KCR
九廣鐵路

Switching tracks

A century of commitment, a decade of expansion

Kowloon-Canton Railway Corporation
Annual Report 2007

Switching Tracks: A century of commitment, a decade of expansion

For nearly 100 years KCRC has provided a world-class railway service for the people of Hong Kong, a service that over the past decade has undergone a rapid and dramatic programme of expansion.

From the planning of West Rail in 1996, through the Light Rail Extensions, Tsim Sha Tsui Extension and Ma On Shan Rail to the completion of the Lok Ma Chau Spur Line in 2007, all of these projects have been completed on time and within budget. This is an achievement in which all of us at KCRC, and indeed all Hong Kong people, can justifiably take pride.

Today, as a consequence of the rail merger, we have switched tracks and assumed a new role of a railway asset holder. Although we are no longer an operator of railways, KCRC will continue contributing to Hong Kong by, for example, investing our revenues in a responsible manner and ensuring that the ongoing new capital projects will be funded to completion.

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Corporate Profile

The Kowloon-Canton Railway came into service in 1910 and played a central role in the life of Hong Kong. In 1982 the Kowloon-Canton Railway Corporation (KCRC) was established through the enactment of the Kowloon-Canton Railway Corporation Ordinance.

Until 1 December 2007 KCRC provided high quality mass transport services, including heavy rail, light rail and feeder bus networks, in the Hong Kong Special Administrative Region. Additionally, the Corporation designed and developed new railways and was active in property development and related commercial activities.

KCRC also contributed significantly to Hong Kong's social and economic development by providing cross-boundary rail services at two crossings, constructing and commissioning new railways, and extending rail services to growing areas of the New Territories.

In February 2004 the Government invited KCRC and the MTR Corporation to commence discussions on a possible merger between the two corporations. In April 2006 the Government and the MTR Corporation signed a non-binding Memorandum of Understanding on the structure and terms for the proposed merger. In June 2007 the Legislative Council passed the Rail Merger Bill, and subsequently in July, the By-laws and regulations of the merged company were also passed.

On 2 December 2007 the Rail Merger Ordinance came into effect. The Rail Merger Ordinance expressly empowers KCRC to grant a service concession to MTR Corporation and expands the scope of the MTR Corporation's franchise for taking up the operation of KCRC's transport services. Following the merger, the MTR Corporation took up the operations of the merged KCR and MTR railway networks.

KCRC today is an asset holding company with responsibility to invest its current significant cash revenues, service its outstanding debts and ensure its ongoing new capital projects will be funded to completion.

A Century of Commitment

The British section of the Kowloon-Canton Railway, or KCR, came into service in 1910 as a single track system, running from Tsim Sha Tsui in Kowloon through the New Territories and up to the border at Lo Wu. This section of the railway later became known as East Rail.

Trains were initially steam hauled, but diesel traction was gradually introduced in the 1950s and by 1962 had replaced all steam trains. The year 1978 marked the commencement of the railway's modernisation and electrification programme. The first stage of electrification was completed with the start of an inner suburban service between Kowloon and Sha Tin on 6 May 1982. Just over a year later, on 15 July 1983, electrification was extended to Lo Wu.

Prior to 1982, the railway had operated as a Government department, but in December of that year the Kowloon-Canton Railway Corporation was created through the enactment of the Kowloon-Canton Railway Corporation Ordinance. The Corporation was wholly government owned, and a Managing Board appointed by the Chief Executive of the Hong Kong Special Administrative Region monitored its operations.

Up to the merger with MTR Corporation in 2007, the Kowloon-Canton Railway Corporation was one of the world's most successful railway operators.

Its network of 120 kilometres, currently managed by MTR Corporation, provides three domestic passenger rail services: East Rail, which operates between East Tsim Sha Tsui and the boundary at Lo Wu and Lok Ma Chau and branches off to Ma On Shan at Tai Wai; West Rail, which runs between the North West New Territories and urban Kowloon; and Light Rail, which acts as a feeder service for West Rail while serving as a major mode of transport within the North West New Territories. All of these railways are supported by feeder buses.

Furthermore, the Corporation also designed and built new railways. The Lok Ma Chau Spur Line, which began operation in 2007, provides a second railway boundary crossing between Hong Kong and the Mainland. Another major project, the Kowloon Southern Link, will link West Rail Nam Cheong Station to East Rail East Tsim Sha Tsui Station. It is targeted for completion in 2009.

In addition to its core territorial rail services, KCRC was also in the business of operating intercity passenger and freight services as well as property development and related commercial activities.

Over the nearly 100 years of its existence, KCRC demonstrated a strong commitment to corporate responsibility through an extensive range of community programmes and environmental initiatives.

1910 – 1979

1910

October

The British (Hong Kong) section of the Kowloon-Canton Railway (KCR) begins operation, with stations at Yau Ma Tei, Sha Tin, Tai Po and Fanling.

1911

October

The Chinese section of the KCR becomes operational, and through train service to Guangzhou commences.

1916

March

Tsim Sha Tsui Terminus opens.

1921

March

The clock tower at Tsim Sha Tsui Terminus comes into operation.

1936

October

Non-stop journeys from Kowloon to Guangzhou begin, in the record time of 2 hours 15 minutes.

1955

August

The first two diesel locomotives come into service.

1962

September

Steam locomotives are totally replaced by diesel trains.

1975

November

Tsim Sha Tsui Terminus is replaced by a new terminus at Hung Hom.

1979

April

Intercity service to Guangzhou resumes since its suspension in 1949.

1980 – 1999

1982

December

Kowloon-Canton Railway Corporation incorporated.

1983

July

Full electric train service to Lo Wu begins.

1986

September

Introduction of feeder bus services.

1988

August

Tuen Mun Pierhead Garden, KCRC's first property project, is completed.

September

Light Rail system commences operation.

1995

March

Phase 1 of the Royal Ascot development in Sha Tin is launched.

1997

May
Intercity service to Beijing and Shanghai is launched.

November
KCRC becomes the first public transport operator in Asia to obtain a corporation-wide ISO 9001 certificate.

1998

August
KCRC's first electrified double deck through train, Ktt, is launched.

October
Construction of West Rail commences.

1999

July
KCRC issues first international bond of US$1 billion.

2000 – 2007

2001

February
Construction of Ma On Shan Rail commences.

April
Construction of the Tsim Sha Tsui Extension commences.

2002

December
Completion of the Metropolis, a joint venture project at Hung Hom Bay.

2003

January
Construction of the Lok Ma Chau Spur Line commences.

December
West Rail and Light Rail Tin Shui Wai Extension commence services.

2004

October
The Tsim Sha Tsui Extension begins operation.

December
Ma On Shan Rail begins operation.

2005

November
Construction of the Kowloon Southern Link commences.

2006

April
The Government announces the structure and terms for the proposed merger of the KCR and MTR systems.

2007

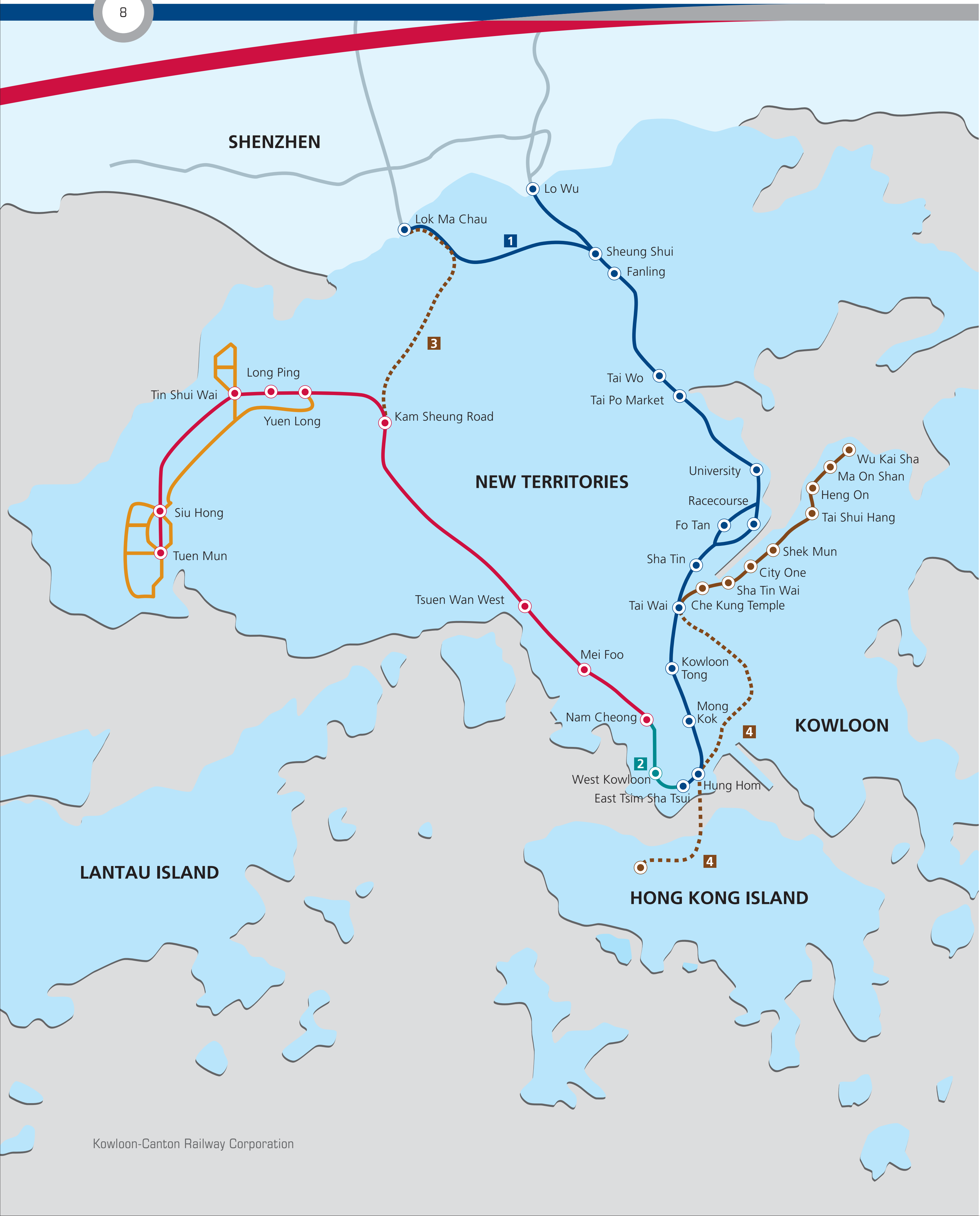
June
The Rail Merger Bill passes in the Legislative Council.

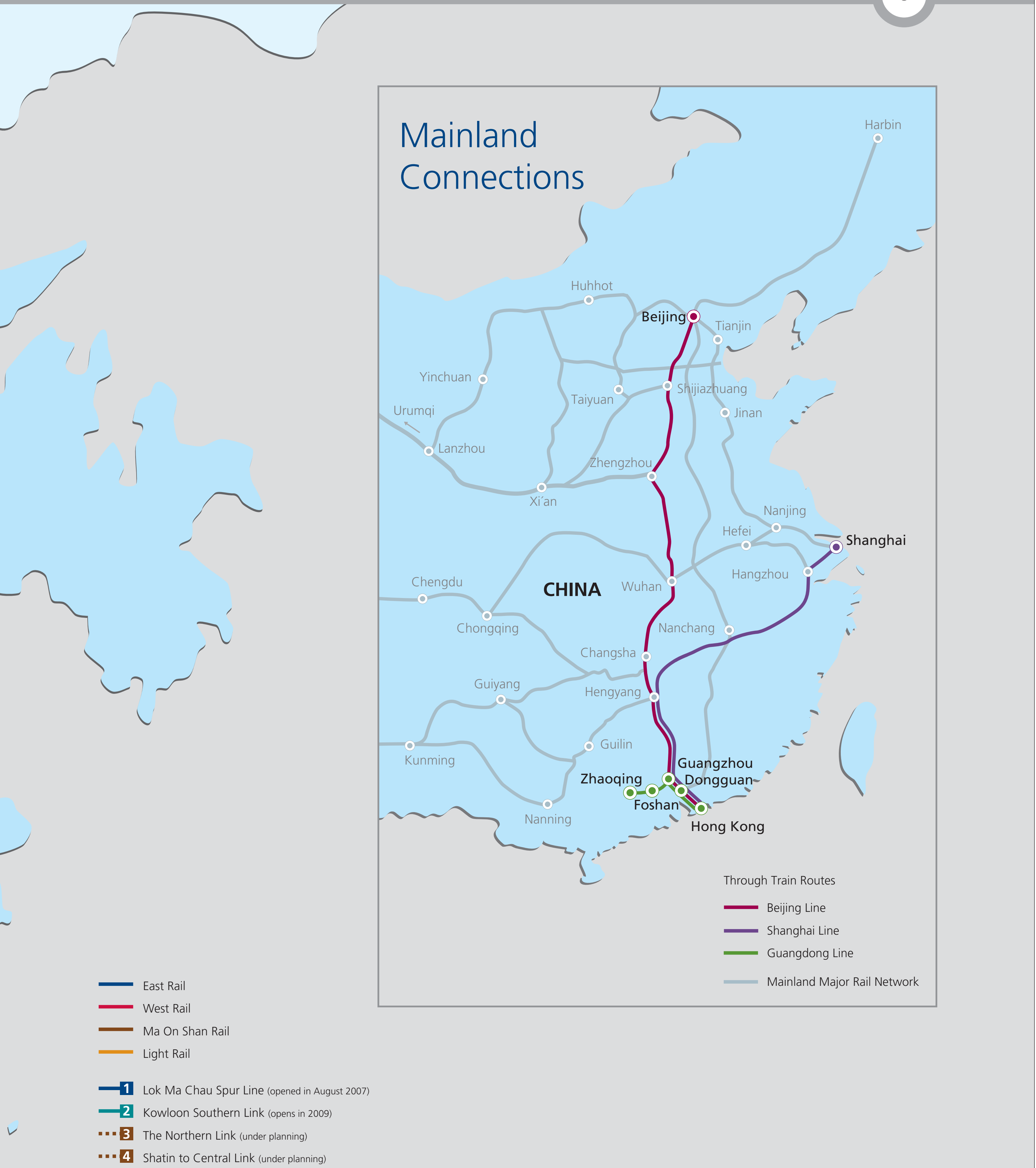
August
The Lok Ma Chau Spur Line begins operation.

October
Gazette notification designating 2 December as the Merger Date under the Rail Merger Ordinance.

December
Merger of the KCR and MTR systems.

KCR Network


SHENZHEN
Lo Wu
Lok Ma Chau
1
Sheung Shui
Fanling
3
Long Ping
Tin Shui Wai
Yuen Long
Kam Sheung Road
Tai Wo
Tai Po Market
NEW TERRITORIES
University
Wu Kai Sha
Ma On Shan
Heng On
Racecourse
Tai Shui Hang
Fo Tan
Siu Hong
Tuen Mun
Sha Tin
Shek Mun
City One
Sha Tin Wai
Tsuen Wan West
Tai Wai
Che Kung Temple
Mei Foo
Kowloon
Tong
Mong
Kok
Nam Cheong
4
KOWLOON
2
West Kowloon
Hung Hom
East Tsim Sha Tsui
4
LANTAU ISLAND
HONG KONG ISLAND


Mainland Connections
Harbin
Huhhot
Beijing
Tianjin
Yinchuan
Taiyuan
Shijiazhuang
Jinan
Urumqi
Lanzhou
Zhengzhou
Xi'an
Nanjing
Hefei
Shanghai
Hangzhou
Chengdu
CHINA
Wuhan
Chongqing
Nanchang
Changsha
Guiyang
Hengyang
Guilin
Kunming
Guangzhou
Zhaoqing
Dongguan
Foshan
Nanning
Hong Kong
Through Train Routes
Beijing Line
Shanghai Line
Guangdong Line
Mainland Major Rail Network
East Rail
West Rail
Ma On Shan Rail
Light Rail
1 Lok Ma Chau Spur Line (opened in August 2007)
2 Kowloon Southern Link (opens in 2009)
3 The Northern Link (under planning)
4 Shatin to Central Link (under planning)

Key Figures and Credit Ratings

Financial Highlights	2007 (HK$ million)	2006 (HK$ million)
Revenue from operations	**5,581**	5,622
Operating profit before depreciation and amortisation	**2,763**	2,600
Operating profit after depreciation and amortisation	**345**	312
Gain on sale of assets under the merger transaction	**6,234**	–
Net profit after tax	**5,321**	278
Capital expenditure	**3,574**	3,317
Interest-bearing borrowings* (HK$ million)	**17,902**	19,212
Debt/equity ratio	**1:3.7**	1:3.1
Interest cover (times)	**5.8**	2.2

* Including short-term bank loans

Credit Ratings	2007	2006
Standard & Poor's		
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	**AA**	AA
Moody's		
Short-term issuer rating	**P-1**	P-1
Long-term local currency issuer rating	**Aa3**	Aa3
Long-term foreign currency issuer rating	**Aa3**	Aa3
Senior unsecured local currency debt rating	**Aa3**	Aa3
Senior unsecured foreign currency debt rating	**Aa3**	Aa3

Operating Highlights	2007#	2006
Number of passengers (millions)		
East Rail (including Ma On Shan Rail and Lok Ma Chau Spur Line*)	**315**	335
Through Train	**3.0**	3.3
West Rail	**71**	73
Light Rail	**125**	136
Bus (excluding East Rail buses)	**30**	30

From 1 January to 1 December 2007

* Lok Ma Chau Spur Line commenced operation on 15 August 2007

	2007#	2006
Freight volume (thousands)		
Southbound goods (tonnes)	**227**	352
Northbound goods (tonnes)	**148**	228
Livestock (heads)	**1**	18

From 1 January to 1 December 2007

Number of Employees	**5,912***	6,049

* As at 1 December 2007

Service Punctuality*	2007# (%)	2006 (%)
East Rail	**99.85**	99.82
Ma On Shan Rail	**99.99**	99.94
West Rail	**99.91**	99.88
Light Rail	**99.95**	99.92

From 1 January to 30 November 2007

* Trains arriving at their destinations within three minutes of the scheduled time

2007 Highlights

January

KCRC and Mainland railways strengthen ties

On 17 January the senior management of KCRC, led by CEO Ir James Blake, met with Mainland railway officials during a Joint Session in Hong Kong. Both sides signed a protocol after the meeting to strengthen co-operation and communication on intercity passenger and freight services.

Purchase of environmentally-friendly buses

A contract was signed with Alexander Dennis Limited on 12 January to purchase 20 environmentally-friendly buses at a cost of about HK$55 million. The buses are fitted with engines compliant with the Euro IV emission standards.

February

Tai Wai Maintenance Centre Open Day

On 11 February KCRC held an open day at the Tai Wai Maintenance Centre, which is among the most modern maintenance centres in Asia. Used for the maintenance of Ma On Shan Rail trains, the centre has achieved an excellent service record since the commissioning of the line in late 2004.

March

Tree planting at Lo Wu

On 17 March the Corporation held a tree planting day at Lo Wu as part of the ongoing effort to maintain a green railway.

April

Launch of Reading Train

To encourage reading, the Corporation launched a special Reading Train in conjunction with the opening of the Children's Reading Festival on 1 April at Hung Hom Station.

June

Celebrating the 10th anniversary of the HKSAR

The Corporation held a series of activities to celebrate the 10th anniversary of the Hong Kong Special Administrative Region. These included an exhibition of the KCRC Lifeline Express Train at Fo Tan Freight Yard, Educational Tours for underprivileged children along the KCR alignments and the KCRC Art Train Design Competition. Free rides were offered to senior citizens and children born in 1997.

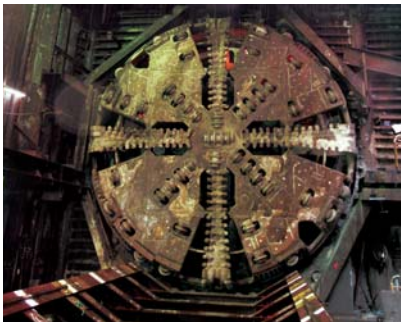
KCRC wins HKMA Training Award 2007

KCRC won the Silver Prize in the Award for Excellence in Training 2007, organised by the Hong Kong Management Association, for the "Go the Extra Mile (GEM) Service Excellence Programme".

Art Trains go into service

A specially decorated Art Train was unveiled in a ceremony on 26 June at Sha Tin Station and two Art Trains were put into service on East Rail and West Rail the next day.

First tunnel breakthrough at KSL



The Kowloon Southern Link reached another important milestone when the tunnel-boring machine *Xiaolongnu* completed the first tunnel on 27 June, ten months after the start of works.

Submission of project proposals

The Corporation submitted proposals for the Northern Link and the Express Rail Link Project to the Government in June.

July

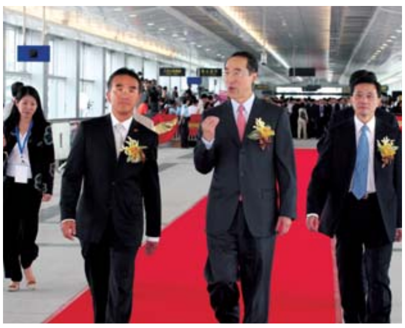
Delivery of first KSL train

The first 7-car train for the Kowloon Southern Link was off-loaded at Hung Hom Freight Terminal on 14 July. A total of 34 train cars have been ordered by the Corporation.

August

Opening of LMC Spur Line

The Lok Ma Chau Spur Line, Hong Kong's second cross-boundary rail link and an extension of East Rail, was opened on 15 August. The commissioning of the Spur Line is expected to relieve congestion at land boundary crossings and cater for the growing numbers of cross-boundary passengers.



September

Middle Road Subway Extension

To mark the start of construction on a new section of pedestrian subway at Tsim Sha Tsui, a subway extension commencement ceremony was held on 3 September. The HK$215 million civil works are scheduled for completion in late 2009. After the opening of the subway, East Rail passengers and members of the public will be able to walk from the East Tsim Sha Tsui Station to the Canton Road area in about 10 minutes.

Citylink Travel Gallery

KCRC partnered with 16 travel agencies to create a travel gallery at Citylink Plaza that offers the community a one-stop travel service. A tenancy contract signing ceremony was held on 14 September and an opening ceremony on 8 October.

Intercity Passenger Services win Prime Award for Brand Excellence

KCRC's Intercity Passenger Services emerged as one of the winners in the "Prime Awards for Brand Excellence 2007", achieving recognition as an excellent brand name in cross-boundary passenger services. Organised by *Prime Magazine*, the presentation ceremony was held on 20 September.

October

KCRC once again honoured with the President's Award

A long-time supporter of The Community Chest of Hong Kong, KCRC once again received the "President's Award" at the Chest's Annual Presentation of Awards held on 8 October.

November

Celebrating "A Century of Commitment"

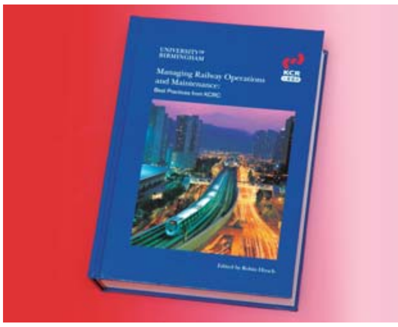
The Corporation's long and eventful history was chronicled in *A Century of Commitment — the KCRC Story*, published in November. Over 200 pages in length, the coffee table book is a bilingual publication heavily illustrated with photos. Each KCRC staff member received a free copy. The book was also put on public sale, with the proceeds donated to The Community Chest of Hong Kong.

KCRC awarded the Asset Management Verification Certificate

The Transport Division's Asset Management System has achieved compliance with the requirements of Part 1 of the Publicly Available Specification 55 (PAS 55), which identifies best practice for asset management. The certificate was awarded to the Corporation by Lloyd's Register Verification Limited on 16 November. PAS 55 is published by the British Standards Institution and provides a consistent set of requirements for asset management across industries.

Book on KCRC Best Practices published

The University of Birmingham published in November a textbook of KCRC's best practices for its MSc programme and other short railway engineering and operations management courses. Comprising more than 480 pages in 37 chapters, the textbook has been well received by local and overseas railway professionals and academics, as well as railway operators who aspire to deliver world-class standards of performance.



Delivery of first Euro IV bus

The Corporation took delivery of the first of the Euro IV engine double-decker buses which it had purchased in January. These new environmentally-friendly buses are fitted with engines that meet the latest environmental and safety standards.

December

Rail Merger

On 2 December the operations of KCRC were merged with those of MTR Corporation. Following the merger, KCRC has become primarily an asset holding company.

