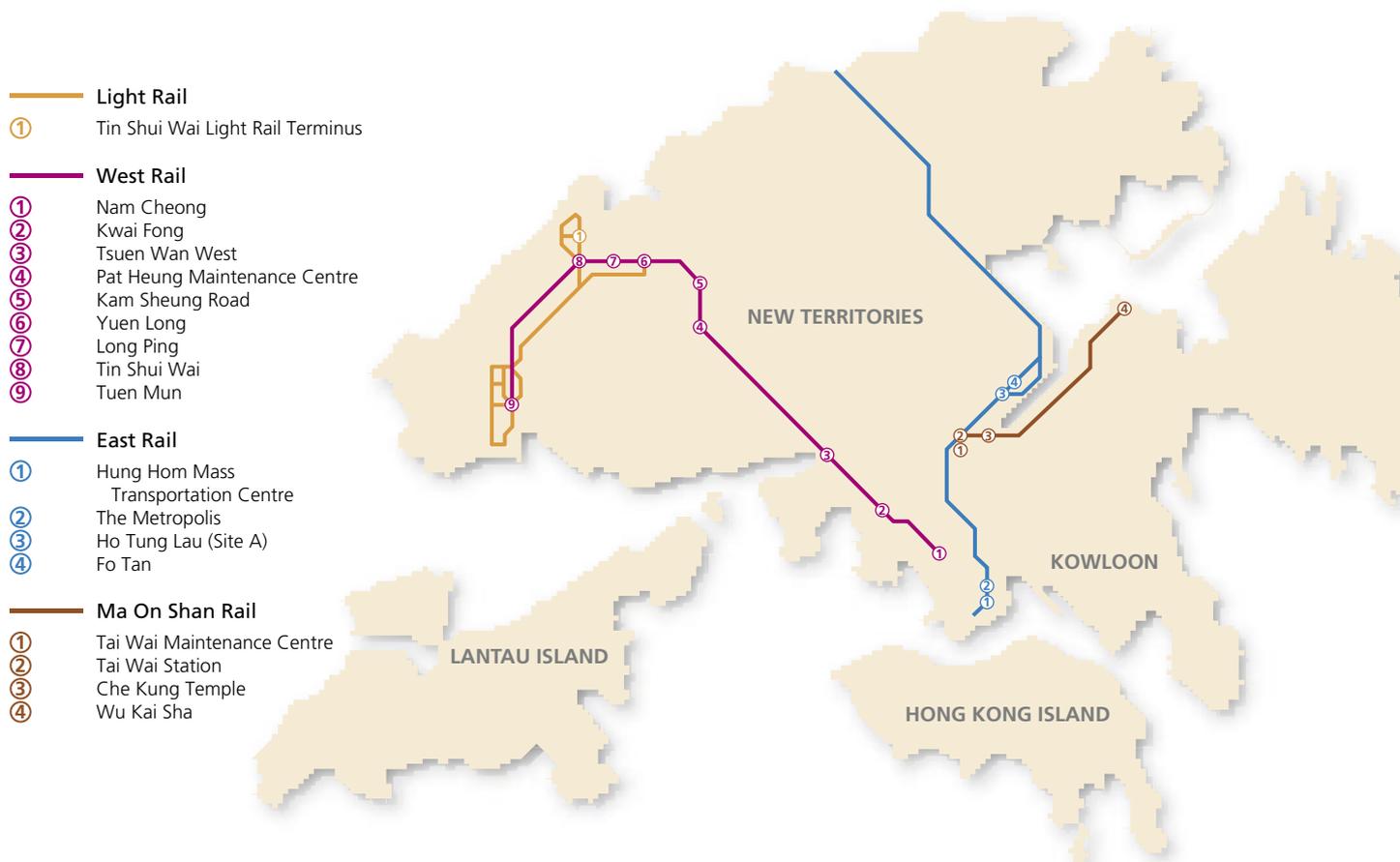
**Responsibilities**

The Corporation undertakes property developments for three primary reasons, all of which support and enhance the achievement of the Corporation's fundamental mission.

First, in maximising the use of the Corporation's assets, such developments generate income that can be used to improve and enhance the existing railway network. Second,

the income from these developments also contributes towards the capital cost of the construction of additional major railway projects. And third, these projects, which are located in close proximity to the Corporation's railway stations, help to secure a permanent and increasing ridership for the Corporation's railways by giving the residents and their visitors convenient access to the railway network.

The Corporation's goal is to build developments that meet the community's aspirations for a better quality of life and are in line with the Government's desire to construct greener and healthier buildings. The Corporation intends to develop these projects jointly with competent property developers.



## Property Development and Other Businesses

In an effort to contribute towards market stability, the Corporation and the Government have reached a consensus that the residential property sites along West Rail and Ma On Shan Rail will be completed no earlier than 2008.

### West Rail Priority Property Sites

Nam Cheong	(4.62 hectares)
Yuen Long	(3.73 hectares)
Tuen Mun	(2.7 hectares)
Tsuen Wan West	(9.41 hectares)
Long Ping	(2.61 hectares)
Tin Shui Wai	(3.48 hectares)
Kam Sheung Road	(9.85 hectares)
Pat Heung Maintenance Centre	(24 hectares)
Kwai Fong	(1.92 hectares)

The Corporation has prepared the designs and project briefs that will enable tender invitations for nine property development projects (comprising 13 sites) with a total land area of more than 62 hectares, in phases, from April 2005 onwards.

It is estimated that 2,244,316 square metres of gross floor area will be created, of which about 91% will be used for residential housing and the remainder for retail, office and car parks, etc. Around 30,000 flats will be completed on these sites between 2008 and 2016.

The Corporation acts as the Government's agent in the development of property sites along West Rail, and the Government will receive the property development profits.

### Ma On Shan Rail Priority Property Sites

Wu Kai Sha	(3.41 hectares)
Tai Wai Maintenance Centre	(7.1 hectares)
Tai Wai Station	(4.85 hectares)
Che Kung Temple	(1.81 hectares)

About 830,850 square metres of gross floor area will be built on these four sites; about 92% of the gross floor area will be used to create 10,972 residential flats between 2008 and 2012.

### Development Projects

The Ho Tung Lau (Site A) joint-venture project between the Corporation and its joint-venture partner, Full Fair Limited, a subsidiary of Sino Land Company Limited, was tendered out days before the Government announced the property moratorium in 2002. Foundation works for the development commenced in April 2004.

The Corporation and Full Fair Limited are incorporating a number of environmentally friendly elements into the development. The designs are being created with input from research conducted by local academic institutions, and this development will set a new standard in environmental housing design for other projects in the pipeline.

The site occupies about 2.65 hectares and provides some 122,900 square metres of gross floor area, comprising 120,900 square metres for residential use and 2,000 square metres for retail purposes. Ten residential towers between 37 to 40 storeys will be built on a two-level podium to provide approximately 1,400 residential units and 290 car park spaces. Pre-sales for these units are scheduled to begin in 2006, and the flats will be completed in the following year.

During the year the Corporation also made progress on several Public Transport Interchanges (PTI) and a number of other property enabling works on development sites along Ma On Shan Rail and West Rail. The completed PTI at Tai Wai and Wu Kai Sha facilitate the operations of Ma On Shan Rail and ensure that the future property developments will have convenient access to nearby railway stations and other public transport,

### Property Development

	Residential floor area (sq m)	Commercial floor area (sq m)
<b>Developed properties</b>		
Pierhead Garden, Tuen Mun	91,400	9,984
Sun Tuen Mun Centre, Tuen Mun	200,000	14,000
Manlai Court, Tai Wai	43,850	420
Hanford Garden, Tuen Mun	88,000	3,200
Sun Yuen Long Centre, Yuen Long	66,430	25,880
Royal Ascot, Sha Tin	271,656	10,000
Mong Kok Station	–	149,590
The Metropolis, Hung Hom	–	132,218*
<b>Sub-total</b>	<b>761,336</b>	<b>345,292</b>
<b>Property under construction</b>		
Ho Tung Lau (Site A)	120,900	2,000
<b>Total</b>	<b>882,236</b>	<b>347,292</b>

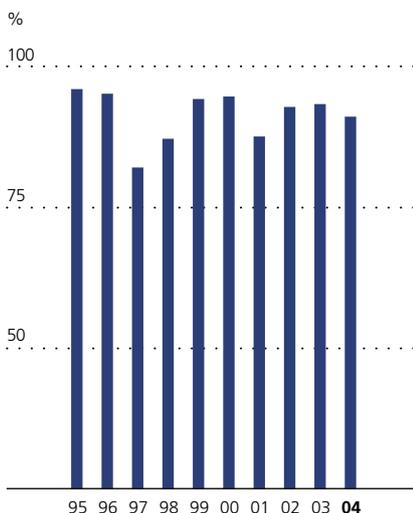
\* including 35,034 square metres of serviced apartment units

boosting both the appeal and value of the property and railway ridership.

The Corporation has used the opportunity presented by the redevelopment of Hung Hom Station outlined in the Sha Tin to Central Link proposal to evaluate the potential of its property assets in the vicinity. Hung Hom Station is set to become an even more significant transportation hub in the future, and maintaining maximum flexibility in regard to future railway expansion is a priority. At the same time, the station's status as a major transportation hub also heightens the appeal of nearby property. An extensive land use re-zoning exercise is currently underway, paving the way for the future exploitation of the site's full property development potential.

The Corporation has also been looking into the feasibility of expanding the commercial trading area at Sha Tin Station in tandem with a strategic improvement and review of the station's design.

### KCRC's Property Occupancy Rate - Station Commercial Premises, Commercial Offices and Shopping Arcades



### Property Services

	Commercial floor area (sq m)	Units of car parking space	Number of residential flats managed
<b>Property management</b>			
Citylink Plaza	24,954	–	–
KCRC Hung Hom Building	5,576	–	–
Pierhead Garden	9,984	168	1,432
Sun Tuen Mun Centre	14,000	421	3,500
Hanford Garden	3,200	237	1,504
Royal Ascot	10,000	2,121	2,504
The Metropolis	23,466	438	662
Trackside Villas	–	72	252
<b>Total</b>	<b>91,180</b>	<b>3,457</b>	<b>9,854</b>
<b>Leasing of office buildings</b>			
Citylink Plaza	21,909		
KCRC Hung Hom Building	5,576		
<b>Total</b>	<b>27,485</b>		
<b>Leasing of shopping centres</b>			
Citylink Plaza	3,045		
Pierhead Plaza	9,984		
Sun Tuen Mun Shopping Centre	14,000		
Shops in Manlai Court	420		
Hanford Plaza	3,200		
Plaza Ascot	10,000		
<b>Total</b>	<b>40,649</b>		
<b>Leasing of residential units</b>		<b>272</b>	

### Station Commercial Activities

- Duty-free business
- Restaurant and rail-bar business
- Public car-parking business
- Park and ride service
- Leasing of retail shops
- Leasing of office accommodation and store rooms
- Automatic teller machines (ATMs)
- Self-service machines and terminals
- Electronic locker systems
- Location film shooting
- Estate management and building maintenance services
- Leasing of retail sales kiosks/counters

### Advertising and Promotions

- Poster advertising
- Large outdoor advertising displays
- Feature advertisements
- Promotional free standing displays
- Commercial exhibitions
- Promotional activities
- Passenger Information Display System

### Telecommunications

- Public payphones
- Optical fibre leasing
- Mobile phone coverage in stations, tunnels and along railway tracks



*New pedestrian subways – including this one at Kowloon Tong – also present new opportunities for advertisers.*

### Commercial Property and Other Businesses

In 2004, the average occupancy rate of KCRC commercial premises in stations, commercial offices and shopping centres was 91.1%. This was attributable to the flexible leasing strategy and multi-faceted promotional activities adopted by the Corporation.

Recurrent revenue generated from commercial facilities and property leasing totalled HK\$695 million in 2004, an increase of 14.5%. Commercial facilities at stations include food and beverage outlets, retail shops, advertising displays, duty-free businesses, telecommunications installations, exhibition space, and machines and

terminals. Property leased by the Corporation includes shopping centres, car parks, offices and residential units.

The Corporation is always mindful of the needs of its tenants, and to accommodate the difficulties faced by tenants in West Rail stations, the Corporation extended the rent-free period to six months and adopted a rent relief scheme. To help increase traffic flow, the Corporation organised a diverse array of innovative promotional activities at its stations during the year. Many of these activities were part of the “West Rail Fun All the Way” campaign, which staged events at West Rail stations during weekends from June through December. The campaign will continue in 2005.

Station improvement works to enhance passenger services and better meet the needs of customers are underway at the Kowloon Tong and Lo Wu stations. Ten new station shops began providing food and beverage and retail services during the year.

The opening of the Tsim Sha Tsui Extension and Ma On Shan Rail offered increased space for advertising sales and added another 148 shops to the Corporation's property portfolio.

The Corporation had rented 33 out of 36 shops in East Tsim Sha Tsui Station by the end of 2004. About two-thirds of the shops in the nine stations along the Ma On Shan Rail alignment had been rented by the time the railway opened in December.

The Corporation continued to organise numerous promotional and marketing programmes in KCRC shopping centres, including a bonus point redemption system, pet shows, Olympics promotional events, and lucky draws featuring travel coupons to help tenants attract customers and build customer loyalty.

### Looking Ahead

The Corporation will invite expressions of interest on one to two property development projects each quarter for at least the next two years.

These new developments will benefit from the results of the Linear City Research Project, which will conclude in September 2005.

The two-year multi-disciplinary project, initiated by the Corporation in partnership with the Chinese University of Hong Kong and with the support of the University of Hong Kong, will help the Corporation better achieve its goals

of creating environmentally sustainable projects that improve the quality of life of their residents and the surrounding communities.

The Corporation will also unveil its on-train Passenger Information Display System in 2005. The audio/visual system's LCD monitors will provide current news, financial news, information and entertainment programmes. These new features will provide a value-added service to passengers and be an attractive option for advertisers.

Building on the success of the renovated Citylink Plaza in Sha Tin, which attracts more shoppers and boasts 100% occupancy and significantly higher yields per square foot after its improvement in 2003, the Corporation will renovate Pierhead Plaza in Tuen Mun in 2005. The new design, with an upgraded layout and façade, aims to make the centre a leading shopping, dining and entertainment destination for residents of Tuen Mun and Castle Peak Road.

# Corporate Support

The members of the KCRC's corporate support teams work to enhance the Corporation's relationships with the communities it serves and to ensure that the KCRC continues to be a caring and responsible employer and corporate citizen.





## 68 Corporate Support: Human Resource

In the past decade the Corporation's business has expanded from railway operation to include both the operation of existing railways and the design and development of new railways. The Corporation has experienced a significant expansion in staff numbers and capabilities; and it has implemented a number of organisational changes in recent years to cope with its fast expanding business.



*The Corporation's friendly staff members are its best ambassadors.*

2004 was a particularly challenging year for the Corporation in terms of staff management.

A balance of internal promotions, staff transferred between railway lines, and new employees, achieved the right mix of employees for the new railways. The new staff received detailed orientation and training to ensure that they were well equipped to perform effectively in their new jobs.

Since taking up the role of a railway developer the Corporation has established a strong project management team. Several railway projects have been completed and commissioned as operating railways, and every effort has been made to retain this cumulative project management expertise and experience by re-deploying team members to other railway projects or the new railways whenever possible. These efforts continued during 2004 as the two East Rail Extensions made the transition from projects to operating railways.

During 2004, the Project Divisions in the former Planning and Works Group were consolidated into a single Capital Projects Division to cope with changes in project development requirements. The Property Services Department was also restructured in order to facilitate top management focus on advertising and the Corporation's growing portfolio of commercial properties in both new property developments and railway stations. These organisational changes necessitated staff re-deployment at various levels and a smooth changeover was achieved through team building between various departments and open communication amongst affected staff.

### Managing Changes

During this time of change, transition, and expansion, a major challenge for human resource management has been to see that all organisational and associated staff changes do not negatively impact staff and their morale, but instead create opportunities for their personal and professional growth.

To this end the Corporation has devoted considerable effort to enhancing direct and open communication between management and staff, encouraging participation and innovation, facilitating staff training and development, and fostering teamwork and team spirit.

The negotiations between the KCRC and the MTR Corporation Limited concerning a possible merger, which began in February on the Government's invitation, inevitably and understandably gave rise to uncertainties and anxieties about the future among staff. The Corporation strived to ensure that all staff were kept well informed of the progress of the merger negotiations. Staff were encouraged to express views, ask questions, and participate in open forums with senior management. The Corporation firmly believes that transparency is important for addressing staff concerns and alleviating their worries.

### Developing KCRC People

The successful operation of the Corporation's fast expanding business would not be possible without a capable, dedicated and stable staff. Therefore one of the Corporation's priorities is the retention of this highly skilled and dedicated workforce so that

the KCRC can continue to successfully surmount challenges and adapt to changing circumstances.

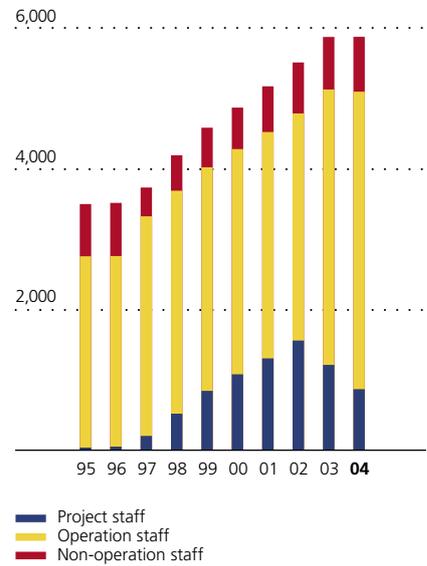
One of the Corporation's goals is to create a corporate culture of which every employee can be proud. Communication is a crucial factor in creating such an environment. To this end, the Corporation has made a concerted effort to solicit staff views, share them within management, and act on such views where appropriate.

The Corporation's response to the biennial Staff Attitude Survey, in which 92% of staff participated, demonstrated that management is concerned with the development and general well-being of staff and is committed to acting when staff feel that change is necessary.

The Corporation strives to promote an environment of continuous learning in which employees are encouraged to pursue excellence. Classroom training and e-learning programmes, together with a learning resources centre, support continuous learning as do regular business seminars on a variety of topics.

In 2004, 19 trainees who joined the Corporation three years ago as graduate trainees successfully completed their training. All were offered positions as entry-level management staff.

### Staff Numbers



### Staff Turnover



## 70 Corporate Support: Human Resource

### Staff Relations

The Corporation fully appreciates and shares staff concerns about conditions of employment and the workplace environment. During 2004, staff concerns were especially high concerning the merger negotiations. The Corporation's special programmes

to address staff concerns in this area included a Merger Staff Newsletter published regularly during the negotiations, a staff merger hotline, and regular meetings with staff and union representatives.

The first meetings of the Management Staff Consultative Committee, established to provide a two-way communication channel at the management staff level, were held during the year. The various departmental / sectional Non-Management Staff Consultative Committees also held regular meetings. Through these meetings the Corporation consults staff on management proposals on key policy issues having a direct impact on all employees and considers suggestions from staff.



*Staff can access a growing number of e-learning programmes on-line at their own convenience.*



*The Corporation received in 2004 a Good People Management Award from the Labour Department in recognition of its outstanding people management practices.*

## Corporate Support: Public Relations

In 2004 most of the Corporation's public relations activities revolved around the opening of the Tsim Sha Tsui Extension and Ma On Shan Rail, increasing West Rail patronage and boosting public confidence in our operations. The Corporation worked to enhance public understanding and use of its new services and continued its customer focused activities to reinforce its relationship with passengers. KCRC also responded to the needs of the community and supported a variety of charitable causes.



*Chairman Mr Michael Tien briefs Legislative Councillors on the Tsim Sha Tsui Extension.*

As one of Hong Kong's major public transport service providers, KCRC has many stakeholders – the public, community groups, Government, legislators and District Council members. The Corporation proactively engages in dialogues with all of these stakeholders in order to identify issues of concern and exchange views. These ongoing dialogues help the Corporation stay close to the

community and achieve its business objectives, ensuring that Hong Kong continues to be served by an efficient, responsible, caring and environmentally responsible railway company.

### Communications with Stakeholders

Over the years the Corporation has established a diverse array of communication channels with its

stakeholders to enhance public understanding and support of its services and hear the views of the people it serves.

Legislative Councillors and members of the Transport Advisory Committee and District Councils are important focuses of these communication efforts, and the Corporation's representatives attended 82 meetings of these bodies during the year. Members also toured the new railways on a number of occasions as they were being built.

In 2004, Passenger Liaison Groups for East Rail and West Rail / Light Rail continued to meet quarterly to discuss issues relating to the railways. A Public Consultation Group, composed of Managing Board Members, senior management, the chairmen of the Traffic and Transport Committees of the District Councils served by KCRC, and representatives from the Passenger Liaison Groups, also met quarterly. These groups again provided extremely useful opinions and insight on the Corporation's business, and the time and effort contributed by their volunteer members were greatly appreciated.

## 72 Corporate Support: Public Relations

The five KCRC Café sessions held at various East Rail and West Rail stations during the year provided another useful opportunity for the Corporation's management to meet passengers face to face. The Café is an important element of the Corporation's programme to continuously upgrade its services.

### The New Railways

Key consultation efforts were also focused on the new railways. The Community Liaison Groups organised by the Corporation in Ma On Shan and Tsim Sha Tsui served as valuable channels for interaction throughout the construction process and helped promote public understanding and acceptance of the new railways. The groups contributed a great deal to enhancing communication and building ties between the Corporation and the community.

Community Liaison Offices in Tai Wai, Shek Mun, Ma On Shan, and Tsim Sha Tsui also helped maintain communication with local residents and disseminated information about the services and facilities of the new railways prior to their opening. Similar offices have been established in Sheung Shui and Lok Ma Chau to facilitate communication with these communities during the construction of the Lok Ma Chau Spur Line.

### Transparency

Transparency in the Corporation's relations with its stakeholders creates effective communication and benefits everyone involved. Two newsletters, KCRC Highlights and KCRC Projects Update, keep the press, members of the public and other interested

parties informed about the latest developments in the Corporation's operations and the progress of new projects.

The Corporation informs the public and media of incidents and service delays as quickly as possible to minimise inconvenience and disturbance to passengers. All public and media complaints and enquiries are handled promptly.

### Publicity

During the year the Corporation publicised its new railways, enhanced network, and efforts to improve connectivity through a variety of media. Awareness campaigns for the Tsim Sha Tsui Extension and Ma On Shan Rail, designed to educate and inform the public, grew in size and scope in the lead up to the openings of the new railways in October and December respectively.

Roving exhibitions were also staged at major shopping malls, schools and

other locations to familiarise the public with the new extensions.

Charity rides and open days were held on both the Tsim Sha Tsui Extension and Ma On Shan Rail. Thousands of people visited the new stations during these events and a total of HK\$650,000 was raised and donated to local charitable organisations.

The year's other major publicity effort was the "West Rail Fun All the Way" campaign, which staged live events at West Rail stations on weekends from June through the end of the year. The campaign was successful in increasing traffic at the stations and has been extended into 2005.

From August to October a specially designed train decorated with Chinese characters ran on West Rail as part of an innovative public arts project entitled "Chinese Calligraphy on West Rail". A joint effort of the Corporation and the Hong Kong Academy for the Performing Arts, the project promoted Chinese calligraphy and enhanced

*Dancers from the Hong Kong Academy for the Performing Arts performed on board West Rail trains as part of a joint community arts programme.*





*The 200 members of the Corporate Volunteer Team donate their free time to helping others.*

public interest in the arts. Dancers from the Academy also performed on board the train several times.