Managing Board

1 January to 1 December 2007

Michael Tien BBS, JP

BSc, MBA
Chairman
Chairman of Strategic Human Resource Committee

Ir James Blake OBE, JP

CEng, FHKIE, FHKEng, FICE, FIStructE, FIHT
Chief Executive Officer
Member of Capital Projects Committee
Member of Finance Committee
Member of Property Committee
Member of Public Consultation Group on Railway Operations

Vincent Lo Wing-sang BBS, JP

BA (Hons)
Chairman of Property Committee
Chairman of Public Consultation Group on Railway Operations

Patrick B Paul CBE

MA, FCA
Chairman of Audit Committee
Member of Strategic Human Resource Committee
Member of Property Committee

Prof Richard Wong Yue-chim SBS, JP

AB, AM, PhD
Chairman of Finance Committee
Member of Capital Projects Committee

Hon Abraham Shek Lai-him SBS,JP

BA, Dip Ed
Member of Audit Committee
Member of Capital Projects Committee
Member of Strategic Human Resource Committee

Ng Leung-sing SBS, JP

Member of Property Committee
Member of Finance Committee
Member of Audit Committee

Eva Cheng Yu-wah JP

(From 1 July 2007)
Member of Property and Capital Projects Committee
Secretary for Transport and Housing of the Hong Kong Special Administrative Region Government

Prof K C Chan SBS, JP

PhD
(From 1 July 2007)
Member of Property and Capital Projects Committee
Secretary for Financial Services and the Treasury of the Hong Kong Special Administrative Region Government

Note: During the year, Mr Frederick Ma Si-hang (Secretary for Financial Services and the Treasury) and Dr Sarah Liao Sau-tung (Secretary for the Environment, Transport and Works) served as Board Members until 30 June 2007 when their appointment ended. Mr Wan Man-yee stepped down when his term of appointment ended on 31 July 2007.

Managing Board & Key Management

from 2 December 2007

Managing Board

Prof K C Chan SBS, JP

PhD
Chairman
Secretary for Financial Services and the Treasury of the Hong Kong Special Administrative Region Government

Eva Cheng Yu-wah JP

Secretary for Transport and Housing of the Hong Kong Special Administrative Region Government

Stanley Y H Ying JP

Member of Audit Committee
Permanent Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government

Francis Ho Suen-wai JP

Permanent Secretary for Transport and Housing (Transport) of the Hong Kong Special Administrative Region Government

Lucia Li Li Ka-lai JP

FCCA, FCPA
Chairman of Audit Committee
Director of Accounting Services of the Hong Kong Special Administrative Region Government

Clement Leung Cheuk-man JP

Member of Audit Committee
Deputy Secretary for Financial Services and the Treasury (Treasury) of the Hong Kong Special Administrative Region Government

Key Management

Ir James Blake OBE, JP

CEng, FHKIE, FHKEng, FICE, FIStructE, FIHT
Chief Officer

Michael J. Arnold

BSc, CEng, MICE, MIHT
Senior Manager-Administration
Company Secretary

Julian P. Walsh

MA, ACA, CPA,
Senior Manager-Finance

Chairman's Statement

"I should above all like to thank all staff for their efforts and patience during the merger negotiations, and for their loyalty and past dedicated service to the Corporation and its passengers."

Some five years since the merger of Hong Kong's railway networks was first mooted in 2002, finality and a fundamental change in the Corporation's business came on 2 December 2007, when MTR Corporation took over operation of KCRC's railway assets under a service concession arrangement. In return, MTR Corporation made an upfront payment and further agreed to pay KCRC an annual share of future revenue generated from those assets. The upfront payment, which totalled HK$12.04 billion, also included the purchase of a number of KCRC properties, property development rights and property management subsidiaries.

After 97 years of operating railway services since the East Rail line first opened in 1910, the merger inevitably brought a feeling of nostalgia. Those who have an interest in local history might enjoy reading the book *A Century of Commitment – the KCRC Story*, which was published by the Corporation in November.

Following the merger, the Corporation has become primarily an asset holding company, with responsibility for monitoring and implementing the service concession and other merger transaction details, servicing its outstanding debts and investing its revenues, principally the payments received from MTR Corporation.

The Hong Kong travelling public benefits from the merger, and for the Corporation, the risks previously associated with its business have now been almost entirely removed. Staff and other fixed costs have become minimal and a secure revenue stream has also been guaranteed with fixed and variable concession payments from MTR Corporation.

Even though the Corporation's business has changed as a result of the merger, the Board continues to look forward with a sense of anticipation. For example, the Corporation remains responsible for funding the Kowloon Southern Link (KSL) project, even though its construction is now being overseen by MTR Corporation under a project management agreement. Completion of the KSL is on track for 2009, when this new asset will be owned by KCRC and operated by MTR Corporation under the service concession arrangement.

On a note of sadness, Mr K Y Yeung, the Corporation's Chairman and Chief Executive from 1996 to 2001, and its Chief Executive Officer from 2001 to 2003, passed away in February 2007. His legacy to Hong Kong during that time is perhaps best reflected in the successful construction and commissioning of West Rail and the three East Rail Extensions, where he provided essential leadership during critical phases of those projects. He would, I am sure, have taken great pride in seeing the opening of the Lok Ma Chau Spur Line in August, being the last of the East Rail Extensions.

May I take this opportunity to express my gratitude to all those Managing Board Members named in this report, who gave willingly of their time to serve on the Board until the merger. I would especially thank Mr Michael Tien for his leadership over the past six years.

I should above all like to thank all staff, nearly 6,000 in total, for their efforts and patience during the merger negotiations, and for their loyalty and past dedicated service to the Corporation and its passengers. I am confident that MTR Corporation has and will continue to benefit from the extensive experience and knowledge that they brought with them upon the merger.

Finally, I should like to express my personal thanks to Mr James Blake, who returned to the Corporation as the Chief Executive Officer from May 2006 until the merger to lead the executive management and all staff of the Corporation through a time of significant change. Mr Blake will continue his service with the Corporation as the new Chief Officer leading a small but very important direct management team, whose experience and background knowledge will prove invaluable as the Corporation settles down to its new responsibilities.

Prof K C Chan

Chairman

7 April 2008

Chief Officer's Statement

As explained in the Chairman's Statement, the KCRC and the MTR Corporation railway networks were successfully merged on 2 December 2007.

Following the merger, the MTR Corporation took over the operation of KCRC's railway assets under a service concession arrangement. The MTR Corporation also purchased a number of KCRC's property assets. In reporting on the results for 2007, therefore, the financial year must be reviewed in two parts, namely, pre and post merger.

Transport Operations

As in the previous 97 years, the Corporation's main business during the first 11 months of 2007 was to provide a railway service to some 1.6 million Hong Kong and Mainland passengers per day. Growth over the period up to 1 December 2007 compared with the same period for 2006 was seen in both passengers and revenue, with total daily average passenger numbers increasing by 2.7% and transport revenue by 4.3%, reflecting improved performance in the Corporation's cross-boundary and domestic markets.

Compared with 2006, East Rail domestic services' average daily patronage grew by 1.8% and for cross-boundary services by 3.9%, the latter partly reflecting the opening of the Lok Ma Chau Spur Line in August. Although the take-up of passengers using the new Spur Line has been rather slow, gradual sustained growth is being seen and is expected to continue as more cross-boundary travellers come to recognise

"Growth over the period up to 1 December 2007 compared with the same period for 2006 was seen in both passengers and revenue."

the convenience offered by the new crossing. Developments taking place on both sides of the boundary will also contribute to the number of potential users.

West Rail patronage continued to show positive growth, with an increase of 6.6% being recorded compared with 2006. Light Rail and bus services in the North West New Territories Transit Service Area similarly showed growth, albeit more modest at 0.9%, but are unlikely to show a substantial increase until the additional 22 Light Rail vehicles and 20 Euro IV environmentally-friendly buses recently ordered by the Corporation are brought into service during 2008 and 2009.

Although the cross-boundary business remains generally positive, the Corporation's share of this market continued the downward trend noted in previous reports. Our share of cross-boundary passengers fell to 60.8% for the first 11 months of 2007, from 61.5% of 2006, meaning that whilst the absolute number of cross-boundary passengers carried by rail has increased by 3.9%, this is not to the same extent as the market as a whole, for which the equivalent increase was about 6.2%. Road-based modes of transport continue to enjoy more growth in the cross-boundary market than rail. This was partly attributed to the opening of the Western Boundary Crossing for road vehicles in July 2007 and the growth in passengers on overnight trips through the Huanggang crossing point.

Average Daily Ridership

(passenger trips)	2007#	2006	% Increase / (Decrease)
East Rail domestic (including Ma On Shan Rail)	**689,000**	677,000	1.8
East Rail cross-boundary (to Lo Wu and Lok Ma Chau)	**250,300**	241,000	3.9
Intercity Through Train	**8,950**	8,970	(0.2)
West Rail	**213,300**	200,100	6.6
Light Rail	**371,700**	373,800	(0.6)
Bus (excluding East Rail buses)	**88,600**	82,400	7.5
Total average daily passenger trips	**1,621,850**	1,583,270	2.4

From 1 January to 1 December 2007

KCRC's train service delivery reached 99.88% (or higher) for all lines, as compared with 99.85% for 2006 and 99.84% for 2005. This continued improvement was achieved despite the isolated incident in February 2007 involving a fire in a low-voltage electrical transformer mounted on the roof of a West Rail train. In the first 11 months of 2007, delays in services of eight minutes or more declined further to only 37, compared with 93 in 2005 and 57 in 2006. When the railways were merged on 2 December 2007, the MTR Corporation took over from KCRC the operation of one of the best railways in the world.

Non-Transport Commercial Operations

During 2007 the leasing of commercial and advertising space in the Corporation's shopping centres and stations and other associated activities generated total non-transport revenue of HK$987 million for the period up to 1 December 2007, a substantial growth in revenue compared with HK$876 million for the whole of 2006. This increase was mainly due to the improved local economy, rising patronage and the leasing of space in the new Lok Ma Chau Terminal Building.

Cross-boundary (Lo Wu and Lok Ma Chau*) Average Daily Passenger Trips

	Passenger trips	% Increase / (Decrease)
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)
2004	232,500	3.6
2005	235,500	1.3
2006	241,000	2.3
2007#	**250,300**	**3.9**

* Lok Ma Chau Spur Line commenced operation on 15 August 2007

\# From 1 January to 1 December 2007

"The Corporation's commitment to sustainability and protection of the environment continued and further energy saving measures were introduced during the year."

From 2 December the revenue from these operations has been taken up by the MTR Corporation, leaving KCRC's primary source of commercial revenue coming from the leasing of four floors of Citylink Plaza in Shatin. During 2007 an entire floor was leased to a number of travel agencies. The other three floors, temporarily occupied by MTR Corporation, will be available for leasing over the next year or so.

Property Development

Excellent progress was made during the year on those property development projects for which joint ventures had been awarded previously, namely, Ho Tung Lau (Site A), Wu Kai Sha Station, Tai Wai Maintenance Centre and Tuen Mun Station. Tenders for the joint venture development of the Tsuen Wan West TW7 site were received in April, but the Board of Directors of Tsuen Wan West TW7 Property Development Limited had decided not to award the tender and to re-tender the project.

With effect from 2 December MTR Corporation, having purchased KCRC's property development rights in respect of the East Rail and Ma On Shan Rail sites, has also taken up the day-to-day responsibility for developing the West Rail sites under an agency agreement. KCRC and the Government remain the shareholders of West Rail Property Development Limited and its 13 subsidiaries, and the expenditure on enabling works at these sites currently on KCRC's books is still expected to be recovered.

Sustainability

The Corporation's commitment to sustainability and protection of the environment continued and further energy saving measures covering, for example, lighting, air conditioning, escalators and recycling, were introduced during the year. In November, the Corporation took delivery of the first one of the 20 Euro IV engine buses it has purchased.These new environmentally-friendly buses are fitted with engines that meet the latest environmental and safety standards and are among the first ones to be put into public service in Hong Kong.

Railway Projects

In August the Corporation successfully opened the East Rail Extension from Sheung Shui to Lok Ma Chau to provide a second rail boundary crossing as an alternative for passengers travelling between Hong Kong and the Mainland.

"By the end of November 2007, 71% of the Kowloon Southern Link works had been successfully concluded."

By the end of November 2007, 71% of the Kowloon Southern Link works had been successfully concluded, with the tunnel-boring machine having completed the first tunnel drive from West Kowloon to the Salisbury and Nathan Roads junction by June as programmed. The second tunnel drive achieved satisfactory progress and has just been completed as well. Cut-and-cover works to construct the West Kowloon Station and the remaining northern section of the tunnel link also made good progress during the year.

On 2 December MTR Corporation became responsible to KCRC for overseeing the completion of the Kowloon Southern Link works under a project management agreement. KCRC remains responsible for funding the project, which is scheduled for completion in 2009.

Financial Results

The Corporation achieved excellent revenue results for the first 11 months of 2007, with total revenue increasing by 6.5% to HK$5,454 million as compared with HK$5,122 million for the same period in 2006. Operating costs before depreciation and amortisation increased by 2.5% to HK$2,800 million with the impact of general inflation and the award of a pay increase for staff. For the whole of 2007, including December when the service concession income was recognised, total revenue increased to HK$5,581 million, while operating costs before depreciation and amortisation for the full year decreased to HK$2,818 million. Earnings before interest, tax, depreciation and amortisation increased by 6.3% to HK$2,763 million from HK$2,600 million in 2006.

Although depreciation and amortisation also increased in 2007 by 5.7% due to the opening of the Lok Ma Chau Spur Line in August, operating profit after depreciation and amortisation grew to HK$345 million. Net profit for 2007 was HK$5,321 million after recognising the gain arising from the sale of property development rights, investment and other properties, and property management and telecommunication businesses to MTR Corporation; merger-related expenses; net interest and finance expenses; share of profit of associates; unrealised accounting gains on changes in the fair value of the Corporation's financial instruments and investment properties; and income tax as explained in the Income Statement.

"I see the major role of KCRC being complementary to that of MTR Corporation in ensuring that Hong Kong continues to enjoy the best railway services possible."

Looking Ahead

The Corporation's main tasks in the year ahead will be to consolidate its business activities reflecting its new non-transport role, to continue servicing its debts, to invest cash not immediately needed following payments made by MTR Corporation, to monitor MTR Corporation's performance under the service concession and other merger transaction related agreements, to fund those works and purchases being undertaken by MTR Corporation on KCRC's behalf, and to tie up any loose ends arising from the merger transaction. In so doing, I see the major role of KCRC being complementary to that of MTR Corporation in ensuring that Hong Kong continues to enjoy the best railway services possible. I look forward to developing close working ties with my MTR colleagues over the coming year.

A Final Thank You to Former Staff

Echoing the Chairman's sentiments, I would also add my heartfelt gratitude to all former staff of the KCRC for their efforts and professionalism throughout the period from the merger announcement in April 2006, and particularly over the 11 months of 2007, without which the merger could not have been achieved with the success which is evident to date. Our former passengers appear not to have been inconvenienced in any way; the only outward signs of change being the changing of KCRC logos and uniforms. Behind the scenes, however, many people worked very long hours to ensure that all would go as planned on 2 December. To those unsung heroes I give my special thanks.

James Blake
Chief Officer
7 April 2008

The sophisticated Operations Control Centre at Fo Tan is the nerve centre of East Rail.

Tai Wai Station is one of the busiest interchange stations along East Rail.

Domestic and Cross-boundary Services

For nearly a century the people of Hong Kong have depended on KCRC trains as a safe and reliable means of travel. KCRC's commitment to providing a world-class passenger railway service continued in 2007. While making extensive preparations for the switch-over of operations to the new merged railway network at the year end, the Corporation's staff met or exceeded all of its service targets.

Satisfactory gains in patronage and revenue

Despite the additional work necessary to ensure a smooth and seamless merger of Hong Kong's two railway networks, our staff provided high quality railway services during the year.

Both patronage and revenue for our domestic and cross-boundary railways made satisfactory gains in the period up to 1 December 2007. Average patronage on East Rail domestic lines increased to 689,000 passenger trips a day, a rise of 1.8% compared with 2006. Daily usage on Ma On Shan Rail was up by 2.1%, and on the Tsim Sha Tsui Extension by 5% over 2006.

East Rail's share of the domestic market was 37.7% for intra-New Territories travel and 48.2% for travel between the New Territories and urban areas, which was 0.2% and 1.3% higher respectively than the same period in 2006.

West Rail continued to build patronage during the year, achieving 213,300 passenger trips a day, an increase of 6.6% over last year.

Total cross-boundary patronage also grew during the period up to 1 December 2007 to an average of 250,300 passengers a day, representing an increase of 3.9% from last year. The new Lok Ma Chau crossing accounted for 21,000 daily passengers from the start of operation on 15 August up to 1 December 2007.

Nevertheless, KCRC's share of the cross-boundary land travel market dropped by 0.7% for the first 11 months of 2007 from 61.5% over the same period last year.

Fare revenue from domestic and cross-boundary services for the period up to 1 December 2007 reached HK$3,856 million, an increase of 5.1%. This was mainly owing to the better performance of the Corporation's cross-boundary and domestic services, as well as increased patronage from the opening of the Lok Ma Chau Spur Line and the general growth of the cross-boundary market in a vibrant economy.

Major service improvements

During the year our substantial investment in service upgrades continued to benefit our passengers.

The most significant service improvement was the opening of a second boundary crossing — East Rail's Lok Ma Chau Spur Line and terminus. On the afternoon of 15 August 2007, the new line officially came into service following the opening of the Futian-Lok Ma Chau

Patronage continued to grow on KCRC's railways during the year.

Quality customer service – a high priority for KCRC.

At a Glance

	East Rail^	Ma On Shan Rail	West Rail
Route length (km)	42.5	11.4	30.5
Number of stations	15	8+	9
Number of rail cars	444	72	154
Daily hours of operation	19.5	19.5	19
Daily number of train trips#	574	493	394
Minimum headway (minutes)			
Peak hours	2.5	3	3.5
Off peak hours	5	5	6
Average daily ridership#			
Domestic	689,000**	–	213,300
Lo Wu and Lok Ma Chau*	250,300	–	–

^ Including Lok Ma Chau Spur Line
+ Excluding Tai Wai Station
* Lok Ma Chau Spur Line commenced operation on 15 August 2007
# From 1 January to 1 December 2007
** Including Ma On Shan Rail

control point. Train service along this extension of East Rail currently operates at 10-minute intervals during peak hours and 12-minute intervals during non-peak hours.

After the opening of the Lok Ma Chau Spur Line, service to the Lo Wu boundary crossing was maintained at a frequency of 5.5 to 6 minutes.

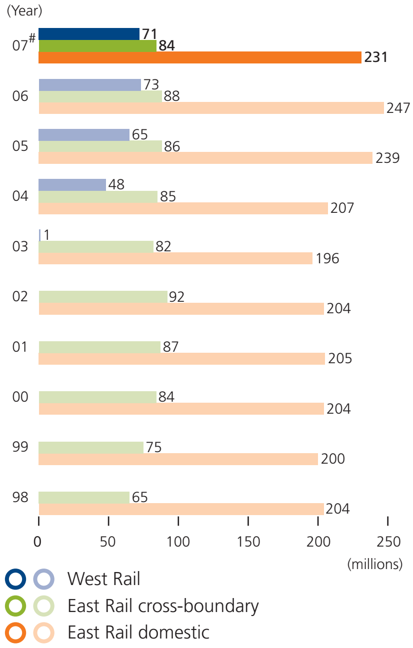
East Rail

Phase II of an extensive renovation project at Lo Wu Station, which began in 2005, was largely completed during the year.

September of the year under review saw the substantial completion of work on Platform 4, which included the widening of the platform and the addition of a third escalator. Three travelators were also installed, on Platforms 2, 3 and 4 respectively.

Additionally, the ticket office on the second floor at Lo Wu Station was expanded and relocated to the western side of the building with more shops added on the ground and second floors.

Domestic and Cross-boundary Patronage



From 1 January to 1 December 2007

Other improvements included the renovation of toilets at ground level, replacement of floor tiles and platform roofs, and the installation of electric sliding doors.

These improvements to the quality of our cross-boundary service enabled us to attain two patronage records at Lo Wu Station. On 8 April, during the Ching Ming Festival, 367,755 passengers crossed the boundary and on 18 August, a non-festival weekend, 326,912 passengers used the boundary crossing.

We also made major improvements at Sheung Shui Station in order to handle the increased passenger flows associated with the opening of the Lok Ma Chau Spur Line. These included the installation of noise barriers for the benefit of local residents and the addition of a modern Train Destination Display System with easy-to-read LED panels and colour coded signage and queuing boxes. Other improvements were made by installing a spot cooling system and replacing floor tiles, ceilings and wall panels.

At Fanling Station we installed more substantial doors and strengthened the fence at the southern side of the down line platform to stop couriers passing goods within the station area.

Track remodelling works continued at Hung Hom Station, which will become the interchange station for East Rail and West Rail when the Kowloon Southern Link opens in 2009. In preparation for the opening of the new line, we also began modification works on the station building and

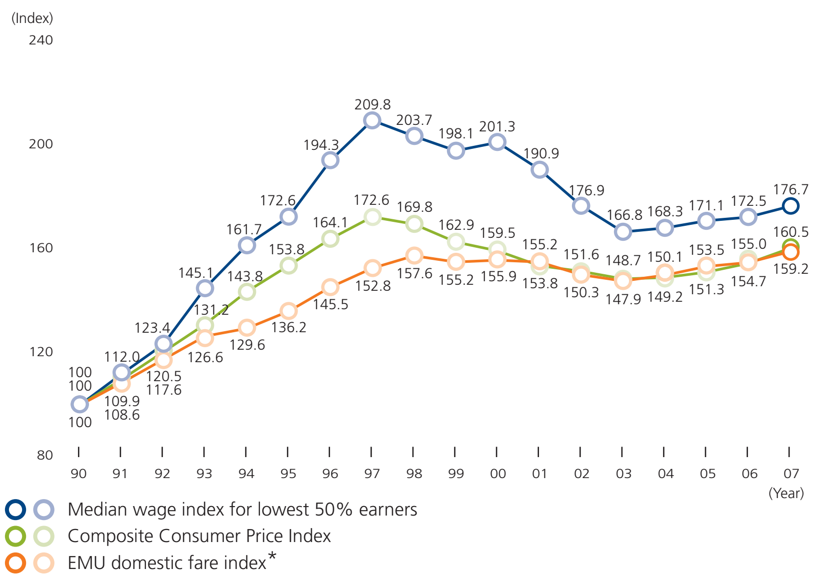
Service Performance

	East Rail		Ma On Shan Rail		West Rail	
	2006	2007#	2006	2007#	2006	2007#
Service delivery*	99.85%	**99.88%**	99.95%	**100%**	99.91%	**99.88%**
Punctuality*	99.82%	**99.85%**	99.94%	**99.99%**	99.88%	**99.91%**
Availability of ticket vending machines*	99.60%	**99.63%**	99.82%	**99.83%**	99.93%	**99.94%**
Availability of Octopus equipment*	99.90%	**99.94%**	99.91%	**99.96%**	99.97%	**99.97%**
Reliability :						
million car-km per failure	0.87	**0.93**	2.69	**3.55**	2.7	**3.22**

* 2007 service targets – 99.0%

Actual performance up to 30 November 2007

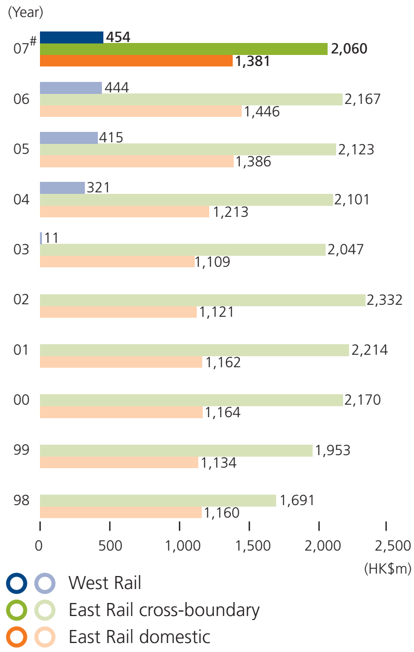
Fares Relative to Income and Inflation



Note: The calculation of Median Wages for the lowest 50% earners Index for 2007 is based on the 4th quarter 2007 data from the Census and Statistics Department.

* Including East Rail Domestic and West Rail revenue.

Domestic and Cross-boundary Revenue



From 1 January to 1 December 2007

successfully completed a HK$15 million air-conditioning improvement project for the departure and arrival halls.

The renovation of Tai Po Market Station, which started in 2006, continued during the year with the entire project to be completed by early 2008.

At Lo Wu and Lok Ma Chau stations and at the trackside of Pak Shek Kok, we installed three anemometers that will enable the Operations Control Centre to gather data for closely monitoring the effect of strong winds on train operations.

Throughout East Rail, we improved the reliability and efficiency of ticket purchases by upgrading our ticket vending machines. We also began work at East Tsim Sha Tsui Station to enlarge the Station Control Room for accommodating MTR's railway system equipment and to prepare for the integration of the two KCR and MTR stations when the Kowloon Southern Link opens.

Ma On Shan Rail

At Wu Kai Sha and Tai Shui Hang stations, we installed two anemometers that will enable us to gather data for closely monitoring the effect of strong winds on train operations along Ma On Shan Rail.

We also adjusted the volume of station public announcement speakers to discourage passengers on escalators from running towards trains and enhanced our station ventilation systems and signage. To reduce noise levels, we extended train service headway to at least 6 minutes and 15 seconds after 11pm and before 7am during operational hours.

Service disruptions

KCRC's train service performance continued to improve in 2007. As a result, delays of eight minutes or more saw a further decline from 93 in 2005 and 57 in 2006 to only 37 in the first 11 months of 2007.

In February an electrical transformer on the roof of a West Rail train caught fire while travelling through the Tai Lam Tunnel. The burning insulating oil generated considerable smoke inside train compartments, and the driver decided to bring the train to a halt. About 1,000 passengers were immediately detrained and evacuated from the tunnel. That this incident was handled without panic or injury demonstrated that the Corporation's procedures for ensuring passenger safety on West Rail are fundamentally sound. Although the fire was an isolated incident with little chance of recurring, the Corporation arranged for the manufacturer to replace all similar transformers with a modern explosion-proof type.

Passenger safety and security

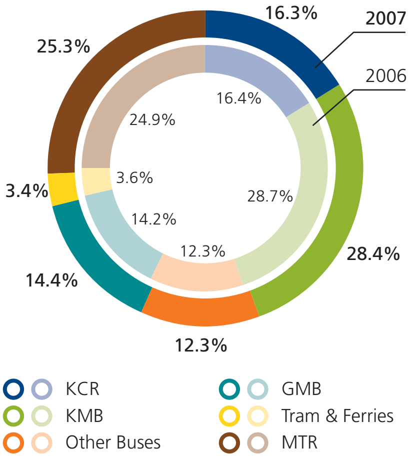
At KCRC we consider the safety and security of our passengers to be our highest priority.

To reduce accidents due to gaps between train doors and curved platforms, we made plans to install an Intelligent Platform Extension System at Lo Wu Station, the first of its kind in Hong Kong. This year, we awarded contracts related to the supply and installation of mechanical gap fillers for the system, which has since undergone exhaustive tests.

During the year we held joint exercises in co-operation with the Hong Kong Police at all stations to increase our ability to deal effectively with incidents. We also carried out a joint exercise with the Police and Fire Services departments at Tai Shui Hang Station, which included a simulated station evacuation. At Sha Tin Wai and City One stations, we tested the responsiveness of maintenance staff from various disciplines in a simulated emergency.

The Corporation has sound safety measures in place for the protection of passengers.

Market Share of Major Franchised Public Transport Modes



Remarks:

1. Tram & Ferries includes HongKong Tramways, New World Ferry and Star Ferry
2. Other Buses includes New World First Bus, Citybus, Long Win and New Lantao Bus
3. KCR includes East Rail, Ma On Shan Rail, West Rail, Light Rail and KCR feeder buses

Source: Transport Department – Traffic and Transport Digest

To promote safety on escalators, we installed tri-lingual audible devices with "hold the hand rail" announcements at the entry landings of 86 escalators at East Rail and West Rail stations, as well as bollards at all East Rail station escalators (except Tai Wai and East Tsim Sha Tsui).

For the "Good Luck Beijing Equestrian Event", which was held in preparation for the 2008 Olympic Games, we worked closely with the Equestrian Company to provide early train services to University and Fanling stations. This enabled spectators and staff to connect to bus services to the event venues in Shatin and Beas River. Our experience during this event will help us provide a safe and orderly transport service when the Olympic Games begin in August 2008.

A major joint exercise was also held with the Police and Fire Services departments at University Station in November to test the contingency arrangements for handling emergencies on trains.

Special promotions for our passengers

To increase patronage on our trains, we organised a number of marketing promotions during the year. These included free rides for senior citizens and children using Octopus cards on 1 July, which marked the 10th anniversary of Hong Kong's return of sovereignty to the Mainland. In the spirit of the occasion, we offered free rides to Ocean Park in July and August for children aged 10 and gave away six-month passes to children born on 1 July 1997.

During the year passengers were able to enjoy free connections with KCR Bus as well as intermodal discounts on GMB buses. We also continued to provide frequent travellers the convenience and value of monthly and daily passes. Passengers travelling to the Hong Kong International Airport and to the Hong Kong Disneyland theme park could take advantage of our Rail-Taxi and Railbus packages, while those headed to Lok Ma Chau benefited from a weekly pass discount. As part of this incentive, passengers could redeem bonus points from HSBC for free cross-boundary rides and HK$50 value added onto their Octopus Card.

To stimulate leisure trips, we offered travel packages to bring people to Ocean Park, Hong Kong Disneyland and Macau, and published guides featuring leisure, shopping and dining attractions along the railway.

Light Rail and Bus

Light Rail service upgrades

Since 1988 Light Rail has been a major mode of transport in the North West New Territories with its nine routes in Tuen Mun and Yuen Long. The opening of West Rail at the end of 2003 gave Light Rail a new role to play as a complementary service to this new line.

During the year under review, patronage on Light Rail for the period up to 1 December 2007 was about 371,700 passenger trips per day, a slight decrease of 0.6% from 2006.

The year also saw a number of improvements to Light Rail service. For example, the existing train-borne radio system was replaced during the year by an upgraded radio system.

To increase operating efficiency and reduce energy consumption, Light Rail vehicles were outstabled at the terminus during non-peak hours starting in April.

A purchase of 22 additional Light Rail vehicles was approved during the year, with the first batch of nine vehicles scheduled for delivery in September 2009.

At a Glance

	Light Rail
Total route length (km)	36.2
Number of stops	68
Daily hours of operation	19
Daily number of trips#	2,764
Minimum headway (minutes)	
Peak hours	1.6
Off peak hours	2.0
Average daily ridership#	371,700

	Bus
Total number of buses	143
Total number of bus routes	14
Daily hours of operation	19
Minimum headway (minutes)	5
Average daily ridership (West Rail feeder buses in North West New Territories Transit Service Area only)#	88,600

From 1 January to 1 December 2007

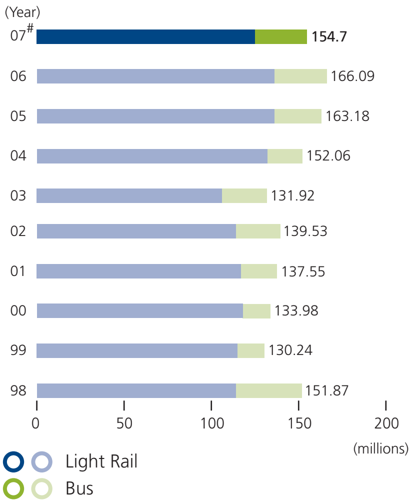
Service Performance

	Light Rail		Bus	
	2006	2007#	2006	2007#
Service delivery*	99.98%	**99.98%**	99.90%	**99.82%**
Punctuality*	99.92%	**99.95%**	–	**–**
Availability of ticket vending machines*	99.91%	**99.92%**	–	**–**
Availability of Octopus equipment*	99.97%	**99.98%**	–	**–**
Reliability : million car-km / number of trips per failure	0.197 million car-km	**0.199 million car-km**	3,060 trips	**3,371 trips**

* 2007 service targets – 99.0%

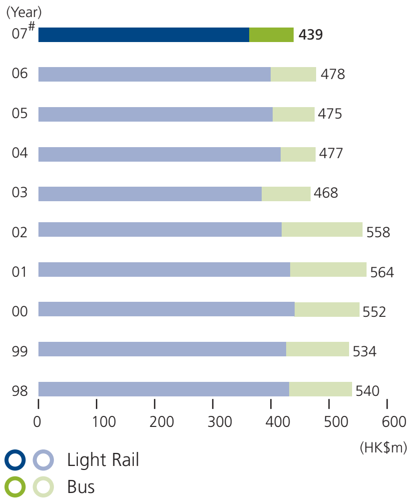
Actual performance up to 30 November 2007

Light Rail and Bus Patronage



From 1 January to 1 December 2007

Light Rail and Bus Revenue



From 1 January to 1 December 2007

New environmentally-friendly buses will provide comfort for passengers, while meeting the highest safety and environmental standards.

Bus ridership on the rise

Bus ridership increased dramatically during the year. For the period up to 1 December 2007, ridership grew by 7.5% to 88,600 compared with 82,400 for 2006.

Throughout 2007 bus operational costs increased substantially, mainly as a result of historically high fuel prices in the first half of the year. Nevertheless, we were able to avoid raising fares by implementing cost control measures wherever practicable.

To improve bus services to passengers, in October we constructed four bus shelters in the North West New Territories.

As an environmentally-responsible organisation, KCRC ordered nine environmentally-friendly double-decker buses that meet the Euro IV standard. The first batch was delivered at the end of November and the remaining double-decker buses together with 11 environmentally-friendly single-decker buses will arrive by mid September 2008.

Following the delivery of the double-decker buses, stringent testing will be carried out before they go into service in 2008.

The Corporation further enhanced its intercity through train services during the year.

At a Glance

Mainland Links

Intercity Passenger Services

Destinations (number of Mainland cities)	6
Average daily passengers#	8,950

Freight#

Containers (TEUs)	8,915
Breakbulk (wagons)	2,305
Livestock (wagons)	28

From 1 January to 1 December 2007

Mainland Links

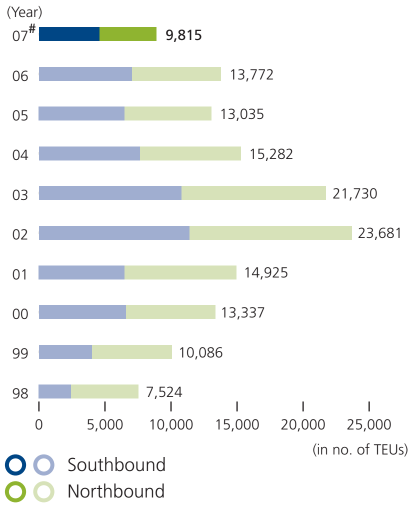
Growing ties with the Mainland

In 2007, the flourishing economy of the Pearl River Delta stimulated higher demand for cross-boundary travel on our intercity passenger through trains. Punctuality from January to April, however, was seriously affected by service interruptions inevitably caused by construction works for the fourth line of the Guangshen Railway between Shenzhen and Guangzhou. This resulted in a considerable loss of Guangzhou-Kowloon Through Train (GZTT) passengers to other means of transport during the affected period.

Our long-haul train services to Beijing and Shanghai benefited from a fare promotion commencing in October 2006 for single trip/round trip individual passengers and group passengers. With some travel agents using the scheme to organise group tours to Beijing and Shanghai, the fare incentive increased patronage for the period up to 1 December 2007 by about 20% over the same period in 2006.

Up to 1 December 2007, the total average daily patronage for through train services was 8,950, a slight increase of 0.2% from the same period in 2006.

Container Traffic



From 1 January to 1 December 2007

During the year we introduced a number of service enhancements and promotions. One of these was the Through Train SMS Alert Service launched in May 2007, which notifies passengers who register for the service of sudden schedule changes via their mobile phones. This service enhancement was well received by the more than two-thirds of our passengers who book tickets in advance.

In 2007 the Mainland's Individual Visit Scheme was extended to cover five more cities (Shijiazhuang, Zhengzhou, Changchun, Hefei and Wuhan), bringing the total to 49 cities. We took advantage of this extension by partnering with business associates to provide special offers to Mainland travellers coming to Hong Kong on our through trains. Among the incentives made available through this scheme were discounts and other special offers at hotels, shopping outlets and tourist attractions.

Additional joint promotions with our travel trade partners during the year included special offers to outbound and inbound through train passengers to increase the competitive edge of our through train services.

The GZTT brand was promoted at major travel expos and trade fairs in Hong Kong and the Mainland during the year, which enhanced the image and awareness of our products. As part of this initiative, we were appointed Official Rail of the China Import and Export Fair in Guangzhou and the Official Rail of the International Travel Expo in Hong Kong in 2007.

During the year the Corporation's Intercity Passenger Services won the Prime Awards for Brand Excellence 2007, organised by *Prime Magazine*, for our outstanding achievements in service quality and business performance in the field of cross-boundary transportation.

Improving our freight services

Freight revenue up to 1 December decreased by 5% to HK$38 million as compared with the same period in 2006, owing mainly to a decrease in rail freight traffic.

One reason for this decline was the construction of the fourth line of the Guangshen Railway from January to April, which seriously affected the reliability of freight services on the Guangshen section and reduced

Freight Links

cross-boundary freight traffic movements. More significantly, however, the improvement of logistics supply chain services and infrastructure in the Mainland intensified competition between railway and other modes of transport.

In order to strengthen our competitiveness, we discussed measures with the Mainland's Ministry of Railways, local railway administrations, railway companies and customs authorities. These measures covered streamlining cross-boundary formalities, developing block train services, improving transit times, securing competitive rail freight packages and providing value-added customer service.

Additionally, in January we implemented electronic data transfer of railway consignment booking and invoicing data with China Travel Service (Cargo) Hong Kong Limited, our major railway freight agent. This initiative will pave the way for full data automation and paper-less transactions between the two organisations.

We have also taken steps to improve communications with rail freight agents by arranging to have SMS messages sent to agents' mobile phones. In addition to the practice of sending fax messages, SMS messages enable us to alert agents immediately if cargo has been detained for examination by the Hong Kong Customs and Excise Department.

To allow for safer freight train operations between Shenzhen and Lo Wu, we installed Mainland automatic train protection equipment on four KCRC locomotives. We further enhanced safety and working conditions in our shunting operation at the Lo Wu Marshalling Yard by replacing the signalling and manual points setting system with a new fully automated system on 2 November.

On 24 August the Corporation's new Asset Management System was implemented for the container and cargo handling equipment in KCRC's freight terminals. This will ensure that the performance of our equipment fully meets business requirements.

Construction of the Kowloon Southern Link, which will link up East Rail with West Rail, is well on its way to completion in 2009.

Network Expansion

The Lok Ma Chau Spur Line went into service on 15 August to provide a second boundary crossing for the travelling public.

A Decade of Expansion

Over the past decade KCRC has more than tripled the size of its railway network from the original line built in 1911. This ambitious programme of network expansion has been based on a simple proposition: to meet the growing transport needs of Hong Kong people by constructing railways of a world-class standard.

Past Progress, Present Achievement

Starting with the West Rail project, this programme has been responsible for the successful completion of the Tsim Sha Tsui Extension, Ma On Shan Rail and, in 2007, the Lok Ma Chau Spur Line. All have been completed on time and within budget, a feat that has rarely been matched by any other railway in the world.

These projects, together with the Kowloon Southern Link currently underway, have built up an unrivalled pool of railway design and engineering expertise which was inherited by MTR Corporation on 2 December.

Lok Ma Chau Spur Line

By the end of 2006 construction of the Lok Ma Chau Terminus was substantially completed, and by early 2007 installation and system acceptance tests of the railway systems in preparation for trial operations were fully completed.

The terminus entered the final pre-operation stage in the second quarter of the year, at which time most of the station facilities were handed over to the relevant parties. These included the station trading area for tenants in April, the Passenger Link Bridge to the Highways Department in May and the Public Transport Interchange to the Transport Department in June.

On 15 August the Lok Ma Chau Spur Line was successfully opened for public service, providing another direct and convenient boundary crossing service for Hong Kong and Shenzhen's combined population of 20 million.

The Kowloon Southern Link

At the end of November, 71% of the construction works for the Kowloon Southern Link had been completed. When it goes into service, this 3.8-kilometre railway will link up the existing East Rail and West Rail lines and provide an intermediate station at West Kowloon.

To construct the tunnels required for this railway, the contractors have been using both tunnel boring and cut-and-cover methods. For the section of the alignment from West Kowloon Station to East Tsim Sha Tsui Station, a tunnel boring machine called *Xiaolongnu* ("Little Dragon Girl") has been employed.

During the ten months since works began in August 2006, *Xiaolongnu* overcame some of Hong Kong's most difficult ground conditions along an alignment under newly reclaimed land. The machine passed under the busy and narrow Canton Road, negotiated the sharp curve at the former Marine Police Headquarters, kept the Hong Kong Cultural Centre open, passed above the MTR's running tunnels at Nathan Road by only two metres, and finally broke through the launching shaft in Salisbury Road to complete the first tunnel in June.

To avoid disruption to the ecologically sensitive Long Valley area, the Lok Ma Chau Spur Line runs mostly through a tunnel.

One of the new trains for the Kowloon Southern Link arrives in Hong Kong.

Works for the second tunnel commenced in September soon after *Xiaolongnu* had been transported back to the launching shaft in Jordan and re-assembled there. This second tunnel was completed in March 2008.

The cut-and-cover method of tunnelling was used for the alignment from West Kowloon Station to Nam Cheong Station. Piling and excavation works were basically complete by the end of November and were followed by the tunnel structure works.

By November 2007 the tunnel structure works between West Kowloon Station and Nam Cheong Station were 33% complete. Construction of the initial phase of the ventilation building superstructure at Yau Ma Tei was finished in July, allowing the start of electrical and mechanical installation works.

Construction of both the platform and concourse levels of West Kowloon Station concluded successfully during the year, and the permanent way contractor moved in to commence work on the track area. By the end of November, the overall station structure was 78% complete.

Railway Systems

During the year trackside walkways were installed at the overrun tunnel section of East Tsim Sha Tsui Station, and the East Rail signalling system at Hung Hom Station was modified for integration with the Kowloon Southern Link.

Trackside cabling works between Hung Hom and East Tsim Sha Tsui stations were completed, and the installation of radio system equipment began at the East Tsim Sha Tsui Station telecom equipment rooms.

All railway systems contracts were awarded during the year. The manufacturing of equipment for the permanent way and major electrical and mechanical systems (including tunnel ventilation, traction power and overhead line, lifts, escalators and platform screen doors) were all on schedule by the end of November.

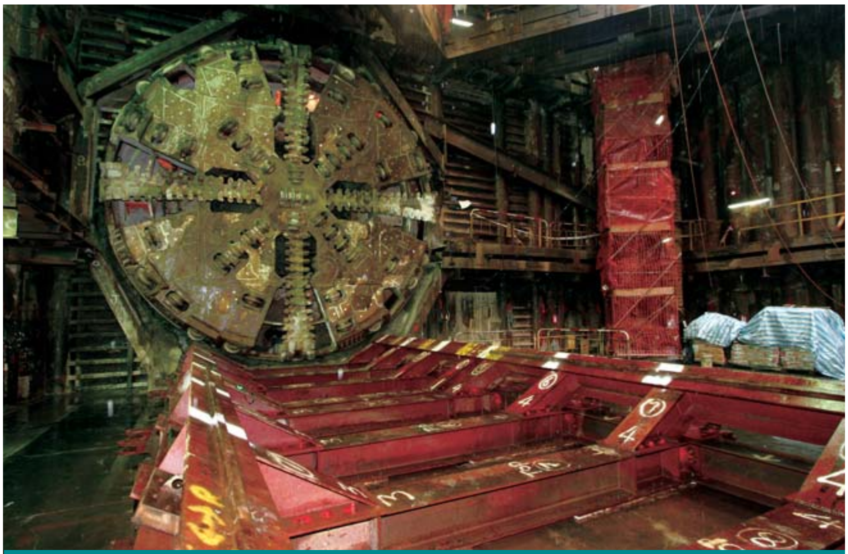
Rolling Stock

As the Kowloon Southern Link will ultimately form part of West Rail, KCRC ordered 34 train cars of the same design as West Rail trains from the same supplier, IKK Consortium. These train cars were delivered to Hong Kong in four batches in the months leading up to October.

Middle Road Subway Extension

To provide direct access between East Tsim Sha Tsui Station and the Canton Road shopping and commercial area, the Corporation has commenced works to extend the existing Middle Road Subway from The Kowloon Hotel to connect with the Kowloon Park Drive Subway and Peking Road Subway.

By year end, diversion of utilities was substantially complete and pipe-piling works were progressing satisfactorily. Installation of the traffic deck started in late 2007 and will continue into mid-2008 to allow for the commencement of excavation work.

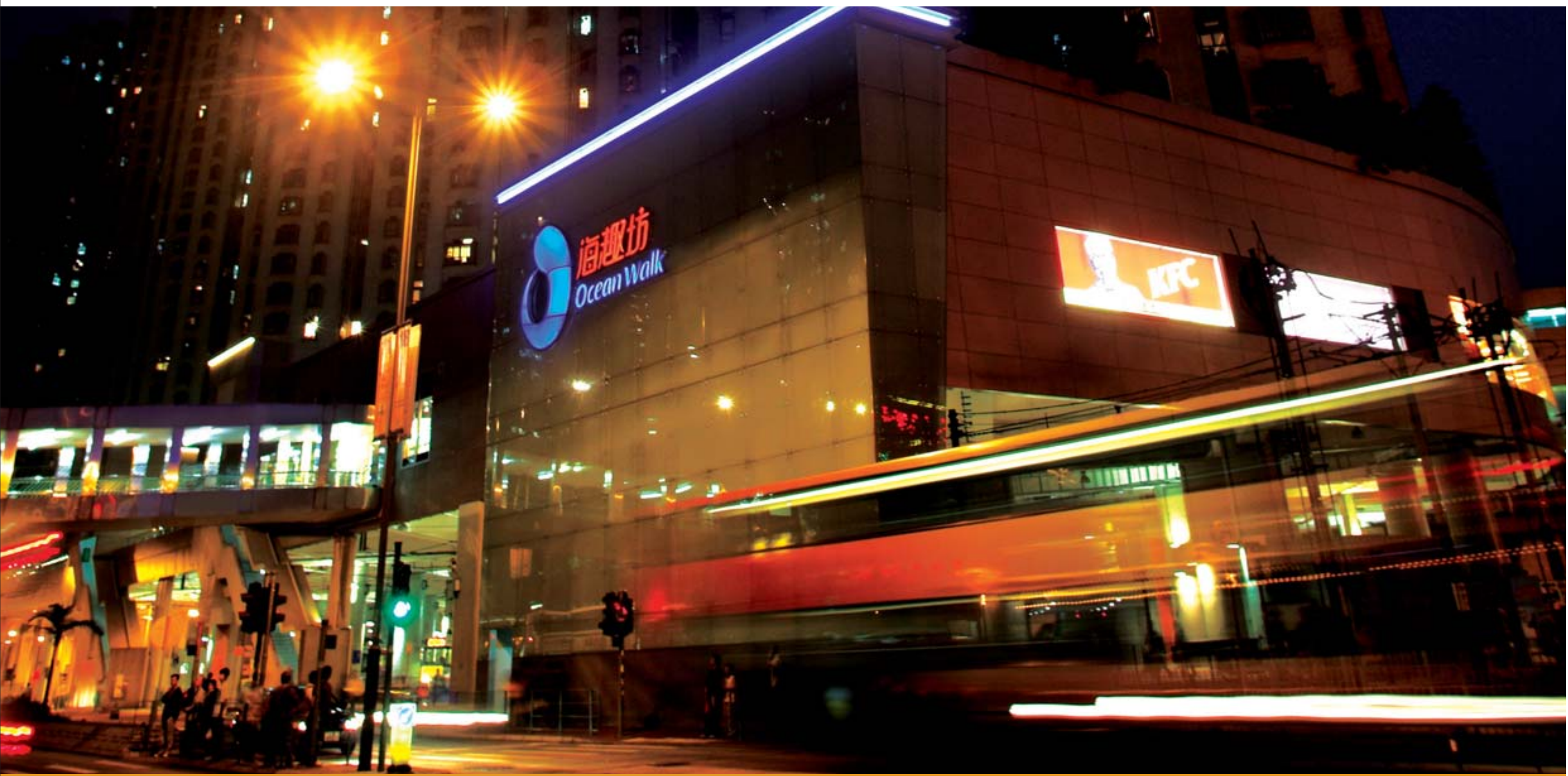


Xiaolongnu, the tunnel boring machine for the Kowloon Southern Link, achieved breakthrough of the first tunnel during the year.

Property Development and Other Businesses

The Corporation continued its property development programme during the year. The construction of the Ho Tung Lau joint venture project remained on schedule.

Property Development and Other Businesses



Ocean Walk in Tuen Mun is one of the Corporation's major shopping centres.

In partnership with established property developers, the Corporation builds high quality residential units for the people of Hong Kong. These developments are located at or near KCR stations and contribute to a permanent and increasing ridership for the Corporation's railways, while providing residents with convenient access to the railway network.

Under the merger transaction, MTR Corporation purchased various investment properties and the property management business of KCRC as well as the property development rights for certain properties at a total cost of HK$7.79 billion.

Property Development

During the year the Corporation continued its property development programme for sites along West Rail and Ma On Shan Rail in line with the co-ordinated programme, which had been agreed with the Government.

Acting as the agent of Tsuen Wan West TW7 Property Development Limited, the Corporation invited

West Rail Priority Property Sites

Nam Cheong	(4.62 hectares)
Yuen Long	(3.46 hectares)
Tuen Mun	(2.66 hectares)
Tsuen Wan West	(9.38 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)

Ma On Shan Rail Priority Property Sites*

Wu Kai Sha	(3.41 hectares)
Tai Wai Maintenance Centre	(7.06 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; 92% of the gross floor area will be used to create 10,686 residential flats between 2009 and 2015.

tenders for the West Rail Tsuen Wan West TW7 joint venture project. This project will comprise seven residential towers of 1,776 flats built above a carpark podium, together with a school of about 10,700 square metres.

Three tenders were received for the project in April 2007. After carefully reviewing the submitted tenders, the Corporation announced that the Board of Directors of Tsuen Wan West TW7 Property Development Limited had decided not to award the tender and would re-tender the project.