### Contributing to the Community

Being a responsible corporate citizen has always been one of the Corporation's guiding principles, and 2004 was an especially memorable year for the Corporation in this respect.

The launch of the KCRC Corporate Volunteer Team in June inaugurated a new era in KCRC volunteering. More than 210 KCRC staff, along with their family members and friends, have joined the team, which in its first six months contributed more than 1,300 hours of service to the community.

In June the Hong Kong Red Cross Blood Transfusion Service presented its Special Merit Award to the Corporation in recognition of its three decades of support. Each year the Corporation hosts blood donation drives at its stations, and thousands of staff and

passengers have donated blood at these activities over the years.

In November the Corporation became one of the first participants in the Po Leung Kuk House Corporate Sponsorship Programme. Po Leung Kuk provides housing and other services for children who cannot stay at their own homes. As part of the new relationship the Corporate Volunteer Team will be regularly involved with the children through visits and activities.

The Corporation also continued its long-running support of The Community Chest and participated in numerous Community Chest events during the year, including the Chest's Green Day and Skip Lunch Day. In recognition of the overall donations made in 2003/2004, the Corporation received a President's Award.

Other charitable events in which the Corporation was involved included the Standard Chartered Hong Kong Marathon, the "Every Step Counts"

Social Inclusion Campaign, the Outward Bound Boundabout Corporate Challenge 2004, the Access-free Orientation Competition of The Hong Kong Society for Rehabilitation, and charity walks staged by a number of non-governmental organisations.

To honour Hong Kong's 14 Olympic and Paralympic athletes who won medals at the 2004 Games, the Corporation awarded them lifelong passes for free travel on East Rail, West Rail and Light Rail.

A fund-raising campaign following the tsunami catastrophe raised HK\$1.45 million: KCRC employees and their relatives and friends donated HK\$800,000, while the Corporation contributed HK\$200,000 and also donated the HK\$447,015 in fare revenue collected during the extended New Year's Eve service hours.

## 74 Corporate Support: Quality Management

As the Corporation's new railway lines become operational and its business expands, a new perspective on managing future needs is required.



*The Corporation's "Change for Better" teams work to identify areas where change is required.*

In July 2004 the Corporation's top management, including the Chief Executive Officer (Acting), all Directors, Department Heads, and some Section Heads, held a two-day Corporate Management Workshop to reflect on the Corporation's vision, values, strategies and goals, and the ways in which the Corporation should move forward.

During the workshop, a consensus emerged that a renewed commitment to the "KCRC Way", which places people firmly at the centre of the Corporation, was the best way for the Corporation to move forward in certain vital areas. These areas included improving organisational effectiveness, fostering a more participative management style, promoting teamwork and commitment,

recognising good performance, and working to create an environment in which all staff are empowered to achieve their full potential.

To succeed, the "KCRC Way" must take root throughout the Corporation. Similar management workshops were therefore held within every division in the Corporation. At the workshops staff were encouraged to identify issues within their division, seek out the root causes of these issues, and generate ideas and action plans to tackle them.

Three inter-departmental and cross-functional "Change for Better" teams: Quality & Processes, Employee Involvement, and Career Development are also studying ways to address these issues and bring about a change in the Corporation's culture. The teams, and the newsletter describing their work, also help foster this culture of change and questioning of the status quo.

Continuous improvement is a cornerstone of the Corporation's integrated management system, which combines the requirements of quality (ISO 9001), environment (ISO 14001), and safety. This process of improvement has accelerated as a result of the management workshops, which, among other things, are streamlining processes across the Corporation and further improving efficiency and productivity.

The valuable project management experience gained in completing West Rail has been captured and developed in the Corporation's integrated management system to help it better manage capital projects. The success of this system can be seen in the fact that the Tsim Sha Tsui Extension and Ma On Shan Rail were both completed on schedule and within budget.

This project management expertise, and the experience in handling community relations and input relating to new projects, will be transferred to the Corporation's new railway projects.

In line with the renewed emphasis on encouraging staff participation and input at all levels, the Corporation's staff suggestion scheme reward system was significantly changed and re-launched as the 'Ideas-hub'. The new scheme offers two rewards to staff members who submit suggestions: one when a good idea is received, and another awarded a year after the idea's implementation. The second reward is calculated according to the savings generated by the suggestion.

KCRC continues to share its successes with others and participated in Hong Kong's 8th Quality Improvement and Experience Sharing Convention. The Corporation and a host of Hong Kong's leading companies gathered to share their successes and learn from each other's experiences at the November convention.

# The Environment

The Corporation's work on the Ecological Enhancement Area near Lok Ma Chau Station typifies the respect and concern for the environment incorporated into all its planning and operational processes.





## The Environment

KCRC incorporates environmental considerations into every aspect of its operations and project management activities and provides an environmentally friendly transport system for Hong Kong's present and future transportation needs. The Corporation cares for the environment and will continue to further improve its environmental performance.



*Over 200 species of birds, including several endangered species, have been sighted at the wetlands recreated by the KCRC.*

The Corporation's Environmental Steering Committee is responsible for formulating and implementing environmental programmes, monitoring the Corporation's environmental performance and advising on improvement actions where necessary. In a move to expand environmental initiatives throughout the Corporation, the Committee was reformed and expanded in July.

In September the Corporation joined the Government's Environmental Protection Department Wastewi\$e Scheme which encourages companies to reduce the amount of waste they generate by setting clear waste avoidance and reduction targets, collecting and recycling materials, and purchasing environmentally friendly materials.

The Corporation has set 14 targets for the coming year, including measures aimed at the use of office items, paper, toner, the company's internal magazine, plastics, clothing, mobile phones, safety helmets and old spectacles. The Corporation will also continue to donate used computers to worthy causes. In April almost 250 surplus computers were donated to the Salvation Army's "Digital Inclusion Action" programme for members of the community who are unable to afford computers of their own.

### Improvement Initiatives

Environmental improvements in our operations and new projects continued, with the Transport Division, created in late 2003, aiming to consolidate its five existing ISO 14001 certificates into one divisional certificate in 2005.

Five new environmentally friendly diesel locomotives entered service on East Rail during the year, replacing

five older diesel locomotives. The new locomotives incorporate features that significantly cut exhaust emissions and reduce fuel consumption. The locomotives also generate less noise.

As part of the Corporation's retrofitting programme all buses with pre-Euro standard engines and all Euro I standard engine buses have now been retrofitted with catalytic converters.

Measures to further reduce the noise emitted by Light Rail vehicles, such as the use of headlub, a specially formulated environmentally friendly lubricant, are being studied.

In the first quarter of 2004 West Rail conducted an extensive study on energy saving opportunities at all of its stations. During the second quarter refinements were introduced in station temperature and lighting control, escalator use during non-peak periods and the switching off or transferring of ticket-vending and add-value machines to other KCR stations.

### New Projects

All construction projects are continually monitored and regularly audited according to our three-tier environmental management system to meet our environmental requirements as well as the Government's.

In conjunction with West Rail's opening a weekly noise monitoring programme was set up to monitor and check the railway's noise levels. Monitoring was subsequently reduced to monthly and then half-yearly intervals as no railway noise levels exceeding Hong Kong's stringent statutory limits had been recorded – evidence that the innovative combination of noise reduction measures adopted by the Corporation is effective.

## The Environment



*The "Greening Ma On Shan Rail" campaign attracted support from many sectors of the community – including these budding environmentalists.*

Work on the Corporation's Ecological Enhancement Area near Lok Ma Chau Station began in June 2002 and is expected to finish in December 2006. The 37-hectare recreated habitat includes fishponds, reedbeds and marshlands for breeding and roosting birds.

Though work is still on-going, the changes in design, high availability of food, and low levels of human disturbance have attracted very high numbers of wildlife species, especially birds, to the enhanced wetlands.

Over 200 species of birds have been spotted in the area, among them nearly half of the species ever recorded in Hong Kong and two endangered and four vulnerable species. At one point more than 10% of the worldwide population of the highly endangered Black-faced Spoonbill was in the wetlands. More species of birds and other animals are expected to visit or make the wetlands their home as the habitats become mature.

The success of the Ecological Enhancement Area, created, along with the Environmental Committee, as a condition of the Spur Line's Environmental Permit, is heartening. The Environmental Committee, which meets quarterly to review and monitor the Corporation's environmental performance, is composed of members from the Corporation and green groups including Friends of the Earth, the World Wide Fund for Nature, and the Hong Kong Bird Watching Society.

The successful results are in large part due to the experience gained in public outreach efforts during West Rail and the other East Rail Extensions projects, leading to the Corporation's approach of promoting Continuous Public Involvement – working together with concerned parties throughout the design and construction process; bringing all concerned into the process from the very beginning.

### Environmental Activities

KCRC holds or supports numerous environmental activities each year. In 2004, for example, the Corporation launched the "Greening Ma On Shan Rail" tree planting campaign in which members of the Ma On Shan community and volunteers from the Corporation planted 6,000 trees along the railway. The Corporation also supported the Community Chest's Green Day programme by providing free unlimited travel tickets, valid for that day, to people who donated money to the event.

The Corporation held its biennial Safety, Health and Environment Week to raise staff awareness and enhance work practices in these three areas. The week's activities included talks by representatives from the Labour Department, the Environmental Protection Department and the MTR Corporation Limited, competitions, and an eco-trip to the Yan Chau Tong Marine Park.

## Investment and Financing Strategies

In 2004 the Corporation entered into a HK\$8 billion credit facilities agreement with 18 local and international banks, and further expanded its self-managed investment portfolio.



*In September the Corporation arranged a syndicated loan of HK\$8 billion with 18 local and international banks.*

### Financing

The Hong Kong dollar inter-bank market remained extremely liquid in 2004, resulting in record low interest rate levels and credit margins. The Corporation seized the favourable market opportunity and self-arranged a HK\$8 billion syndicated loan in 2004 with a syndicate of 18 banks. The loan comprised a five-year, seven-year and ten-year tranche at competitive margins. The syndicated loan marked the Corporation's return to the local

banking market and the ten-year tranche served as a benchmark for other quality borrowers in Hong Kong. The committed loan facility and cash on hand will be sufficient to cover all expected Corporation needs including capital expenditure over the next several years.

In 2004, Standard & Poor's and Moody's affirmed the credit ratings of the Corporation at the same level as those of the Hong Kong SAR Government.

## Investment and Financing Strategies

### Credit Ratings

	2004
<b>Standard &amp; Poor's</b>	
Short-term local currency corporate credit rating	<b>A-1+</b>
Short-term foreign currency corporate credit rating	<b>A-1</b>
Long-term local currency corporate credit rating	<b>AA-</b>
Long-term foreign currency corporate credit rating	<b>A+</b>
<b>Moody's</b>	
Short-term rating	<b>P-1</b>
Issuer rating – domestic currency	<b>Aa3</b>
Issuer rating – foreign currency	<b>A1</b>

*The credit ratings for the Corporation assigned by Standard & Poor's and Moody's are at the same level as those of the Hong Kong SAR Government.*

As at 31 December 2004, the Corporation had interest-bearing borrowings of HK\$19,748 million, with an average maturity of five years. The average cost of borrowing was 6.5% in 2004.

### Investment

In May 2004, the Corporation took over the management of the bond funds from two external investment managers, thereby substantially increasing its self-managed portfolio.

Despite the continuous disbursement of cash to meet capital expenditure,

the Corporation still managed a significant portfolio. As at 31 December 2004, the Corporation's cash and cash equivalents and investments in securities amounted to HK\$7,854 million. During the year, a net income of HK\$170 million was generated from these investments. About 28% of the funds were managed by external managers and the remainder was invested by the Corporation's Treasury Department in a diversified portfolio of bank deposits and fixed income instruments. All investments were of investment-grade quality.

### Debt Facilities and Programmes

	2004 (HK\$ million)		2003 (HK\$ million)	
	Drawn	Undrawn	Drawn	Undrawn
Medium term note programme	<b>8,998</b>	<b>14,425</b>	8,985	14,399
Global notes	<b>7,807</b>	–	7,794	–
Retail notes	<b>1,000</b>	–	1,000	–
Export credit loan facilities	<b>1,985</b>	<b>29</b>	2,253	51
Syndicated loan facilities	–	<b>8,000</b>	–	–
Bank overdraft facilities	–	<b>25</b>	–	25
Letters of credit	–	<b>20</b>	–	20
Letters of credit for leveraged leases	–	<b>2,280</b>	–	2,276
Uncommitted short-term facilities	–	<b>1,650</b>	–	2,350
<b>Total</b>	<b>19,790</b>	<b>26,429</b>	20,032	19,121

### Investments Managed by Investment Managers and KCRC

	2004 (HK\$ million)	2003 (HK\$ million)
<b>Investment managers</b>		
Fixed income portfolios	2,227	11,054
<b>KCRC</b>		
Cash and cash equivalents	3,531	2,677
Certificates of Deposit	–	37
Bonds issued by financial institutions	–	1,153
Deposits placed with custodian bank	2,096	–
<b>Sub-total</b>	<b>5,627</b>	3,867
<b>Total</b>	<b>7,854</b>	14,921

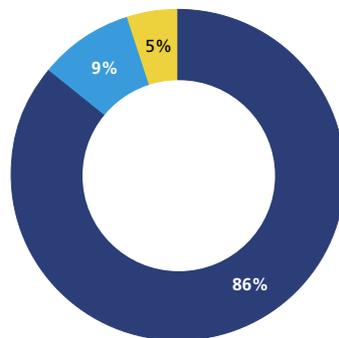
### Risk Management

The Corporation continued to manage its currency and interest rate risks using off-balance sheet financial derivative instruments in the form of interest rate swaps, currency swaps and foreign exchange forward contracts. All these instruments were contracted on a prudent basis in accordance with the Managing Board's approved hedging policy and guidelines and have been employed only for hedging purposes.

In order to maintain a balanced and risk-averse debt profile, the Corporation seeks to hedge its foreign currency borrowings into either Hong Kong dollars or US dollars and limit its US dollar exposure to no greater than 30% of its total borrowings. Moreover, the Corporation aims to maintain the proportion of its fixed interest rate debt between 30% and 75%.

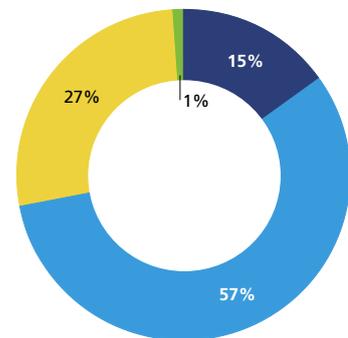
As at 31 December 2004, the proportion of borrowings denominated or hedged into Hong Kong dollars stood at 87% (2003: 87%). The proportion of fixed interest rate borrowings stood at 75% (2003: 66%).

### Maturity Profile of Investments



■ Less than six months  
■ Six months but less than one year  
■ One year but less than two years

### Composition of Investments by Credit Quality



■ AAA  
■ AA  
■ A  
■ BBB

# Financial Review

KCRC is a well-managed and long-established corporation with an excellent operational and financial record. It is charged with two main duties: to provide high quality transportation and related services, and to operate with commercial prudence.

## Profit and Loss

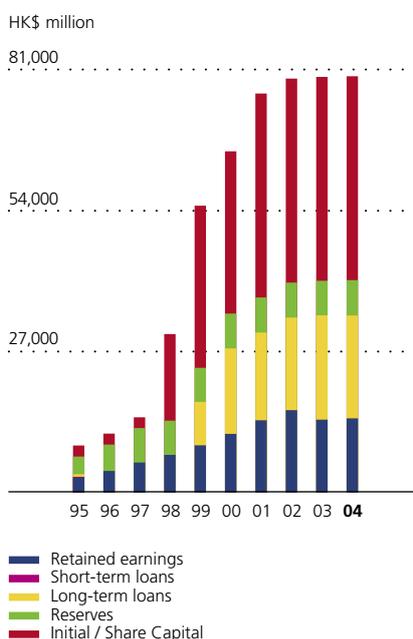
Transport revenue increased by 12.1% to HK\$4,281 million, compared with HK\$3,819 million in 2003 mainly because of the recovery from the impact of SARS and the full year operation of West Rail, partly offset by loss of cross-boundary market share to road-based modes of transportation.

Commercial revenue for 2004 from the leasing of shopping centres and office space, estate management, telecommunications, advertising, station kiosks and shops increased by 14.5% to HK\$695 million from

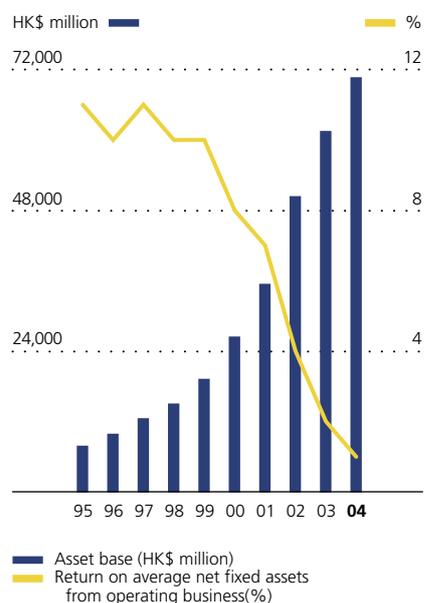
HK\$607 million in 2003, mainly as a result of the expiry of the Rent Relief Scheme introduced during the SARS period and the opening of new station shops at West Rail, East Tsim Sha Tsui Station and Ma On Shan Rail.

Operating costs before depreciation for 2004 increased by 31.8% to HK\$2,807 million from HK\$2,129 million in 2003, mainly because of the full year operation of West Rail. Staff costs increased by 21.9% to HK\$1,464 million from HK\$1,201 million in 2003, energy costs rose by 68.3% to HK\$456 million from HK\$271 million, maintenance costs grew by 31.6% to

## Capital Structure



## Assets



HK\$371 million from HK\$282 million in 2003, and other expenses increased by 37.6% to HK\$516 million from HK\$375 million in 2003.

Operating profit before depreciation, net finance expenses/(income) and before tax declined by 5.6% to HK\$2,169 million in 2004, compared with HK\$2,297 million in 2003.

The operating margin before depreciation and net finance expenses/(income) decreased from 51.9% in 2003 to 43.6% in 2004.

Depreciation increased by 118.2% to HK\$1,632 million from HK\$748 million in 2003 mainly for West Rail, the Tsim Sha Tsui Extension, and Ma On Shan Rail.

Net finance income of HK\$353 million in 2003 became net finance expenses of HK\$41 million in 2004, mainly because finance expenses related to West Rail, the Tsim Sha Tsui Extension,

and Ma On Shan Rail could no longer be capitalised following the opening of these new railways.

A share of profit of an associate of HK\$16 million was recognised in the year, compared with HK\$8 million in 2003.

Deferred tax in the amount of HK\$82 million was recognised in 2004, compared with HK\$528 million in 2003.

Net profit after tax was HK\$429 million, a 68.9% reduction compared with HK\$1,381 million in the previous year.

The Corporation achieved a return on net fixed assets of 0.6%, which was 1.6% lower than the return of 2.2% achieved in 2003. This was attributable primarily to a reduced profit coupled with a higher asset base with the commencement of operation of West Rail, the Tsim Sha Tsui Extension, and Ma On Shan Rail, and the construction

works of the Lok Ma Chau Spur Line, which has not been put into revenue operations.

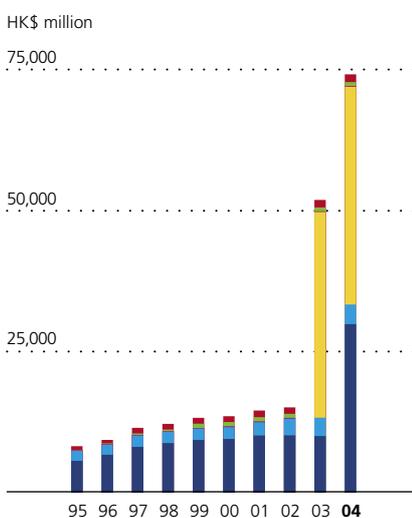
## Capital Expenditure

Capital expenditure decreased by 18.9% from HK\$11,122 million to HK\$9,022 million mainly because of the completion of West Rail in December 2003. The capital expenditure of 2004 was mainly for the construction of the Tsim Sha Tsui Extension and Ma On Shan Rail, the wrap up of West Rail contracts, investment to cater for replacement of aged assets, and safety and environmental improvements.

## Cash Flow

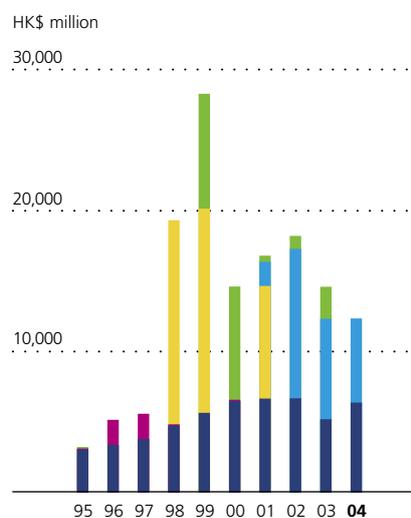
The net cash flow before financing increased from an outflow of HK\$2,497 million in 2003 to a cash inflow of HK\$2,282 million in 2004, mainly due to the completion of West Rail. As a result, loan drawdown was not

## Net Fixed Assets



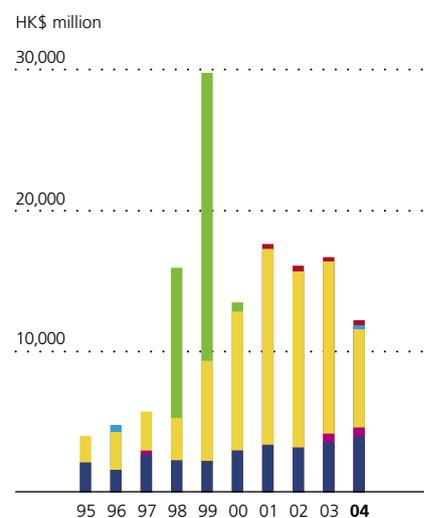
East Rail  
Light Rail  
West Rail  
Bus  
Freight  
Property

## Cash Inflow



Recurrent revenue  
Non-recurrent revenue  
Share capital  
Investments and deposits  
Loans

## Cash Outflow



Operating costs & tax  
Dividends  
Capital expenditure  
Loan repayments  
Investments and deposits  
Non-recurrent expenditure

## Financial Review

required in 2004. After including interest and dividend payments and cash flows of other financing activities, there was a net cash inflow of HK\$114 million for the year compared to a net cash outflow of HK\$2,108 million for 2003.

### Transport

East Rail revenue increased 4.6% from HK\$3,266 million to HK\$3,415 million in the year, mainly due to the recovery in patronage after the impact of SARS and the opening of the Tsim Sha Tsui Extension, partly offset by loss of cross-boundary market share to road-based transportation.

West Rail completed its first full year of operations and contributed revenue of HK\$382 million in the year.

Light Rail revenue was HK\$416 million in 2004, a decrease of 11.1% from HK\$468 million in 2003, mainly due to lower Light Rail feeder bus revenue as

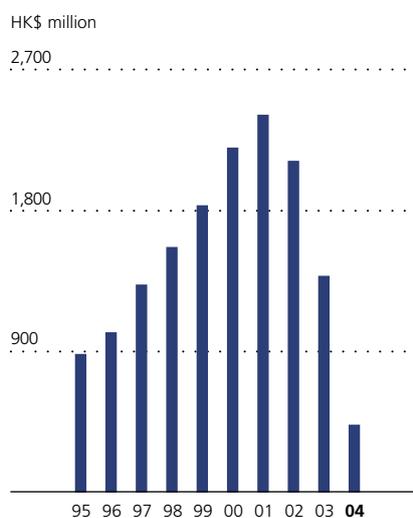
a result of the rationalisation of feeder bus service upon West Rail's opening in late 2003.

Freight revenue decreased by 8.1% to HK\$68 million in 2004 from HK\$74 million in 2003, mainly due to decreases in rail freight traffic, forwarding business and terminal services revenue.

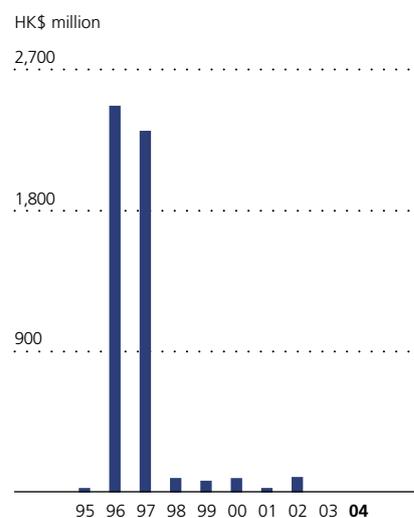
As a result, transport revenue, including fare and non-fare revenue, increased by 12.1% to HK\$4,281 million, compared with HK\$3,819 million in 2003.

Operating costs before depreciation, after allocation of corporate expenses, increased by 35.2% to HK\$2,622 million from HK\$1,939 million in 2003, mainly due to the full year operation of West Rail and the opening of the Tsim Sha Tsui Extension and Ma On Shan Rail. Profit generated from the Corporation's transport business before depreciation, after allocation of corporate expenses, dropped by 11.8%

### Profit from Operating Businesses



### Profit on Property Development



to HK\$1,659 million from HK\$1,880 million in 2003. Depreciation increased by 123.0% to HK\$1,601 million from HK\$718 million in 2003. As a result, transport profit after depreciation dropped by 95% to HK\$58 million from HK\$1,162 million in 2003.

Capital expenditure was HK\$416 million, which was 55.7% lower than the HK\$940 million spent in 2003, mainly because of the gradual completion of the facilities improvement works at Lo Wu Terminal, replacement of diesel locomotives, completion of grade separation works at LRT junction and the replacement of the Light Rail vehicle information system, and wrap up of works on Light Rail Extensions in Tin Shui Wai.

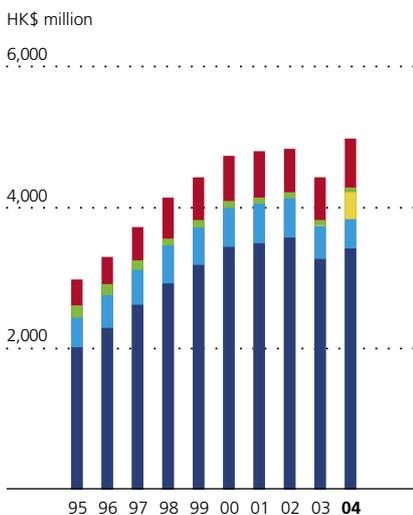
**Property**

Commercial revenue increased to HK\$695 million, up 14.5% from HK\$607 million in 2003, mainly as a

result of the expiry of the Rent Relief Scheme for SARS and the opening of new station shops at West Rail, and East Tsim Sha Tsui Station. Total operating costs before depreciation, after allocation of corporate expenses, decreased by 2.6% to HK\$185 million from HK\$190 million in 2003. Profit generated from the Corporation's property related business before depreciation, after allocation of corporate expenses, was HK\$510 million, an increase of 22.3% from HK\$417 million in 2003. Depreciation increased by 3.3% to HK\$31 million from HK\$30 million in 2003. Property related profit after depreciation was HK\$479 million, an increase of 23.8% from HK\$387 million in 2003.

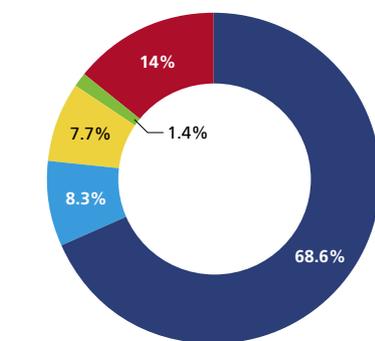
Capital expenditure was HK\$61 million, compared with HK\$70 million in 2003. The decrease was mainly due to the substantial completion of mobile phone system installation and renovation of commercial premises in 2003.

**Recurrent Revenue**



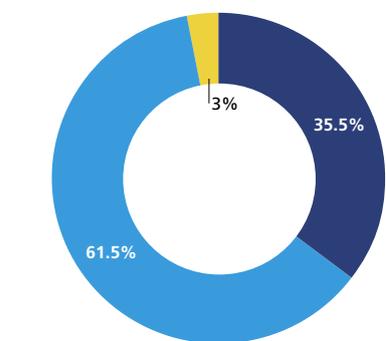
- East Rail
- Light Rail
- West Rail
- Freight
- Property

**Total Share of Recurrent Revenue**



- East Rail
- Light Rail
- West Rail
- Freight
- Property

**Share of East Rail Recurrent Revenue**



- Domestic service
- Cross-boundary service
- Through train service

## Report of the Members of the Managing Board

The Members of the Managing Board have pleasure in submitting herewith the report and audited financial statements for the financial year ended 31 December 2004.

### Kowloon-Canton Railway Corporation Ordinance

The Kowloon-Canton Railway Corporation Ordinance was enacted in 1982 to establish the Corporation and empower it to operate the Kowloon-Canton Railway. Amendments in 1986 and 1998 empowered the Corporation to construct and operate Light Rail and new railways, and enabled the Government to inject equity into the Corporation to fund the construction of such new railways. Inter alia, the Ordinance contains provisions covering the appointments and roles of the Members of the Managing Board.

On 24 December 2001, the Kowloon-Canton Railway Corporation (Amendment) Ordinance 2001 was enacted. The amendment provided for the separation of the functions and duties of the Chairman from those of the Chief Executive by creating the office of Chief Executive Officer of the Corporation. The Chief Executive Officer was also appointed as a Member of the Managing Board.

### Principal Activities of the Corporation

The principal activities of the Corporation are :

- the operation of a railway system between Kowloon (East Tsim Sha Tsui Station) and Lo Wu, between Tuen Mun and Nam Cheong and between Tai Wai and Wu Kai Sha
- the operation of cross-boundary passenger and freight services in association with Mainland railway authorities
- the operation of the North West New Territories light rail system
- the detailed planning, design and construction of extensions to the current railway system
- the development of associated commercial activities, including the sale of advertising space, the marketing of concessions and property leasing
- the development of property
- the operation of feeder bus services
- the principal activities of the subsidiary companies are set out in Note 13 to the financial statements

### The Managing Board

The Board is the governing body of the Corporation with authority to exercise the duties conferred upon it by the Kowloon-Canton Railway Corporation Ordinance. The Board comprises the Chairman and eight members, all of whom are appointed by the Chief Executive of the Hong Kong Special Administrative Region, and the Chief Executive Officer, who is appointed by the Corporation subject to the prior approval of the Chief Executive of the Hong Kong Special Administrative Region.

During the year under review, Members of the Board who served were Mr Michael Tien (Chairman), Mr Samuel M H Lai (Chief Executive Officer (Acting) – appointed 1 January 2004), Mr Vincent Cheng Hoi-chuen (retired on 15 November 2004), Mr Vincent Lo Wing-sang, Mr Frederick Ma Si-hang (the Secretary for Financial Services and the Treasury), Dr Sarah Liao Sau-tung (the Secretary for the Environment, Transport and Works), Mr Wan Man-ye, Mr Patrick B Paul, Mr Patrick Wang Shui-chung (resigned on 31 January 2004), Mr Victor So Hing-woh (resigned on 31 January 2004), Professor Richard Wong Yue-chim (appointed 1 February 2004), The Honourable Abraham Shek Lai-him (appointed 1 February 2004) and Mr Ng Leung-sing (appointed 16 November 2004). Brief biographical details of Board Members are set out on pages 8 and 9.

The Board meets regularly each month save for August, the summer recess, and on an ad hoc basis when appropriate. It is responsible, inter alia, for overall corporate strategy, acquisition and divestment policy, approval of the Corporation's annual budget, major financing arrangements, passenger fares and freight charges, and for ensuring that sound administrative systems and procedures are in place. It also reviews monthly the Corporation's operating results, safety record, and the progress made towards annual targets. The Board has delegated to the Chief Executive Officer the authority for the management of day-to-day operations.

Several committees have been formed to oversee specific aspects of the Corporation's operations and to make appropriate recommendations to the

Managing Board for decision. These committees, with the exception of the Audit Committee, are served by a number of Expert Members, each being appointed for a term of one year. These experts serve in an advisory capacity. Appointed to the Capital Projects Committee are Dr Greg Wong Chak-yan, a consulting civil engineer; Ir Teresa Cheng Yeuk-wah, a Senior Counsel (resigned on 27 September 2004); Ir Daniel M Cheng, an environmental industrialist (retired on 31 January 2004); Mr Wan Man-lung, Principal Government Engineer, Rail Development; Dr Hung Wing-tat (appointed 10 February 2004), an Associate Professor of Civil Engineering of the Hong Kong Polytechnic University; Miss Jennifer Lee-shoy, a lawyer specialising in Construction Law (appointed 20 December 2004); and Mr Ernest Kwok Shiu-keung, a lawyer and civil engineer (appointed 20 December 2004). Appointments to the Strategic Human Resource Committee included Mrs Paula Ko Wong Chau-mui, a senior human resource executive of a major bank; and Mrs Anita To Yu Ming-chi, a general manager of a multinational company. Appointed to the Property Committee, Mr Philip Nunn, a lawyer with special expertise in construction and arbitration, and appointed to the Finance Committee, Mr Alfred Li Hung-kwan, a retired Chartered Accountant and company executive director. With the exception of those newly appointed and those who retired or resigned in 2004, all the Expert Members have recently had their appointments renewed for a further one year.

The appointment of these Expert Members, who are not Members of the Managing Board, is intended to strengthen the role of the various

committees in advising the Managing Board. The various committees are described in the following paragraphs:

### The Audit Committee

This Committee reviews the Corporation's annual financial statements prior to their submission for approval by the Board, monitors accounting policies, considers matters relating to management and internal controls and receives and appraises reports from the internal and external auditors. Mr Patrick B Paul chairs this Committee.

The Corporation's Internal Audit Department reviews the internal controls of all major financial and operational activities and reports to the Audit Committee.

### Capital Projects Committee

This Committee keeps under review and makes recommendations to the Managing Board on subjects relating to all major capital projects undertaken by the Corporation, excluding property development projects. Mr Wan Man-ye chairs the Capital Projects Committee.

### The Strategic Human Resource Committee

This Committee reviews and makes recommendations to the Board with respect to the appointments and terminations of appointment and remuneration of the Chief Executive Officer, Executive Directors who are not Members of the Managing Board and those Senior Executives who report directly to the Chief Executive Officer. It also recommends to the Board the appropriate levels of remuneration for all staff. Mr Michael Tien chairs this Committee.

## Report of the Members of the Managing Board

### The Property Committee

The Property Committee oversees all property development matters and considers any proposals to generate additional revenue from the land and property held by the Corporation, and through the Corporation the purchase of commercial properties constructed in conjunction with its new railway projects. Mr Vincent Lo Wing-sang chairs this Committee.

### The Finance Committee

The Finance Committee deals with the investment of surplus funds, financing arrangements generally and advises the Managing Board on the Corporation's strategies for the financing of future major capital projects. The Corporation's Treasury Department, which reports to the Finance Committee, operates within a set of strategies, policies and guidelines, which are defined by the Managing Board to cover funding, cash investment, and risk management. Professor Richard Wong Yue-chim replaced Mr Vincent Cheng Hoi-chuen as the Chairman of this Committee on 22 November.

### Long-term Planning, Business Planning and Financial Management Framework

Business plans, incorporating triennial forecasts of income and expenditure, are prepared each year for submission to the Managing Board. Once approved, the first year of the Business Plan forms the basis for formulating the Budget for that year.

There are defined procedures and regular quality reviews of the operation of the Corporation's computerized systems to ensure the accuracy and completeness of financial records

and the efficiency of data processing. There are defined procedures for the appraisal, review and approval of all major capital, recurrent and revenue contracts. All contracts over HK\$50 million and all consultancy services over HK\$10 million require the approval of the Managing Board. Operating and financial reports, comparing results against their respective budgets and providing updates on significant events, are delivered to the Managing Board on a monthly basis.

### Corporate Governance

The Managing Board maintains high standards of corporate governance. It supports the principles of good corporate governance contained in the Cadbury Committee's Code of Best Practice and requires that these be followed by the Corporation to the extent that they are applicable to it, given that it is a statutory and unlisted body. Although not required to do so, the Corporation has complied throughout the year with the Code of Best Practice as set out by The Stock Exchange of Hong Kong Limited in Appendix 14 to the Listing Rules, except for item 12 which states that "If an independent Non-executive Director resigns or is removed from office, the Exchange should be notified of the reason why" and which is not applicable to the Corporation. The Corporation shall adopt The Stock Exchange of Hong Kong Limited's new Code on Corporate Practices when it comes into effect on 1 July 2005. It is the Corporation's policy to be responsive to key stakeholders, the Government and its customers and to ensure that its business transactions are transparent.

The Corporation has since 2003 adopted a code of ethics that complies with Section 406 of The Sarbanes-Oxley Act of 2002 and Items 406 and 601 of the Securities and Exchange Commission Regulation S-K. The code applies to all Senior Financial Officers of the Corporation, which comprise its Chief Executive Officer, Director-Finance, General Manager-Financial Control and General Manager-Corporate Treasury, as well as to any other person performing similar functions.

### Memberships of the Managing Board, its Committees and Executive Directors who are not Members of the Managing Board

Details of the Members of the Managing Board, members of Committees and Executive Directors who are not Members of the Managing Board, for the year are listed on pages 8 to 11.

### Interests in Contracts of Members of the Managing Board, Expert Members of Committees and the Executive Directors who are not Members of the Managing Board

No contracts of significance to which the Corporation or any of its subsidiaries was a party and in which a Member of the Managing Board, or Expert Members of Committees and Executive Directors who are not Members of the Managing Board, had a material interest subsisted at the end of the year or at any time during the year.

At no time during the year was the Corporation or any of its subsidiaries a party to any arrangements to enable Members of the Managing Board, or Expert Members of Committees

and Executive Directors who are not Members of the Managing Board, to acquire benefits by means of the acquisition of shares in or debt securities of the Corporation or any body corporate.

### Customers and Suppliers

Turnover attributable to the five largest customers of the Group (which comprises the Corporation and its subsidiaries) accounted for less than 30% of the total turnover of the Group for the year. Purchases attributable to the five largest suppliers of the Group accounted for less than 30% of the value of the Group's total purchases for the year.

### Financial Statements

The results of the Group for the year ended 31 December and the state of affairs of the Corporation and of the Group at that date are set out in the financial statements on pages 94 to 146. To facilitate better understanding by overseas readers of the basis upon which the financial statements are prepared, supplementary information for the difference between accounting principles generally accepted in Hong Kong and the United States is set out on pages 147 to 154, which is subject to audit by the external auditors.

### Fixed Assets

Movements in fixed assets during the year are set out in Note 9 to the financial statements.

### Share Capital

Details of the Corporation's share capital are set out in Note 28 to the financial statements. Any further contributions of capital will be determined by the Government in consultation with the Corporation.

### Dividend

Details of the Corporation's proposed dividend to the Government are set out in Note 7 to the financial statements.

### Retirement Benefit Scheme

Details of the Corporation's retirement benefit scheme are set out in Note 36 to the financial statements.

### Capitalised Finance Income/Expenses

Details of the Corporation's capitalised finance income/expenses are set out in Note 4 to the financial statements.

### Interest-bearing Borrowings

Details of the Corporation's interest-bearing borrowings are set out in Note 26 to the financial statements.

### Turnover, Financial Results and Financial Position

Details of the Corporation's turnover, financial results and financial position are set out in Note 3 to the financial statements, the Chief Executive Officer's Statement, Financial Review and Ten-year Statistics of the annual report.

### Donations

Donations made during the year amounted to HK\$1,277,680 (2003: HK\$482,018). Donations include HK\$661,707, being revenue paid to charities from Ma On Shan Rail and Tsim Sha Tsui Extension charity rides.

### Going Concern

The financial statements on pages 94 to 146 have been prepared on a going concern basis. The Board has approved the Corporation's budget for 2005 and is satisfied that the Corporation can operate in a viable manner for the foreseeable future.

### Responsibility for the Financial Statements

The Kowloon-Canton Railway Corporation Ordinance requires the Corporation to produce financial statements. In doing so, the Corporation complies with all applicable Hong Kong Financial Reporting Standards (which include all applicable Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong, the disclosure requirements of the Hong Kong Companies Ordinance and the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited, and produces financial statements that give a true and fair view of the Corporation's financial results and position for the financial year to which they relate.

### Auditors

In accordance with section 14B (4) of the Kowloon-Canton Railway Corporation Ordinance, KPMG were appointed as auditors by the Chief Executive of the Hong Kong Special Administrative Region.

By order of the Managing Board  
**David Fleming**  
*Company Secretary*  
 28 February 2005

## Auditors' Report

### Auditors' report to the Members of the Managing Board of the Kowloon-Canton Railway Corporation

We have audited the financial statements on pages 94 to 146 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

#### Respective Responsibilities of the Corporation and Auditors

The Kowloon-Canton Railway Corporation Ordinance requires the Corporation to prepare financial statements and the Corporation has resolved to prepare financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion solely to you, as a body, in accordance with section 14B(3) of the Kowloon-Canton Railway Corporation Ordinance, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

#### Basis of Opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis,

of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Corporation in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Corporation's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

#### Opinion

In our opinion, the financial statements give a true and fair view of the state of affairs of the Corporation and of the Group as at 31 December 2004 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

#### KPMG

*Certified Public Accountants*  
Hong Kong  
28 February 2005

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## Consolidated Income Statement

for the year ended 31 December 2004 (Expressed in Hong Kong dollars)

	Note	2004 \$ million	2003 \$ million
<b>Turnover</b>	3(a)	<b>4,976</b>	4,426
Operating costs before depreciation	3(b)	<b>2,807</b>	2,129
Operating profit before depreciation		<b>2,169</b>	2,297
Depreciation	3(c)	<b>1,632</b>	748
Operating profit before net finance income/(expenses)		<b>537</b>	1,549
Net finance income/(expenses)	4	<b>(41)</b>	353
Profit after net finance income/(expenses)		<b>496</b>	1,902
Share of profit of associate		<b>16</b>	8
<b>Profit before taxation</b>		<b>512</b>	1,910
Income tax	5(a)	<b>(83)</b>	(529)
<b>Profit after taxation</b>	6	<b>429</b>	1,381
<b>Dividend attributable to the year:</b>			
Final dividend proposed after the balance sheet date	7	<b>172</b>	620

## Consolidated Balance Sheet

at 31 December 2004 (Expressed in Hong Kong dollars)

	Note	2004 \$ million	2003 \$ million
<b>Assets</b>			
Fixed assets	9		
– Investment properties		1,026	878
– Other properties, plant and equipment		66,766	50,979
		<b>67,792</b>	51,857
Construction in progress	10	6,991	15,101
Deferred expenditure	11	1,462	900
Properties under development	12	1,892	1,448
Interest in associate	14	57	42
Loan receivable	15	733	774
Loan to subsidiary	16	3,576	3,232
Investments	17	4,323	12,244
Stores and spares	18	319	254
Interest receivable	19	49	63
Other receivables	20	707	612
Cash and cash equivalents	21	3,531	2,677
		<b>91,432</b>	89,204
<b>Liabilities</b>			
Interest payable	22	485	474
Other payables	23	2,444	2,098
Accrued charges and provisions for capital projects	24	3,971	1,782
Lease payable	25	717	758
Interest-bearing borrowings	26	19,748	20,013
Deferred income	27	708	743
Deferred tax liabilities	5(d)	3,212	3,131
		<b>31,285</b>	28,999
<b>Net Assets</b>			
		<b>60,147</b>	<b>60,205</b>
<b>Capital and Reserves</b>			
Share capital	28	39,120	39,120
Development reserve	29	6,535	6,535
Investment property revaluation reserve	30	265	117
Investment revaluation reserve	31	(16)	(1)
Proposed dividend	7	172	620
Retained profits	32	14,071	13,814
		<b>60,147</b>	60,205

Approved and authorised for issue by the Managing Board on 28 February 2005

**Michael Tien**

**Samuel Lai**

**Patrick B Paul**

*Members of the Managing Board*

## Corporation Balance Sheet

at 31 December 2004 (Expressed in Hong Kong dollars)

	Note	2004 \$ million	2003 \$ million
<b>Assets</b>			
Fixed assets	9		
– Investment properties		1,026	878
– Other properties, plant and equipment		66,716	50,942
		<b>67,742</b>	51,820
Construction in progress	10	6,991	15,101
Deferred expenditure	11	1,462	900
Properties under development	12	1,892	1,448
Interest in associate	14	9	9
Loan receivable	15	16	16
Loan to subsidiary	16	3,576	3,232
Investments	17	4,323	12,244
Stores and spares	18	319	254
Interest receivable	19	32	60
Other receivables	20	719	628
Cash and cash equivalents	21	3,426	2,557
		<b>90,507</b>	88,269
<b>Liabilities</b>			
Interest payable	22	468	471
Other payables	23	2,343	1,994
Accrued charges and provisions for capital projects	24	3,971	1,782
Interest-bearing borrowings	26	19,748	20,013
Deferred income	27	663	707
Deferred tax liabilities	5(d)	3,212	3,131
		<b>30,405</b>	28,098
<b>Net Assets</b>			
		<b>60,102</b>	<b>60,171</b>
<b>Capital and Reserves</b>			
Share capital	28	39,120	39,120
Development reserve	29	6,535	6,535
Investment property revaluation reserve	30	265	117
Investment revaluation reserve	31	(16)	(1)
Proposed dividend	7	172	620
Retained profits	32	14,026	13,780
		<b>60,102</b>	60,171

Approved and authorised for issue by the Managing Board on 28 February 2005

**Michael Tien**

**Samuel Lai**

**Patrick B Paul**

*Members of the Managing Board*

## Consolidated Statement of Changes in Equity

for the year ended 31 December 2004 (Expressed in Hong Kong dollars)

	Note	2004 \$ million	2003 \$ million
Opening balance – Total equity		<b>60,205</b>	59,512
Surplus/(deficit) on revaluation of investment properties	30	<b>148</b>	(17)
Surplus/(deficit) on revaluation of investments	31	<b>(54)</b>	(76)
Net profits/(losses) not recognised in the income statement		<b>94</b>	(93)
Revaluation deficit transferred to the income statement on redemption and disposal of securities	31	<b>39</b>	25
Retained profit for the year		<b>429</b>	1,381
Dividend paid during the year	7	<b>(620)</b>	(620)
Closing balance – Total equity		<b>60,147</b>	60,205

## Consolidated Cash Flow Statement

for the year ended 31 December 2004 (Expressed in Hong Kong dollars)

	Note	2004 \$ million	2003 \$ million
<b>Operating activities</b>			
Net cash inflow from operations	33	2,306	2,179
Net cash outflow from property development		(376)	(308)
Hong Kong profits tax paid		(1)	(1)
<b>Net cash inflow from operating activities</b>		<b>1,929</b>	<b>1,870</b>
<b>Investing activities</b>			
Decrease/(increase) in deposits with banks with more than three months of maturity when placed		(740)	743
Payments for capital expenditure:			
– West Rail project		(1,371)	(5,367)
– East Rail Extensions project		(4,534)	(5,282)
– other capital projects and purchase of fixed assets		(1,076)	(1,587)
Interest received		1,358	725
Loan to subsidiary		(24)	(382)
Receipts from redemption and disposal of investments		6,740	6,783
<b>Net cash inflow/(outflow) from investing activities</b>		<b>353</b>	<b>(4,367)</b>
<b>Net cash inflow/(outflow) before financing</b>		<b>2,282</b>	<b>(2,497)</b>
<b>Financing activities</b>			
Net cash flows on drawdown/(repayment) of loans		(273)	2,271
Dividend paid		(620)	(620)
Interest paid		(1,387)	(1,329)
Net income from derivative financial instruments		138	111
Amounts paid in respect of expenses for the issue of interest-bearing borrowings		(11)	(7)
Other borrowing costs paid		(15)	(37)
<b>Increase/(decrease) in cash and cash equivalents</b>		<b>114</b>	<b>(2,108)</b>
<b>Cash and cash equivalents at 1 January</b>		<b>2,477</b>	<b>4,585</b>
<b>Cash and cash equivalents at 31 December</b>		<b>2,591</b>	<b>2,477</b>
<b>Analysis of the balances of cash and cash equivalents</b>			
Cash at bank and in hand	21(a)	36	54
Deposits with banks within three months of maturity when placed	21(a)	2,555	2,423
		<b>2,591</b>	<b>2,477</b>

# Notes to the Financial Statements

(Expressed in Hong Kong dollars)

## 1 Establishment of the Corporation

The Kowloon-Canton Railway Corporation ("the Corporation") was incorporated under the Kowloon-Canton Railway Corporation Ordinance ("the Ordinance") on 24 December 1982 to undertake the operation of the Hong Kong section of the Kowloon-Canton Railway and to construct and operate a Light Rail Transit System in the North West New Territories of the Hong Kong Special Administrative Region ("HKSAR").