The Ho Tung Lau (Site A) joint venture project remained on schedule in 2007. At the end of November, the superstructure construction works were progressing well, with topping out of the residential towers scheduled for early 2008. The developer of the project is Full Fair Limited, a wholly-owned subsidiary of Sino Land Company Limited.

The Wu Kai Sha Station joint venture project between the Corporation and Shine Harvest International Limited (a wholly-owned subsidiary of Sino Land Company Limited) made very good progress during the year. The foundation of this 3.41-hectare project has been completed, and superstructure works are progressing smoothly.

The Tai Wai Maintenance Centre joint venture project between the Corporation and East Asia Investment Limited (a wholly-owned subsidiary of Cheung Kong (Holdings) Limited) also made good progress during the year. The major building works contract for Phase 1 was awarded in July 2007. Twelve 43-to 50-storey residential blocks providing about 4,300 residential units will be built in three phases on this 7.1-hectare site.

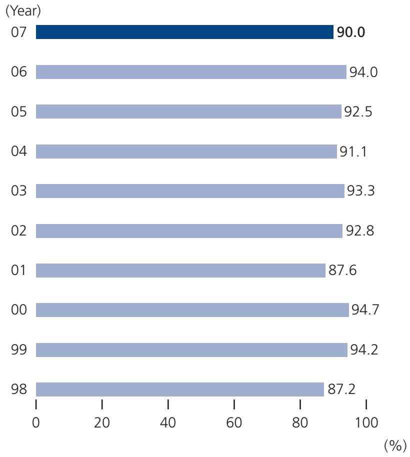
The Tuen Mun Station property development is a joint venture project between Tuen Mun Property Development Limited (of which the Corporation is an agent) and Wetland Park Management Services Limited (a wholly-owned subsidiary company of Sun Hung Kai Properties Limited). It occupies a site area of about 2.7 hectares, providing 2,161 residential units. The project made satisfactory progress during the year, with Phase 1 foundation works nearing completion in November.

A new vision in urban planning

The Linear City research project was completed in October 2007. The key findings that emerged from this research confirm that railways present special conditions and opportunities in urban planning.

Property Occupancy Rate

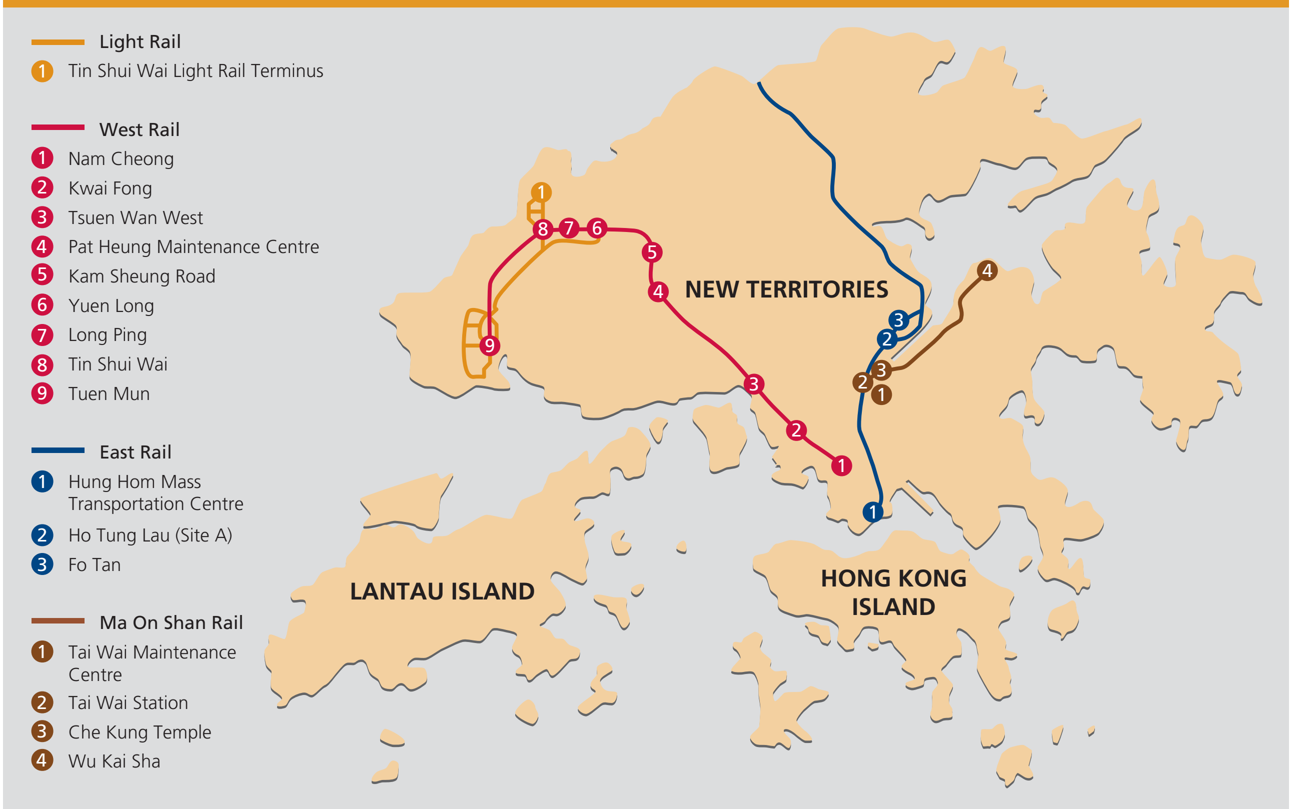
Station Commercial Premises, Commercial Offices and Shopping Centres



The findings also show that, although great attention has been paid to the integrated aspects of transport planning under current government policies, this integration has been limited to transport only. According to the research, planning should be extended to take into account numerous other factors in the larger context of urban development, among which transport should serve as one but not the only integrative mechanism.

Another important insight that can be drawn from the research suggests that while there is much room for improvement in housing and related development policies, these policies cannot by themselves ensure positive and sustainable results for railways and the communities that develop alongside them. A major factor in the implementation of these policies towards improving the quality of developments along railways is the need for a broader vision and improvement in the design process itself.

Property Development Sites



Property Development

	Residential floor area (sq m)	Commercial floor area (sq m)
Developed properties		
Pierhead Garden, Tuen Mun	91,400	9,832
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*
Sub-total	**761,336**	**345,140**
Properties under construction		
Ho Tung Lau (Site A)	120,900	2,000
Tai Wai Maintenance Centre	313,955	–
Tuen Mun Station	119,512	25,000
Wu Kai Sha	168,650	3,000
Sub-total	**723,017**	**30,000**
Total	**1,484,353**	**375,140**

* Including 35,034 square metres of serviced apartment units

Property Services

	Commercial floor area (sq m)	Units of car parking space	Number of residential flats managed
Property management			
Citylink Plaza	24,954	–	–
KCRC Hung Hom Building	5,576	–	–
Pierhead Garden	9,832	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
Total	**91,028**	**3,457**	**9,854**

Property Services

For the period up to 1 December 2007, recurrent revenue totalled HK$987 million, compared with HK$876 million for the entire year of 2006. The overall occupancy rate of station shops and shopping centres reached 90% in 2007.

Shopping Centres

Covering approximately 2,245 square metres, the seventh floor of Citylink Plaza was vacated for lease in 2007. To improve the trade mix and widen the shopper profile of Citylink Plaza, the Corporation successfully solicited 16 travel agencies to lease the entire seventh floor. The floor was renamed Citylink Travel Gallery and officially opened for business in October.

Station Facilities

Renovation works at Sheung Shui and Lo Wu stations were completed during the year, adding another 300 square metres of retail space to these stations. Retail services provided in the stations include convenience stores, cake shops, food and beverage outlets, clinics, travel agencies, and currency exchange shops.

At Tai Po Market Station, renovations continued throughout the year. When the works are completed, approximately 300 additional square metres will be available for providing retail services to passengers.

Lok Ma Chau Station

Lok Ma Chau Station opened for service on 15 August with 73 units for shops (including four units for duty free) and one restaurant, occupying a total of around 6,500 square metres. With its wide variety of retail services — ranging from a bakery and confectionery shop to convenience stores and a medical centre — this new terminus serves as a convenient stop for cross-boundary passengers.

Other Businesses

With the opening of the Lok Ma Chau Station and vigorous promotions at Lo Wu and Hung Hom stations, the Duty Free business recorded a 50% revenue growth in the first 11 months of 2007.

Station Commercial Activities

- Duty Free business
- Restaurants
- Public car-parking business
- Park and ride service
- Leasing of retail shops
- Leasing of office accommodation and store rooms
- Automatic teller machines
- Self-service machines and terminals
- Location film shooting
- Estate management and building maintenance services
- Leasing of retail sales kiosks / counters

Telecommunications Services

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

Advertising and Promotions

- Poster advertising
- Large outdoor advertising displays
- Feature advertising
- Promotional free-standing displays
- Distribution of free newspapers
- Commercial exhibitions
- Promotional activities
- Multi-media advertising system – Newsline Express

Property Services

Leasing of office buildings	(sq m)
Citylink Plaza	21,909
KCRC Hung Hom Building	5,576
Total	**27,485**

Leasing of shopping centres	(sq m)
Citylink Plaza	3,045
Ocean Walk	9,832
Sun Tuen Mun Shopping Centre	14,000
Hanford Plaza	3,200
Plaza Ascot	10,000
Total	**40,077**

Leasing of residential units	**272 units**

Station shops at the new Lok Ma Chau Terminus opened for business in 2007.

Revenue for Newsline Express in the period up to the end of November 2007 achieved a remarkable growth of 50% from that of 2006. This shows that the medium has become well accepted in the market and adds value to the experience of riding our trains. The business also won the KCRC Chairman's Award during the year.

The state-of-the-art design and innovative system adopted for Newsline Express have also been well recognised by the industry, winning the Silver Prize in the Best Ubiquitous Networking Category (Mobile Infotainment Application) and the Bronze Prize in the Best Lifestyles Category (Free Living) of the Hong Kong Information and Communication Technology Award 2007.

The Corporation's outdoor advertising sites at Hung Hom car park achieved 100 percent occupancy during the year. Moreover, the introduction of a new format for feature advertising increased advertiser satisfaction with KCRC media. Advertising income gained a substantial growth during the year despite the volatile advertising market.

Despite more stringent controls on fee charges to operators under the Telecommunication Ordinance, the Corporation was still able to maintain growth in this business.

During the year, the Corporation established a property management service in the new Lok Ma Chau Station and other renovated East Rail stations, namely, Tai Po Market, Sheung Shui and Lo Wu stations.

In 2007, the Corporation carried out a series of promotional activities and events during festive periods such as Chinese New Year, Easter, the summer school break and Halloween. All were well received by both tenants and shoppers.

Human Resource and Quality Management

Training continued to be a major focus of the Corporation, with programmes designed to prepare staff for the rail merger in December.

Human Resource and Quality Management

Training was a key component in preparing staff during the run-up to the merger in December 2007.

In the lead-up to the merger in December 2007, the Corporation provided staff with the skills and knowledge they needed for adjusting to a new corporate culture and the changes that lie ahead.

Human Resource

In 2007 the Corporation stepped up its training programmes to equip staff for the merger in December. These covered a wide range of courses, from networking and managing change to specialised IT applications.

Despite the pressures faced by the Corporation's nearly 6,000 permanent and contract staff, our service to passengers remained at a very high level throughout the year. This was in large part the result of programmes such as the "Go the Extra Mile" campaign, which won the Silver Prize in the Award for Excellence in Training 2007 organised by the Hong Kong Management Association.

Staff Training and Development

In 2007 we continued to emphasise training and development to prepare staff for change and increase their competency levels. A total of 506 training classes were organised in 2007, compared with 351 classes in 2006, representing an increase of 44%. Each employee received an average of 7.2 days of training during the year.

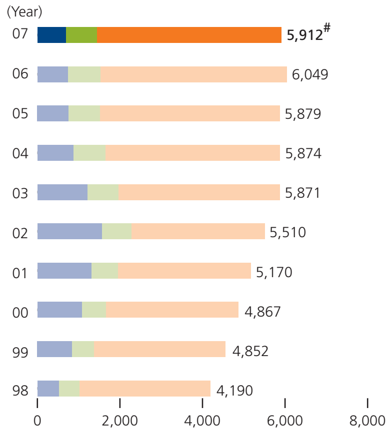
One of our most popular programmes, which was launched in mid-2006 and continued in 2007, was our "Embracing Change for Future Success" series of workshops. Designed to prepare staff for future challenges, the workshops covered a wide variety of topics, such as business Putonghua, English writing and speaking skills, presentation skills, the railway business, working in China, coaching, Neuro-linguistic Programming, career transition, interviewing skills and personal effectiveness. Ninety-six classes were offered in the series, with over 3,500 staff participating.

A series of six seminars kept staff abreast of developments in the market and featured celebrities sharing their thoughts on the keys to success. Subjects included creativity, networking, investment, communication and career development. Over 10,000 staff participated in the seminars, either in person or via webcast.

During the year we encouraged staff to upgrade their knowledge and skills through self-learning. More than 50 e-courses on management and IT subjects were offered to staff via e-learning at home or in the office. Since the launch of these courses in 2002, the number of e-learners has continued to grow. In 2007 45% of all staff had enrolled as e-learners, an increase of 166% over 2002.

For the approximately 900 staff of the Infrastructure & Buildings Department, we held a special series of customised workshops on managing change.

Staff Numbers



As at 1 December 2007

One of the sessions in the Corporation's award-winning "Go the Extra Mile" training programme.

A series of ongoing courses enhanced staff members' customer service skills and allowed them to share experiences with one another.

To familiarise staff with the Oracle system used by MTR Corporation, we held a series of courses that showed staff how to carry out their day-to-day business activities after the merger using the new software. The courses covered finance, the supply chain, maintenance and project management. Over 56 classes and nine briefing sessions were held with a total of 1,380 staff participating.

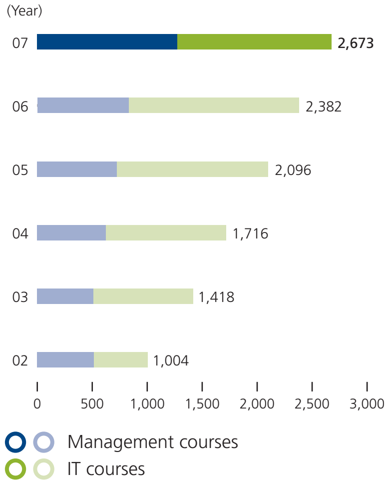
As a result of the courses, business operations proceeded smoothly during the merger transition.

In 2007 we introduced new learning programmes, which included an on-line video tutorial on Chinese input methods and "e-Learning Plus", an interactive forum for e-tutors and e-learners on management and language topics.

More than 3,800 items at the Learning Resource Centre were available on loan to staff during the year. The loan rate grew from 2,420 items in 2002 to 9,488 in 2007, an increase of 292%.

To keep staff up to date on railway industry news, the Learning Resource Centre introduced *Railway* e-magazine, covering international and mainland China railway news. Both *Railway* and a new e-magazine on learning English had a combined readership of over 16,000.

Number of participants in E-learning Programmes



Quality Management

As part of the Corporation's "Go the Extra Mile" (GEM) campaign to promote service excellence, a Service Champions Programme first launched in December 2005 continued during the year. Under this programme, 29 frontline supervisors from the Transport Division were nominated as Service Champions to act as role models for other frontline staff in promoting customer care. During a special workshop the Service Champions received skills and knowledge training and shared their experiences with one another.

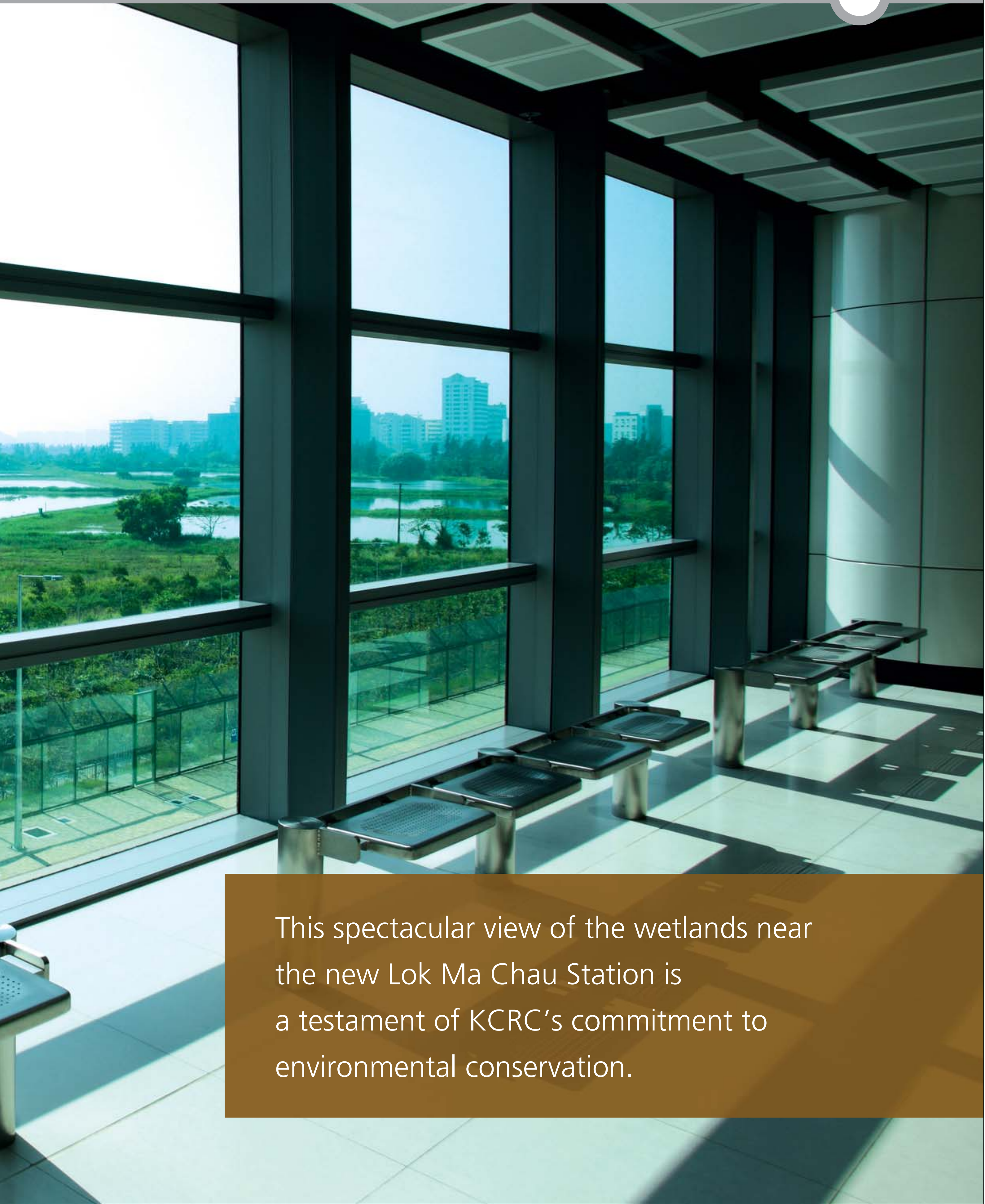
Also during the year we organised a Change Champions Gathering featuring a presentation on behavioural skills and Neuro-linguistic Programming and how they could be used to tackle change and overcome obstacles.

KCRC's GEM programme won the Silver Prize in the Award for Excellence in Training 2007, held by the Hong Kong Management Association. The award recognised the 100 GEM customer care training workshops for the 2,300 frontline staff of the Transport Division and the innovative approaches used in the programme. The training programme was also recognised in the 2007 KCRC Chairman's Award, the Corporation's highest accolade.

To recognise the winners of the Business Process Improvement Project Competition 2007, we held a joint gathering to thank staff who had submitted over 270 suggestions to Ideas-hub, the Corporation's staff suggestion and reward scheme.

During the year the Corporation implemented an Asset Management System in the Transport Division. Based on the Publicly Available Specification 55 standards, this system helps to optimise the management of the Corporation's physical assets so that they perform their function to the required service levels in a sustainable manner. The system also takes into account optimum lifecycle costs, health, safety, environmental performance and other factors.

Creating a Culture of Sustainability



This spectacular view of the wetlands near the new Lok Ma Chau Station is a testament of KCRC's commitment to environmental conservation.

Creating a Culture of Sustainability

Tree planting is one of the many activities undertaken by the Corporation to enhance the environment.

In 2007 KCRC continued to uphold its social, economic and environmental responsibilities and made certain that both its railway operations and infrastructure projects lived up to the highest international standards.

Our Commitment to Sustainability

In line with our commitment to integrate sustainability into all our operations and the infrastructure projects we undertake, throughout 2007 we provided support to our staff in anticipation of the merger at the end of the year, maintained open lines of communication with our passengers, and carried out programmes to raise safety awareness among our passengers, staff and contractors. We also continued to set the standard for environmentally-responsible practices in both our railway operations and new railway projects.

The Environment

KCRC has long been committed to the environment and has implemented systems and practices to improve what is already a clean and efficient means of mass transport.

After obtaining ISO 9001 certification in 1997, KCRC became certified in the ISO 14001 environmental standard for all key areas of its Transport Division and Capital Projects Division by the end of 2006.

As part of our environmental improvement plans, we are constantly striving to make more efficient use of power in all of our train stations. Accordingly, we have modified station lighting zones and timer controls on station air-conditioning and spot cooler units, and routinely switched off escalators and ticket vending machines during non-peak hours.

As part of our Tai Po Market Station renovation project, we are installing a green roof with grass and other plants to form a garden that will reduce the ambient temperature both inside and outside station premises. This will lessen the need for air-conditioning, as well as enhance the scenic environment. Work is expected to be completed in 2009.

Other measures have included the installation of local electronic filing systems to save paper and the testing of new energy-efficient LED fluorescent tubes for use inside our stations. We are also collecting waste paper, newspapers and spent batteries from the public in our stations, as part of our recycling programme.

The first Euro IV engine double-decker bus was delivered in November.

To explore the benefits of the rail merger and share best practices, we carried out an energy-reduction project at the Nam Cheong joint interchange station. After conducting energy studies, we have adopted a new mode of station operation that has resulted in a 3% saving in annual energy costs.

In November we took delivery of our first Euro IV engine double-decker buses, and the single-decker Euro IV engine buses will be received later in 2008. These new environmentally-friendly buses are fitted with the latest engines meeting the strictest environmental and safety standards.

With the certification of the Capital Projects Division to ISO 14001, KCRC is ensuring that all new railway projects are constructed in an environmentally-responsible manner. For the Kowloon Southern Link project, a state-of-the-art slurry type tunnel-boring machine is being used to construct the tunnel section along Canton Road and Salisbury Road. This machine helps us keep dust and airborne particles away from nearby hotels, museums and cultural centres and avoid unnecessary traffic problems in that busy area.

The enhanced wetlands at Lok Ma Chau have succeeded in attracting many species of birds, including some endangered species.

At our new Lok Ma Chau Spur Line, we have created an Ecological Enhancement Area that comprises 37 hectares of fishponds, marsh and reed beds to provide a suitable habitat for local and migratory bird species in the region. So far, this wetland has attracted over 200 species of birds, including some endangered species.

On 7 November 2007, a record 200 Black-faced Spoonbills were spotted at the Lok Ma Chau wetlands. (The previous high was 160 in January 2006.) This number represents around 12% of the worldwide population and shows again that the Corporation's environmental commitment is paying healthy environmental and ecological dividends.

During the year the KCRC Corporate Environmental Steering Committee held its second Environmental Week, with the aim of further promoting environmental awareness and education among staff. The week-long programme of activities, seminars and events included an environmental quiz, a green video competition, general environmental talks, technical talks on renewable energy from the Electrical and Mechanical Services Department and Housing Department and tours of the Lok Ma Chau wetland.

As a member of the Environmental Protection Department's Wastewi$e scheme, the Corporation was pleased to have been awarded the Gold Wastewi$e logo for achieving the 20 waste reduction targets that were set over the past two years.

Promotion of conservation through example

In addition to promoting sustainability within our own operations, KCRC encourages conservation through example.

During the year we donated 600 used computers to a charity for distribution to those in need. Similarly, we held a drive to collect surplus Chinese New Year cakes and treats contributed by staff, passengers and shop tenants for donation to a charitable organisation.

In our ongoing tree planting programme, 100 primary school students were invited to participate in planting trees next to the Lo Wu Station track. In 2007 we planted another 360 trees bringing the total for this programme to over 10,000 trees.

Although concrete sleepers are mostly used for our railways, we still have a number of timber sleepers at certain parts of the railway, which need to be replaced periodically. Fifty-eight used timber sleepers were donated to a secondary school for building a rooftop garden and were used for creating benches, plant borders and a fishpond.

Community Involvement

We believe that as a public corporation we must be transparent and accountable. In order to explain our actions and obtain feedback from the public, we engage our stakeholders through a number of channels. These include a Public Consultation Group (PCG), whose members comprised the Corporation's senior management and representatives of the Traffic and Transport Committees of the District Councils along our alignment and our Passenger Liaison Groups. The PCG met regularly throughout 2007 to discuss issues relating to our railway services.

Three rounds of Passenger Liaison Group meetings were held during the year. Topics of discussion focused on East Rail, West Rail and Ma On Shan Rail. In particular, passengers' views were sought on the Intelligent Platform Extension System, Lo Wu Improvement Works Phase II and the lift and escalator passenger safety education campaign. Other topics included the Lok Ma Chau Spur Line and West Rail and Light Rail service arrangements.

KCRC Café meetings were also held, in which passengers had the opportunity to meet the Corporation's management face-to-face and present their views on our services.

Passenger Education

In June a revised version of *Your Safety Guide on KCR Rails* was published for the use of passengers. The booklet provides safety tips regarding escalators, lifts, station platforms, KCRC trains and Light Rail crossings. It also contains a list of emergency devices on trains and at stations, with information on how to react in case of a fire, blackout or evacuation.

In our lift and escalator safety campaign, we encouraged passengers with bulky luggage, the elderly and passengers in need to use lifts instead of escalators. Other safety awareness programmes promoted escalator and platform gap safety and warned passengers not to rush trains as doors were closing.

Campaigns were also held on how to correctly validate Octopus stored value cards to avoid card malfunctions.

Caring for Staff

As the prospect of a merger created a degree of uncertainty for our staff, we launched a wellness programme to address their needs. A series of functions and seminars was conducted focusing on work-life balance and holistic healthy living. Specialists in

KCRC management heard issues of public concern through its Passenger Liaison Group programme.

physical and psychological wellness conducted inspiring talks in areas such as life transition from middle age to retirement. The talks attracted over 2,900 participants.

We also encouraged direct and open communication between management and staff. In addition to regular meetings with representatives of staff consultative committees and unions, we held hundreds of mass briefings and intensive group discussions during the year. These gave staff insights into the merger integration process and enabled management to obtain their feedback.

To promote interaction between the staff of KCRC and MTR Corporation, we organised a series of social events, including cross-company visits and photography, cooking and orienteering competitions. The events enabled staff to understand and appreciate each other's operations, as well as get to know one another better in a more relaxed and casual setting. They also proved to be excellent vehicles for fostering cross-fertilisation of ideas and cultural integration.

Health and Safety

The safety of passengers, the general public, staff and contractors remained a top priority for KCRC during the year.

In 2007 we continued to emphasise a risk management approach to safety. On all of our projects, we have achieved an excellent safety record by setting realistic objectives for our staff and contractors, monitoring and measuring performance against other employers in Hong Kong and conducting regular independent audits against international standards. We also reviewed and updated our safety and risk management programmes as required.

The threat of an epidemic outbreak of avian flu remained a concern during the year. In 2007 the Management Committee approved a Response Plan for Special Medical Situations and established a Corporate Response Team to coordinate responses across divisions and develop contingency plans for various scenarios. A drill was also carried out at Sha Tin Station to test the ability of frontline staff to handle bird carcasses found on railway premises in accordance with the Corporation's safety guidelines and handling procedures. Free and voluntary on-site influenza vaccinations were provided to all staff in October and November.

For promoting safety and health among staff and contractors, the Corporation hosted a Corporate Safety Month in November together with MTR Corporation. We also shared best practices and our experiences in health and safety with other utility companies through a Joint Utilities Safety & Occupational Health Policy Group. The Group's Safety Forum 2007, hosted by the Corporation, was held during Corporate Safety Month in November.

During the year, we maintained a very low rate of accidents on our construction sites. Two of our contractors performed particularly well and received silver awards under the Considerate Contractors Site Award Scheme, organised by the then Environment, Transport and Works Bureau.

These excellent results can be attributed to the many new safety initiatives we implemented on the Kowloon Southern Link project, the first to have Corporation staff as site staff. One of these was a Job Hazard Analysis (JHA) system for foremen and workers. In addition to raising safety awareness among supervisors and workers, the JHA system gave back responsibility for hazard control to on-site supervisors, who have greater control over their workers. Another initiative that made a difference was a 35-hour safety training course provided to front line site staff by the Safety Section.

During the year the Corporation also held its second annual safety week organised jointly with the MTR Corporation to promote a safety culture within both organisations. The highlight of the week was the signing of a mission statement by all senior management staff.

KCRC and MTR Corporation banded together during Corporate Safety Month to promote safety among staff and contractors.

Construction Safety

Number of reportable accidents per 1,000 workers

	2003	2004	2005	2006	2007
Lok Ma Chau Spur Line[1]	4.08	13.68	13.98	6.19	**N.A.**
Kowloon Southern Link[2]	–	–	2.72	1.38	**15.00**
Public Works Contracts[3]	20.30	19.80	17.40	13.20	**11.50**
HK Construction Industry[4]	68.10	60.30	59.90	64.30	**Not yet available**

1 LMC Spur Line works were completed at the end of 2006
2 KSL below ground works during 2007
3 Source – the then Environment, Transport and Works Bureau and the Development Bureau
4 Source – Labour Department

Passenger Safety

Number of passengers and members of the public injured per million passenger journeys

	2003	2004	2005	2006	2007
East Rail*	0.65	0.74	0.71	0.74	**0.74**
West Rail	2.33	0.79	0.55	0.51	**0.46**
Light Rail	0.25	0.14	0.17	0.29	**0.18**
Bus	0.10	0.21	0.18	0.15	**0.14**

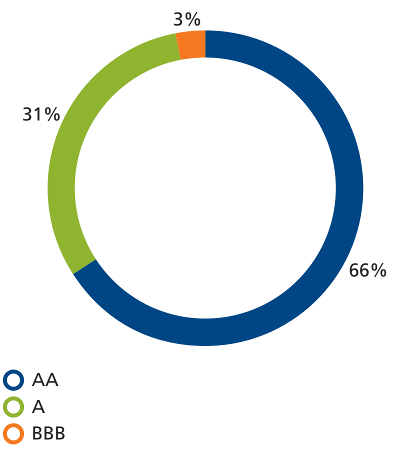
* Including the Tsim Sha Tsui Extension, Ma On Shan Rail and Lok Ma Chau Spur Line

Investment and Financing Strategies

Investments

	2007 (HK$ million)
Cash and cash equivalents	6,636
Bonds issued by financial institutions	2,585
Total	9,221

Composition of Investments by Credit Quality



Financing

Taking advantage of the low interest rate environment, we prepaid our export credit loans from Japan Bank for International Cooperation and Export Development Canada in April and May respectively. Subsequently, we have utilised bank facilities to meet our funding requirements during the year.

In August we sought the acknowledgement from the lenders of the syndicated loan facilities that the granting of a long-term service concession by us to MTR Corporation does not constitute any breach of the provisions of the credit facilities agreement. The lenders have acknowledged our request and a drawdown under the facilities was made in September.

As at 31 December 2007, the Group had interest-bearing borrowings (including short-term bank loans) of HK$17,902 million, with an average maturity of 2.27 years. The average cost of borrowing was 7.81%.

Credit Rating

In July 2007 Moody's affirmed KCRC's long-term local and foreign currency issuer ratings at Aa3. This followed the approval by the Legislative Council of the Hong Kong SAR of the primary legislation for the proposed operational merger with MTR Corporation. Standard & Poor's also affirmed KCRC's long-term local and foreign currency corporate credit ratings at AA, following the affirmation of the long-term local and foreign currency credit ratings of the Government of the Hong Kong SAR at AA.

Investment

As at 31 December 2007, the Group's cash and cash equivalents and investments in securities amounted to HK$9.2 billion.

Risk Management

KCRC manages its currency and interest rate exposures with derivative instruments, such as interest rate swaps, currency swaps and foreign exchange forward contracts in accordance with the Managing Board's approved hedging guidelines. These instruments have been employed for hedging purposes only. Our objectives are to reduce the foreign currency exposure in respect of debt obligations by converting such obligations into either Hong Kong dollars or US dollars, and to maintain our US dollar exposure in debt obligations at no greater than 30% of total debt obligations.

Moreover, we seek to limit our exposure to interest rate risk by maintaining fixed interest rate debts at between 30% and 75% of total debt obligations.

As at 31 December 2007, the proportion of borrowings denominated or hedged into Hong Kong dollars stood at 96% (2006: 89%).

As at 31 December 2007, the proportion of fixed interest rate borrowings stood at 73% (2006: 74%).

We have entered into ISDA Master Agreements with all swap counterparties. All counterparties having outstanding swap transactions with us have confirmed that the service concession arrangement with MTR Corporation would not constitute an event of default under the ISDA Master Agreement.

Compliance

KCRC has strived to comply with all rules and regulations of the stock exchanges and regulatory authorities that govern the listing and trading of KCRC's debt securities.

In connection with the service concession arrangement with MTR Corporation, we launched a consent solicitation process in September to obtain consent from holders of our outstanding notes to amend certain provisions in the relevant indenture and agency agreements so as to allow the service concession arrangement to proceed without breach of any provisions in those agreements. Subsequently, in October, we obtained the requisite consent and the indenture and agency agreements have been amended accordingly.

Credit Ratings

	2007
Standard & Poor's	
Short-term local currency corporate credit rating	**A-1+**
Short-term foreign currency corporate credit rating	**A-1+**
Long-term local currency corporate credit rating	**AA**
Long-term foreign currency corporate credit rating	**AA**
Moody's	
Short-term issuer rating	**P-1**
Long-term local currency issuer rating	**Aa3**
Long-term foreign currency issuer rating	**Aa3**
Senior unsecured local currency debt rating	**Aa3**
Senior unsecured foreign currency debt rating	**Aa3**

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

Debt Facilities and Programmes

	2007 (HK$ million)		2006 (HK$ million)	
	Drawn	**Undrawn**	Drawn	Undrawn
Medium term note programme	**9,024**	**14,473**	8,994	14,418
Global notes	**7,833**	**–**	7,804	–
Retail notes	**1,000**	**–**	1,000	–
Export credit loan facilities	**–**	**–**	1,407	10
Syndicated loan facilities	**–**	**8,000**	–	8,000
Bank overdraft facilities	**–**	**25**	–	25
Letters of credit	**–**	**20**	–	20
Letters of credit for leveraged leases	**–**	**2,459**	–	2,279
Uncommitted short-term facilities	**45**	**3,055**	–	2,200
Total	**17,902**	**28,032**	19,205	26,952

Financial Review

With the rail merger having taken place on 2 December 2007, the Corporation's financial results for 2007 reflect eleven months of pre-merger transport and commercial operations and one month under the service concession arrangement after the merger.

Arising from the sale of investment and other properties together with property development and property management rights under the merger transaction, a one-off pre-tax profit of HK$6.2 billion was recognised in 2007, resulting in an after-tax profit of HK$5.3 billion for the year.

Profit and Loss

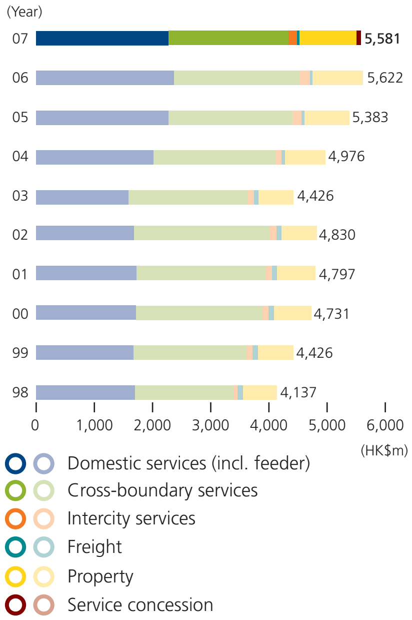
Transport revenue for 2007 amounted to HK$4,524 million, representing the income from the Corporation's transport operations up to the day before the merger on 2 December 2007, compared with HK$4,746 million for the year in 2006. Compared with the same period in 2006, transport revenue for the period up to 1 December 2007 increased by 4.3%, mainly because of better performance of the cross-boundary and East Rail domestic services resulting from the growth of the cross-boundary market and the local economy as well as increased patronage from the newly opened Lok Ma Chau Spur Line and the continuous build up of patronage from West Rail.

Commercial revenue from the leasing of shopping centres and office space, estate management, telecommunications, advertising, station kiosks and shops increased by 12.7% to HK$987 million for the period up to 1 December 2007 from HK$876 million in 2006, mainly because of the growth of the duty free business as well as higher revenue from shopping centres.

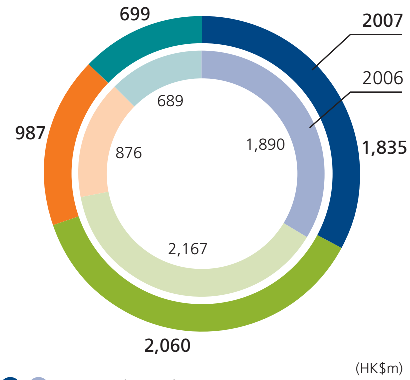
The one month concession income of HK$70 million was recognised from 2 December representing the fixed payment and the amortisation of the upfront payment under the service concession arrangement.

Operating costs before depreciation and amortisation for 2007 decreased by 6.8% to HK$2,818 million from HK$3,022 million in 2006. Staff costs decreased by 5.1% to HK$1,464 million from HK$1,543 million in 2006; energy costs decreased by 2.7% to HK$471 million from HK$484 million in 2006; maintenance, spares and supplies costs decreased by 12.3% to HK$458 million from HK$522 million in 2006; and other expenses decreased by 10.1% to HK$425 million from HK$473 million in 2006.

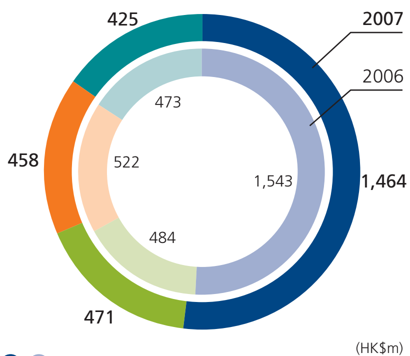
Recurrent Revenue



Share of Recurrent Revenue



Operating Expenses



As a result, operating profit before depreciation and amortisation increased by 6.3% to HK$2,763 million from HK$2,600 million in 2006.

The operating margin before depreciation and amortisation and net interest and finance expenses/(income) increased from 46.2% in 2006 to 49.5% in 2007.

Depreciation and amortisation increased by 5.7% to HK$2,418 million from HK$2,288 million in 2006, mainly because of the opening of the Lok Ma Chau Spur Line in August 2007.

Therefore, operating profit after depreciation and amortisation increased by 10.6% to HK$345 million from HK$312 million in 2006.

A one-off pre-tax profit of HK$6.2 billion was recognised in 2007 from the sale of investment and other properties together with property development and property management rights under the merger transaction.

Merger-related expenses increased from HK$20 million in 2006 to HK$216 million in 2007.

Net interest and finance expenses increased by 168% to HK$847 million from HK$316 million in 2006, mainly because interest expenses related to the Lok Ma Chau Spur Line project could no longer be capitalised upon its completion in March 2007.

Share of profit of associates of HK$39 million was recognised in 2007, compared with HK$27 million in 2006, representing an increase of 44.4%.

After taking into account the above, a profit before unrealised gains and tax of HK$5,555 million was recorded in 2007, compared with HK$430 million in 2006.

The unrealised accounting profits resulting from the changes in fair value of investment properties, financial instruments and the hedged portion of interest bearing borrowings were HK$550 million in 2007, compared with the net unrealised accounting losses of HK$99 million in 2006.

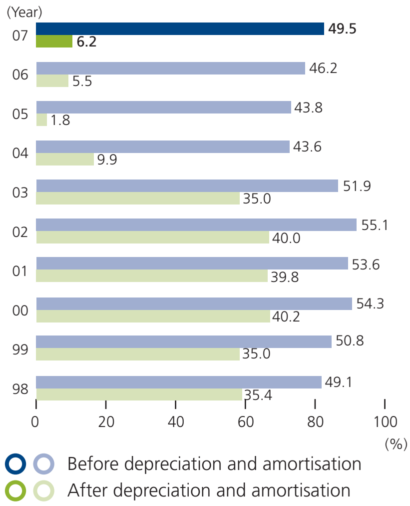
Income tax in the amount of HK$784 million was recognised in 2007, compared with HK$53 million in 2006.

As a result, net profit after tax was HK$5,321 million in 2007, compared with HK$278 million in 2006.

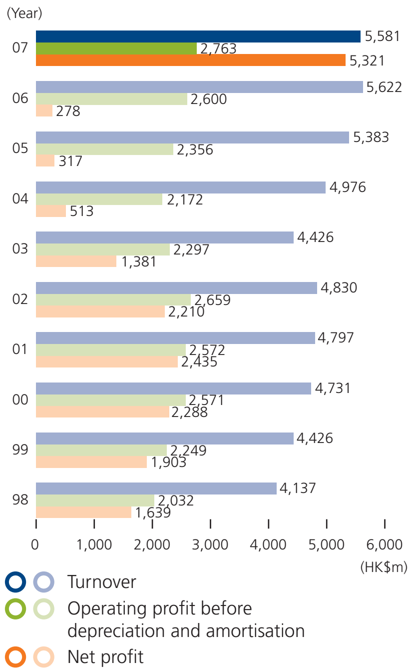
Capital Expenditure

Capital expenditure for the year increased by 7.7% from HK$3,317 million in 2006 to HK$3,574 million in 2007, due in large part to the progress of works for the Kowloon Southern Link.

Operating Margin



Net Results from Underlying Businesses



The capital expenditure of 2007 was mainly for the construction of the Kowloon Southern Link and the outstanding works of the Lok Ma Chau Spur Line, investment to prepare for the replacement of aged assets and safety and environmental improvements.

Cash Flow

The net cash inflow from operations increased by 8.4% to HK$2,889 million from HK$2,664 million in 2006. On the other hand, the net cash outflow from property development was HK$38 million compared with an inflow of HK$1,505 million in 2006. After taking into account the net cash inflow from the package of the rail merger deal of about HK$11 billion, partly set off by capital expenditure for the Kowloon Southern Link and payment for purchase of investments, net cash inflow before financing increased to HK$5,629 million from HK$1,421 million in 2006. Net cash outflow from financing activities increased to HK$2,943 million from HK$1,784 million in 2006. As a result, there was a net cash inflow of HK$2,686 million for the year compared with a net cash outflow of HK$363 million in 2006.

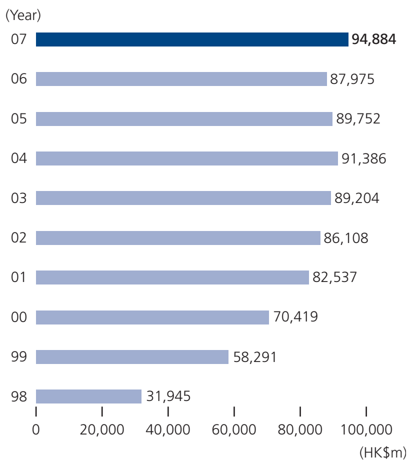
Transport

East Rail revenue amounted to HK$3,593 million for the year, representing the income from East Rail operations up to the day before the merger on 2 December 2007, compared with HK$3,780 million for the year in 2006. Compared with the same period in 2006, East Rail revenue for the period up to 1 December 2007 increased by 4.1%, mainly due to the growth of the cross-boundary market and the local economy as well as increased patronage from the newly opened Lok Ma Chau Spur Line.

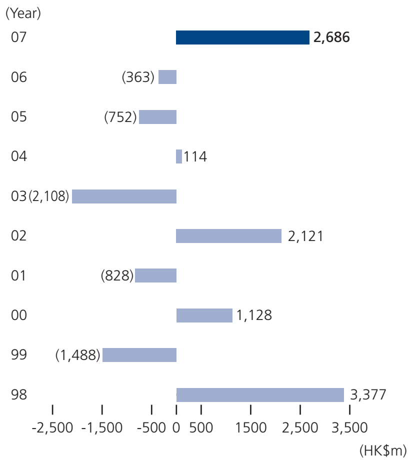
West Rail and Light Rail revenue was HK$893 million for the year, representing the income from West Rail and Light Rail operations up to the day before the merger on 2 December 2007, compared with HK$922 million for the year in 2006. Compared with the same period in 2006, West Rail and Light Rail revenue for the period up to 1 December 2007 increased by 5.6%, mainly due to the continuous build-up of West Rail patronage.

Freight revenue was recorded at HK$38 million for the year, representing the income from freight operations up to the day before the merger on 2 December 2007, compared with HK$44 million in 2006. Compared with the same period in 2006, freight revenue for the period up to 1 December 2007 decreased by 5.3%, mainly due to the disruption arising from the construction of a fourth track between Guangzhou and Shenzhen.

Total Assets



Net Cash Inflow / (Outflow)



Consequently, transport revenue, including fare and non-fare revenue, amounted to HK$4,524 million for the year, representing the income from transport operations up to the day before the merger on 2 December 2007, compared with HK$4,746 million for the year in 2006. Operating costs before depreciation and amortisation decreased by 6.5% from HK$2,650 million in 2006 to HK$2,479 million for the year. Profit generated from the Corporation's transport business before depreciation and amortisation decreased by 2.4% from HK$2,096 million in 2006 to HK$2,045 million for the year. Depreciation and amortisation decreased by 3.6% from HK$2,233 million in 2006 to HK$2,152 million for the year. As a result, loss before sharing of corporate overheads decreased by 21.9% to HK$107 million from HK$137 million in 2006.

Capital expenditure increased to HK$1,197 million from HK$414 million in 2006, mainly for the outstanding works of the Lok Ma Chau Spur Line.

Property

Although reflecting only eleven months of business in 2007, commercial revenue increased by 12.7% to HK$987 million from HK$876 million in 2006, mainly because of the growth of the duty free business, especially with the service commencement of Lok Ma Chau Station in August 2007. Total operating costs before depreciation and amortisation decreased by 9% to HK$161 million from HK$177 million in 2006. Profit generated from the Corporation's property related business before depreciation and amortisation increased by 18.2% to HK$826 million from HK$699 million in 2006. Depreciation and amortisation increased by 5.3% to HK$40 million from HK$38 million in 2006. No property development profit was recognised in the year, compared with a profit of HK$427 million in 2006. After taking into account the unrealised accounting profit resulting from the change in valuation of investment properties of HK$9 million, property related profit before sharing of corporate overheads decreased by 33% to HK$795 million from HK$1,187 million in 2006.

Capital expenditure decreased by 35.1% to HK$48 million compared with HK$74 million in 2006, mainly due to the completion of the renovation of Ocean Walk (formerly Pierhead Plaza).

The members of the Managing Board have pleasure in submitting herewith their report and audited financial statements for the financial year ended 31 December 2007.

Kowloon-Canton Railway Corporation Ordinance

The Kowloon-Canton Railway Corporation Ordinance (the KCRC Ordinance), enacted in 1982, established the Corporation and empowered 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 KCRC Ordinance contains provisions covering the appointments and roles of the Members of the Managing Board.

An amendment of the KCRC Ordinance in December 2001 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.

On 2 December 2007 following the enactment of the Rail Merger Ordinance, the MTR Corporation commenced operating the KCRC's railway assets by way of a Service Concession for an initial period of 50 years, which is extendable. KCRC retains ownership of the railway assets covered in the Service Concession Agreement, and there is provision for KCRC to take back and operate its assets should this ever become necessary.

Principal Activities of the Corporation

Until 2 December 2007, the principal activities of the Corporation were:

(a) the operation of a railway system between Kowloon (East Tsim Sha Tsui Station) and Lo Wu and Lok Ma Chau, between Tuen Mun and Nam Cheong and between Tai Wai and Wu Kai Sha

(b) the operation of cross-boundary passenger and freight services in association with Mainland railway authorities

(c) the operation of the North West New Territories light rail system

(d) the detailed planning, design and construction of extensions to the current railway system

(e) the development of associated commercial activities, including the sale of advertising space, the marketing of concessions and property leasing

(f) the development of property

(g) the operation of feeder bus services

The principal activities of the subsidiary companies incorporated to facilitate the undertaking of the above activities are set out in Note 19 to the financial statements.

From 2 December 2007, the principal activities of the Corporation have become :

(a) railway asset holder, with responsibility for monitoring MTR Corporation's compliance with the terms of the Service Concession Agreement

(b) investing the upfront payment of HK$12.04 billion and subsequent annual payments from MTR Corporation

(c) servicing the Corporation's outstanding debts

(d) managing its remaining subsidiaries

The Managing Board

Members

The Board is the governing body of the Corporation with authority to exercise the duties conferred upon it by the KCRC Ordinance. Until 31 July 2007, the Board comprised the Chairman and eight other members, all of whom were appointed by the Chief Executive of the Hong Kong Special Administrative Region, and the Chief Executive Officer who was appointed by the Corporation subject to the prior approval of the Chief Executive of the Hong Kong Special Administrative Region. From 1 August 2007, following a member stepping down at the end of his term of appointment, the number of members fell to seven.