The assets, rights and liabilities of the then existing railway were vested in the Corporation on 1 February 1983 in accordance with Section 7 of the Ordinance.

The Kowloon-Canton Railway Corporation (Permitted Activities) Order 1996 came into operation on 17 February 1996. It enabled the Corporation to plan, design and prepare for the construction of a new railway system in the North West New Territories ("the West Rail") and pursuant to an amendment to the Kowloon-Canton Railway Corporation Ordinance, which came into effect on 3 April 1998, the Corporation's powers were extended to permit it to construct and operate additional railways.

## 2 Significant accounting policies

### (a) Statement of compliance

Although not required to do so under the Ordinance, the Corporation has prepared these financial statements in accordance with all applicable Hong Kong Financial Reporting Standards (which include all applicable Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong and the disclosure requirements of the Hong Kong Companies Ordinance. These financial statements also comply with the applicable disclosure provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited. A summary of the significant accounting policies adopted by the Corporation and its subsidiaries ("the Group") is set out below.

### (b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is historical cost modified by the revaluation of investment properties and the marking to market of investments as explained in the accounting policies set out below.

### (c) Basis of consolidation

The consolidated financial statements include the financial statements of the Corporation and its subsidiaries made up to 31 December each year. The results of subsidiaries acquired or disposed of during the year are included in the consolidated financial statements from or to the date of their acquisition or disposal, as appropriate.

Intra-group balances and transactions are eliminated in full in preparing the consolidated financial statements.

The financial statements of certain subsidiaries held by the Corporation for the sole purpose of developing, on behalf of the Government, commercial or residential properties along the West Rail, Phase I route are excluded from the consolidation as the Corporation has no effective control over nor beneficial interests in the net assets of these subsidiaries, other than the amount of capital provided.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 2 Significant accounting policies (continued)

#### (d) Investments in subsidiaries

A subsidiary, in accordance with the Hong Kong Companies Ordinance, is a company in which the Group, directly or indirectly, holds more than half of the issued share capital, or controls more than half the voting power or controls the composition of the board of directors. Subsidiaries are considered to be controlled if the Corporation has the power, directly or indirectly, to govern the financial and operating policies, so as to obtain benefits from their activities.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements, unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions which significantly impair its ability to transfer funds to the Group, in which case, it is stated in the consolidated balance sheet at fair value with changes in fair value recognised in the same way as for other investments.

Intra-group balances and transactions, and any unrealised profits arising from intra-group transactions, are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

In the Corporation's balance sheet, an investment in a subsidiary is stated at cost less any impairment losses (see note 2(h)), unless it is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions which significantly impair its ability to transfer funds to the Corporation, in which case, it is stated at fair value with changes in fair value recognised in the same way as for other investments.

#### (e) Associate

An associate is an entity in which the Group or Corporation has significant influence, but not control or joint control, over its management, including participation in the financial and operating policy decisions.

Unless the investment in an associate is acquired and held exclusively with a view to subsequent disposal in the near future or operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor, in which case it is stated at fair value with changes in fair value recognised in the same way as for other investments, an investment in an associate is accounted for in the consolidated financial statements under the equity method and is initially recorded at cost and adjusted thereafter for the post acquisition change in the Group's share of the associate's net assets. The consolidated income statement reflects the Group's share of the post-acquisition results of the associate for the year.

Unrealised profits and losses resulting from transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates, except where unrealised losses provide evidence of an impairment of the asset transferred, in which case they are recognised immediately in the income statement.

The results of the associates are included in the Corporation's income statement to the extent of dividends received and receivable, providing the dividend is in respect of a period ending on or before that of the Corporation and the Corporation's right to receive the dividend is established before the balance sheet date. In the Corporation's balance sheet, its investments in associates are stated at cost less impairment losses (see note 2(h)), unless they are acquired and held exclusively with a view to subsequent disposal in the near future or operate under severe long-term restrictions that significantly impair their ability to transfer funds to the investor or venturer, in which case they are stated at fair value with changes in fair value recognised in the same way as for other investments.

## 2 Significant accounting policies *(continued)*

### (f) Fixed assets

(i) Fixed assets are carried in the balance sheet on the following bases:

- Fixed assets, except investment properties, are stated at cost less accumulated depreciation (see note 2(g)) and impairment losses (see note 2(h)), and include land, initial costs of rail tracks and sleepers, the cost of ballast, buildings, infrastructure, rolling stock and other equipment utilised by the Group or Corporation in the operation of its rail networks and ancillary commercial activities.

The cost of fixed assets vested by the Government has been determined as follows:

- for fixed assets vested on 1 February 1983 – as determined by the Financial Secretary.
- for fixed assets vested subsequent to 1 February 1983 – based on actual cost as reflected in the Government's records.

Fixed asset expenditure below \$20,000 per item is expensed to the income statement as incurred.

- Investment properties with an unexpired lease term of more than 20 years are stated in the balance sheet at their open market value which is assessed annually by external qualified valuers.

(ii) Changes in the value of investment properties arising upon revaluations are dealt with in the investment property revaluation reserve. The only exceptions are as follows:

- if the total of this reserve is insufficient to cover a revaluation deficit, on a portfolio basis, the excess of the deficit is charged to the income statement.
- where a deficit has previously been charged to the income statement and a revaluation surplus subsequently arises, this surplus is firstly credited to the income statement to the extent of the deficit previously charged to the income statement and is, thereafter, taken to the investment property revaluation reserve.

(iii) Subsequent expenditure on an existing fixed asset is added to the carrying amount of the asset if, either future economic benefits will flow to the Group or Corporation, or the condition of the asset will improve beyond its originally assessed standard of performance.

Expenditure on repairs or maintenance of an existing fixed asset to restore or maintain the originally assessed standard of performance of the asset is recognised as an expense when incurred.

(iv) Gains or losses arising from the retirement or disposal of a fixed asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised as income or expense in the income statement on the date of retirement or disposal.

On disposal of an investment property, the related portion of surpluses or deficits previously taken to the investment property revaluation reserve is transferred to the income statement.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 2 Significant accounting policies (continued)

#### (f) Fixed assets (continued)

##### (v) Leased assets

- Fixed assets held under lease agreements that give rights equivalent to ownership are treated as if the Group or Corporation owns them outright.
- Fixed assets held for use in operating leases are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's or Corporation's depreciation policies, as set out in note 2(g). Impairment losses are accounted for in accordance with the accounting policy, as set out in note 2(h). Revenue arising from operating leases is recognised in accordance with the Group's or Corporation's revenue recognition policies, as set out in note 2(n).
- Where the Group or Corporation has the use of assets under operating leases, payments made under the leases are charged to the income statement in equal instalments over the accounting periods covered by the lease term.

#### (g) Depreciation

- (i) No depreciation is provided in respect of investment properties with an unexpired lease term of more than 20 years since the valuation takes into account the state of each property at the date of valuation. The Corporation and the Group do not currently hold any investment properties with an unexpired lease term of less than 20 years.
- (ii) Leasehold land other than that relating to investment properties is depreciated over the remaining period of the lease.
- (iii) The initial cost of rail tracks, ballast and sleepers is not depreciated. The cost of replacing rail tracks and sleepers is charged to the income statement as and when incurred.
- (iv) All other fixed assets are depreciated on a straight-line basis at the following rates per annum calculated to write off the cost of each asset over its estimated useful life:

Tunnels, bridges and roads	1%
Buildings	2%
Rolling stock (electrical)	2.5-3.3%
Rolling stock (diesel)	3-20%
Lifts and escalators	5%
Ballast replacement programmes	7%
Machinery and equipment	3-10%
Telecommunication and signalling systems and airconditioning plant	7-10%
Fare collection systems	7-10%
Mobile phone systems	10-14%
Furniture and fixtures	7-33%
Computer and office equipment (including computer software)	20-33%
Buses	6-10%
Other motor vehicles	7-25%

- (v) The useful lives of the various categories of fixed assets are reviewed regularly in the light of actual asset condition and asset replacement programmes. The depreciation charge for the current and future periods will be adjusted if there are significant changes from previous estimates.

## 2 Significant accounting policies *(continued)*

### (h) Impairment of assets

Internal and external sources of information are reviewed at each balance sheet date to identify indications that the following assets may be impaired or an impairment loss previously recognised no longer exists or may have decreased:

- fixed assets (other than investment properties carried at revalued amounts);
- construction in progress;
- deferred expenditure;
- investments in subsidiaries; and
- interest in associate.

If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised in the income statement to reduce the carrying amount of an asset to its recoverable amount.

#### (i) Calculation of recoverable amount

The recoverable amount of an asset is the greater of its net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of time value of money and the risks specific to the asset. Where there are assets that do not generate cash inflows largely independent of those from other assets, recoverable amounts are determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

#### (ii) Reversals of impairment losses

An impairment loss is reversed if there has been a favourable change in the estimates used to determine the recoverable amount.

A reversal of impairment losses is limited to the asset's carrying amount that would have been determined had no impairment loss been recognised in prior years. Reversals of impairment losses are credited to the income statement in the year in which the reversals are recognised.

### (i) Construction in progress

Assets under construction and capital works for the operating railways are stated at cost less impairment losses (see note 2(h)). Costs comprise direct costs of construction, such as materials, staff costs and overheads, as well as net finance income/expenses (see note 2(q)) capitalised during the period of construction or installation and testing. Capitalisation of these costs ceases and the asset concerned is transferred to fixed assets when substantially all the activities necessary to prepare the asset for its intended use are completed, at which time it commences to be depreciated in accordance with the policies detailed in note 2(g).

Costs incurred by the Corporation in respect of feasibility studies on proposed railway related construction projects (including consultancy fees, in-house staff costs and overheads) are dealt with as follows:

- where the proposed projects are at a preliminary review stage with no certainty of the proposed project proceeding, the costs concerned are written off to the income statement.
- where the proposed projects are at a detailed study stage, having demonstrated an acceptable financial viability and having obtained the Managing Board's approval to proceed further, the costs concerned are initially dealt with as deferred expenditure and then transferred to construction in progress after the relevant project agreements are reached with the Government.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 2 Significant accounting policies (continued)

#### (j) Deferred expenditure

As described in note 2(i), deferred expenditure relates to costs incurred for proposed projects which will be transferred to construction in progress after the relevant project agreements are reached with the Government.

#### (k) Property development

The Corporation is involved in a number of property development projects. When the Corporation determines or reaches agreement with its property developers to develop a site for resale or for rent, the net book value of existing land and buildings on the development site included in fixed assets are transferred to properties under development. Costs related to the respective projects are also charged to properties under development until such time that profit on the development is recognised by the Corporation.

Profits on property development are recognised in the income statement as follows:

- where the Corporation receives payments from developers as a consequence of their participation in a project to develop a property: after taking into account the outstanding risks and obligations in connection with the development, if any, retained by the Corporation.
- where the Corporation's share of profit is based on the actual sales proceeds from the sale of properties: after the completion of sales agreements for a substantial proportion of the development, the issue of occupation permits and the receipt of a substantial proportion of the sales proceeds.
- where the Corporation's profit is based on the retention of certain properties from the development: when the properties retained are ready for use by the Corporation after taking into account outstanding risks, if any, retained by the Corporation in connection with the development. The profit recognised is measured at the fair value of the properties retained less any costs incurred by the Corporation thereon.

#### (l) Jointly controlled operations

Assets that the Corporation controls and the liabilities that it incurs in respect of its interests in jointly controlled operations are recognised in the balance sheet and classified according to the nature of the relevant item. The Corporation's share of the income that it earns from the sale of goods or services by the jointly controlled operations along with the expenses that it incurs are included in the income statement when it is probable that economic benefits associated with the transactions will flow to or from the Corporation, as applicable.

#### (m) Investments

Investments of the Corporation comprise:

- (i) Temporary investment of funds from the equity injection received and borrowings obtained specifically for the construction of the East Rail Extensions, Kowloon Southern Link and Sha Tin to Central Link before the funds are used for such purposes ("pre-funding investments"); and
- (ii) Investment of surplus funds from the Corporation's operations ("other investments").

All investments are stated in the balance sheet at their fair value.

Changes in fair value of pre-funding investments, together with all income generated from such investments including interest income, exchange gains or losses, gains or losses arising from transactions in derivative financial instruments for hedging against foreign currency investments and gains or losses arising from the disposal of such investments, are capitalised as construction in progress or deferred expenditure, as appropriate.

## 2 Significant accounting policies *(continued)*

### (m) Investments *(continued)*

Changes in fair value of other investments are recognised in the investment revaluation reserve until the investment is sold, collected or otherwise disposed of or until there is objective evidence that the investment is impaired, at which time the relevant cumulative gain or loss is transferred from investment revaluation reserve to the income statement.

Transfers from the investment revaluation reserve to the income statement as a result of impairments are reversed when the circumstances and events that led to the impairment cease to exist and there is persuasive evidence that the new circumstances and events will persist for the foreseeable future.

Profits or losses on disposal of other investments are accounted for in the income statement as they arise. The profit or loss includes any amount previously held in the investment revaluation reserve in respect of these investments.

### (n) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group or Corporation and the revenue and costs, if applicable, can be measured reliably, revenue is recognised in the income statement as follows:

#### (i) Passenger and freight services

- When the services are provided.

#### (ii) Rental and licence income

- Rental income receivable under operating leases is recognised in the income statement in equal instalments over the accounting periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset. Lease incentives granted are recognised in the income statement as an integral part of the aggregate net lease payment receivable. Contingent rentals are recognised as income in the accounting period in which they are earned.

#### (iii) Interest income

- Interest income from dated debt securities, as it accrues adjusted by the amortisation of the premium or discount on acquisition so as to achieve a constant rate of return over the period from the date of purchase to the date of maturity.
- Interest income from bank deposits, on a time-apportioned basis by reference to the principal outstanding and the rate applicable.

#### (iv) Other income

- Once the related services or goods are delivered.

### (o) Lease out and lease back transactions

A series of lease out and lease back transactions with third parties is linked and accounted for as one arrangement when the overall economic effect cannot be understood without reference to the series of transactions as a whole and when the series of transactions is closely interrelated, negotiated as a single arrangement and takes place concurrently or in a continued sequence.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 2 Significant accounting policies *(continued)*

#### (o) Lease out and lease back transactions *(continued)*

The primary purpose of such arrangements is to achieve a particular tax result for the third parties in return for a fee received by the Corporation. The arrangements do not, in substance, involve a lease under the Statement of Standard Accounting Practice ("SSAP") 14 (Leases) since the Corporation retains all the risks and rewards incident to the ownership of the underlying assets and enjoys substantially the same rights to their use as before the transactions. The transactions are, therefore, not accounted for as leases. Where commitments by the Corporation to make long-term lease payments have been defeased by the placement of security deposits, those commitments and deposits are not recognised as obligations and assets of the Corporation. In the case where the Corporation's commitments and deposits meet the definition of a liability and an asset, such commitments and deposits are recognised as obligations and assets in the balance sheet. The income and expenses arising from the arrangements are accounted for on a net basis in order to reflect the overall commercial effect of the transactions. The net amounts are accounted for as deferred income and are amortised over the applicable lease terms of the transactions.

#### (p) Stores and spares

Stores and spares are valued at cost of purchase on a weighted average basis. Obsolete stores and spares are written off to the income statement. When stores and spares are consumed, the carrying amount of those stores and spares is recognised as an expense in the year in which the consumption occurs.

#### (q) Borrowing costs and investment income

Borrowing costs incurred on borrowings during the year are dealt with in the income statement except to the extent that they are capitalised as being directly attributable to the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use or sale.

Borrowing costs include interest on borrowings; amortisation of discounts relating to borrowings; amortisation of ancillary costs incurred in connection with the arrangement of borrowings, gains or losses arising from transactions in derivative financial instruments for hedging against foreign currency borrowings and exchange differences arising from foreign currency borrowings. Exchange differences are capitalised to the extent that they are regarded as an adjustment to interest costs.

Investment income includes interest income, gains or losses arising from transactions in derivative financial instruments for hedging against foreign currency investments, gains or losses on disposals of investments and exchange differences arising from investments.

Investment income earned on the temporary investment of the equity injection received and borrowings obtained specifically for the acquisition, construction or production of an asset which necessarily takes a substantial period of time to get ready for its intended use prior to the date of expenditure for such purpose is credited to construction in progress or deferred expenditure, as appropriate.

#### (r) Translation of foreign currencies

Foreign currency transactions during the year are translated into Hong Kong dollars at the exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the market exchange rates ruling at the balance sheet date. Forward foreign exchange contracts, swaps and options used as a hedge against foreign currency investments and liabilities are revalued at the balance sheet date at the exchange rates ruling at that date. Gains and losses on currency hedging transactions are used to offset gains and losses resulting from currency fluctuations inherent in the underlying foreign currency investments and liabilities. Differences arising on foreign currency translation and revaluation of forward exchange contracts, swaps and options are dealt with in the income statement except that they are capitalised to the extent as discussed in note 2(q).

## 2 Significant accounting policies *(continued)*

### (s) Income tax

- (i) Income tax for the year comprises current tax and movements in deferred tax assets and liabilities. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement except to the extent that they relate to items recognised directly to equity, in which case they are recognised in equity.
- (ii) Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date and any adjustment to tax payable in respect of previous years.
- (iii) Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for tax purposes. Deferred tax assets also arise from unused tax losses and unused tax credits.

All deferred tax liabilities and all deferred tax assets, to the extent that it is probable that future taxable profits will be available against which the asset can be utilised, are recognised.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of the assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date. Deferred tax assets and liabilities are not discounted.

The carrying amount of a deferred tax asset is reviewed at each balance sheet date and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow the related tax benefit to be utilised. Any such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

- (iv) Current and deferred tax assets and liabilities are offset if, and only if, the Group or Corporation has the legally enforceable right to set off current tax assets against current tax liabilities and the following additional conditions are met:
  - in the case of current tax assets and liabilities, the Group or Corporation intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously; or
  - in the case of deferred tax assets and liabilities, if they relate to income taxes levied by the same taxation authority on either:
    - the same taxable entity; or
    - different taxable entities, which, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered, intend to realise the current tax assets and settle the current tax liabilities on a net basis or realise and settle simultaneously.

### (t) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Corporation or the Group has a legal or constructive obligation arising as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made. Where the time value of money is material, provisions are stated at the present value of the expenditure expected to settle the obligation.

Where it is not probable that an outflow of economic benefits will be required, or the amount cannot be estimated reliably, the obligation is disclosed as a contingent liability.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 2 Significant accounting policies (continued)

#### (u) Employee benefits

Obligations for contributions to the defined contribution scheme operated by the Corporation and to the Mandatory Provident Fund as required under the Hong Kong Mandatory Provident Fund Schemes Ordinance, are recognised as an expense in the income statement as incurred, except to the extent that they are capitalised as part of the costs of construction in progress, deferred expenditure and properties under development.

Salaries, annual bonuses, paid annual leave, leave passage and non-monetary benefits are accrued in the year during which the services are provided by employees.

#### (v) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and on hand, demand deposits with banks and other financial institutions, and short-term, highly liquid investments that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, having been within three months of maturity at acquisition.

For the purposes of the consolidated cash flow statement, cash equivalents would also include bank overdrafts that are repayable on demand and form an integral part of the Group's cash management but exclude bank deposits with more than three months of maturity when placed.

#### (w) Related parties

For the purposes of these financial statements, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or other entities.

#### (x) Segment reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Business segment information is the primary reporting format in accordance with the Group's internal financial reporting. Segment revenue, expenses, results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis to that segment.

Segment capital expenditure is the total cost incurred during the period to acquire segment assets that are expected to be used for more than one period.

Unallocated items mainly comprise financial and corporate assets, interest-bearing loans, borrowings, corporate and financing expenses.

### 3 Turnover, operating costs and operating profit before net finance income/(expenses)

- (a) Turnover represents the revenue from passenger, freight and property services after eliminating inter-company transactions. The amounts of revenue recognised in turnover by principal activities during the year are as follows:

	2004 \$ million	2003 \$ million
Transport services		
Passenger services		
– East Rail	3,415	3,266
– Light Rail	416	468
– West Rail	382	11
Freight services	68	74
	<b>4,281</b>	3,819
Property services	695	607
	<b>4,976</b>	4,426

- (b) Operating costs before depreciation comprise the following:

	2004 \$ million	2003 \$ million
Staff costs		
– Gross amount including retirement costs of \$138 million (2003: \$137 million)	2,156	2,262
– Amount capitalised including retirement costs of \$17 million (2003: \$29 million)	(692)	(1,061)
	<b>1,464</b>	1,201
Electricity and fuel	456	271
Repairs and maintenance	181	133
Stores and spares consumed	158	115
General supplies	32	34
Government rent and rates	68	64
Octopus cards usage fees	33	29
Cost of services acquired	144	105
Property ownership and management expenses	63	56
Others	208	121
	<b>2,807</b>	2,129

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 3 Turnover, operating costs and operating profit before net finance income/(expenses) (continued)

(c) Depreciation comprises the following:

	2004 \$ million	2003 \$ million
Depreciation		
– assets held for use under operating leases	16	17
– other assets	1,622	735
– depreciation charge capitalised	(6)	(4)
	<b>1,632</b>	748

(d) Operating profit before net finance income/(expenses) is arrived at after charging:

	2004 \$ million	2003 \$ million
Fixed assets written off on disposal	24	9
Auditors' remuneration		
– Audit services	4	4
– Tax compliance services	1	1
Operating lease charges (minimum lease payments)		
– Hire of plant and machinery	29	21
– Rental of property	13	14
Remuneration of Members of the Managing Board and Executive Directors who are not Members of the Managing Board		
– Fees for Members of the Managing Board including the Chairman but excluding the Chief Executive Officer	1	1
– Contributions to retirement benefit schemes for the Chief Executive Officer and Executive Directors who are not Members of the Managing Board	2	1
– Emoluments of the Chief Executive Officer and Executive Directors who are not Members of the Managing Board	33	40
and after crediting:		
Rentals receivable from operating leases less direct outgoings of \$17 million (2003: \$13 million) (including contingent rentals of \$29 million (2003: \$20 million))	499	449
Rentals receivable from investment properties less direct outgoings of \$18 million (2003: \$16 million)	62	68

**3 Turnover, operating costs and operating profit before net finance income/(expenses) (continued)**

(e) Fees for Members of the Managing Board including the Chairman but excluding the Chief Executive Officer are shown below:

	<b>2004</b>	2003
	<b>\$'000</b>	\$'000
<b>Chairman</b>		
Mr Michael P S Tien	<b>220</b>	220
<b>Members</b>		
Mr Vincent H C Cheng*	<b>96</b>	110
Mr Edmund T C Lau**	–	4
Dr Sarah S T Liao in the capacity of Secretary for the Environment, Transport and Works	<b>110</b>	110
Mr Vincent W S Lo	<b>110</b>	110
Mr Frederick S H Ma in the capacity of Secretary for Financial Services and the Treasury	<b>110</b>	110
Mr L S Ng***	<b>14</b>	–
Mr Patrick B Paul	<b>110</b>	110
The Honourable Abraham L H Shek****	<b>101</b>	–
Mr Victor H W So#	<b>9</b>	106
Mr M Y Wan	<b>110</b>	110
Mr Patrick S C Wang##	<b>9</b>	110
Professor Richard Y C Wong###	<b>101</b>	–
	<b>1,100</b>	1,100

\* Mr Vincent H C Cheng resigned on 15 November 2004.

\*\* Mr Edmund T C Lau resigned on 14 January 2003.

\*\*\* Mr L S Ng was appointed on 16 November 2004.

\*\*\*\*The Honourable Abraham L H Shek was appointed on 1 February 2004.

# Mr Victor H W So resigned on 31 January 2004.

## Mr Patrick S C Wang resigned on 31 January 2004.

### Professor Richard Y C Wong was appointed on 1 February 2004.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 3 Turnover, operating costs and operating profit before net finance income/(expenses) (continued)

- (f) Emoluments of the Chief Executive Officer and Executive Directors who are not Members of the Managing Board include salaries, retirement benefit scheme contributions, allowances, benefits-in-kind and accruals for gratuities and annual leave entitlements. Details are shown below:

	2004 \$ million			2003 \$ million
	Base pay, allowances, retirement benefit scheme contributions, gratuities and benefits-in-kind	Variable remuneration	Total	Base pay, allowances, retirement benefit scheme contributions, gratuities and benefits-in-kind total
Mr Samuel M H Lai* <i>Acting Chief Executive Officer</i>	4.89	0.51	5.40	5.11
Mr K K Lee* <i>Senior Director-Capital Projects</i>	3.83	0.40	4.23	4.16
Mr Y T Li* <i>Senior Director-Transport</i>	3.91	0.37	4.28	3.81
Mr Ian M Thoms* <i>Director-West Rail</i>	3.49	0.39	3.88	4.05
Mr Daniel C Lam* <i>Director-Property</i>	3.72	0.41	4.13	4.10
Mr Lawrence C P Li** <i>Director-Finance</i>	2.80	–	2.80	–
Mrs Mimi Cunningham* <sup>Ⓞ</sup> <i>Director-Human Resource</i>	2.18	0.38	2.56	–
Mr K Y Yeung <sup>#</sup> <i>Chief Executive Officer</i>	–	–	–	6.47
Mr James Blake <sup>#</sup> <i>Senior Director-Capital Projects</i>	–	–	–	5.27
Mr Jonathan H G Yu <sup>##</sup> <i>Director-Operations</i>	6.12	–	6.12	4.00
Mr Kenneth K S Leung <sup>###</sup> <i>Director-New Railway Projects</i>	2.03	–	2.03	3.96
	<b>32.97</b>	<b>2.46</b>	<b>35.43</b>	40.93

\* Effective from 1 July 2004, a portion of total remuneration was converted to variable remuneration related to performance. The 2004 emoluments of individual Executive Director were higher or lower than those of 2003 mainly due to variable remuneration, a general 0.2% increase in remuneration, an additional special allowance for acting responsibility applicable to some Executive Directors and an increase or a decrease in accruals for annual leave.

\*\* Mr Lawrence C P Li assumed his post with effect from January 2004.

Ⓞ Mrs Mimi Cunningham assumed her post with effect from May 2004.

# Mr K Y Yeung and Mr James Blake retired on 1 January 2004.

## Mr Jonathan H G Yu's remuneration includes a contractual payment totalling \$1.2 million and an end-of-service payment of \$0.9 million. He left the Corporation on 3 January 2005.

### Mr Kenneth K S Leung retired on 1 July 2004.

The above includes the remuneration of the five highest paid employees of the Corporation.

#### 4 Net finance income/(expenses)

	2004 \$ million	2003 \$ million
<i>Investment income</i>		
Interest income from deposits with banks	48	50
Interest income from investments	166	510
Interest income from loan receivable	53	3
Interest income from loan to subsidiary	241	211
Net income from derivative financial instruments	95	143
Net exchange gain	15	–
Net realised loss on redemption and disposal of investments (including deficit of \$39 million transferred from investment revaluation reserve (2003: \$25 million))	(67)	(60)
	<b>551</b>	857
*Less: Amount capitalised	<b>(173)</b>	(435)
	<b>378</b>	422
<i>Borrowing costs</i>		
Interest expense on lease payable	52	3
Interest expenses on other loans	1,384	1,355
Other borrowing costs	20	37
Net exchange loss	–	28
	<b>1,456</b>	1,423
#Less: Amount capitalised	<b>(1,037)</b>	(1,354)
	<b>419</b>	69
Net finance income/(expenses)	<b>(41)</b>	353

\* Interest income capitalised was earned at rates ranging between 1.37% (2003: 2.20%) and 2.54% (2003: 4.04%) per annum.

# Interest expenses capitalised were charged at rates ranging between 6.02% (2003: 6.10%) and 6.88% (2003: 6.75%) per annum.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 5 Income tax

(a) Income tax in the consolidated income statement represents:

	2004 \$ million	2003 \$ million
Current tax		
Provision for Hong Kong profits tax at 17.5% of the estimated assessable profits for the year	1	1
Deferred tax		
Origination and reversal of temporary differences	81	283
Effect of increase in tax rate on deferred tax balances at 1 January	–	244
	81	527
Share of associate's deferred tax	1	1
	83	529

The provision for Hong Kong profits tax is all in respect of the estimated assessable profits for the year of the subsidiaries of the Corporation. The Corporation sustained a loss for tax purposes during the year and has accumulated tax losses carried forward of approximately \$7,100 million at 31 December 2004 (2003: approximately \$3,800 million) which are available to set off against future assessable profits.

(b) Reconciliation between tax expense and accounting profit at applicable tax rates:

	2004 \$ million	2003 \$ million
Profit before taxation	512	1,910
Tax on accounting profit before tax	90	334
Tax effect of non-deductible expenses	30	(39)
Tax effect of non-taxable revenue	(37)	(10)
Effect on opening deferred tax balances resulting from an increase in tax rate during the year	–	244
Actual tax expense	83	529

(c) Current tax in the balance sheet represents:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Provision for Hong Kong profits tax for the year	1	1	–	–
Provisional profits tax paid	(1)	(1)	–	–
	–	–	–	–

## 5 Income tax (continued)

(d) Deferred tax assets and liabilities of the Group and the Corporation recognised:

The components of deferred tax (assets)/liabilities of the Group and the Corporation recognised in the Group's and the Corporation's balance sheets and the movements during the year are as follows:

	Future benefit of tax losses \$ million	Depreciation allowances in excess of the related depreciation \$ million	Total \$ million
At 1 January 2003	(412)	3,016	2,604
Charged/(credited) to the consolidated income statement	(253)	780	527
At 31 December 2003	(665)	3,796	3,131
At 1 January 2004	<b>(665)</b>	<b>3,796</b>	<b>3,131</b>
Charged/(credited) to the consolidated income statement	<b>(585)</b>	<b>666</b>	<b>81</b>
At 31 December 2004	<b>(1,250)</b>	<b>4,462</b>	<b>3,212</b>

	2004 \$ million	2003 \$ million
Deferred tax assets likely to be recovered after more than 12 months	<b>(1,250)</b>	(665)
Deferred tax liabilities likely to be settled after more than 12 months	<b>4,462</b>	3,796
	<b>3,212</b>	3,131

## 6 Profit after taxation

Of the consolidated profit after taxation, \$418 million (2003: \$1,376 million) has been dealt with in the financial statements of the Corporation.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 7 Proposed dividend

	2004 \$ million	2003 \$ million
(a) Dividend attributable to the year:		
Final dividend proposed after the balance sheet date of \$439.67 per share (2003: \$1,584.87 per share)	172	620

The final dividend proposed after the balance sheet date has not been recognised as a liability at the balance sheet date, but has been included in the balance sheet as a separate component of equity.

	2004 \$ million	2003 \$ million
(b) Dividend attributable to the previous financial year, approved and paid during the year:		
Final dividend in respect of the previous financial year, approved and paid during the year, of \$1,584.87 per share (2003: \$1,584.87 per share)	620	620

### 8 Segmental reporting

Business segment information is chosen as the primary reporting format because this is more relevant to the Group's internal financial reporting. According to SSAP 26 (Segment reporting), a business segment is a distinguishable component of an enterprise that is engaged for providing an individual product or service and is subject to risks and returns different from other business segments. In determining the nature of risks and returns, SSAP 26 states that an enterprise's internal organisational and management structure and its system of internal financial reporting form the basis for identifying the predominant source and nature of risks and returns facing the enterprise.

In December 2003, East Rail Division and West Rail/Light Rail Division were combined to form a single Transport Division to allow management more flexibility in the deployment of resources and enable the Corporation to achieve synergy and savings, particularly for those services common to both railway networks, such as maintenance. The Transport Division manages all the transport services including East Rail, Light Rail, West Rail and Freight. Since December 2003, most of the costs are common to various railway services including East Rail, Light Rail, West Rail and Freight.

Consistent with the internal organisational and management structure of the Corporation, a transport services segment has been created in place of East Rail, Light Rail, West Rail and Freight and the figures for 2003 have been restated for comparison purposes.

No geographical segment information is shown as virtually all of the turnover and operating profit is derived from activities in Hong Kong.

## 8 Segmental reporting (continued)

### 2004

#### Operating results

	Transport Services \$ million	Property \$ million	Consolidated Total \$ million
Revenue	4,281	695	4,976
Segment operating costs before depreciation	(2,450)	(128)	(2,578)
Inter-segment charges <sup>(1)</sup>	35	(35)	–
Segment result before depreciation	1,866	532	2,398
Depreciation	(1,581)	(29)	(1,610)
Segment result	285	503	788
Unallocated corporate expenses and depreciation			(251)
Operating profit before net finance income/(expenses)			537
Net finance income/(expenses)			(41)
Share of profit of associate			16
Income tax			(83)
Profit after taxation			429

<sup>(1)</sup> Inter-segment charges represent cost recoveries from other segments for services rendered.

#### Assets and liabilities

	Transport Services \$ million	Property \$ million	Consolidated Total \$ million
Segment assets	66,576	1,682	68,258
Properties under development	–	1,892	1,892
Interest in associate	–	–	57
Railways under construction <sup>®</sup>	–	–	7,981
Unallocated assets <sup>#</sup>	–	–	13,244
	66,576	3,574	91,432
Segment liabilities	367	636	1,003
Deferred income	584	124	708
Unallocated liabilities <sup>*</sup>	–	–	29,574
	951	760	31,285

<sup>®</sup> Comprising construction costs of Lok Ma Chau (\$6,519 million) and planning and design costs of Sha Tin to Central Link, Kowloon Southern Link and Northern Link (\$1,462 million).

<sup>#</sup> Comprising construction in progress for Corporate (\$46 million), Corporate assets (\$363 million), investments (\$4,323 million), loan receivable (\$733 million), loan to subsidiary (\$3,576 million), interest receivable (\$49 million), other receivables (\$623 million) and cash and cash equivalents (\$3,531 million).

<sup>\*</sup> Comprising interest-bearing borrowings (\$19,748 million), interest payable (\$485 million), accrued charges and provisions for capital projects (\$3,875 million), lease payable (\$717 million), other payables (\$1,537 million) and deferred tax liabilities (\$3,212 million).

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 8 Segmental reporting (continued)

#### Other information

	Transport Services \$ million	Property \$ million	Consolidated Total \$ million
Capital expenditure			
– Operational railways	6,675	61	6,736
– Railways under construction	–	–	2,278
– Unallocated capital expenditure	–	–	8
	<b>6,675</b>	<b>61</b>	<b>9,022</b>

2003

#### Operating results

	Transport Services \$ million	Property \$ million	Consolidated Total \$ million
Revenue	3,819	607	4,426
Segment operating costs before depreciation	(1,779)	(121)	(1,900)
Inter-segment charges <sup>(1)</sup>	21	(21)	–
Segment result before depreciation	2,061	465	2,526
Depreciation	(698)	(24)	(722)
Segment result	1,363	441	1,804
Unallocated corporate expenses and depreciation			(255)
Operating profit before net finance income/(expenses)			1,549
Net finance income/(expenses)			353
Share of profit of associate			8
Income tax			(529)
Profit after taxation			1,381

<sup>(1)</sup> Inter-segment charges represent cost recoveries from other segments for services rendered.

## 8 Segmental reporting (continued)

### Assets and liabilities

	Transport Services \$ million	Property \$ million	Consolidated Total \$ million
Segment assets	51,279	1,462	52,741
Properties under development	–	1,448	1,448
Interest in associate	–	–	42
Railways under construction <sup>®</sup>	–	–	14,991
Unallocated assets <sup>#</sup>	–	–	19,982
	51,279	2,910	89,204
Segment liabilities	1,499	529	2,028
Deferred income	629	114	743
Unallocated liabilities <sup>*</sup>	–	–	26,228
	2,128	643	28,999

<sup>®</sup> Comprising construction costs of East Rail Extensions (\$14,091 million) and planning and design costs of the Sha Tin to Central Link and Kowloon Southern Link (\$900 million).

<sup>#</sup> Comprising construction in progress for Corporate (\$12 million), Corporate assets (\$471 million), investments (\$12,244 million), loan receivable (\$774 million), loan to subsidiary (\$3,232 million), interest receivable (\$63 million), other receivables (\$509 million) and cash and cash equivalents (\$2,677 million).

<sup>\*</sup> Comprising interest-bearing borrowings (\$20,013 million), interest payable (\$474 million), accrued charges and provisions for capital projects (\$896 million), lease payable (\$758 million), other payables (\$956 million) and deferred tax liabilities (\$3,131 million).

### Other information

	Transport Services \$ million	Property \$ million	Consolidated Total \$ million
Capital expenditure			
– Existing businesses	5,744	70	5,814
– Railway under construction	–	–	5,290
– Unallocated capital expenditure	–	–	18
	5,744	70	11,122

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 9 Fixed assets

Fixed assets comprise:

(a) The Group

	Investment properties \$ million	Leasehold land and permanent way \$ million	Tunnels, bridges and roads \$ million	Buildings \$ million	Rolling stock \$ million	Other equipment \$ million	Total \$ million
<b>Cost or valuation:</b>							
At 1 January 2004	878	9,540	10,815	20,297	8,055	8,997	58,582
Reclassification	–	(2,326)	2,121	233	–	(28)	–
Transfer from construction in progress	–	865	3,471	7,172	1,219	2,123	14,850
Additions	–	1,046	299	1,159	8	87	2,599
Disposals	–	(7)	–	(3)	–	(90)	(100)
Surplus on revaluation	148	–	–	–	–	–	148
At 31 December 2004	1,026	9,118	16,706	28,858	9,282	11,089	76,079
<b>Accumulated depreciation:</b>							
At 1 January 2004	–	195	90	970	2,005	3,465	6,725
Reclassification	–	(14)	21	–	–	(7)	–
Charge for the year	–	141	124	448	239	686	1,638
Written back on disposal	–	–	–	(1)	–	(75)	(76)
At 31 December 2004	–	322	235	1,417	2,244	4,069	8,287
<b>Net book value:</b>							
At 31 December 2004	1,026	8,796	16,471	27,441	7,038	7,020	67,792
At 31 December 2003	878	9,345	10,725	19,327	6,050	5,532	51,857

## 9 Fixed assets (continued)

Fixed assets comprise:

(b) The Corporation

	Investment properties \$ million	Leasehold land and permanent way \$ million	Tunnels, bridges and roads \$ million	Buildings \$ million	Rolling stock \$ million	Other equipment \$ million	Total \$ million
<b>Cost or valuation:</b>							
At 1 January 2004	878	9,540	10,815	20,297	8,055	8,960	58,545
Reclassification	–	(2,326)	2,121	233	–	(28)	–
Transfer from construction in progress	–	865	3,471	7,172	1,219	2,106	14,833
Additions	–	1,046	299	1,159	8	87	2,599
Disposals	–	(7)	–	(3)	–	(90)	(100)
Surplus on revaluation	148	–	–	–	–	–	148
At 31 December 2004	1,026	9,118	16,706	28,858	9,282	11,035	76,025
<b>Accumulated depreciation:</b>							
At 1 January 2004	–	195	90	970	2,005	3,465	6,725
Reclassification	–	(14)	21	–	–	(7)	–
Charge for the year	–	141	124	448	239	682	1,634
Written back on disposal	–	–	–	(1)	–	(75)	(76)
At 31 December 2004	–	322	235	1,417	2,244	4,065	8,283
<b>Net book value:</b>							
At 31 December 2004	1,026	8,796	16,471	27,441	7,038	6,970	67,742
At 31 December 2003	878	9,345	10,725	19,327	6,050	5,495	51,820

- (c) Permanent way principally comprises the initial costs of rail tracks and sleepers, a portion of the initial cost of ballast and subsequent expenditure on major ballast replacement programmes.
- (d) Other equipment comprises lifts and escalators, telecommunication and signalling systems, machinery, furniture and fixtures, motor vehicles, computer and office equipment.
- (e) The Group's and Corporation's leasehold land with a net book value of \$5,663 million (2003: \$4,449 million) and \$28 million (2003: \$29 million) is held in Hong Kong under medium-term and long-term leases respectively.
- (f) The Group and the Corporation leases out investment properties and certain properties which are either used in or ancillary to the Group's and Corporation's rail business, under operating leases. The leases typically run for an initial period of two to five years, with an option to renew the lease after that date at which time all terms are re-negotiated. The leases may include additional rentals based on sales revenue of the tenants in excess of the basic rentals.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 9 Fixed assets (continued)

- (g) The Group's and Corporation's investment properties, held in Hong Kong under long-term leases, were valued at 31 December 2004 by an independent firm of surveyors, Knight Frank, which has among its staff fellow and associate members of the Hong Kong Institute of Surveyors, on the basis of capitalisation of the net income with due allowance for reversionary income potential. The revaluation surplus of \$148 million (2003: deficit of \$17 million) has been transferred to the investment property revaluation reserve (see note 30).
- (h) Other than investment properties, included in fixed assets are assets held for use under operating leases with gross carrying amounts and related accumulated depreciation charges as follows:

	<b>Gross carrying amount 2004 \$ million</b>	<b>Related accumulated depreciation 2004 \$ million</b>	Gross carrying amount 2003 \$ million	Related accumulated depreciation 2003 \$ million
Goods yard at Hung Hom Bay	85	9	131	12
Hung Hom Station Car Park	55	22	55	22
Offices at Hung Hom Station	21	6	21	5
Offices at Hung Hom freight building	6	1	8	1
Citylink Plaza at Sha Tin Station	104	60	104	58
Goods yard at Mongkok Station	45	6	45	5
Shops at stations	672	59	545	52
Mobile phone coverage system	87	37	70	31
Trackside Villas	19	4	19	3
	<b>1,094</b>	<b>204</b>	998	189

Although these properties are leased to tenants, they are either used in or are ancillary to the Group's and Corporation's rail business and are not held for their investment potential and are, accordingly, not classified as investment properties.

- (i) The Group's and Corporation's total future minimum lease payments under non-cancellable operating leases are receivable as follows:

	<b>2004 \$ million</b>	2003 \$ million
Within one year	659	596
After one year but within five years	914	1,171
After five years	41	108
	<b>1,614</b>	1,875

## 9 Fixed assets (continued)

- (j) The Group and Corporation have entered into a number of individually structured transactions or arrangements with unrelated parties to lease out and lease back assets which include rolling stock, signalling equipment, revenue collection equipment and railway infrastructure. Under each arrangement, the Group and Corporation has leased the assets to an overseas investor, who has prepaid all the rentals in relation to a lease agreement. Simultaneously, the Group and Corporation has leased the assets back from the overseas investor and will pay the rentals on a semi-annual or annual basis in accordance with a pre-determined payment schedule. The Group and Corporation has an option to purchase the overseas investor's leasehold interest in the assets at a pre-determined date for a fixed or agreed amount. Part of the rental prepayments received from the overseas investor has been placed in deposits or invested in debt securities, or loaned to an unrelated party, the repayments of which will be sufficient to meet the Group's and Corporation's rental obligations and the amount payable for exercising the purchase option under the lease agreement. As long as the Group and Corporation comply with the requirements of the lease agreements, the Group and Corporation will continue to be entitled to quiet enjoyment of and continued possession, use or operation of the assets. The arrangements have been entered with investors in the United States and the United Kingdom.

As at 31 December 2004, a portion of the Group's and Corporation's assets with a total original cost of \$11,819 million (2003: \$11,836 million) and net book value of \$7,913 million (2003: \$8,300 million) is covered by nine arrangements. Six arrangements involve rolling stock, with basic lease terms of 15 to 28 years. Two arrangements, one involving signalling equipment and the other involving the revenue collection system, have a basic lease term of 15 years. The remaining arrangement involving railway infrastructure has basic lease terms of between 24 years and 27 years. Since the Group and Corporation retain risks and rewards incident to ownership of the underlying assets in respect of each arrangement and enjoys substantially the same rights to their use as before the arrangements, no adjustment has been made to fixed assets. As a result of the nine arrangements, the Group and Corporation has received cash of \$13,410 million (2003: \$13,410 million) and, assuming exercise of the purchase option in each arrangement, will be obligated to make long-term lease payments with a total estimated net present value of \$12,681 million (2003: \$12,681 million), which obligations are expected to be funded with the proceeds of existing deposits and investments totalling \$11,964 million (2003: \$11,923 million).

The total net amounts of cash received by the Group and Corporation from the arrangements have been recorded as deferred income and are being amortised to the income statement over the applicable lease terms of the arrangements. The total amount of \$39 million (2003: \$23 million) recognised for the year has been included in turnover in the income statement.