During the year up to 2 December 2007, Members of the Board who served were Mr Michael Tien (Chairman), Ir James Blake (Chief Executive Officer), Mr Vincent Lo Wing-sang, Mr Frederick Ma Si-hang (the Secretary for Financial Services and the Treasury) (until 30 June 2007), Dr Sarah Liao Sau-tung (the Secretary for the Environment, Transport and Works) (until 30 June 2007), Prof K C Chan (the Secretary for Financial Services and the Treasury) (from 1 July 2007), Ms Eva Cheng Yu-wah (the Secretary for Transport and Housing) (from 1 July 2007), Mr Wan Man-yee (until 31 July 2007), Mr Patrick B Paul, Prof Richard Wong Yue-chim, The Hon Abraham Shek Lai-him and Mr Ng Leung-sing. All existing members stood down on 1 December 2007.

With effect from 2 December 2007, Members of the Board were all public officers (appointed ex-officio), being Prof K C Chan (Chairman) (the Secretary for Financial Services and the Treasury), Ms Eva Cheng Yu-wah (the Secretary for Transport and Housing), Mr Stanley Ying Yiu-hong (the Permanent Secretary for Financial Services and the Treasury (Treasury)), Mr Francis Ho Suen-wai (the Permanent Secretary for Transport and Housing (Transport)), Mr Clement Leung Cheuk-man, (the Deputy Secretary for Financial Services and the Treasury (Treasury)), and Mrs Lucia Li Li Ka-lai (the Director of Accounting Services).

The number of Board and Committee Meetings held and attended (in parentheses) by each Member or his/her alternates during the year up to 2 December 2007 is listed in the table below.

	Board Meetings	Audit Committee	Property Committee (Until 31 July 2007)	Capital Projects Committee (Until 31 July 2007)	Property & Capital Projects Committee (From 1 August 2007)	Strategic Human Resource Committee	Finance Committee
Mr Michael Tien Chairman Non-Executive Member	9 (8)					1 (1)	
Ir James Blake Chief Executive Officer Executive Member	9 (9)		3 (2)	4 (4)	1 (1)		2 (2)
Mr Frederick Ma Si-hang Ex-Officio Member	6 (6)[1]		3 (3)[4]	4 (4)[5]		1 (1)[7]	2 (2)[8]
Dr Sarah Liao Sau-tung Ex-Officio Member	6 (6)[1]			4 (4)[6]			
Prof K C Chan Ex-Officio Member	3 (3)[3]				1 (1)[7]		
Ms Eva Cheng Ex-Officio Member	3 (3)[3]				1 (1)[7]		
Mr Vincent Lo Wing-sang Non-Executive Member	9 (9)		3 (3)		1 (1)		
Mr Wan Man-yee Non-Executive Member	6 (6)[2]	4 (4)		4 (4)			
Mr Patrick B Paul Non-Executive Member	9 (4)	4 (4)	3 (2)		1 (0)	1 (1)	
Prof Richard Wong Yue-chim Non- Executive Member	9 (5)			4 (1)	1 (0)		2 (2)
The Hon Abraham Shek Lai-him Non-Executive Member	9 (8)	4 (4)		4 (2)	1 (1)	1 (1)	
Mr Ng Leung-sing Non-Executive Member	9 (7)		3 (3)		1 (1)		2 (2)

1 Appointment ended on 30 June 2007. Alternates attended 4 meetings
2 Appointment ended on 31 July 2007
3 Appointed on 1 July 2007. Alternates attended 1 meeting
4 Alternates attended 3 meetings
5 Alternates attended 3 meetings and 1 meeting attended by Principal Assistant Secretary for Financial Services and the Treasury (Treasury)
6 Alternates attended 4 meetings
7 Alternates attended 1 meeting
8 Alternates attended 2 meetings

After the merger, one Board meeting was held on 3 December 2007, and attended by Prof K C Chan (Chairman), Ms Eva Cheng Yu-wah, Mr Stanley Ying Yiu-hong, Mr Francis Ho Suen-wai, Mr Clement Leung Cheuk-man, and Mrs Lucia Li Li Ka-lai. There were no Committee meetings in December.

Alternate Members

Alternate Members in office during 2007 were Mr Martin McKenzie Glass, Mr Alan Lai Nin, Mr David Lau Kam-kuen and Mr Clement Leung Cheuk-man (alternates for the Secretary for Financial Services and the Treasury), and Mr Henry Chan Chi-yan, Ms Annie Choi Suk-han, Ms Cathy Chu Man-ling, Mr Patrick Ho Chung-kei, Mr Francis Ho Suen-wai, Ms Annette Lee Lai-yee and Mr Philip Yung Wai-hung (alternates for the Secretary for the Environment, Transport and Works up to 1 July 2007 and then for the Secretary for Transport and Housing).

The Board met regularly each month, 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 (until 2 December 2007), 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 (until 2 December 2007) and the Chief Officer (from 2 December 2007) the authority for the management of day-to-day operations.

Committees

Until 2 December 2007 committees were formed to oversee specific aspects of the Corporation's operations and function and to make appropriate recommendations to the Managing Board for decision. These committees, with the exception of the Audit Committee, were served by a number of Expert Members, each being appointed for a specified period of time. The appointment of these Expert Members, who were not Members of the Managing Board and served in an advisory capacity, strengthened the role of the various committees in the execution of their various roles and as advisors to the Managing Board. Appointed to the Capital Projects Committee were Dr Greg Wong Chak-yan, a consulting civil engineer; Mr Wan Man-lung, Principal Government Engineer, Rail Development; Dr Hung Wing-tat, an Associate Professor of Civil Engineering of the Hong Kong Polytechnic University; and Ms Jennifer Lee-shoy, a lawyer specialising in Construction Law. Appointed to the Strategic Human Resource Committee was Mrs Anita To Yu Ming-chi, a general manager of a multinational company. Appointed to the Property Committee was Mr Philip Nunn, a lawyer with expertise in construction, arbitration and property development, and appointed to the Finance Committee, Mr Alfred Li Hung-kwan, a retired Chartered Accountant and company executive director. All Expert Members had their appointments renewed in July 2007 for six months from 1 August 2007 until 31 January 2008 or until the date of the rail merger, whichever date came earlier.

The number of Committee Meetings held and attended (in parentheses) by each Expert Member during the year up to 2 December 2007 is listed in the table below.

Expert Member	Property Committee (Until 31 July 2007)	Capital Projects Committee (Until 31 July 2007)	Property & Capital Projects Committee (From 1 August 2007)	Strategic Human Resource Committee	Finance Committee
Mr Philip Nunn	3 (3)		1 (0)		
Mr Alfred Li Hung-kwan					2 (1)
Mr Greg Wong Chak-yan		4 (3)	1 (1)		
Mr Hung Wing-tat		4 (4)	1 (1)		
Mr Wan Man-lung		4 (4)	1 (1)		
Ms Jennifer Lee-shoy		4 (3)	1 (1)		
Mrs Anita To Yu Ming-chi				1 (1)	

Following the rail merger on 2 December 2007, the Managing Board decided to retain only the Audit Committee. The other previous committees were no longer required given the changed nature of the Corporation's business.

With effect from 2 December 2007, the Audit Committee comprised Mrs Lucia Li Li Ka-lai (Chairman), Mr Stanley Ying Yiu-hong and Mr Clement Leung Cheuk-man. No meeting of the Committee was held in December 2007.

Prior to 2 December 2007, the Audit Committee had as a member possessing "recent and relevant experience", Mr Patrick B Paul (Chairman of the Committee), who is a chartered accountant and was formerly Chairman of Pricewaterhouse-Coopers (HK). On 2 December 2007, Mrs Lucia Li Li Ka-lai, who is also a chartered accountant and the Director of Accounting Services of the Hong Kong SAR Government, replaced Mr Paul as the Chairman of the Committee.

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. 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 computerised 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 projects, and all major expenditure and revenue contracts. All capital projects over HK$50 million, 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 put to and conducted by 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 New Code of Corporate Governance as set out by The Stock Exchange of Hong Kong Limited in Appendix 14 to the Listing Rules to the extent that they are applicable to the Corporation. 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 Officers of the Corporation and to any other person performing similar functions. Details relating to Corporate Governance are to be found on the Corporation's website www.kcrc.com.

Memberships of the Managing Board and its Committees

Details of the Members of the Managing Board and members of Committees for the year are listed on pages 16 to 17 of this Annual Report.

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 subsidiaries of the Corporation.

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 2007 and the state of affairs of the Corporation and of the Group at that date are set out in the financial statements on pages 83 to 170.

Fixed Assets

Movements in fixed assets during the year are set out in Note 15 to the financial statements.

Share Capital

Details of the Corporation's share capital are set out in Note 30 to the financial statements. Any further contributions of capital will be determined by the Government in consultation with the Corporation.

Dividend

The Corporation does not recommend the payment of a dividend to the Government in respect of the year ended 31 December 2007.

Retirement Benefit Scheme

Details of the Corporation's retirement benefit scheme, responsibility for which was passed over to the MTR Corporation on 2 December 2007, are set out in Note 36 to the financial statements.

Capitalised Interest and Finance Expenses

Details of the Corporation's capitalised interest and finance expenses are set out in Note 9 to the financial statements.

Interest-bearing Borrowings

Details of the Corporation's interest-bearing borrowings are set out in Note 28 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 the financial statements, the Chief Officer's Statement, Financial Review and the Ten-year Statistics of the annual report.

Donations

During the year, the Corporation donated a total of HK$2,164,763.36 to charitable organisations.

Going Concern

The financial statements on pages 83 to 170 have been prepared on a going concern basis. The Managing Board has approved the Corporation's budget for 2008 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 International Financial Reporting Standards issued by the International Accounting Standards Board, Hong Kong Financial Reporting Standards 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

Michael J. Arnold
Company Secretary
7 April 2008

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INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF THE MANAGING BOARD OF THE KOWLOON-CANTON RAILWAY CORPORATION

We have audited the consolidated financial statements of the Kowloon-Canton Railway Corporation (“the Corporation”) set out on pages 83 to 170, which comprise the consolidated and the Corporation balance sheets as at 31 December 2007, the consolidated income statement, the consolidated statement of changes in equity and the consolidated cash flow statement for the year then ended and a summary of significant accounting policies and other explanatory notes.

Board Members’ responsibilities for the financial statements

The Board Members of the Corporation are responsible for the preparation and the true and fair presentation of these financial statements in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board, Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the Kowloon-Canton Railway Corporation Ordinance. This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor’s responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made 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.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Corporation’s preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board Members, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Corporation and of the Group as at 31 December 2007 and of the Group’s profit and cash flows for the year then ended in accordance with International Financial Reporting Standards and Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the applicable disclosure requirements of the Hong Kong Companies Ordinance.

KPMG
Certified Public Accountants
8th Floor, Prince’s Building
10 Chater Road, Central, Hong Kong
7 April 2008

Consolidated Income Statement

for the year ended 31 December 2007 (Expressed in Hong Kong dollars)

	Note	**2007 $ million**	2006 $ million
Turnover	5	**5,581**	5,622
Operating costs before depreciation and amortisation	6	**(2,818)**	(3,022)
Operating profit before depreciation and amortisation	7	**2,763**	2,600
Depreciation and amortisation	8	**(2,418)**	(2,288)
Operating profit after depreciation and amortisation		**345**	312
Gain on sale of property development rights		**4,868**	–
Gain on sale of investment properties and other property, plant and equipment		**1,318**	–
Gain on sale of property management and telecommunication business		**48**	–
Merger-related expenses		**(216)**	(20)
Interest and finance income	9(a)	**476**	499
Interest and finance expenses	9(b)	**(1,323)**	(815)
Profit from property development		**–**	427
Share of profit of associate		**39**	27
Profit before unrealised gains/losses		**5,555**	430
Gains/(losses) on changes in fair value of derivative financial instruments and hedged borrowings	10	**541**	(198)
Net valuation gains on investment properties	15	**9**	99
Profit before taxation		**6,105**	331
Income tax	11(a)	**(784)**	(53)
Profit for the year wholly attributable to the sole shareholder of the Corporation	12	**5,321**	278
Dividend payable to the sole shareholder of the Corporation attributable to the year proposed after the balance sheet date	13(a)	**–**	82

The notes on pages 88 to 170 form part of these financial statements.

Consolidated Balance Sheet

at 31 December 2007 (Expressed in Hong Kong dollars)

	Note	2007 $ million	2006 $ million
Assets			
Fixed assets	15		
– Property, plant and equipment		**67,260**	58,498
– Investment properties		**–**	1,378
		67,260	59,876
Interest in leasehold land held for own use under operating leases	15	**5,931**	5,524
Construction in progress	16	**5,509**	13,644
Deferred expenditure	17	**1,585**	1,389
Properties under development	18	**20**	449
Interest in associate	20	**138**	99
Loan to non-controlled subsidiary	21	**4,407**	4,022
Derivative financial assets	32(e)	**132**	92
Investments	22	**2,585**	–
Stores and spares	23	**–**	362
Interest and other receivables	24	**681**	571
Cash and cash equivalents	25	**6,636**	1,947
		94,884	87,975
Liabilities			
Short-term bank loans	28	**45**	–
Interest and other payables	26	**1,222**	2,459
Accrued charges and provisions for capital projects	27	**1,935**	2,054
Derivative financial liabilities	32(e)	**54**	540
Interest-bearing borrowings	28	**17,857**	19,212
Deferred income	29	**4,566**	527
Deferred tax liabilities	11(d)	**4,033**	3,250
		29,712	28,042
Net Assets		**65,172**	59,933
Capital and Reserves			
Share capital	30	**39,120**	39,120
Reserves	31	**26,052**	20,813
Total equity		**65,172**	59,933

Approved and authorised for issue by the Managing Board on 7 April 2008

Professor K C Chan
Mrs Lucia Li
Members of the Managing Board

Mr James Blake
Chief Officer

The notes on pages 88 to 170 form part of these financial statements.

Corporation Balance Sheet

at 31 December 2007 (Expressed in Hong Kong dollars)

	Note	**2007 $ million**	2006 $ million
Assets			
Fixed assets	15		
– Property, plant and equipment		**67,260**	58,462
– Investment properties		**–**	1,378
		67,260	59,840
Interest in leasehold land held for own use under operating leases	15	**5,931**	5,524
Construction in progress	16	**5,509**	13,644
Deferred expenditure	17	**1,585**	1,389
Properties under development	18	**20**	449
Interest in associate	20	**42**	42
Loan to non-controlled subsidiary	21	**4,407**	4,022
Derivative financial assets	32(e)	**132**	92
Investments	22	**2,585**	–
Stores and spares	23	**–**	362
Interest and other receivables	24	**681**	578
Cash and cash equivalents	25	**6,636**	1,795
		94,788	87,737
Liabilities			
Short-term bank loans	28	**45**	–
Interest and other payables	26	**1,222**	2,307
Accrued charges and provisions for capital projects	27	**1,935**	2,054
Derivative financial liabilities	32(e)	**54**	540
Interest-bearing borrowings	28	**17,857**	19,212
Deferred income	29	**4,566**	492
Deferred tax liabilities	11(d)	**4,033**	3,251
		29,712	27,856
Net Assets		**65,076**	59,881
Capital and Reserves			
Share capital	30	**39,120**	39,120
Reserves	31	**25,956**	20,761
Total equity		**65,076**	59,881

Approved and authorised for issue by the Managing Board on 7 April 2008

Professor K C Chan
Mrs Lucia Li
Members of the Managing Board

Mr James Blake
Chief Officer

The notes on pages 88 to 170 form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December 2007 (Expressed in Hong Kong dollars)

	Note	**2007 $ million**	2006 $ million
Total equity at 1 January		**59,933**	59,653
Net profit for the year	31	**5,321**	278
Revaluation deficit transferred to the income statement on redemption and disposal of available-for-sale securities	31	**–**	2
Dividend approved and paid during the year	13(b)	**(82)**	–
Total equity at 31 December		**65,172**	59,933

The notes on pages 88 to 170 form part of these financial statements.

Consolidated Cash Flow Statement

for the year ended 31 December 2007 (Expressed in Hong Kong dollars)

	Note	2007 $ million	2006 $ million
Operating activities			
Net cash inflow from operations	33	**2,889**	2,664
Upfront payment for Service Concession		**4,250**	–
Net payment for liabilities and assets transferred to MTRCL		**(728)**	–
Receipt on sale of property development rights after netting off $70 million relating to enabling work costs reimbursement		**4,840**	–
Net cash inflow/(outflow) relating to property development		**(38)**	1,505
Hong Kong profits tax paid		**(1)**	(1)
Net cash inflow from operating activities		**11,212**	4,168
Investing activities			
Decrease/(increase) in deposits with banks with maturity more than three months when placed		**(2,003)**	1,084
Payments for capital expenditure:			
– East Rail Extensions project		**(1,028)**	(2,038)
– Kowloon Southern Link project		**(1,865)**	(1,344)
– Other capital projects and purchase of fixed assets		**(848)**	(1,140)
Interest received		**53**	237
Repayment from/(loan to) non-controlled subsidiary		**(37)**	38
Payment for the purchase of investments		**(2,574)**	–
Receipts on sale of fixed assets		**1**	5
Receipts on sale of investment properties and other property, plant and equipment after netting off $162 million for the transfer of cash and cash equivalents of certain subsidiaries to MTRCL		**2,678**	–
Receipts on sale of property management businesses		**40**	–
Receipts on redemption and disposal of available-for-sale securities		**–**	411
Net cash outflow from investing activities		**(5,583)**	(2,747)
Net cash inflow before financing		**5,629**	1,421
Financing activities			
Net cash outflow on repayment of loans		**(1,360)**	(298)
Dividend paid		**(82)**	–
Interest paid		**(1,396)**	(1,388)
Net cash outflow relating to derivative financial instruments		**(98)**	(77)
Finance expenses paid		**(7)**	(21)
Net cash outflow from financing activities		**(2,943)**	(1,784)
Net increase/(decrease) in cash and cash equivalents		**2,686**	(363)
Cash and cash equivalents at 1 January		**1,476**	1,839
Cash and cash equivalents at 31 December		**4,162**	1,476
Analysis of the balances of cash and cash equivalents			
Cash at bank and in hand	25	**35**	71
Deposits with banks with maturity of less than three months when placed	25	**4,127**	1,405
		4,162	1,476

The notes on pages 88 to 170 form part of these financial statements.

Notes to the Financial Statements

(Expressed in Hong Kong dollars)

1 Establishment of the Corporation

The Kowloon-Canton Railway Corporation (the "Corporation") was incorporated in Hong Kong 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. 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 Ordinance was amended in 1986, 1998 and 2001. The amendment in 1986 enabled the Corporation to construct and operate the Light Rail system. The amendment in 1998 expanded the Corporation's power by permitting the Corporation to construct and operate any additional railway that the Secretary for Transport and Housing (the Secretary for Transport at the time of amendment) may authorise the Corporation to construct. The amendment in December 2001 provided for the separation of the functions and duties of the Chairman from those of the Chief Executive Officer by creating the office of Chief Executive Officer. The Chief Executive Officer was also appointed as a member of the Managing Board.

On 8 June 2007, the Legislative Council passed the Rail Merger Bill (which was published in the Hong Kong Special Administrative Region ("HKSAR") Government Gazette on 11 June 2007). Following agreement by the respective parties to the detailed merger transaction terms, the Rail Merger took place on 2 December 2007 (the "Appointed Day"). The Chief Executive of the HKSAR appointed six public officers as members of the Managing Board with effect from the Appointed Day. As provided for under the amendments made to the Ordinance by the Rail Merger Bill, the position of Chief Executive Officer has been left vacant, with a Chief Officer, who is not a member of the Managing Board, being appointed by the Board to be responsible for managing the day-to-day business of the Corporation.

2 Rail Merger with MTR Corporation Limited ("MTRCL")

The Rail Merger Ordinance permitted the granting of a long-term service concession (the "Service Concession") in respect of the Corporation's rail and bus operations, and the sale of certain rail-related assets (the "Purchased Rail Assets"), subsidiaries (namely Hanford Garden Property Management Company Limited, Pierhead Garden Management Company Limited, Royal Ascot Management Company Limited, Sun Tuen Mun Centre Management Company Limited and V-Connect Limited) and property-related rights and interests of the Corporation, to MTRCL.

Since the Appointed Day, the Corporation has been responsible for monitoring MTRCL's compliance with its obligations under the merger transaction, including revenue sharing, annual payments and the specified day-to-day activities of the Corporation outsourced to MTRCL. The Corporation, besides meeting its obligations under the merger transaction, retains responsibility for the management and financing of its debts, for investing any available funds and for managing its remaining subsidiaries and other assets excluded from the merger transaction (the "Excluded Assets").

2 Rail Merger with MTR Corporation Limited ("MTRCL") (continued)

Service Concession

The Service Concession grants MTRCL the right to operate the Corporation's existing railway lines (including the Kowloon Southern Link upon completion) and other rail-related businesses ("concession assets") for a period of 50 years (the "Concession Period"). Under the Service Concession, MTRCL receives all revenues generated from the operation of the Corporation's rail network and other rail-related businesses. During the Concession Period, except for projects retained by the Corporation as specified under the Merger Framework Agreement, MTRCL is responsible for the daily operations and maintenance of the transport operations and will fund all related operating capital expenditure, including the improvement and replacement of the Corporation's railway network assets. The Corporation does not have responsibility for any railway or bus operations during the Concession Period.

In consideration of the Service Concession and the Purchased Rail Assets, MTRCL agreed to make an upfront payment on the Appointed Day to the Corporation of $4.25 billion (received on 3 December 2007), at the end of every year thereafter a fixed annual payment of $750 million and commencing after the first 36 months, an additional variable annual payment based on revenue generated above the first $2.5 billion from the operation of the Corporation's rail network and other rail-related businesses during each financial year of MTRCL. The variable payments are computed at 10% of such revenue between $2.5 billion and $5 billion; 15% of such revenue between $5 billion and $7.5 billion; and 35% of such revenue beyond $7.5 billion.

The Corporation's role during the Concession Period will essentially comprise the following duties:

(i) acting as the grantor of the Service Concession to MTRCL, monitoring the compliance of MTRCL with the terms of the Service Concession and receiving concession payments from MTRCL;

(ii) holding legal and beneficial title to all assets not forming part of the sale to MTRCL, such as the initial concession assets, which are defined as the physical assets including the Corporation's railway land required for the operation of the Corporation's railway system which were capitalised by the Corporation immediately prior to the Appointed Day, the Corporation's shares in Octopus Holdings Limited and the Excluded Assets;

(iii) acting as the borrower and obligor in relation to the Corporation's existing financial obligations and contingent liabilities; and

(iv) holding legal and beneficial title to and funding all capital expenditure for any new railway project that was under construction as of the Appointed Day, such as the Kowloon Southern Link, and acting as the principal of the project management agreement with MTRCL under which the Corporation, among other things, employs MTRCL as its agent and in other capacities, to complete the construction of the Kowloon Southern Link.

Should the Corporation undertake any new railway projects during the Concession Period, these would be subject to a service concession granted by the Corporation in favour of MTRCL, with the parties entering into a Supplemental Service Concession Agreement.

2 Rail Merger with MTR Corporation Limited ("MTRCL") (continued)

Service Concession (continued)

Furthermore, pursuant to the merger related agreements, certain assets and liabilities, mainly the deposits, retention monies, advances of a deposit nature and accounts receivable and payable were transferred to MTRCL on the Appointed Day by means of vesting, novating and/or assigning the respective contracts to MTRCL. The relevant notes to the financial statements relating to those balance sheet items, which are affected by the merger related agreements, are listed below:

Assets

– other receivables; and

– cash and cash equivalents.

Liabilities

– other payables;

– accrued charges and provisions for capital projects; and

– deferred income.

Property package

On the Appointed Day, the Corporation received from MTRCL a total amount of $7.79 billion as proceeds for the transfer of the economic benefit of the property development rights of eight development sites along the East Rail, the Ma On Shan Rail, the Light Rail and the Kowloon Southern Link amounting to $4.91 billion; for the sale of investment properties, certain fixed assets currently held by the Corporation and certain of the Corporation's subsidiaries amounting to $2.84 billion; and for the sale of property management rights of various existing and future development sites amounting to $40 million. Separately, MTRCL agreed to reimburse the Corporation for property development enabling works costs incurred or to be incurred by the Corporation once the joint venture for the respective property development site is formed.

The details of the properties covered by the property package are shown below:

Property development rights

– Ho Tung Lau (Site A);

– Wu Kai Sha;

– Tai Wai Maintenance Centre;

– Che Kung Temple;

– Tai Wai Station;

– Tin Shui Wai Light Rail Terminus;

– Kowloon Southern Link – Site C; and

– Kowloon Southern Link – Site D.

2 Rail Merger with MTR Corporation Limited ("MTRCL") (continued)

Property package (continued)

Investment properties

– commercial areas and car parking spaces of Pierhead Garden in Tuen Mun;

– commercial areas and car parking spaces of Hanford Garden in Tuen Mun;

– commercial accommodation and kindergarten of Royal Ascot in Sha Tin; and

– residential units and car parking spaces of Royal Ascot in Sha Tin.

Fixed assets

– retail floor and first to sixth floors of Citylink Plaza in Sha Tin;

– portions of ground floor and first floor of Hung Hom Building; and

– staff quarters and club house of Trackside Villas in Tai Po.