- (k) Included in additions are amounts paid and payable to the Government by the Corporation in respect of the following:
- (i) \$9 million (2003: \$51 million) for the lease of land required for construction sites for the West Rail project. The land does not have a measurable value as it cannot be assigned and can only be used by the Corporation and/or its contractors.
  - (ii) \$37 million (2003: \$40 million) for land resumption work on the West Rail project undertaken by the Government on behalf of the Corporation.
  - (iii) \$958 million (2003: \$181 million) for compensation in respect of resumed land in respect of the West Rail project paid and payable by the Government on behalf of the Corporation. The Corporation is obligated to reimburse such sums to the Government.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 10 Construction in progress

Construction in progress comprises:

- (a) The Group

	Balance as at 1 January 2004 \$ million	Costs incurred during the year \$ million	Transfer to fixed assets \$ million	Balance as at 31 December 2004 \$ million
<b>East Rail Extensions</b>				
Building and other civil works	8,473	2,507	(7,456)	3,524
Rolling stock	135	821	(931)	25
Plant and equipment	1,541	967	(2,080)	428
Consultants' fees	1,380	255	(1,259)	376
Land and related costs	715	396	(509)	602
Overheads				
– Staff costs and other expenses	1,366	411	(1,289)	488
– On-cost recovery	(299)	(58)	336	(21)
	13,311	5,299	(13,188)	5,422
Net finance expenses	780	859	(542)	1,097
	14,091	6,158	(13,730)	6,519
<b>Other assets under construction</b>				
Buildings and other civil works	463	199	(523)	139
Rolling stock	161	23	(181)	3
Other equipment	314	230	(216)	328
Overheads	72	130	(200)	2
	1,010	582	(1,120)	472
	15,101	6,740	(14,850)	6,991

**10 Construction in progress** (continued)

(b) The Corporation

	Balance as at 1 January 2004 \$ million	Costs incurred during the year \$ million	Transfer to a subsidiary \$ million	Transfer to fixed assets \$ million	Balance as at 31 December 2004 \$ million
<b>East Rail Extensions</b>					
Buildings and other civil works	8,473	2,507	–	(7,456)	3,524
Rolling stock	135	821	–	(931)	25
Plant and equipment	1,541	967	–	(2,080)	428
Consultants' fees	1,380	255	–	(1,259)	376
Land and related costs	715	396	–	(509)	602
Overheads					
– Staff costs and other expenses	1,366	411	–	(1,289)	488
– On-cost recovery	(299)	(58)	–	336	(21)
	13,311	5,299	–	(13,188)	5,422
Net finance expenses	780	859	–	(542)	1,097
	14,091	6,158	–	(13,730)	6,519
<b>Other assets under construction</b>					
Buildings and other civil works	463	199	–	(523)	139
Rolling stock	161	23	–	(181)	3
Other equipment	314	230	(17)	(199)	328
Overheads	72	130	–	(200)	2
	1,010	582	(17)	(1,103)	472
	15,101	6,740	(17)	(14,833)	6,991

(c) East Rail Extensions

- (i) Included in land and related costs incurred during the year are amounts paid and payable to the Government by the Corporation in respect of the following:
- \$42 million (2003: \$52 million) for the lease of land required for construction sites for the East Rail Extensions project. The land does not have a measurable value as it cannot be assigned and can only be used by the Corporation and/or its contractors.
  - \$190 million (2003: \$170 million) for land resumption work undertaken by the Government and compensation in respect of resumed land paid and payable by the Government on behalf of the Corporation in respect of the East Rail Extensions project. The Corporation is obligated to reimburse such sums to the Government.
- (ii) Included in on-cost recovery credited during the year is an amount of \$48 million (2003: \$52 million) received and receivable from the Government for certain essential public infrastructure works and other works along the route of East Rail Extensions undertaken by the Corporation on its behalf pursuant to the entrustment agreements in respect of such entrustment works.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 10 Construction in progress (continued)

(d) Other assets under construction

Included in other assets under construction credited during the year are on-cost recoveries received and receivable in respect of the following:

- \$11 million (2003: \$39 million) from the Government for certain essential public infrastructure works and other works along the West Rail, Phase I route undertaken by the Corporation on its behalf pursuant to the entrustment agreements in respect of such entrustment works.
- \$16 million (2003: \$35 million) from the subsidiary, West Rail Property Development Limited, for property development along the West Rail, Phase I route as governed by the Shareholding Agreement between the Corporation and the Government (see note 16).

### 11 Deferred expenditure

Deferred expenditure comprises:

	Balance as at 1 January 2004 \$ million	Expenditure during the year \$ million	Net finance expenses \$ million	Balance as at 31 December 2004 \$ million
Sha Tin to Central Link	731	437	11	1,179
Kowloon Southern Link	169	107	3	279
Northern Link	–	4	–	4
	<b>900</b>	<b>548</b>	<b>14</b>	<b>1,462</b>

Included in expenditure incurred during the year are amounts paid and payable to the Government by the Corporation in respect of the following:

- \$3 million (2003: \$5 million) for land resumption work on the Sha Tin to Central Link project undertaken by the Government on behalf of the Corporation.
- \$5 million (2003: \$2 million) for land resumption work on the Kowloon Southern Link project undertaken by the Government on behalf of the Corporation.

## 12 Properties under development

Properties under development held in Hong Kong under long-term leases comprise:

	2004 \$ million	2003 \$ million
Balance as at 1 January	1,448	1,153
Expenditure during the year	444	314
Transfer from deferred income	–	(19)
Balance as at 31 December	1,892	1,448

The balance of expenditure on properties under development is mainly related to the development sites at Che Kung Temple Station, Tai Wai Maintenance Centre, Tai Wai Station and Wu Kai Sha Station. To strengthen the measures for stabilisation of property prices, the Secretary for Housing, Planning and Lands announced on 15 October 2003 that the Government and the Corporation had agreed not to invite expression of interests for the four property development projects along the Ma On Shan Rail before 2005, and the first phase of these projects would not be completed earlier than 2008.

## 13 Investment in subsidiaries

	Corporation	
	2004 \$ million	2003 \$ million
Unlisted shares, at cost	–	–

Details of the subsidiaries are as follows:

Name of company	Place of incorporation and operation	Number of issued and fully paid shares**	Par value of shares	Percentage of shares held by the Corporation	Percentage of shares held by a subsidiary	Principal activities
Manlai Court Property Management Company Limited	Hong Kong	25,500 'A' 24,500 'B'	\$1 \$1	100% Nil	Nil Nil	Property management
Sun Tuen Mun Centre Management Company Limited	Hong Kong	25,000 'A' 25,000 'B'	\$1 \$1	100% 100%	Nil Nil	Property management
Royal Ascot Management Company Limited	Hong Kong	25,000 'A' 25,000 'B'	\$1 \$1	100% 100%	Nil Nil	Property management
Hanford Garden Property Management Company Limited	Hong Kong	10,000	\$1	100%	Nil	Property management
Pierhead Garden Management Company Limited	Hong Kong	25,000 'A' 25,000 'B'	\$1 \$1	100% Nil	Nil 100%	Property management

\*\* All the issued and fully paid shares of the subsidiaries are ordinary shares.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 13 Investment in subsidiaries (continued)

Name of company	Place of incorporation and operation	Number of issued and fully paid shares**	Par value of shares	Percentage of shares held by the Corporation	Percentage of shares held by a subsidiary	Principal activities
The Metropolis Management Company Limited	Hong Kong	25,500 'A' 24,500 'B'	\$1 \$1	100% Nil	Nil Nil	Property management
Capital System Limited	Hong Kong	5,000	\$1	100%	Nil	Investment holding
Buoyant Asset Limited	Hong Kong	100	\$10	100%	Nil	Rolling stock leasing facilitation
Advanced Asset Limited	Hong Kong	100	\$10	100%	Nil	Signalling system leasing facilitation
Quality Asset Limited	Hong Kong	100	\$10	100%	Nil	Signalling system leasing facilitation
Kasey Asset Limited	Hong Kong	100	\$10	100%	Nil	Rolling stock leasing facilitation
Circuit Asset Limited	Hong Kong	100	\$10	100%	Nil	Rolling stock leasing facilitation
Shining Asset Limited	Hong Kong	100	\$10	100%	Nil	Revenue collection system leasing facilitation
Fluent Asset Limited	Hong Kong	100	\$10	100%	Nil	Rolling stock leasing facilitation
Kudos Asset Limited	Hong Kong	100	\$10	100%	Nil	Rolling stock leasing facilitation
Unique Asset Limited	Hong Kong	100	\$10	100%	Nil	Rolling stock leasing facilitation
Bowman Asset Limited	Cayman Islands	1,000	US\$1	100%	Nil	Railway infrastructure leasing facilitation

\*\* All the issued and fully paid shares of the subsidiaries are ordinary shares.

**13 Investment in subsidiaries** *(continued)*

<b>Name of company</b>	<b>Place of incorporation and operation</b>	<b>Number of issued and fully paid shares**</b>	<b>Par value of shares</b>	<b>Percentage of shares held by the Corporation</b>	<b>Percentage of shares held by a subsidiary</b>	<b>Principal activities</b>
Statesman Asset Limited	Cayman Islands	1,000	US\$1	100%	Nil	Railway infrastructure leasing facilitation
Interwind Asset Limited	Hong Kong	100	\$10	100%	Nil	Railway equipment leasing facilitation
V-Connect Limited	Hong Kong	100	\$10	100%	Nil	Mobile communication system operation
*West Rail Property Development Limited	Hong Kong	51 'A' 49 'B'	\$10 \$10	100% Nil	Nil Nil	Property development
*Kam Sheung Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Kwai Fong Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Long Ping Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Long Ping South Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Nam Cheong Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Pat Heung Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Tin Shui Wai Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Tsuen Wan West Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Tuen Mun Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Yuen Long Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development

\* These subsidiaries are held by the Corporation for the sole purpose of developing commercial or residential property along the West Rail, Phase I route on behalf of the Government and their financial statements are excluded from consolidation as the Corporation has no effective control over nor beneficial interests in the net assets of these subsidiaries, other than the amount of capital provided.

\*\* All the issued and fully paid shares of the subsidiaries are ordinary shares.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 13 Investment in subsidiaries (continued)

Name of company	Place of incorporation and operation	Number of issued and fully paid shares**	Par value of shares	Percentage of shares held by the Corporation	Percentage of shares held by a subsidiary	Principal activities
*Tsuen Wan West Cityside Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Tsuen Wan West TW6 Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development
*Tsuen Wan West TW7 Property Development Limited	Hong Kong	100	\$10	Nil	100%	Property development

\* These subsidiaries are held by the Corporation for the sole purpose of developing commercial or residential property along the West Rail, Phase I route on behalf of the Government and their financial statements are excluded from consolidation as the Corporation has no effective control over nor beneficial interests in the net assets of these subsidiaries, other than the amount of capital provided.

\*\* All the issued and fully paid shares of the subsidiaries are ordinary shares.

### 14 Interest in associate

The interest in associate is as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Unlisted shares, at cost	–	–	9	9
Share of net assets	57	42	–	–
	57	42	9	9

**14 Interest in associate** *(continued)*

Details of the associate, which is incorporated and operates in Hong Kong are as follows:

Name of company	Number of issued and fully paid shares	Par value of shares	Percentage of shares held	Principal activities
Octopus Cards Limited	42,000,000 ordinary	\$1	22.1%	Development and operation of the Octopus cards system

On 17 January 2001, the Corporation entered into a service agreement with Octopus Cards Limited in order to formalise the existing arrangements for the provision of services to each other relating to the use of Octopus cards. Under the service agreement, the Corporation will continue to accept the use of Octopus cards for payment of fares and to provide add-value, refund and other ancillary services to Octopus Cards Limited.

During the year, the Group made payments to Octopus Cards Limited amounting to \$33 million (2003: \$29 million) in respect of fees for the use of the Octopus cards system. These payments were made based on the fare revenue generated from Octopus cards. No other charges were made or incurred by the Group in respect of the administration of the Octopus cards system. The Group received \$8 million (2003: \$7 million) from Octopus Cards Limited in respect of ticket loading agent fees for providing add-value amounts on Octopus cards and handling fees for issuing new cards and handling refunds for returned cards.

**15 Loan receivable**

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Loan receivable	<b>733</b>	774	<b>16</b>	16

Under one of those lease arrangements entered into by the Group and the Corporation referred to in note 9(j), the future lease payments are funded by the interest earned on the loan receivable and the repayment of the loan receivable made by the Group and the Corporation to an unrelated party. The interest rate on the loan receivable is predetermined.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 15 Loan receivable (continued)

The loan receivable is scheduled to be repaid by instalments over the duration of the lease arrangement until its expiry in 2018, as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Within one year	31	42	–	–
After one year	702	732	16	16
	<b>733</b>	774	<b>16</b>	16

### 16 Loan to subsidiary

On 24 February 2000, the Corporation and the Government entered into a shareholding agreement (the "Shareholding Agreement") for the formation of a sub-group of the Corporation under an intermediate holding company, West Rail Property Development Limited ("WRPDL"), to undertake all property developments along the West Rail, Phase I route. The issued share capital of WRPDL comprises 51 ordinary "A" shares and 49 ordinary "B" shares, which are held by the Corporation and the Government respectively. The ordinary "A" shares are not entitled to any distribution by WRPDL other than a return of capital, and the ordinary "B" shares are entitled to all dividends declared by WRPDL and a return of capital.

All costs incurred or to be incurred in relation to the West Rail property developments are to be funded by loans from the Corporation to WRPDL bearing interest at an annual rate of 1% over the Corporation's average cost of funds in the preceding year. To the extent that WRPDL is unable to repay the loan, the Government shall seek the necessary authority to reimburse costs incurred by the Corporation. The Government has also undertaken to indemnify the Corporation against all liabilities properly incurred by the Corporation in relation to such property developments.

Subsidiaries of WRPDL have been formed to handle the property developments along the West Rail, Phase I route whereby the Government will receive the profits less losses from the developments and the Group or Corporation will earn management fees.

## 17 Investments

(a) Investments comprise:

	<b>2004</b>	2003
	<b>\$ million</b>	\$ million
Debt securities		
– Listed outside Hong Kong	<b>578</b>	1,165
– Listed in Hong Kong	–	5
– Unlisted	<b>1,645</b>	6,968
Interest-bearing deposits temporarily placed with custodian bank	<b>2,100</b>	4,106
Total fair value of investments	<b>4,323</b>	12,244
Total market value of listed investments	<b>578</b>	1,170

No debt securities issued by the Government and Government-owned entities in Hong Kong are included in investments.

(b) Investments are expected to mature as follows:

	<b>2004</b>	2003
	<b>\$ million</b>	\$ million
Within one year	<b>3,960</b>	11,231
After one year	<b>363</b>	1,013
	<b>4,323</b>	12,244

## 18 Stores and spares

Stores and spares are expected to be consumed as follows:

	<b>2004</b>	2003
	<b>\$ million</b>	\$ million
Within one year	<b>164</b>	124
After one year	<b>155</b>	130
	<b>319</b>	254

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 19 Interest receivable

Interest is receivable as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Within one year	48	63	31	60
After one year	1	–	1	–
	<b>49</b>	63	<b>32</b>	60

### 20 Other receivables

(a) Other receivables comprise:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Amounts due from subsidiaries	–	–	23	42
Amount due from associate	1	3	1	3
Amount due from the Government	510	393	510	393
Debtors, deposits and prepayments	196	216	185	190
	<b>707</b>	612	<b>719</b>	628

The amount due from the Government represents \$446 million (2003: \$341 million) in respect of certain essential public infrastructure works and other works along the routes of the West Rail and East Rail Extensions undertaken on behalf of the Government pursuant to the respective entrustment agreements with the Government in respect of such entrustment works and \$64 million (2003: \$52 million) for "on-costs" charged to the Government in respect of such entrustment works.

(b) Other receivables are expected to be recovered as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Within one year	684	585	696	601
After one year	23	27	23	27
	<b>707</b>	612	<b>719</b>	628

## 20 Other receivables (continued)

(c) Included in other receivables are debtors with the following ageing analysis:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Current	652	526	664	542
Less than one month overdue	6	8	6	8
One to three months overdue	17	14	17	14
More than three months overdue	2	11	2	11
Total debtors	677	559	689	575
Deposits and prepayments	30	53	30	53
	<b>707</b>	612	<b>719</b>	628

For debtors of commercial property leasing and franchise operations, no credit is allowed except for revenue sharing arrangements. For debtors of other business dealings, the normal credit period extended is one month.

## 21 Cash and cash equivalents

(a) Cash and cash equivalents comprise:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Deposits with banks				
– Within three months of maturity when placed	2,555	2,423	2,450	2,303
– More than three months of maturity when placed	940	200	940	200
Cash at bank and in hand	36	54	36	54
Cash and cash equivalents in the balance sheets	3,531	2,677	3,426	2,557
Less: deposits with banks with more than three months of maturity when placed	(940)	(200)		
Cash and cash equivalents in the cash flow statement	2,591	2,477		

(b) At 31 December 2004, the deposits with banks were placed to mature within one year.

## 22 Interest payable

Interest payable is expected to be settled within one year.

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 23 Other payables

(a) Other payables comprise:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Deposits and advances	1,173	1,326	1,085	1,228
Creditors and accrued charges	1,271	770	1,257	763
Amount due to the Government	–	2	–	2
Amounts due to subsidiaries	–	–	1	1
	<b>2,444</b>	2,098	<b>2,343</b>	1,994

(b) Other payables are expected to be settled as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Within one year	1,569	1,138	1,468	1,034
After one year	875	960	875	960
	<b>2,444</b>	2,098	<b>2,343</b>	1,994

(c) Included in other payables are creditors with the following ageing analysis:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Due within one month or on demand	468	265	460	259
Due after six months	313	271	313	271
Total creditors	781	536	773	530
Deposits and advances received	1,173	1,326	1,085	1,228
Accrued charges	490	236	485	236
	<b>2,444</b>	2,098	<b>2,343</b>	1,994

## 24 Accrued charges and provisions for capital projects

The balance includes accrued charges related to capital projects which are settled upon certification of work in progress and also provisions for claims on contracts in respect of the West Rail and East Rail Extensions projects. It also includes the amount of \$1,361 million (2003: \$383 million) for amounts payable to the Government in relation to the West Rail, East Rail Extensions, Sha Tin to Central Link and Kowloon Southern Link projects.

Accrued charges and provisions for capital projects of the Group and of the Corporation are all expected to be settled or utilised within one year.

## 25 Lease payable

The lease payments under the lease arrangement disclosed in note 15 are expected to be made as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Within one year	31	42	–	–
After one year	686	716	–	–
	<b>717</b>	758	–	–

The payments are to be funded by the interest earned on loan receivable and the repayment of the loan receivable as discussed in note 15 in accordance with the terms of the lease arrangement.

## 26 Interest-bearing borrowings

(a) Interest-bearing borrowings comprise:

	2004 \$ million	2003 \$ million
<b>Capital market instruments</b>		
US dollar notes due 2009 – see (b) below	7,771	7,770
HK dollar notes due 2013 – see (b) below	800	800
US dollar notes due 2014 – see (b) below	388	388
US dollar notes due 2010 – see (c) below	7,785	7,780
HK dollar Retail notes due 2008 and 2013 – see (d) below	1,020	1,023
	<b>17,764</b>	17,761
<b>Bank loans</b>		
Export credit loans – see (f) below	1,984	2,252
	<b>19,748</b>	20,013

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 26 Interest-bearing borrowings (continued)

- (b) The Corporation issued 7.25% notes due 2009 with a principal amount of US\$1 billion at a discount on 27 July 1999, 7.77% notes due 2014 with a principal amount of US\$50 million at a discount on 17 November 1999 and 4.65% notes due 2013 with a principal amount of HK\$800 million at par on 9 June 2003 under its US\$3 billion medium term note programme. All the notes issued are unsecured and repayable in full on the respective due dates.
- (c) The Corporation issued 8.00% notes due 2010 with a principal amount of US\$1 billion at a discount on 16 March 2000. These notes are registered with the United States Securities and Exchange Commission and listed on the Stock Exchange of Hong Kong Limited, the London Stock Exchange Limited and the New York Stock Exchange, Inc. All the notes issued are unsecured and repayable in full on the due date.
- (d) The Corporation issued 3% notes due 2008 with a principal amount of HK\$300 million at a premium and 4.8% notes due 2013 with a principal amount of HK\$700 million at a premium on 6 June 2003. All the notes issued are unsecured and repayable in full on the respective due dates.
- (e) All the net proceeds received from the notes issued are invested in fixed income instruments or placed on deposit with banks or issuers with triple B or above credit ratings until they are required to meet development costs.
- (f) During the year, the Corporation has repaid US\$33.4 million in accordance with the provisions of the loan agreement in respect of a US\$337.7 million export credit loan facility provided by Japan Bank for International Cooperation. As at 31 December 2004, the outstanding balance of the facility amounted to US\$220.2 million, of which about 66% bore interest at a fixed rate and the remaining 34% bore interest at a rate of LIBOR plus a margin. The loan is unsecured and repayable by seventeen semi-annual instalments commencing on 21 April 2003.

During the year, US\$2.7 million has been drawn and US\$4.3 million has been repaid by the Corporation under a US\$42 million export credit loan facility provided by Export Development Canada. As at 31 December 2004, the outstanding balance of the facility amounted to US\$33.9 million, which bore interest at a rate of LIBOR plus a margin. The loan is unsecured and repayable by seventeen semi-annual instalments commencing on 4 May 2004.

- (g) At 31 December 2004, the interest-bearing borrowings were repayable as follows:

	<b>Capital market instruments 2004 \$ million</b>	<b>Bank loans 2004 \$ million</b>	<b>Total 2004 \$ million</b>	Total 2003 \$ million
Within one year	–	299	299	297
After one year but within two years	–	300	300	298
After two years but within five years	8,075	916	8,991	1,211
After five years	9,689	469	10,158	18,207
	<b>17,764</b>	<b>1,984</b>	<b>19,748</b>	20,013

## 27 Deferred income

(a) Movements on deferred income comprise:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Balance at 1 January	743	434	707	434
Net income accrued during the year	4	18	–	–
Net amount received during the year	8	337	–	319
Transfer to properties under development	–	(19)	–	(19)
Transfer to the income statement	(47)	(27)	(44)	(27)
	<b>708</b>	<b>743</b>	<b>663</b>	<b>707</b>

(b) Deferred income is expected to be recognised in the income statement as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Within one year	48	48	43	44
After one year	660	695	620	663
	<b>708</b>	<b>743</b>	<b>663</b>	<b>707</b>

## 28 Share capital

	2004		2003	
	No. of shares	\$ million	No. of shares	\$ million
<b>Share capital:</b>				
<b>Authorised:</b>				
Shares of \$100,000 each	425,000	42,500	425,000	42,500
<b>Issued and fully paid:</b>				
At 31 December	391,200	39,120	391,200	39,120

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 29 Development reserve

The development reserve represents appropriations of all profits from property developments to retained reserves within the Corporation. The development reserve has been created and can only be released in accordance with the relevant provisions of the Kowloon-Canton Railway Corporation Ordinance.

	2004 \$ million	2003 \$ million
Balance at 1 January and 31 December	<b>6,535</b>	6,535

### 30 Investment property revaluation reserve

The investment property revaluation reserve comprises:

	2004 \$ million	2003 \$ million
Balance at 1 January	<b>117</b>	134
Surplus/(deficit) arising on revaluation during the year (Note 9)	<b>148</b>	(17)
Balance at 31 December	<b>265</b>	117

### 31 Investment revaluation reserve

The revaluation reserve arising on investments comprises:

	2004 \$ million	2003 \$ million
Balance at 1 January	<b>(1)</b>	50
Deficit arising on revaluation	<b>(103)</b>	(197)
Less: Amount capitalised	<b>49</b>	121
	<b>(54)</b>	(76)
Deficit realised on redemption and disposal	<b>79</b>	60
Less: Deficit capitalised in prior years	<b>(40)</b>	(35)
Deficit transferred to the income statement on redemption and disposal	<b>39</b>	25
Balance at 31 December	<b>(16)</b>	(1)

### 32 Retained profits

Profits are retained as follows:

	Group		Corporation	
	2004 \$ million	2003 \$ million	2004 \$ million	2003 \$ million
Retained profits at 1 January	14,434	13,673	14,400	13,644
Dividend approved in respect of the previous year (Note 7)	(620)	(620)	(620)	(620)
Retained profit for the year	429	1,381	418	1,376
Retained profits at 31 December	14,243	14,434	14,198	14,400
Representing:				
Proposed dividend (Note 7)	172	620	172	620
Retained profits after proposed dividend	14,071	13,814	14,026	13,780

Included in the retained profits of the Group is an amount of \$48 million (2003: \$33 million), being the retained profits attributable to an associate.

### 33 Notes to the consolidated cash flow statement

Reconciliation of operating profit before net finance income/(expenses) to net cash inflow from operations:

	2004 \$ million	2003 \$ million
Operating profit before net finance income/(expenses)	537	1,549
Depreciation	1,632	748
Fixed assets written off	24	9
Increase in stores and spares	(65)	(41)
Increase in other receivables	(262)	(69)
Increase/(decrease) in other payables and deferred income	440	(17)
	2,306	2,179

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 34 Related parties

The Corporation is wholly owned by the Government. The Corporation has entered into transactions with the Government in respect of the developments of the West Rail, Phase I and East Rail Extensions which are considered to be related party transactions under Statement of Standard Accounting Practice 20 and these are disclosed in notes 1, 2(c), 9(k), 10(c) and (d), 11, 13, 16, 20(a) and 24 to the financial statements. Transactions with Government departments and agencies in the course of their normal dealings with the Corporation are not considered to be related party transactions.

Members of the Managing Board and the Executive Directors who are not Members of the Managing Board and parties related to them are also related parties of the Corporation. During the year there were no significant transactions with any such parties other than their remuneration which is disclosed in note 3 to the financial statements.

The Corporation and four other local transport companies (including the MTR Corporation Limited) entered into an agreement in 1994 to develop and operate the Octopus cards system through a central body called Octopus Cards Limited. During the year, Octopus Cards Limited earned fees for the use of the Octopus cards system from the Corporation and paid ticket loading agent fees and handling fees to the Corporation. Details of the transactions are disclosed in note 14 to the financial statements.

### 35 Outstanding commitments

- (a) Commitments outstanding at 31 December 2004 in respect of capital expenditure not provided for in the financial statements were as follows:

	<b>2004</b>	2003
	<b>\$ million</b>	\$ million
Authorised and contracted for	<b>2,951</b>	7,151
Authorised but not contracted for	<b>2,015</b>	6,154
	<b>4,966</b>	13,305

- (b) At 31 December 2004, the total future minimum lease payments under non-cancellable operating leases for property are payable as follows:

	<b>2004</b>	2003
	<b>\$ million</b>	\$ million
Within 1 year	<b>40</b>	87
After 1 year but within 5 years	<b>18</b>	53
	<b>58</b>	140

The operating leases are mainly related to work areas used for construction of new railways. During the year amounts payable under operating leases totalling \$54 million (2003: \$105 million) were capitalised as part of construction in progress or deferred expenditure, as appropriate.

### 36 Retirement benefit scheme

The Kowloon-Canton Railway Corporation Retirement Benefit Scheme (the Scheme) was established on 1 February 1983 under trust. With effect from 16 November 1994, the Scheme has been registered under Section 18 of the Occupational Retirement Schemes Ordinance.

Prior to 1 January 2000, the Scheme was a defined benefit retirement scheme which provided benefits for all eligible employees of the Corporation. Benefits were calculated by reference to the unit price, accrued service, salary and number of accumulated units of a member. With effect from 1 January 2000, a new defined contribution section has been introduced to the Scheme by means of a Deed of Variation dated 24 February 2000. All eligible employees joining the Corporation on or after 1 January 2000 joined the new defined contribution section of the Scheme.

Following the agreement of more than 90% of the members of the defined benefit section of the Scheme, with effect from 1 April 2000, all 3,709 members (excluding 37 non consenters) joined the defined contribution section and the 37 non consenters ceased to be members of the Scheme on 1 April 2000. Pursuant to a Deed of Variation dated 31 March 2000, the defined benefit section of the Scheme was terminated and a Mandatory Provident Fund ("MPF") Appendix was introduced to the Scheme. From 1 April 2000, all benefits payable under the Scheme are calculated by reference to the Corporation's contributions and members' own contributions, together with investment returns on these contributions.

For members joining the Scheme before 1 January 2000, the Corporation's contribution rates are 12% and 16% of the respective salaries of non-management staff and management staff. For members joining on or after 1 January 2000, the Corporation's contribution rates for the first eight years are 8% and 12% of the respective salaries of non-management staff and management staff and, thereafter, the contribution rates will be 10% and 15% of the respective salaries of non-management staff and management staff.

On 17 July 2000, the Scheme was granted an exemption certificate by the Mandatory Provident Fund Schemes Authority under Section 5 of the Mandatory Provident Fund Schemes Ordinance. This means that all potential future members of the Scheme must be given a one-off opportunity to elect to join either the Scheme or an MPF Scheme.

Where there are employees who leave the Scheme prior to their entitlement to all or part of the Corporation's contributions vesting fully, such contributions shall be used to reduce the future contributions of the Corporation due under the Scheme.

The Group's total retirement cost charged to the income statement during the year ended 31 December 2004 amounted to \$121 million (2003: \$108 million) net of a capitalised amount of \$17 million (2003: \$29 million), after a forfeiture of unvested contributions of \$3 million (2003: \$2 million).

## Notes to the Financial Statements

(Expressed in Hong Kong dollars)

### 37 Debt facilities and programmes

Total unutilised debt facilities and programmes available to the Corporation comprise:

	2004 \$ million	2003 \$ million
\$1,650 million (2003: \$2,350 million) short-term uncommitted revolving credit facilities	1,650	2,350
\$20 million (2003: \$20 million) letters of credit	20	20
\$25 million (2003: \$25 million) overdraft facilities	25	25
\$8,000 million (2003: \$nil) syndicated loan facilities	8,000	–
US\$3,000 million (2003: US\$3,000 million) medium term note programme	14,425	14,399
US\$292 million (2003: US\$292 million) letters of credit for leveraged leases	2,280	2,276
US\$258 million (2003: US\$296 million) export credit loan facilities	29	51
	<b>26,429</b>	<b>19,121</b>

### 38 Off-balance sheet financial instruments

The Corporation uses off-balance sheet derivative financial instruments such as interest rate swaps, currency swaps and foreign exchange forward contracts to manage its interest rate and foreign currency risks. All transactions in derivative instruments are undertaken by the Corporation solely for hedging purposes. The Corporation does not engage in the trading or speculation of derivative financial instruments. As at 31 December 2004, the Corporation has outstanding derivative financial instruments in the notional amount of \$21,867 million (2003: \$24,850 million) comprising:

	2004 \$ million	2003 \$ million
Interest rate swaps	4,142	5,697
Cross currency swaps	15,184	15,573
Foreign exchange forward contracts	2,541	3,580
	<b>21,867</b>	<b>24,850</b>

### 39 Contingent liabilities

- (a) At 31 December 2004, the Group had contingent liabilities arising from certain contractors' claims in respect of the contracts for the construction of the West Rail and East Rail Extensions projects where the Group's total obligations cannot be estimated reliably. The Group has made provision in the financial statements at 31 December 2004 for its best estimate of amounts which are likely to be payable in connection with these claims. The amounts payable upon resolution of the claims may be eventually in excess of amounts estimated by the Group and accounted for in the financial statements at 31 December 2004. The Group is in the process of resolving these claims.
- (b) The lease arrangements referred to in note 9(j) are subject to certain terms and conditions under the related agreements whereby one of the lease arrangements may be subject to mandatory termination upon the occurrence of certain specified events or circumstances. Management has considered the likelihood of such events occurring and has concluded that there was a possibility that one of the lease arrangements may be subject to mandatory termination before the end of the basic lease term. Should mandatory termination of the lease arrangement occur, the maximum exposure of the Group after deduction of the transaction benefit is estimated to be approximately \$62 million at 31 December 2004 (2003: \$65 million), the actual amount of which will depend on the interest rates prevailing at the date of termination.

### 40 Assessment of impairment of fixed assets

At 31 December 2004 the Corporation assessed whether there was any impairment of the Group's fixed assets at that date in accordance with the Group's accounting policies for the assessment of asset impairment.

In assessing the value in use of the Group's railway assets the entire railway network, current and committed, has been treated as representing the smallest cash-generating unit on the basis that once the Kowloon Southern Link, which has been gazetted by the Government, is completed in 2009 the current East Rail and West Rail networks will be linked and it will not be possible to allocate passenger revenue to any specific part of the network.

The estimated cash flows of the railway network were calculated for a period consistent with the estimated useful life of the core assets of the railway network and were discounted using the Corporation's weighted average cost of capital at 31 December 2004.

As a result of this assessment, management consider that the railway assets of the Group are not impaired at 31 December 2004 and, accordingly, that no provision for impairment of the Group's railway assets is required at that date.

## Notes to the Financial Statements

*(Expressed in Hong Kong dollars)*

### **41 Possible merger of the Corporation and MTR Corporation Limited**

On 24 February 2004, the Government invited the two railway corporations to commence negotiations on a possible merger. On 16 September 2004, the two corporations submitted their Joint Merger Report to the Government on the outcome of their negotiations, including preliminary transaction terms and the framework of a draft operating agreement with key terms on, inter alia, the fare adjustment mechanism, and safeguards and measures to deal with service disruption. The Government is currently considering the content of the Report.

These financial statements have not included any adjustments to the carrying value of assets or liabilities which may be required once the Government announces the results of its study of the report as it is uncertain what will be the outcome and the consequent effect on the Corporation's operations and financial condition.

### **42 Recently issued financial reporting standards**

The Hong Kong Institute of Certified Public Accountants has recently issued a number of new and revised financial reporting standards ("HKFRSs") which will be applicable for accounting period beginning on or after 1 January 2005. The Corporation has already commenced an assessment of the impact of these new and revised HKFRSs but is not yet in a position to determine whether these new and revised HKFRSs will have a significant impact on the results of operations and financial position of the Corporation.

## US GAAP Reconciliations

### Summary of differences between accounting principles generally accepted in Hong Kong and the United States

The Group's consolidated financial statements are prepared in accordance with accounting principles generally accepted in Hong Kong ("HK GAAP"), which differ in certain significant respects from accounting principles generally accepted in the United States ("US GAAP"). The significant differences relate to the following items and the adjustments considered necessary to reconcile consolidated profit after taxation and consolidated shareholder's funds in accordance with US GAAP are shown in the tables set out in the following pages.

#### 1 Investment property revaluation and depreciation

Under HK GAAP, investment properties are stated on the basis of appraised values and depreciation expense is not provided on investment properties. Under US GAAP, such revaluations are not permitted. Accordingly, the investment properties of the Group, which are stated at open market value, have been restated at historical cost less accumulated depreciation.

Depreciation has been based on the historical cost of the properties and a useful life of 50 years. The gross historical cost of properties subject to depreciation under US GAAP which are not depreciated under HK GAAP amounted to HK\$761 million and HK\$761 million at 31 December 2003 and 31 December 2004, respectively.

#### 2 Depreciation on certain fixed assets

As permitted by HK GAAP, the initial costs of the Group's permanent way, which principally comprises rail tracks, ballast and sleepers, is not depreciated. The costs of replacement of permanent way are charged to the income statement as and when the expenses are incurred.

Under US GAAP the costs of permanent way are depreciated over the estimated useful lives of the assets and the costs of replacement are capitalised and depreciated over their estimated useful lives.

In previous years, no adjustments under US GAAP were made for the permanent way relating to the East Rail and Light Rail systems on the basis that the original costs of the permanent way would have already been fully depreciated under US GAAP and on the basis that the cumulative effect of the difference in accounting for the costs of replacement of the permanent way under HK GAAP and US GAAP was not significant.

The Group's new railway system and extensions, the West Rail system, the Tsim Sha Tsui Extension and the Ma On Shan Rail, were put into use on 20 December 2003, 24 October 2004 and 21 December 2004 respectively. As permitted by HK GAAP, the costs of the permanent way of these routes are not depreciated. Under US GAAP the costs of the permanent way of these routes are depreciated over the estimated useful lives of the assets. Accordingly, an adjustment of HK\$104 million has been made to the income statement to record the depreciation charge for the year ended 31 December 2004 under US GAAP calculated using a straight line basis over the estimated useful lives ranged from 10 to 15 years. In 2003, no adjustment was made for the depreciation charge on the permanent way of the West Rail system as the effect of the 12 days' period was not material.

In addition, an adjustment of HK\$15 million (net of related depreciation charges of HK\$1 million) has been made to the income statement to reverse the costs of replacement of permanent way charged to income statement for the year ended 31 December 2004 under HK GAAP.

## US GAAP Reconciliations

### Summary of differences between accounting principles generally accepted in Hong Kong and the United States *(continued)*

#### 3 Investments

Under HK GAAP, investment securities are stated in the balance sheet at fair value. Changes in fair value of pre-funding investments are capitalised to construction in progress or deferred expenditure. Additionally, interest earned and realised gains and losses on pre-funding investments are capitalised to construction in progress or deferred expenditure. When the construction projects are complete and the related assets are ready for their intended use the net cumulative costs are transferred from construction in progress to fixed assets and depreciated in accordance with the Group's depreciation policies. The depreciation charge for the year under HK GAAP is based on the net capitalised costs including interest earned and realised and unrealised gains and losses on pre-funding investments.

Under US GAAP, the Group's investments in debt securities are classified as "available for sale" and reported at fair value, with unrealised gains and losses net of applicable income taxes reported in other comprehensive income. Additionally, under US GAAP, interest earned and realised gains and losses on investments are reflected in the income statement. Accordingly, under US GAAP, the depreciation charge on fixed assets is based on the costs capitalised in accordance with US GAAP which exclude interest earned and realised and unrealised gains and losses on pre-funding investments.

Under both HK GAAP and US GAAP, no provision for impairment or reversal of prior years' provisions for impairment of investment securities has been made for the year ended 31 December 2004.

The costs of the Group's fixed assets in respect of the West Rail system, the Tsim Sha Tsui Extension and the Ma On Shan Rail include interest earned and realised and unrealised gains and losses on pre-funding investments capitalised under HK GAAP. As the fixed assets in respect of the West Rail system, the Tsim Sha Tsui Extension and the Ma On Shan Rail have been put into use and subject to depreciation since 20 December 2003, 24 October 2004 and 21 December 2004 respectively, an adjustment of HK\$88 million has been made to the income statement to record the depreciation charge for the year ended 31 December 2004 under US GAAP based on the costs of the fixed assets of these routes excluding capitalised interest earned and realised and unrealised gains and losses on pre-funding investments. In 2003, no adjustment was made for the depreciation charge on the fixed assets of the West Rail system as the effect of the 12 days' period was not material.

#### 4 Revenue recognition on property development

In 1997, the Group disposed of certain investment properties in exchange for other investment properties. The cost of the acquired properties was stated at the fair value of the properties disposed of. Under US GAAP, the cost of the acquired properties should be stated at the cost of the properties being disposed of. Accordingly, an adjustment of HK\$61 million has been made to shareholder's equity to restate the cost of properties acquired under US GAAP. This adjustment will be reversed upon disposal of the related properties.

#### 5 Capitalisation of certain costs

Under HK GAAP, certain costs of a non-incremental nature are capitalised in connection with capital projects. Under US GAAP, it is not permissible to capitalise these non-incremental costs. The preponderance of the capitalised costs relating to capital projects is incremental in nature and, accordingly, is properly capitalised under both HK GAAP and US GAAP.

## Summary of differences between accounting principles generally accepted in Hong Kong and the United States *(continued)*

### 6 Capitalised interest and foreign exchange differences

Under HK GAAP, prior to 1 January 1997, the Group did not capitalise interest costs to capital projects.

Under US GAAP, interest costs, to the extent incurred, are required to be capitalised to capital projects. Capitalised interest costs are determined based on specific borrowings related to the acquisition or construction of an asset, if an entity's financing plans associate a specific new borrowing with a qualifying asset. If average accumulated expenditure for the asset exceeds the amounts of specific new borrowings associated with the asset, additional interest costs capitalised are based on the weighted average rate applicable to other borrowings of the entity.

With effect from 1 January 1997, the Group's accounting policy under HK GAAP for capitalising interest costs is similar to US GAAP.

Further, under HK GAAP, foreign exchange differences are capitalised to the extent that they are regarded as an adjustment to interest costs. Under US GAAP, foreign exchange differences are not capitalised.

### 7 Income taxes

Under US GAAP income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognised for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognised in income statement in the period that includes the enactment date.

With effect from 1 January 2003, the Group's accounting policy under HK GAAP for the recognition of deferred tax is similar to US GAAP except that under HK GAAP all deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The Group's tax losses do not expire under current tax legislation.

### 8 Derivative financial instruments ("derivatives")

Under US GAAP, all derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in fair value of the derivative and of the hedged item attributable to the hedged risk are recognised in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income and are recognised in the income statement when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognised in earnings immediately.

Under HK GAAP, derivatives are not required to be recorded on the balance sheet.

## US GAAP Reconciliations

### Summary of differences between accounting principles generally accepted in Hong Kong and the United States *(continued)*

#### 9 Lease out and lease back transactions

Under HK GAAP, where commitments by the Group to make long-term lease payments have been defeased by the placement of security deposits or advances of loans under lease out and lease back transactions, those commitments and deposits or loans receivable are not recognised as obligations and assets of the Group. In the case where the Group's commitments and deposits or loans receivable meet the definition of a liability and an asset, such commitments and deposits or loans receivable are recognised as obligations and assets in the balance sheet.

Under US GAAP, cash deposits cannot be used to offset obligations if there is no legal right to offset. The security deposits placed or loans advanced by the Group, which are used to defease the lease obligations and consist of cash lease deposits, cannot be used to offset the lease obligations since there is no legal right to offset. Accordingly, under US GAAP the security deposits placed or loans advanced to defease the lease obligations and the related commitments to make long-term lease payments would be reflected separately in the balance sheet.

#### 10 Recently issued accounting standard

In January 2003, the Financial Accounting Standard Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46") and in December 2003, issued a revision to FIN 46 ("FIN 46R") which supersedes FIN 46. FIN 46R is an effort to expand upon and strengthen existing accounting guidance as to when an entity should consolidate the financial results of another entity. FIN 46R requires "variable interest entities" ("VIE") as defined therein to be consolidated by an entity if that entity is obligated to bear a majority of expected losses of the VIE or is entitled to receive a majority of expected residual returns of the VIE, or both. The entity that is required to consolidate a VIE is referred to as the VIE's primary beneficiary. The interpretation also requires certain disclosures about VIEs that an entity is not required to consolidate, but in which it has a significant variable interest.

The Group is required to apply FIN 46R to variable interests in VIEs created after 31 December 2003. For variable interests in VIEs created before 1 January 2004, FIN 46R will be applied in the financial statements for the period beginning 1 January 2005. For VIEs that must be consolidated under FIN 46R that were created before 1 January 2004, the assets, liabilities and non-controlling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognised interest being recognised as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and non-controlling interest of the VIE.

The Corporation is evaluating the impact of applying FIN 46R to existing VIEs in which it has variable interests and has not yet completed this analysis. The Group does not have any variable interests in VIEs created after 31 December 2003. However, the Corporation believes that an unrelated entity created in December 2003 under one of the Group's lease out and lease back transactions meets the criteria to be a VIE. Under this transaction, the Group has loaned a portion of the lease prepayments received from the overseas investor to an unrelated entity created in December 2003 for the sole purpose of investing the loan proceeds in "available for sale" debt securities and other financial assets structured to meet the Group's lease obligations arising from the transaction. As the Group is obligated to bear the loss or is entitled to receive the gain which may arise from the realisation of the "available for sale" debt securities upon termination of the transaction before the end of the basic lease term, the Group is considered to be the unrelated entity's primary beneficiary. As such, it is reasonably possible that the Group would be required to consolidate such unrelated entity under the requirements of FIN 46R in compliance with US GAAP for the year ending 31 December 2005.

As the Group's loan receivable from this unrelated entity and lease obligations arising from this lease out and lease back transaction have already been reflected separately in the reconciliation of consolidated shareholder's funds to US GAAP, the consolidation of this unrelated entity is not expected to have material impact on the Group's financial position. Apart from this, the Corporation does not consider that there are any other VIEs in which the Group has significant variable interests or primary beneficial interests.

## Summary of differences between accounting principles generally accepted in Hong Kong and the United States (continued)

### 11 Statement of cash flows

Under HK GAAP, the Group presents its cash flows for: (a) operating activities; (b) investing activities; and (c) financing activities. Interest received is included in investing activities while interest paid and financing expenses paid are included in financing activities.