Corporation's subsidiaries

– Pierhead Garden Management Company Limited;

– Sun Tuen Mun Centre Management Company Limited;

– Hanford Garden Property Management Company Limited;

– Royal Ascot Management Company Limited;

– V-Connect Limited; and

– Metropolis Management Company Limited (the "MMC") #

Under an Equity Sub-participation Agreement, which formed part of the merger transaction, the Corporation is obliged to act on MTRCL's instructions in respect of the exercise of any and all rights the Corporation has as a shareholder of the MMC. Although there has been no direct disposition of the shares of MMC to MTRCL, all the beneficial interests previously entitled to by the Corporation now rest with MTRCL after entering into this agreement.

3 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 International Financial Reporting Standards ("IFRSs") issued by the International Accounting Standards Board ("IASB"). 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 and the Hong Kong Companies Ordinance. A summary of the significant accounting policies adopted by the Corporation and its controlled subsidiaries (the "Group") is set out below.

These financial statements have also been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA") and accounting principles generally accepted in Hong Kong.

Although HKFRSs have been fully converged with IFRSs in all material respects since 1 January 2005, these financial statements are the first published financial statements in which the Group makes an explicit and unreserved statement of compliance with IFRSs. Therefore, in preparing these financial statements management has given due consideration to the requirements of IFRS 1, First-time Adoption of International Financial Reporting Standards. For this purpose, the date of the Group's transition to IFRSs was determined to be 1 January 2006, being the beginning of the earliest period for which the Group presents full comparative information in these financial statements.

With due regard to the Group's accounting policies in previous periods and the requirements of IFRS 1, management has concluded that no adjustments to the amounts reported under HKFRSs as at the date of transition to IFRSs, or in respect of the year ended 31 December 2006, were required in order to enable the Group to make an explicit and unreserved statement of compliance with IFRSs in the first IFRS financial statements which included these amounts as comparatives. Accordingly, these financial statements continue to include a statement of compliance with HKFRSs as well including, for the first time, a statement of compliance with IFRSs, without adjustment to the Group's and the Corporation's financial position, financial performance or cash flows either at the date of transition to IFRSs or at the end of latest period presented in accordance with HKFRSs.

(b) Basis of preparation of the financial statements

The measurement basis used in the preparation of the financial statements is the historical cost basis except where stated otherwise in the accounting policies set out below.

The preparation of financial statements in conformity with IFRSs and HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the prevailing circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

3 Significant accounting policies (continued)

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

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements with significant effect on the financial statements and estimates with significant risk of material adjustment are discussed in note 42.

The accounting policies set out below have been applied consistently to each period presented in these financial statements, except where the adoption of a new or revised accounting standard is not permitted to be applied retrospectively.

(c) Basis of consolidation

The consolidated financial statements comprise the Corporation and its controlled subsidiaries and the Group's interest in associate made up to 31 December each year.

The financial statements of certain subsidiaries held by the Corporation for the sole purpose of developing, on behalf of the Government of the HKSAR (the "Government"), commercial or residential properties along the West Rail, Phase I route are excluded from the consolidation on the basis that these are not considered to be controlled subsidiaries 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. The Corporation is not entitled to any earnings distribution, nor is it required to ultimately fund any losses which may be sustained by these subsidiaries.

Furthermore, the financial statements of the Metropolis Management Company Limited ("MMC"), which is established for the sole purpose of rendering property management services to a commercial property, are also excluded from the consolidation on the basis that, under the Equity Sub-participation Agreement which formed part of the merger transaction, the Corporation is obliged to act on MTRCL's instructions in respect of the exercise of any and all rights the Corporation has as a shareholder of the MMC. All the beneficial interests previously entitled to by the Corporation rest with MTRCL although there has been no direct disposition of the shares of MMC to MTRCL.

3 Significant accounting policies (continued)

(d) Investments in subsidiaries

Subsidiaries are entities controlled by the Corporation. Control exists when the Corporation has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account.

An investment in a controlled subsidiary is consolidated into the consolidated financial statements from the date that control commences until the date that control ceases. An investment in a non-controlled subsidiary is excluded from consolidation and is stated at cost less impairment losses, if any, in the Group's and Corporation's balance sheet.

Intra-group balances and transactions and any unrealised profits arising from intra-group transactions with controlled subsidiaries are eliminated in full in preparing the consolidated financial statements. Unrealised losses resulting from intra-group transactions with controlled subsidiaries 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 controlled subsidiary is stated at cost less impairment losses, if any.

(e) Interest in 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.

An investment in an associate is accounted for in the Group's 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 includes the Group's share of the post-acquisition and post-tax results of associates 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 associate, 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 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, an investment in an associate is stated at cost less impairment losses, if any.

3 Significant accounting policies (continued)

(f) Investments

Investments comprise:

(i) temporary investment of funds from the equity injection received and borrowings obtained specifically for the construction of the East Rail Extensions and Kowloon Southern Link before the funds are used for such purposes (“pre-funding investments”); and

(ii) investment of surplus funds from the Corporation’s operations and receipts arising from the Rail Merger with MTRCL (“other investments”).

All the pre-funding investments are available-for-sale investments and are recognised initially at fair value at the date of recognition plus transaction costs. The fair value is remeasured at the balance sheet date, with any resultant gain or loss, together with all income generated from such investments, including interest income, foreign exchange gains or losses, impairment losses, realised gains or losses arising from transactions in derivative financial instruments entered into for hedging foreign currency pre-funding investments and gains or losses arising from the derecognition of such investments, capitalised to the related projects.

Other investments comprise dated debt securities that the Group or the Corporation have the positive ability and intention to hold to maturity and are classified as held-to-maturity securities. Held-to-maturity securities are stated in the balance sheet at amortised cost less impairment losses, if any.

Investments are recognised/derecognised on the trade date, which is the date the Group or the Corporation commits to purchase/sell the investments or when the investments expire.

(g) Derivative financial assets and liabilities

The Group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities. In accordance with its policies, the Group does not hold or issue derivative financial instruments for trading purposes.

All the Group’s derivative financial instruments are recognised initially as derivative financial assets or liabilities at fair value. The fair value of each derivative financial instrument is remeasured at each balance sheet date, with any resultant gain or loss recognised immediately in the income statement, except where the derivatives qualify for cash flow hedge accounting, in which case recognition of any resultant gain or loss depends on the item being hedged as covered by the policy statement below.

3 Significant accounting policies (continued)

(g) Derivative financial assets and liabilities (continued)

(i) Cash flow hedges

The currency swaps are designated as hedges of the variability in cash flows attributable to the foreign exchange risk of certain of the Group's interest-bearing borrowings denominated in foreign currencies and recognised in the financial statements.

Changes in fair value of currency swaps that hedge recognised monetary liabilities in foreign currencies are recognised in the income statement as required under IAS 39 and HKAS 39.

(ii) Fair value hedges

The interest rate swaps are designated as hedges of the variability in the fair value attributable to interest rate risk of certain of the Group's fixed rate interest-bearing borrowings recognised in the financial statements.

Changes in fair value of interest rate swaps designated as hedging instruments in a fair value hedge are recognised in the income statement.

When a hedging relationship ceases to meet the requirements of hedge accounting, any adjustment to the carrying amount of the then hedged item is amortised to the income statement over the remaining life of the item based on a recalculated effective interest rate at the date amortisation begins.

(h) Investment properties

Investment properties comprise land and/or buildings which are owned or held under a leasehold interest to earn rental income and are held for their investment potential.

Investment properties are stated in the balance sheet at fair value. Any gain or loss arising from a change in fair value is recognised in the income statement.

Gains or losses arising from the retirement or disposal of an investment property are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in the income statement on the date of retirement or disposal.

3 Significant accounting policies (continued)

(i) Property, plant and equipment

(i) Property, plant and equipment, including those assets which are the subject of the Service Concession with MTRCL, is stated in the balance sheet at cost less accumulated depreciation and impairment losses, if any.

During the Concession Period, MTRCL is responsible for the daily operations and maintenance of the railway operations and will fund all related expenditure including the improvement and replacement of the Corporation's railway network assets. Such expenditure on improvement and replacement of the Corporation's railway network assets is defined as Additional Concession Property ("ACP") pursuant to the Service Concession Agreement. According to the Service Concession Agreement, the ACP will be returned to the Corporation at no cost, together with the initial concession assets acquired by the Corporation, upon the expiry or termination of the Concession Period subject to a threshold of $115.8 billion of cumulative expenditure funded by MTRCL which will be adjusted from time to time pursuant to the provisions of Service Concession Agreement. As the ACP will be returned together with the initial concession assets acquired by the Corporation before the Rail Merger, the ACP, although funded by MTRCL, is treated in the same way as the initial concession assets and is capitalised in the balance sheet at cost less accumulated depreciation and impairment losses, if any. The cost of ACP that is funded by MTRCL is credited as deferred income and amortised to the income statement over the remaining Concession Period.

Property, plant and equipment relating to rail networks and ancillary commercial activities which is the subject of the Service Concession comprises:

- buildings which are situated on leasehold land, where the fair value of the building could be measured separately from the fair value of the leasehold land at the inception of the lease; and
- other items of plant and equipment including tunnels, bridges, roads, permanent ways, rolling stock and other equipment.

The cost of property, plant and equipment vested by the Government has been determined as follows:

- for property, plant and equipment vested on 1 February 1983 – as determined by the Financial Secretary; and
- for property, plant and equipment vested subsequent to 1 February 1983 – based on actual cost as reflected in the Government's records.

3 Significant accounting policies (continued)

(i) Property, plant and equipment (continued)

The cost of property, plant and equipment acquired by the Group and ACP funded by MTRCL comprises:

– its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;

– any costs, such as the costs of material, direct labour, an appropriate proportion of production overheads and interest and finance income/expenses directly attributable to bringing the asset to the location and condition capable of operating in the manner intended by management; and

– the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, where the obligation is incurred by the Group when the item is acquired.

Expenditure incurred by the Group on property, plant and equipment, which is below $20,000 per item or expected to be fully used within one year, is expensed to the income statement when incurred.

(ii) Subsequent expenditure on existing property, plant and equipment, for both concession assets and non-concession assets, 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 incurred by the Group on repairs or maintenance of existing property, plant and equipment to restore or maintain the originally assessed standard of performance of the asset is recognised as an expense when incurred.

Expenditure incurred by MTRCL after the Appointed Day on repair or maintenance of concession assets is borne by MTRCL.

(iii) Gains or losses arising from the retirement or disposal of an item of property, plant and equipment including concession assets, are determined as the difference between the net disposal proceeds and the carrying amount of the item and are recognised in the income statement on the date of retirement or disposal.

3 Significant accounting policies (continued)

(j) Depreciation and amortisation

(i) Depreciation for property, plant and equipment, including ACP, is calculated to write off the cost of an item of property, plant and equipment less its estimated residual value, if any, using the straight-line basis over its estimated useful life as follows:

	No. of years
Tunnels, bridges and roads (see note 3(j)(iii))	43-65
Buildings (see note 3(j)(iii))	50
Rolling stock	30-40
Locomotives and wagons	15-35
Lifts and escalators	20
Permanent way comprising rails, ballast, sleepers and concrete civil works (see note 3(j)(iii))	10-50
Machinery and equipment	10-30
Telecommunication and signalling systems and air-conditioning plant	5-15
Fare collection systems	15
Mobile phone systems	7-10
Furniture and fixtures	3-15
Computer and office equipment (including computer software)	3-5
Buses	10-17
Other motor vehicles	4-15

(ii) Where parts of an item of property, plant and equipment have different useful lives, the cost of the item is allocated on a measurable basis between the parts and each part is depreciated separately. Both the useful life of an asset and its residual value, if any, are reviewed annually. The residual value of an asset is the estimated amount that the Group could currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset was already of the age and in the condition expected at the end of its useful life.

(iii) Tunnels, bridges, roads, concrete civil works and buildings situated on leasehold land are depreciated over the shorter of the unexpired term of the related lease and their estimated useful lives.

3 Significant accounting policies (continued)

(k) Leased assets

(i) Classification of leased assets

Leases of assets under which the lessee assumes substantially all the risks and rewards of ownership are classified as finance leases. Leases of assets under which the lessor has not transferred substantially all the risks and rewards of ownership are classified as operating leases, except that property held under an operating lease that would otherwise meet the definition of an investment property may be classified as an investment property on a property-by-property basis.

(ii) Assets leased out under operating leases

Where the Group leases out assets under operating leases, the assets are included in the balance sheet according to their nature and, where applicable, are depreciated in accordance with the Group's depreciation policies.

(iii) Operating lease charges

Where the Group has the use of assets held 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, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased asset.

Land lease premiums, land resumption costs and other costs directly associated with the acquisition of leasehold land held for own use under operating leases are amortised on a straight-line basis over the period of the lease term. The cost in relation to leasehold land vested by the Government has been determined as follows:

– vested on 1 February 1983 – as determined by the Financial Secretary; and

– vested subsequent to 1 February 1983 – based on actual cost as reflected in the Government's records or the costs incurred by the Corporation directly associated with the acquisition of leasehold land.

3 Significant accounting policies (continued)

(l) Impairment of assets

(i) Impairment of financial assets

All financial assets are reviewed at each balance sheet date to determine whether there is objective evidence of impairment. Objective evidence of impairment includes observable data that comes to the attention of the Group about one or more of the following loss events:

– significant financial difficulties being experienced by a debtor;

– a breach of contract, such as a default or delinquency in interest or principal payments;

– it becomes probable that the debtor will enter bankruptcy or some form of financial reorganisation;

– significant changes in the technological, market, economic or legal environment that have an adverse effect on the debtor; and

– a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost.

If any such evidence exists, an impairment loss is determined and recognised as follows:

– For interest and other receivables carried at cost, an impairment loss is measured as the difference between the asset's carrying amount and the estimated future cash flows (taking into account bad and doubtful debts), discounted at the current market rate of return of a similar financial asset where the effect of discounting is material. This assessment is made collectively where financial assets carried at amortised cost share similar risk characteristics, such as similar past due status, and have not been individually assessed as impaired. Future cash flows for financial assets which are assessed for impairment collectively are based on historical loss experience for assets with credit risk characteristics similar to the collective group.

– For loan to non-controlled subsidiary carried at amortised cost, an impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (taking into account bad and doubtful debts), discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at the date of initial recognition of these assets), except where the present value is not determinable as there are no fixed repayment terms.

– For held-to-maturity investments carried at amortised cost, the impairment loss is measured as the difference between the carrying amount of the financial asset and the estimated future cash flows, discounted at the current market rate of return of similar financial asset where the effect of discounting is material.

– Impairment losses are reversed if the subsequent increase in fair value can be objectively related to an event occurring after the impairment loss was recognised. Reversals of impairment losses in such circumstances are recognised in the income statement to the extent that the cumulative impairment loss has been charged to the income statement.

3 Significant accounting policies (continued)

(l) Impairment of assets (continued)

(ii) Impairment of other 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:

– property, plant and equipment;

– interest in leasehold land held for own use under operating leases;

– construction in progress;

– deferred expenditure;

– properties under development;

– investments in subsidiaries; and

– interest in associate.

If any such indication exists, the asset's recoverable amount is estimated.

– 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 an asset does not generate cash inflows largely independent of those from other assets, the recoverable amount is determined for the smallest group of assets that generates cash inflows independently (i.e. a cash-generating unit).

– Recognition of impairment losses

An impairment loss is recognised in the income statement whenever the carrying amount of an asset, or the cash-generating unit to which it belongs, exceeds its recoverable amount. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the other assets in the unit (or group of units) on a pro rata basis, except that the carrying value of an asset will not be reduced below its individual fair value less costs to sell, or value in use, if determinable.

– 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 an impairment loss 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.

3 Significant accounting policies (continued)

(m) Construction in progress

Assets under construction and capital works for the operating railways are stated at cost incurred by the Corporation or by MTRCL in the case of ACP less impairment losses, if any. Costs comprise direct costs of construction, including materials, staff costs and overheads, interest and finance income/expenses and gains or losses arising from changes in fair value of pre-funding investments capitalised during the period of construction or installation and testing. Capitalisation of these costs is suspended or ceased when substantially all the activities necessary to prepare the qualifying asset for its intended use are interrupted or completed. The assets concerned are transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use are completed, at which time the assets begin to be depreciated in accordance with the relevant policies. Land lease premiums, land resumption costs and other related costs incurred by the Corporation for the purpose of acquiring the land on which the new railways or extensions to existing railways are to be operated are initially included in construction in progress. These costs are transferred to interest in leasehold land held for own use under operating leases when the related assets are completed and ready for their intended use at which time the costs begin to be amortised in accordance with the relevant policies.

Costs incurred by the Corporation or MTRCL in the case of ACP 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 as incurred; and

– 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.

(n) Deferred expenditure

Deferred expenditure relates to costs incurred for proposed railway related construction projects which will be transferred to construction in progress after the relevant project agreements are reached with the Government.

3 Significant accounting policies (continued)

(o) Property development

When the Corporation determines or reaches agreement with property developers to develop a site for resale or for rent, the carrying amount of the leasehold land and existing buildings on the development site are transferred to properties under development. Costs related to the respective projects incurred by the Corporation are also dealt with as properties under development until such time that profit on the development is recognised by the Corporation.

Profits on property development undertaken in conjunction with property developers are recognised in the income statement as follows:

– where the Corporation receives payments from property developers as a consequence of their participation in a project to develop a property, such payments are set off against the balance in properties under development in respect of that project. Any surplus amounts of payments received from property developers in excess of the balance in properties under development are transferred to deferred income. In such circumstances, further costs subsequently incurred by the Corporation in respect of that project are charged against the related balance of deferred income and any excess is charged to properties under development to the extent it is considered to be recoverable. The balance of deferred income is credited to the income statement when the property enabling works are completed and acceptable for development, and after taking into account the outstanding risks and obligations in connection with the development, if any, retained by the Corporation. The balance of properties under development not previously offset by payments received from property developers is charged to the income statement where the costs are considered to be irrecoverable, together with provision for losses, if any, borne by the Corporation in respect of the development;

– where the Corporation receives a share of profits from the sale of properties, profits are recognised upon the issue of occupation permits provided the amounts of revenue and related costs can be measured reliably; and

– where the Corporation retains certain assets of the development, profits are measured based on the fair value of such assets and are recognised at the time of receipt after taking into account the costs incurred by the Corporation in respect of the development and the outstanding risks, if any, retained by the Corporation in connection with the development.

3 Significant accounting policies (continued)

(p) Jointly controlled operations

Assets that the Corporation owns and the liabilities that it incurs for the purpose of jointly controlled operations are recognised in the balance sheet and classified according to the nature of the relevant item. The Corporation's share of revenue from 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.

Jointly controlled operations include intercity train services to and from Hong Kong and Mainland China which are jointly provided by the Corporation and its Mainland China railway counterparts. The related revenue sharing arrangements are negotiated and agreed between the relevant parties on commercial terms with reference to the ratio of distance travelled within Hong Kong and Mainland China for each route. The term of the revenue sharing arrangements is not fixed but either party is entitled to terminate the operation with advance notice.

(q) Loan to non-controlled subsidiary

Loan to non-controlled subsidiary is a non-derivative financial asset without fixed or determinable repayment terms and is not quoted in an active market. It arose when the Group entered into a shareholding agreement with the Government 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. Loan to non-controlled subsidiary is initially recognised at fair value, which is equivalent to cost, and thereafter is stated at cost less impairment losses, if any.

(r) 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.

(s) 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. Cash equivalents are readily convertible into known amounts of cash with an insignificant risk of changes in value and have a maturity of less than three months at acquisition.

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

3 Significant accounting policies (continued)

(t) Interest and other receivables

Interest and other receivables are initially recognised at fair value and thereafter are stated at amortised cost less impairment losses, if any, except where the present value is not determinable because there is no fixed repayment term. In such cases, interest and other receivables are stated at cost less impairment losses, if any.

(u) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, the unhedged portion of interest-bearing borrowings is stated at amortised cost with any difference between the cost and redemption value being recognised in the income statement over the period of the borrowings using the effective interest method.

Subsequent to initial recognition, the carrying amount of the portion of interest-bearing borrowings, which is the subject of a fair value hedge, is remeasured and the change in fair value attributable to the risk being hedged is recognised in the income statement to offset the effect of the gain or loss on the related hedging instrument.

(v) Interest and other payables

Interest and other payables are initially recognised at fair value and thereafter are stated at amortised cost except where the present value is not determinable because there are no fixed payment terms. In such cases, other payables are stated at cost.

(w) Employee benefits

(i) Short term employee benefits and contributions to defined contribution retirement plans

Salaries, annual bonuses, paid annual leave, contributions to defined contribution retirement plans and the cost of non-monetary benefits are accrued in the year in which the associated services are rendered by employees.

(ii) Termination benefits

Termination benefits are recognised when, and only when, the Group demonstrably commits itself to terminate employment or to provide benefits as a result of voluntary redundancy by having a detailed formal plan which is without realistic possibility of withdrawal.

3 Significant accounting policies (continued)

(x) 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 assets, to the extent that it is probable that future taxable profits will be available against which the assets can be utilised, are recognised. All deferred tax liabilities 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. Such reduction is reversed to the extent that it becomes probable that sufficient taxable profits will be available.

(iv) Current tax balances and deferred tax balances, and movements therein, are presented separately from each other and are not offset. Current tax assets are offset against current tax liabilities, and deferred tax assets against deferred tax liabilities 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, they relate to income taxes levied by the same taxation authority on either:
  - the same taxable entity; or
  - different taxable entities which intend to realise the current tax assets and settle the current tax liabilities on a net basis in the same period.

3 Significant accounting policies (continued)

(y) Provisions and contingent liabilities

Provisions are recognised for liabilities of uncertain timing or amount when the Group or the Corporation 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 possibility of an obligation arising as a result of a past event is disclosed as a contingent liability, unless the probability of outflow of economic benefits is remote. Possible obligations, whose existence will only be confirmed by the occurrence or non-occurrence of one or more future events are also disclosed as contingent liabilities unless the probability of outflow of economic benefits is remote.

(z) Revenue recognition

Provided it is probable that the economic benefits will flow to the Group 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

Revenue is recognised when the services are provided.

(ii) Rental and licence income

Rental and licence income receivable under operating leases is recognised in the income statement in equal instalments over the periods covered by the lease term, except where an alternative basis is more representative of the pattern of benefits to be derived from the use of 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 is recognised as it accrues using the effective interest method.

(iv) Concession income

Concession income is recognised over the remaining Concession Period on a systematic basis.

(v) Other income

Other income is recognised once the related services or goods are delivered and the related risks and rewards of ownership have been transferred.

3 Significant accounting policies (continued)

(aa) 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.

The primary purpose of such arrangements is to achieve a particular tax result for the third parties in return for a fee. The arrangements do not, in substance, involve a lease under IAS 17 and HKAS 17 since the Group retains all the risks and rewards incidental to the ownership of the underlying assets and enjoys substantially the same rights to their use as before the transactions were entered into. The transactions are, therefore, not accounted for as leases.

Where commitments to make long-term lease payments have been defeased by the placement of security deposits or by the advance of loans to third party, they are not recognised in the balance sheet. Where commitments and deposits or advances of loans to third party meet the definition of a liability and an asset, they are recognised 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.

(ab) 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 foreign exchange rates ruling at the balance sheet date.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the foreign exchange rates ruling at the transaction dates. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated into Hong Kong dollars using the foreign exchange rates ruling at the dates the fair value was determined.

3 Significant accounting policies (continued)

(ac) Interest and finance income/expenses

(i) Interest and finance income includes:

- interest income from bank deposits, investments and loans to other parties;
- interest income arising from delayed reimbursement from MTRCL relating to property development enabling works;
- realised gains arising from derivative financial instruments designated as hedges for borrowings;
- net gains on redemption and disposal of investments; and
- net exchange gains arising from foreign currency transactions.

(ii) The Group's interest and finance income arising from non-derivative financial assets are not classified as at fair value through the income statement.

Interest and finance income is credited to the income statement in the period in which it is earned, except for the portion generated from pre-funding investments which is credited to construction in progress or deferred expenditure, as appropriate.

(iii) Interest and finance expenses include:

- interest payable on borrowings;
- finance expenses including amortisation of discounts/premiums and ancillary costs incurred in connection with the arrangement of borrowings calculated using the effective interest rate;
- realised losses arising from derivative financial instruments designated as hedges for borrowings;
- net realised losses on redemption and disposal of investments; and
- net exchange losses arising from foreign currency transactions.

(iv) The Group's interest and finance expenses arising from non-derivative financial liabilities are not classified as at fair value through the income statement.

Interest and finance expenses are expensed in the income statement in the period in which they are incurred, 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.

3 Significant accounting policies (continued)

(ad) 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 (being members of key management personnel and/or their close family members) or other entities and include entities which are under the significant influence of related parties of the Group where those parties are individuals.

(ae) 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 are allocated from other segments on a cost recovery basis.

Segment capital expenditure is the total cost incurred during the year to acquire segment assets.

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

4 Changes in accounting policies

The IASB has issued a number of new and revised IFRSs and Interpretations that are first effective for the current accounting period commencing 1 January 2007 or available for early adoption. The equivalent new and revised HKFRSs and Interpretations consequently issued by HKICPA have the same effective date as those issued by the IASB and are in all material respects identical to the pronouncements issued by the IASB. There have been no other material changes to HKFRSs.