Under US GAAP, interest received, interest paid and financing expenses paid are all included in operating activities. The Group considers all highly liquid investments purchased with a maturity of three months or less to be cash or cash equivalents. Summarised cash flow data by operating, investing and financing activities in accordance with US GAAP are set out below:

	2004 \$ million	2003 \$ million
<b>Net cash provided/(used) by:</b>		
Operating activities	2,012	1,333
Investing activities	(1,005)	(5,092)
Financing activities	(893)	1,651
Change in cash and cash equivalents	114	(2,108)
Cash and cash equivalents at 1 January	2,477	4,585
Cash and cash equivalents at 31 December	2,591	2,477

### 12 Statement of changes in shareholder's funds

The changes of shareholder's funds for the year are set out as follows:

	2004 \$ million	2003 \$ million
Balance as at 1 January	66,743	66,205
Net profit for the year	312	1,512
Deficit on revaluation of investments in "available for sale" securities	(103)	(197)
Revaluation deficit transferred to the income statement on redemption and disposal of securities	79	60
Decrease in fair value of cash flow hedges	(518)	(303)
Increase in other comprehensive income arising from deferred tax	93	86
Dividend approved during the year	(620)	(620)
Balance as at 31 December	65,986	66,743

## US GAAP Reconciliations

### Summary of differences between accounting principles generally accepted in Hong Kong and the United States *(continued)*

#### 13 Adjustments to balance sheet items under US GAAP

The cumulative adjustments to the balance sheet items under US GAAP as a result of the significant differences between HK GAAP and US GAAP as described in notes 1 to 6 are set out as follows:

	Note	At 31 December 2004 \$ million	At 31 December 2003 \$ million
<b>Fixed assets</b>			
– investment property revaluation and depreciation	1	(401)	(239)
– accumulated depreciation on certain fixed assets	2	(89)	–
– investment income capitalised under HK GAAP	3	6,039	5,094
– accumulated depreciation on interest income capitalised	3	(88)	–
– revenue recognition on property development	4	(61)	(61)
– capitalisation of certain costs net of related depreciation	5	(498)	(362)
– capitalisation of interest net of related amortisation	6	231	240
– capitalised net foreign exchange losses	6	(36)	(44)
		<b>5,097</b>	<b>4,628</b>
<b>Construction in progress</b>			
– investment income capitalised under HK GAAP	3	1,960	2,839
– valuation of investment portfolio	3	(8)	(1)
– capitalisation of certain costs net of related depreciation	5	(57)	(188)
– capitalised net foreign exchange losses	6	(13)	(15)
		<b>1,882</b>	<b>2,635</b>
<b>Deferred expenditure</b>			
– investment income capitalised under HK GAAP	3	22	12
– valuation of investment portfolio	3	(2)	–
– capitalisation of certain costs net of related depreciation	5	(81)	(62)
– capitalised net foreign exchange losses	6	2	2
		<b>(59)</b>	<b>(48)</b>

## Summary of differences between accounting principles generally accepted in Hong Kong and the United States *(continued)*

### 14 Reconciliation of consolidated profit after taxation to US GAAP

	Note	Year ended 31 December 2004 \$ million	Year ended 31 December 2003 \$ million
<b>Consolidated profit after taxation for the year in accordance with HK GAAP</b>		<b>429</b>	1,381
<b>Adjustments required under US GAAP</b>			
Depreciation on investment properties	1	(14)	(15)
Depreciation on certain fixed assets	2	(89)	–
Depreciation on interest income capitalised	3	(88)	–
Investment income capitalised under HK GAAP	3	76	292
Capitalisation of certain costs net of related depreciation	5	(24)	(119)
Amortisation of capitalised interest	6	(9)	(9)
Capitalised net foreign exchange differences	6	10	(19)
Derivative financial instruments	8	(17)	24
Tax effect of the above adjustments		38	(23)
<b>Consolidated net income for the year in accordance with US GAAP</b>		<b>312</b>	1,512

## US GAAP Reconciliations

### Summary of differences between accounting principles generally accepted in Hong Kong and the United States *(continued)*

#### 15 Reconciliation of consolidated shareholder's funds to US GAAP

	Note	At 31 December 2004 \$ million	At 31 December 2003 \$ million
<b>Consolidated shareholder's funds in accordance with HK GAAP</b>		<b>60,147</b>	60,205
<b>Adjustments required under US GAAP</b>			
Accumulated depreciation on investment properties	1	(136)	(122)
Asset revaluation reserve	1	(265)	(117)
Accumulated depreciation on certain fixed assets	2	(89)	–
Accumulated depreciation on interest income capitalised	3	(88)	–
Valuation of investment portfolio	3	(10)	(1)
Investment income capitalised under HK GAAP	3	8,021	7,945
Revenue recognition on property development	4	(61)	(61)
Capitalisation of certain costs net of related depreciation	5	(636)	(612)
Capitalisation of interest net of related amortisation	6	231	240
Capitalised net foreign exchange differences	6	(47)	(57)
Derivative financial instruments	8	(1,032)	(497)
Lease obligations	9	(13,041)	(12,742)
Lease deposits and loan receivable	9	13,041	12,742
Deferred tax liabilities		(49)	(180)
<b>Consolidated shareholder's equity in accordance with US GAAP</b>		<b>65,986</b>	66,743

## Consolidated Income Statement

for the year ended 31 December 2004

	Note	2004 US\$ million	2004 GBP million	2004 JPY million
<b>Turnover</b>	3(a)	<b>638</b>	<b>331</b>	<b>64,885</b>
Operating costs before depreciation	3(b)	<b>360</b>	<b>187</b>	<b>36,602</b>
Operating profit before depreciation		<b>278</b>	<b>144</b>	<b>28,283</b>
Depreciation	3(c)	<b>209</b>	<b>108</b>	<b>21,281</b>
Operation profit before net finance expenses		<b>69</b>	<b>36</b>	<b>7,002</b>
Net finance expenses	4	<b>(5)</b>	<b>(3)</b>	<b>(535)</b>
Profit after net finance expenses		<b>64</b>	<b>33</b>	<b>6,467</b>
Share of profit of associate		<b>2</b>	<b>1</b>	<b>209</b>
<b>Profit before taxation</b>		<b>66</b>	<b>34</b>	<b>6,676</b>
Income tax	5(a)	<b>(11)</b>	<b>(6)</b>	<b>(1,082)</b>
<b>Profit after taxation</b>	6	<b>55</b>	<b>28</b>	<b>5,594</b>
<b>Dividend attributable to the year:</b>				
Final dividend proposed after the balance sheet date	7	<b>22</b>	<b>11</b>	<b>2,243</b>

The foreign currency figures shown are for reference purposes only and are converted from Hong Kong dollars at the following exchange rates:  
 US\$1 = HK\$7.80, GBP1 = HK\$15.040 and JPY1 = HK\$0.07669

## Consolidated Balance Sheet

at 31 December 2004

	Note	2004 US\$ million	2004 GBP million	2004 JPY million
<b>Assets</b>				
Fixed assets	9			
– Investment properties		132	68	13,378
– Other properties, plant and equipment		8,559	4,439	870,596
		<b>8,691</b>	<b>4,507</b>	<b>883,974</b>
Construction in progress	10	896	465	91,159
Deferred expenditure	11	187	97	19,064
Properties under development	12	243	126	24,671
Interest in associate	14	7	4	743
Loan receivable	15	94	49	9,558
Loan to subsidiary	16	459	238	46,629
Investments	17	554	287	56,370
Stores and spares	18	41	21	4,160
Interest receivable	19	6	3	639
Other receivables	20	91	47	9,219
Cash and cash equivalents	21	453	235	46,042
		<b>11,722</b>	<b>6,079</b>	<b>1,192,228</b>
<b>Liabilities</b>				
Interest payable	22	62	32	6,324
Other payables	23	313	162	31,869
Accrued charges and provisions for capital projects	24	509	264	51,780
Lease payable	25	92	48	9,349
Interest-bearing borrowings	26	2,532	1,313	257,504
Deferred income	27	91	47	9,232
Deferred tax liabilities	5(d)	412	214	41,883
		<b>4,011</b>	<b>2,080</b>	<b>407,941</b>
<b>Net Assets</b>				
		<b>7,711</b>	<b>3,999</b>	<b>784,287</b>
<b>Capital and Reserves</b>				
Share capital	28	5,015	2,601	510,106
Development reserve	29	838	434	85,213
Investment property revaluation reserve	30	34	18	3,455
Investment revaluation reserve	31	(2)	(1)	(209)
Proposed dividend	7	22	11	2,243
Retained profits	32	1,804	936	183,479
		<b>7,711</b>	<b>3,999</b>	<b>784,287</b>

The foreign currency figures shown are for reference purposes only and are converted from Hong Kong dollars at the following exchange rates:  
 US\$1 = HK\$7.80, GBP1 = HK\$15.040 and JPY1 = HK\$0.07669

# Corporation Balance Sheet

at 31 December 2004

	Note	2004 US\$ million	2004 GBP million	2004 JPY million
<b>Assets</b>				
Fixed assets	9			
– Investment properties		132	68	13,378
– Other properties, plant and equipment		8,553	4,436	869,944
		<b>8,685</b>	<b>4,504</b>	<b>883,322</b>
Construction in progress	10	896	465	91,159
Deferred expenditure	11	187	97	19,064
Properties under development	12	243	126	24,671
Interest in associate	14	1	1	117
Loan receivable	15	2	1	209
Loan to subsidiary	16	459	238	46,629
Investments	17	554	287	56,370
Stores and spares	18	41	21	4,160
Interest receivable	19	4	2	417
Other receivables	20	92	48	9,376
Cash and cash equivalents	21	439	228	44,673
		<b>11,603</b>	<b>6,018</b>	<b>1,180,167</b>
<b>Liabilities</b>				
Interest payable	22	60	31	6,103
Other payables	23	300	156	30,552
Accrued charges and provisions for capital projects	24	509	264	51,780
Interest-bearing borrowings	26	2,532	1,313	257,504
Deferred income	27	85	44	8,645
Deferred tax liabilities	5(d)	412	214	41,883
		<b>3,898</b>	<b>2,022</b>	<b>396,467</b>
<b>Net Assets</b>				
		<b>7,705</b>	<b>3,996</b>	<b>783,700</b>
<b>Capital and Reserves</b>				
Share capital	28	5,015	2,601	510,106
Development reserve	29	838	434	85,213
Investment property revaluation reserve	30	34	18	3,455
Investment revaluation reserve	31	(2)	(1)	(209)
Proposed dividend	7	22	11	2,243
Retained profits	32	1,798	933	182,892
		<b>7,705</b>	<b>3,996</b>	<b>783,700</b>

The foreign currency figures shown are for reference purposes only and are converted from Hong Kong dollars at the following exchange rates:  
 US\$1 = HK\$7.80, GBP1 = HK\$15.040 and JPY1 = HK\$0.07669

## 158 Consolidated Statement of Changes in Equity

for the year ended 31 December 2004

	Note	2004 US\$ million	2004 GBP million	2004 JPY million
Opening balance – Total equity		<b>7,718</b>	<b>4,003</b>	<b>785,043</b>
Surplus on revaluation of investment properties	30	<b>19</b>	<b>10</b>	<b>1,930</b>
Deficit on revaluation of investments	31	<b>(7)</b>	<b>(4)</b>	<b>(704)</b>
Net profits not recognised in the income statement		<b>12</b>	<b>6</b>	<b>1,226</b>
Revaluation deficit transferred to the income statement on redemption and disposal of securities	31	<b>5</b>	<b>3</b>	<b>508</b>
Retained profit for the year		<b>55</b>	<b>28</b>	<b>5,594</b>
Dividend paid during the year	7	<b>(79)</b>	<b>(41)</b>	<b>(8,084)</b>
Closing balance – Total equity		<b>7,711</b>	<b>3,999</b>	<b>784,287</b>

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 US\$1 = HK\$7.80, GBP1 = HK\$15.040 and JPY1 = HK\$0.07669

## Consolidated Cash Flow Statement

for the year ended 31 December 2004

	Note	2004 US\$ million	2004 GBP million	2004 JPY million
<b>Operating activities</b>				
Net cash inflow from operations	33	295	153	30,069
Net cash outflow from property development		(48)	(25)	(4,903)
Hong Kong profits tax paid		–	–	(13)
<b>Net cash inflow from operating activities</b>		<b>247</b>	<b>128</b>	<b>25,153</b>
<b>Investing activities</b>				
Increase in deposits with banks with more than three months of maturity when placed		(95)	(49)	(9,649)
Payments for capital expenditure :				
– West Rail project		(176)	(91)	(17,877)
– East Rail Extensions project		(581)	(301)	(59,121)
– other capital projects and purchase of fixed assets		(138)	(72)	(14,031)
Interest received		174	90	17,708
Loan to subsidiary		(3)	(2)	(313)
Receipts from redemption and disposal of investments		864	448	87,886
<b>Net cash inflow from investing activities</b>		<b>45</b>	<b>23</b>	<b>4,603</b>
<b>Net cash inflow before financing</b>		<b>292</b>	<b>151</b>	<b>29,756</b>
<b>Financing activities</b>				
Net cash flows on repayment of loans		(35)	(18)	(3,560)
Dividend paid		(79)	(41)	(8,084)
Interest paid		(178)	(92)	(18,086)
Net income from derivative financial instruments		18	9	1,799
Amounts paid in respect of expenses for the issue of interest-bearing borrowings		(1)	(1)	(143)
Other borrowing costs paid		(2)	(1)	(196)
<b>Increase in cash and cash equivalents</b>		<b>15</b>	<b>7</b>	<b>1,486</b>
<b>Cash and cash equivalents at 1 January</b>		<b>317</b>	<b>165</b>	<b>32,299</b>
<b>Cash and cash equivalents at 31 December</b>		<b>332</b>	<b>172</b>	<b>33,785</b>
<b>Analysis of the balances of cash and cash equivalents</b>				
Cash at bank and in hand	21(a)	5	2	469
Deposits with banks within three months of maturity when placed	21(a)	327	170	33,316
		<b>332</b>	<b>172</b>	<b>33,785</b>

The foreign currency figures shown are for reference purposes only and are converted from Hong Kong dollars at the following exchange rates:  
 US\$1 = HK\$7.80, GBP1 = HK\$15.040 and JPY1 = HK\$0.07669

## Ten-year Statistics

<b>Financial</b> (HK\$ million)	<b>2004</b>	2003	2002
<b>Income Statement</b>			
Revenue from operations	<b>4,976</b>	4,426	4,830
Operating profit before depreciation	<b>2,169</b>	2,297	2,659
Net finance expenses/(income)	<b>41</b>	(353)	(618)
Profit on property development	<b>–</b>	–	94
Net profit			
Before property development & related profits tax	<b>429</b>	1,381	2,116
After property development	<b>429</b>	1,381	2,210
Dividend	<b>172</b>	620	620
<b>Balance Sheet</b>			
Total assets	<b>91,432</b>	89,204	86,108
Net current assets / (liabilities)	<b>(2,294)</b>	(748)	1,397
Interest-bearing borrowings	<b>19,748</b>	20,013	17,753
Equity	<b>60,147</b>	60,205	59,512
<b>Key financial data</b>			
Capital expenditure	<b>9,022</b>	11,122	12,308
Return on average net fixed assets (%)			
Before property development & related profits tax	<b>1</b>	2	4
After property development	<b>1</b>	2	4
Return on equity (%)	<b>1</b>	2	4
Revenue per employee excluding project staff	<b>0.994</b>	0.950	1.222
Debt / equity ratio	<b>1:3.0</b>	1:3.0	1:3.4
Debt to total capitalisation (%)	<b>25</b>	25	23
Interest cover (times)	<b>2.5</b>	2.9	3.4

2001	2000	1999	1998	1997	1996	1995
4,797	4,731	4,426	4,137	3,718	3,294	2,973
2,572	2,571	2,249	2,032	1,769	1,471	1,276
(490)	(302)	(222)	(164)	(20)	45	25
24	87	71	88	2,308	2,468	24
2,411	2,201	1,832	1,565	1,325	1,020	881
2,435	2,288	1,903	1,639	3,263	3,077	901
–	–	–	–	–	300	–
82,537	70,419	58,291	31,945	15,866	13,544	10,175
2,135	5,727	9,857	8,663	(674)	(315)	(952)
16,831	16,395	8,299	–	–	–	608
59,580	48,901	46,588	30,253	14,317	11,163	8,263
14,595	10,829	8,444	3,286	3,582	2,538	2,065
7	8	10	10	11	10	11
7	9	10	11	26	31	11
4	5	4	5	23	28	11
1.240	1.248	1.183	1.127	1.053	0.951	0.859
1:3.5	1:3.0	1:5.6	–	–	–	1:13.6
22	25	15	–	–	–	7
3.3	3.4	7.9	–	–	–	24.8

## Ten-year Statistics

<b>Operating</b> (million)	<b>2004</b>	2003	2002
<b>East Rail including Tsim Sha Tsui Extension and Ma On Shan Rail*</b>			
Total number of passengers	<b>292</b>	278	296
Domestic	<b>207</b>	196	204
Cross-boundary	<b>85</b>	82	92
Daily average number of passengers	<b>0.799</b>	0.762	0.812
Revenue car-km operated	<b>79.35</b>	78.68	78.92
Total passenger-km travelled	<b>4,385</b>	4,183	4,540
Safety performance (unit)			
Number of passengers & public injured	<b>216</b>	181	180
Passengers & public injured per million passengers carried	<b>0.74</b>	0.65	0.61
<b>Through Train Operations</b>			
Total number of passengers	<b>3.0</b>	2.1	2.3
<b>Light Rail</b>			
Total number of passengers	<b>132</b>	106	114
Daily average number of passengers	<b>0.360</b>	0.291	0.314
Revenue car-km operated	<b>11.29</b>	10.71	10.76
Safety performance (unit)			
Number of passengers & public injured	<b>18</b>	27	33
Passengers & public injured per million passengers carried	<b>0.14</b>	0.25	0.29
<b>West Rail**</b>			
Total number of passengers	<b>48</b>	1	–
Daily average number of passengers	<b>0.131</b>	0.107	–
Revenue car-km operated	<b>34.17</b>	1.15	–
Safety performance (unit)			
Number of passengers & public injured	<b>38</b>	3	–
Passengers & public injured per million passengers carried	<b>0.79</b>	2.33	–

\* East Rail Tsim Sha Tsui Extension and Ma On Shan Rail commenced operation on 24 October 2004 and 21 December 2004 respectively.

\*\* West Rail commenced operation on 20 December 2003.

2001	2000	1999	1998	1997	1996	1995
292	288	275	269	261	247	232
205	204	200	204	206	199	189
87	84	75	65	55	48	43
0.799	0.788	0.755	0.737	0.716	0.675	0.636
75.57	73.78	72.58	71.40	69.33	69.69	69.30
4,487	4,466	4,263	4,204	4,115	3,853	3,591
191	192	186	168	157	153	163
0.65	0.67	0.67	0.62	0.60	0.62	0.71
2.1	2.0	1.7	1.4	1.5	1.8	2.1
117	118	115	114	126	125	123
0.319	0.323	0.314	0.314	0.346	0.342	0.336
10.68	10.68	10.25	10.29	9.66	9.42	9.10
35	27	51	42	73	86	55
0.30	0.23	0.44	0.37	0.58	0.69	0.45
—	—	—	—	—	—	—
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—	—	—	—	—	—	—
—	—	—	—	—	—	—
—	—	—	—	—	—	—

## Ten-year Statistics

<b>Operating</b> (million)	<b>2004</b>	2003	2002
<b>Bus</b>			
Total number of passengers*	<b>20</b>	26	26
Bus-km operated*	<b>6.95</b>	7.70	6.78
Safety performance (unit)			
Number of passengers & public injured	<b>8</b>	4	4
Passengers & public injured per million passengers carried	<b>0.21</b>	0.10	0.09
<b>Freight</b>			
Freight volume			
Southbound goods (tonnage)	<b>0.5</b>	0.6	0.7
Northbound goods (tonnage)	<b>0.3</b>	0.4	0.5
Livestock (head)	<b>0.4</b>	0.7	0.9
<b>Employees at year end (number)</b>			
Transport	<b>4,227</b>	3,914	3,228
Property	<b>109</b>	97	92
Capital Projects	<b>867</b>	1,211	1,557
Corporate & other services	<b>671</b>	649	633
	<b>5,874</b>	5,871	5,510

\* With effect from May 1999, the East Rail feeder bus services were operated by Kowloon Motor Bus Company (1933) Limited. Hence the number of passengers carried by these services and their bus-km operated have been excluded from KCRC's operating statistics.

2001	2000	1999	1998	1997	1996	1995
21	16	16	38	39	38	36
6.20	5.43	5.17	6.03	5.84	5.99	5.84
8	6	4	14	23	18	16
0.21	0.18	0.12	0.37	0.59	0.47	0.44
0.6	0.7	0.7	0.7	0.9	1.2	1.8
0.4	0.4	0.5	0.5	0.6	0.8	0.9
0.9	1.1	1.2	1.3	1.4	1.5	1.6
3,218	3,202	3,179	3,169	3,121	3,106	3,113
75	74	68	61	39	29	30
1,303	1,077	841	518	201	50	36
574	514	494	442	370	327	317
5,170	4,867	4,582	4,190	3,731	3,512	3,496

## Banks and Financial Institutions

The following is a list of key relationship banks and financial institutions which provide services to the Corporation in respect of its financing, hedging, investment and cash management activities.

ABN AMRO Bank N.V.	HSBC
American Express Bank Limited	ING Bank N.V.
Australia and New Zealand Banking Group Limited	International Bank of Asia Ltd.
Banca Intesa S.p.A.	Japan Bank for International Cooperation
Banco Bilbao Vizcaya Argentaria, S.A.	JPMorgan Chase Bank, National Association
Bank of America, National Association	KBC Bank N.V.
Bank of China (Hong Kong) Limited	Lehman Brothers
Bank of Communications	Liu Chong Hing Bank Limited
Bank of East Asia, Limited, The	Merrill Lynch & Co., Inc.
Bank of New York, The	Mizuho Corporate Bank, Ltd.
Bank of Nova Scotia, The	Morgan Stanley
Bank of Tokyo-Mitsubishi, Limited, The	Nanyang Commercial Bank, Limited
Barclays Bank Plc.	National Australia Bank, Limited
Bayerische Hypo-und Vereinsbank Aktiengesellschaft	Oversea-Chinese Banking Corporation Limited
Bayerische Landesbank	Rabobank
BNP Paribas	Royal Bank of Scotland Plc, The
Calyon	Sanpaolo IMI S.p.A.
Canadian Imperial Bank of Commerce	Shanghai Commercial Bank Limited
Citibank, N.A.	Societe Generale
Commerzbank AG	Standard Chartered Bank (Hong Kong) Limited
Commonwealth Bank of Australia	Sumitomo Mitsui Banking Corporation
Credit Suisse First Boston	Tai Fung Bank Limited
Dah Sing Bank Limited	UBS AG
DBS Bank Ltd.	UFJ Bank Limited
Deutsche Bank AG	UniCredito Italiano S.p.A.
DZ Bank AG Deutsche Zentral-Genossenschaftsbank	United Overseas Bank Limited
Export Development Canada	WestLB AG
Fortis Bank	Wing Hang Bank Limited
HSH Nordbank AG	Wing Lung Bank Limited
Hang Seng Bank Limited	

## List of Consultants

Name of Contract	Contract No.	Consultant	Division	Contract Amount (Lump Sum) (in HK\$)
1. Preliminary Project Feasibility Study on Northern Link	NOL-100	Ove Arup & Partners Hong Kong Ltd.	Capital Projects	\$8,888,830.00
2. Property Design Review Consultancy Services for Tsuen Wan West Station	PDR-TW6 & TW7	Ronald Lu & Partners (HK) Ltd	Property	\$5,890,000.00
3. Ecological Monitoring for West Rail	TSA-024	Asia Ecological Consultants Ltd.	Capital Projects	\$4,716,330.00
4. Cross-boundary and Domestic Model Update and Calibration	–	MVA Hong Kong Limited	Capital Projects	\$4,000,000.00
5. Wheel/Rail Interface Consultancy Work, West Rail	GSA-037	Parsons Brinckerhoff (Asia) Ltd.	Capital Projects	\$3,768,800.00
6. Property Design Review Consultancy Services for Tuen Mun Station	PDR-TUM	Wong Tung & Partners Ltd.	Property	\$3,665,000.00
7. Design and Project Consultancy Services for Renovation of Pierhead Plaza and Construction of Footbridge	DPC-PP	Ivanho Architects Ltd.	Property	\$2,253,710.00
8. Design and Construction Management Consultancy for Widening of Platform No. 4 at Lo Wu Station	–	Leigh & Orange Ltd.	Transport	\$1,974,960.00
9. Provision of Transport Planning Services for the Proposed Merger of KCRC and MTRCL	–	MVA Hong Kong Limited	Capital Projects	\$1,920,000.00
10. The Technical Study on Mid-Life Refurbished Electric Multiple Units for Lok Ma Chau Operation	ETS-3000	Scott Wilson Ltd.	Transport	\$1,885,000.00

## Glossary of Financial Terms

### Debt to total capitalisation

Total interest-bearing borrowings expressed as a percentage of the sum of total interest-bearing borrowings and equity.

### Debt/equity ratio

Total interest-bearing borrowings divided by the sum of share capital, development reserve, investment property revaluation reserve, investment revaluation reserve, proposed dividend and retained profits.

### Interest cover

Earnings before interest, tax and depreciation plus gross interest income before capitalisation divided by gross interest expenses before capitalisation.

### Net current assets/liabilities

Net current assets/liabilities include stores and spares, interest receivable, other receivables, cash and cash equivalents, interest payable, other payables, and accrued charges and provisions for capital projects.

### Net fixed assets

For the purposes of calculating the return on average net fixed assets, net fixed assets include the net book value of the historical costs of fixed assets and construction in progress. In other words, any revaluation surplus or deficit of investment properties is excluded.

### Operating margin

Operating profits before net finance income/expenses divided by turnover.

### Return on average net fixed assets

Net profit after taxation divided by the average net fixed assets of the period.

### Revenue per employee excluding project staff

Turnover divided by the number of employees excluding project staff at the end of the period.

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### Further Information

The Corporate Affairs Department will be pleased to supply any further information on request. Please contact:

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*This annual report is available via: [www.kcrc.com](http://www.kcrc.com)*