These developments have not resulted in any significant changes to the accounting policies applied in these financial statements compared to those applied in the Group's financial statements for the year ended 31 December 2006. However, as a result of the adoption of HKFRS 7, Financial instruments: Disclosures and the amendments to HKAS 1, Presentation of financial statements: Capital disclosures, these financial statements include certain additional disclosures which are explained as follows.

4 Changes in accounting policies (continued)

As a result of the adoption of HKFRS 7 (which is equivalent to IFRS 7), the financial statements include expanded disclosure about the significance of the Group's financial instruments and the nature and extent of risks arising from those instruments, compared with the information previously required to be disclosed by HKAS 32, Financial instruments: Disclosure and presentation. These disclosures are provided throughout these financial statements, in particular in note 32.

The amendment to HKAS 1 (which is equivalent to the amendment to IAS 1) introduces additional disclosure requirements to provide information about the level of capital and the Group's and the Corporation's objectives, policies and processes for managing capital. These new disclosures are set out in note 30.

Both HKFRS 7 and the amendments to HKAS 1 do not have any impact on the classification, recognition and measurement of the amounts recognised in the financial statements.

The Group has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 43).

5 Turnover

Turnover represents the revenue from passenger, freight, property services and the Service Concession after eliminating inter-company transactions. The revenue relating to the principal activities of the Corporation prior to the Appointed Day were passenger, freight and property services whereas, after the Appointed Day, the main stream of revenue to the Corporation is generated from the Service Concession. The amounts of revenue recognised in turnover during the year are as follows:

	2007 $ million	2006 $ million
Transport services		
Passenger services		
– East Rail	**3,593**	3,780
– West Rail and Light Rail	**893**	922
Freight services	**38**	44
	4,524	4,746
Property services	**987**	876
Service Concession income	**70**	–
	5,581	5,622

6 Operating costs before depreciation and amortisation

	2007 $ million	2006 $ million
Staff costs		
– Gross amount including retirement costs of $127 million (2006: $136 million) after a forfeiture of unvested contributions of $1 million (2006: $1 million)	**1,965**	2,092
– Staff costs capitalised	**(501)**	(549)
	1,464	1,543
Electricity and fuel	**471**	484
Repairs and maintenance	**243**	274
Stores and spares consumed	**191**	217
General supplies	**24**	31
Government rent and rates	**55**	78
Octopus cards usage fees	**37**	38
Cost of services acquired	**144**	148
Property ownership and management expenses	**50**	66
Others	**139**	143
	2,818	3,022

7 Operating profit before depreciation and amortisation

(a) Operating profit before depreciation and amortisation is arrived at after charging:

	2007 $ million	2006 $ million
Fixed assets written off on disposal	**30**	24
Auditors' remuneration		
– Audit services	**5**	4
– Other professional services	**6**	1
Operating lease charges (minimum lease payments)		
– Hire of plant and machinery	**26**	28
– Rental of property	**9**	9
Remuneration of Members of the Managing Board, Executive Directors and Chief Officer 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, Executive Directors and Chief Officer who are not Members of the Managing Board	**1**	1
– Emoluments of the Chief Executive Officer, Executive Directors and Chief Officer who are not Members of the Managing Board	**23**	26
and after crediting:		
Rentals receivable from operating leases less direct outgoings of $21 million (2006: $20 million) (including contingent rentals of $73 million (2006: $63 million))	**837**	756
Rentals receivable from investment properties less direct outgoings of $10 million (2006: $11 million)	**80**	75

7 Operating profit before depreciation and amortisation (continued)

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

	2007 $'000	2006 $'000
Chairman		
Professor K C Chan in the capacity of Secretary for Financial Services and the Treasury*	**46**	–
Mr Michael P S Tien#	**202**	220
Members		
Ms Eva Cheng in the capacity of Secretary for Transport and Housing**	**46**	–
Mr Francis Ho in the capacity of Permanent Secretary for Transport and Housing (Transport)***	**–**	–
Mr Stanley Ying in the capacity of Permanent Secretary for Financial Services and the Treasury (Treasury)***	**–**	–
Mr Clement Leung in the capacity of Deputy Secretary for Financial Services and the Treasury (Treasury)***	**–**	–
Mrs Lucia Li in the capacity of Director of Accounting Services***	**–**	–
Mr Vincent W S Lo#	**101**	110
Mr L S Ng#	**101**	110
Mr Patrick B Paul#	**101**	110
The Honourable Abraham L H Shek#	**101**	110
Professor Richard Y C Wong#	**101**	110
Mr M Y Wan##	**64**	110
Dr Sarah S T Liao in the capacity of Secretary for the Environment, Transport and Works###	**55**	110
Mr Frederick S H Ma in the capacity of Secretary for Financial Services and the Treasury###	**55**	110
	973	1,100

7 Operating profit before depreciation and amortisation (continued)

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

* Professor K C Chan in the capacity of Secretary for Financial Services and the Treasury was appointed on 1 July 2007. He was also appointed as Chairman on 2 December 2007. No fees were payable to him for the period from 2 December 2007 to 31 December 2007.

** Ms Eva Cheng in the capacity of Secretary for Transport and Housing was appointed on 1 July 2007. No fees were payable to her for the period between 2 December 2007 and 31 December 2007.

*** On the Appointed Day, the Chief Executive of the HKSAR appointed public officers as Members of the Managing Board. No fees were payable to these Members for the period from 2 December 2007 to 31 December 2007.

The appointment ended on 1 December 2007.

Mr M Y Wan's appointment ended on 31 July 2007.

The appointment of Dr Sarah S T Liao in the capacity of Secretary for the Environment, Transport and Works and Mr Frederick S H Ma in the capacity of Secretary for Financial Services and the Treasury ended on 30 June 2007.

(c) Emoluments of the Chief Executive Officer, Executive Directors and Chief Officer who are not Members of the Managing Board include fixed remuneration which comprises base pay, allowances and gratuities; benefits-in-kind; retirement benefit scheme contributions and variable remuneration. Details of emoluments are shown below:

	2007 $ million				2006 $ million			
	Fixed remuneration and benefits-in-kind	Contribution to retirement benefit scheme	Variable* remuneration	Total	Fixed remuneration and benefits-in-kind	Contribution to retirement benefit scheme	Variable* remuneration	Total
Mr James Blake**	4.97	–	–	4.97	3.00	–	1.19	4.19
Mr K K Lee##	3.72	0.31	–	4.03	3.12	0.32	0.91	4.35
Mr Y T Li##	3.84	0.27	–	4.11	3.22	0.29	0.81	4.32
Mr Daniel C Lam###	4.04	0.01	–	4.05	3.24	0.01	0.92	4.17
Mr Lawrence C P Li##	2.59	0.20	–	2.79	2.28	0.22	0.44	2.94
Mrs Mimi Cunningham##	3.68	0.01	–	3.69	3.18	0.01	0.86	4.05
Mr Samuel M H Lai#	–	–	–	–	3.04	0.13	–	3.17
	22.84	0.80	–	23.64	21.08	0.98	5.13	27.19

7 Operating profit before depreciation and amortisation (continued)

(c) Emoluments of the Chief Executive Officer, Executive Directors and Chief Officer who are not Members of the Managing Board include fixed remuneration which comprises base pay, allowances and gratuities; benefits-in-kind; retirement benefit scheme contributions and variable remuneration. Details of emoluments are shown below: (continued)

* Variable remuneration mainly comprises amounts withheld from employees' basic salary package and released for payment upon their satisfactory performance being confirmed by the Managing Board. In view of the Rail Merger, the Managing Board approved the termination of variable remuneration scheme in 2007. As such, the amounts withheld from employees' basic salary package up to 1 December 2007 were reimbursed and the fixed remuneration reflects the employee's full basic salary.

** Mr James Blake joined the Corporation on 22 March 2006 as the Chief Executive Officer and was re-appointed as the Chief Officer on 2 December 2007.

Mr Samuel M H Lai's remuneration includes an end-of-service payment of $1.1 million. He left the Corporation on 1 May 2006.

The employment contracts with these employees were vested in MTRCL on the Appointed Day.

Mr Daniel C Lam left the Corporation on 2 December 2007.

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

8 Depreciation and amortisation

	2007 $ million	2006 $ million
Depreciation:		
– assets leased out under operating leases	**31**	32
– other assets	**2,266**	2,141
– depreciation charge capitalised	**(3)**	(4)
	2,294	2,169
Amortisation:		
– amortisation of interest of leasehold land held for own use under operating leases	**124**	119
	2,418	2,288

Notes to the Financial Statements

(Expressed in Hong Kong dollars)

9 Interest and finance income/expenses

(a) Interest and finance income

	2007 $ million	2006 $ million
Interest income from deposits	**58**	143
Interest income from MTRCL relating to property development enabling works	**25**	–
Interest income from investments	**3**	4
Interest income from loan to non-controlled subsidiary	**364**	320
Interest income from non-derivative financial assets	**450**	467
Realised gains arising from derivative financial instruments	**26**	32
	476	499

(b) Interest and finance expenses

	2007 $ million	2006 $ million
Interest expenses on loans	**1,417**	1,407
Finance expenses	**9**	9
Interest and finance expenses on non-derivative financial liabilities	**1,426**	1,416
Realised losses arising from derivative financial instruments	**124**	126
Exchange loss (net)	**44**	40
Realised losses on redemption and disposal of investments (including nil (2006: $2 million) transferred from the investments revaluation reserve)	**–**	3
	1,594	1,585
Less: Amount capitalised#	**(271)**	(770)
	1,323	815

Interest expenses capitalised were charged at average interest rates ranging between 7.69% (2006: 7.10%) and 7.91% (2006: 7.98%) per annum.

10 Gains/(losses) on changes in fair value of derivative financial instruments and hedged borrowings

	2007 $ million	2006 $ million
Net gain/(loss) arising from derivative financial instruments	**526**	(216)
Net gain arising from hedged interest-bearing borrowings	**15**	18
	541	(198)

11 Income tax

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

	2007 $ million	2006 $ million
Current tax		
Provision for Hong Kong profits tax at 17.5% of the estimated assessable profits for the year	**1**	1
Deferred tax charge		
Origination and reversal of temporary differences	**783**	52
	784	53

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 $7,900 million at 31 December 2007 (2006: approximately $10,800 million) which are available to set off against future assessable profits. The tax losses do not expire under current tax legislation.

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

	2007 $ million	2006 $ million
Profit before taxation	**6,105**	331
Tax on accounting profit before taxation at 17.5%	**1,068**	58
Tax effect of non-deductible expenses	**46**	31
Tax effect of non-taxable revenue	**(330)**	(36)
Actual tax expense	**784**	53

11 Income tax (continued)

(c) Current tax in the balance sheet represents:

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Provision for Hong Kong profits tax for the year	**1**	1	**–**	–
Provisional profits tax paid	**(1)**	(1)	**–**	–
	–	–	**–**	–

(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 sheet and the movements during the year are as follows:

The Group

	Future benefit of tax losses $ million	Depreciation allowances in excess of the related depreciation $ million	Revaluation of investment properties $ million	Total $ million
At 1 January 2006	(1,707)	4,828	77	3,198
Charged/(credited) to the income statement	(189)	224	17	52
At 31 December 2006	(1,896)	5,052	94	3,250
At 1 January 2007	**(1,896)**	**5,052**	**94**	**3,250**
Charged/(credited) to the income statement	**517**	**360**	**(94)**	**783**
At 31 December 2007	**(1,379)**	**5,412**	**–**	**4,033**

11 Income tax (continued)

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

The Corporation

	Future benefit of tax losses $ million	Depreciation allowances in excess of the related depreciation $ million	Revaluation of investment properties $ million	Total $ million
At 1 January 2006	(1,707)	4,828	77	3,198
Charged/(credited) to the income statement	(189)	225	17	53
At 31 December 2006	(1,896)	5,053	94	3,251
At 1 January 2007	**(1,896)**	**5,053**	**94**	**3,251**
Charged/(credited) to the income statement	**517**	**359**	**(94)**	**782**
At 31 December 2007	**(1,379)**	**5,412**	**–**	**4,033**

The deferred tax assets and liabilities as at 31 December 2007 are expected to be recovered or settled after 12 months.

12 Profit for the year wholly attributable to the sole shareholder of the Corporation

Of the consolidated profit for the year amounting to $5,321 million (2006: $278 million), $5,277 million (2006: $252 million) has been dealt with in the financial statements of the Corporation.

13 Proposed dividend

(a) Dividend payable to the sole shareholder of the Corporation attributable to the year:

	2007 $ million	2006 $ million
Final dividend proposed after the balance sheet date of nil (2006: $209.61 per share)	**–**	82

(b) Dividend payable to the sole shareholder of the Corporation attributable to the previous financial year, approved and paid during the year:

	2007 $ million	2006 $ million
Final dividend in respect of the previous financial year, approved and paid during the year, of $209.61 per share (2006: nil per share)	**82**	–

14 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 IAS 14 and HKAS 14, 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, IAS 14 and HKAS 14 state 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.

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

14 Segmental reporting (continued)

2007

Operating results

	Transport services segment $ million	Property segment $ million	Consolidated total $ million
Revenue	4,524	987	5,511
Operating costs before depreciation and amortisation	(2,509)	(131)	(2,640)
Inter-segment charges[1]	30	(30)	–
Depreciation and amortisation	(2,152)	(40)	(2,192)
Result after depreciation and amortisation	(107)	786	679
Net valuation gains on investment properties	–	9	9
Result	(107)	795	688
Unallocated revenue			70
Unallocated corporate expenses, depreciation and amortisation			(404)
Merger-related expenses			(216)
Gain on sale of property development rights			4,868
Gain on sale of investment properties and other property, plant and equipment			1,318
Gain on sale of property management and telecommunication business			48
Interest and finance income			476
Interest and finance expenses			(1,323)
Share of profit of associate			39
Gains on changes in fair value of derivative financial instruments and hedged borrowings			541
Income tax			(784)
Profit after taxation			5,321

[1] Inter-segment charges represent cost recoveries from other segments for services rendered.

14 Segmental reporting (continued)

Assets and liabilities

	Transport services segment $ million	Property segment $ million	Consolidated total $ million
Assets	72,880	480	73,360
Properties under development	–	20	20
Interest in associate	–	–	138
Railways under construction@	–	–	6,625
Unallocated assets#	–	–	14,741
	72,880	500	94,884
Liabilities	1,510	15	1,525
Deferred income	301	88	389
Unallocated liabilities*	–	–	27,798
	1,811	103	29,712

@ Comprising construction and land costs of Kowloon Southern Link ($5,040 million) and planning and design costs of Shatin to Central Link and Express Rail Link/Northern Link ($1,585 million).

Comprising corporate assets and construction in progress for corporate office ($303 million), loan to non-controlled subsidiary ($4,407 million), derivative financial assets ($132 million), investments ($2,585 million), interest and other receivables ($678 million) and cash and cash equivalents ($6,636 million).

* Comprising interest-bearing borrowings ($17,857 million), accrued charges and provisions for capital projects ($425 million), short-term bank loans ($45 million), interest and other payables ($1,207 million), deferred tax liabilities ($4,033 million), derivative financial liabilities ($54 million) and deferred income ($4,177 million).

Other information

	Transport services segment $ million	Property segment $ million	Consolidated total $ million
Capital expenditure			
– Operational railways	1,197	48	1,245
– Railways under construction	–	–	2,295
– Unallocated capital expenditure	–	–	34
	1,197	48	3,574

14 Segmental reporting (continued)

2006

Operating results

	Transport services segment $ million	Property segment $ million	Consolidated total $ million
Revenue	4,746	876	5,622
Operating costs before depreciation and amortisation	(2,690)	(137)	(2,827)
Inter-segment charges[1]	40	(40)	–
Depreciation and amortisation	(2,233)	(38)	(2,271)
Result after depreciation and amortisation	(137)	661	524
Profit from property development	–	427	427
Net valuation gains on investment properties	–	99	99
Result	(137)	1,187	1,050
Unallocated corporate expenses, depreciation and amortisation			(232)
Interest and finance income			499
Interest and finance expenses			(815)
Share of profit of associate			27
Losses on changes in fair value of derivative financial instruments and hedged borrowings			(198)
Income tax			(53)
Profit after taxation			278

[1] Inter-segment charges represent cost recoveries from other segments for services rendered.

14 Segmental reporting (continued)

Assets and liabilities

	Transport services segment $ million	Property segment $ million	Consolidated total $ million
Assets	63,786	2,049	65,835
Properties under development	–	449	449
Interest in associate	–	–	99
Railways under construction@	–	–	14,722
Unallocated assets#	–	–	6,870
	63,786	2,498	87,975
Liabilities	339	714	1,053
Deferred income	325	202	527
Unallocated liabilities*	–	–	26,462
	664	916	28,042

@ Comprising construction and land costs of Lok Ma Chau and Kowloon Southern Link ($13,333 million) and planning and design costs of Shatin to Central Link and Express Rail Link/Northern Link ($1,389 million).

Comprising corporate assets and construction in progress for corporate office ($317 million), derivative financial assets ($92 million), loan to non-controlled subsidiary ($4,022 million), interest and other receivables ($492 million) and cash and cash equivalents ($1,947 million).

* Comprising interest-bearing borrowings ($19,212 million), accrued charges and provisions for capital projects ($1,983 million), interest and other payables ($1,477 million), deferred tax liabilities ($3,250 million) and derivative financial liabilities ($540 million).

Other information

	Transport services segment $ million	Property segment $ million	Consolidated total $ million
Capital expenditure			
– Operational railways	414	74	488
– Railways under construction	–	–	2,817
– Unallocated capital expenditure	–	–	12
	414	74	3,317

15 Fixed assets and interest in leasehold land held for own use under operating leases

(a) **The Group**

	Investment properties $ million	Tunnels, bridges, roads and permanent way $ million	Buildings $ million	Rolling stock $ million	Other equipment $ million	Total fixed assets $ million	Interest in leasehold land held for own use $ million
Cost or valuation:							
At 1 January 2006	1,171	20,225	29,447	9,271	11,372	71,486	5,985
Transfer from construction in progress	112	11	41	4	265	433	7
Additions/(reversal of over-accruals)	–	(6)	199	1	54	248	(9)
Disposals	(4)	(20)	(1)	(3)	(49)	(77)	–
Fair value adjustment	99	–	–	–	–	99	–
At 31 December 2006	1,378	20,210	29,686	9,273	11,642	72,189	5,983
At 1 January 2007	**1,378**	**20,210**	**29,686**	**9,273**	**11,642**	**72,189**	**5,983**
Transfer from construction in progress	**2**	**5,945**	**3,873**	**81**	**1,230**	**11,131**	**536**
Additions	**–**	**40**	**29**	**–**	**35**	**104**	**16**
Disposals	**(1,389)**	**(14)**	**(115)**	**(5)**	**(295)**	**(1,818)**	**(31)**
Fair value adjustment	**9**	**–**	**–**	**–**	**–**	**9**	**–**
At 31 December 2007	**–**	**26,181**	**33,473**	**9,349**	**12,612**	**81,615**	**6,504**
Accumulated depreciation and amortisation:							
At 1 January 2006	–	847	2,015	2,519	4,807	10,188	340
Charge for the year	–	473	610	274	816	2,173	119
Written back on disposals	–	(2)	–	(3)	(43)	(48)	–
At 31 December 2006	–	1,318	2,625	2,790	5,580	12,313	459
At 1 January 2007	**–**	**1,318**	**2,625**	**2,790**	**5,580**	**12,313**	**459**
Charge for the year	**–**	**523**	**643**	**275**	**856**	**2,297**	**124**
Written back on disposals	**–**	**(3)**	**(40)**	**(5)**	**(207)**	**(255)**	**(10)**
At 31 December 2007	**–**	**1,838**	**3,228**	**3,060**	**6,229**	**14,355**	**573**
Carrying amounts:							
At 31 December 2007	**–**	**24,343**	**30,245**	**6,289**	**6,383**	**67,260**	**5,931**
At 31 December 2006	1,378	18,892	27,061	6,483	6,062	59,876	5,524

15 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(b) **The Corporation**

	Investment properties $ million	Tunnels, bridges, roads and permanent way $ million	Buildings $ million	Rolling stock $ million	Other equipment $ million	Total fixed assets $ million	Interest in leasehold land held for own use $ million
Cost or valuation:							
At 1 January 2006	1,171	20,225	29,447	9,271	11,321	71,435	5,985
Transfer from construction in progress	112	11	41	4	265	433	7
Additions/(reversal of over-accruals)	–	(6)	199	1	54	248	(9)
Disposals	(4)	(20)	(1)	(3)	(49)	(77)	–
Fair value adjustment	99	–	–	–	–	99	–
At 31 December 2006	1,378	20,210	29,686	9,273	11,591	72,138	5,983
At 1 January 2007	**1,378**	**20,210**	**29,686**	**9,273**	**11,591**	**72,138**	**5,983**
Transfer from construction in progress	**2**	**5,945**	**3,873**	**81**	**1,230**	**11,131**	**536**
Additions	**–**	**40**	**29**	**–**	**35**	**104**	**16**
Disposals	**(1,389)**	**(14)**	**(115)**	**(5)**	**(244)**	**(1,767)**	**(31)**
Fair value adjustment	**9**	**–**	**–**	**–**	**–**	**9**	**–**
At 31 December 2007	**–**	**26,181**	**33,473**	**9,349**	**12,612**	**81,615**	**6,504**
Accumulated depreciation and amortisation:							
At 1 January 2006	–	847	2,015	2,519	4,797	10,178	340
Charge for the year	–	473	610	274	811	2,168	119
Written back on disposals	–	(2)	–	(3)	(43)	(48)	–
At 31 December 2006	–	1,318	2,625	2,790	5,565	12,298	459
At 1 January 2007	**–**	**1,318**	**2,625**	**2,790**	**5,565**	**12,298**	**459**
Charge for the year	**–**	**523**	**643**	**275**	**851**	**2,292**	**124**
Written back on disposals	**–**	**(3)**	**(40)**	**(5)**	**(187)**	**(235)**	**(10)**
At 31 December 2007	**–**	**1,838**	**3,228**	**3,060**	**6,229**	**14,355**	**573**
Carrying amounts:							
At 31 December 2007	**–**	**24,343**	**30,245**	**6,289**	**6,383**	**67,260**	**5,931**
At 31 December 2006	1,378	18,892	27,061	6,483	6,026	59,840	5,524

15 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(c) Permanent way principally comprises the cost of rail tracks, sleepers, track base and ballast.

(d) Other equipment comprises lifts and escalators, telecommunication and signalling systems, machinery, furniture and fixtures, motor vehicles and computer and office equipment.

(e) Prior to the Appointed Day, the Group and the Corporation leased out investment properties and certain properties which were either used in or ancillary to the Group's and Corporation's rail business, under operating leases. The leases typically ran for an initial period of two to five years, with an option to renew the lease after that date at which time all terms would be re-negotiated. Certain leases included additional rentals based on sales revenue of the tenants in excess of the basic rentals. On the Appointed Day, all the investment properties and most of the other properties were either disposed of or, under the Service Concession Agreement, transferred to MTRCL.

(f) At the end of each financial reporting period, the fair values of the Group's and Corporation's investment properties, held in Hong Kong under long-term leases, were remeasured on an open market basis, by either making reference to comparable sales in the relevant locality, or otherwise, by capitalising the net income with due allowance for reversionary income potential. For the year ended 31 December 2006, the valuations were carried out by an independent firm of surveyors which has among its staff Fellow and Associate members of the Hong Kong Institute of Surveyors and the Royal Institution of Chartered Surveyors with good valuation experience in Hong Kong. A net fair value of $99 million was transferred to the income statement in 2006. In 2007, the Group's and the Corporation's investment properties were remeasured prior to the sale of these properties, based on an assessment made by management of the Corporation on an open market basis as adopted in previous years. As a result, a net fair value gain of $9 million has been transferred to the income statement.

15 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(g) Included in fixed assets are assets leased out under operating leases with gross carrying amounts and related accumulated depreciation charges as follows:

	2007		2006	
	Gross carrying amount $ million	Related accumulated depreciation $ million	Gross carrying amount $ million	Related accumulated depreciation $ million
Goods yard at Hung Hom Bay	–	–	84	13
Hung Hom Station Car Park	–	–	55	25
Hung Hom Building	–	–	23	7
Offices at Hung Hom freight building	–	–	6	1
Citylink Plaza at Sha Tin Station	16	8	144	68
Goods yard at Mongkok Station	–	–	45	8
Shops at stations	–	–	802	93
Mobile phone coverage system	–	–	84	48
Trackside Villas	–	–	36	9
	16	8	1,279	272

Although these properties are leased to tenants, they are not held for their investment potential. These assets are situated on railway land vested in the Corporation by the Government for railway purposes and are either used in or are ancillary to the Group's railway business. They are an integral part of the railway network and cannot be sold separately without the agreement of the Government. Accordingly, these assets are not classified as investment properties. On the Appointed Day, all these properties were sold to MTRCL as part of the property package, except for the 7th to 10th floors of Citylink Plaza at Sha Tin Station.

(h) The minimum total future amounts received by the Group and Corporation under non-cancellable operating leases are expected to be received as follows:

	2007 $ million	2006 $ million
Within one year	10	896
After one year but within five years	20	1,739
After five years	–	155
	30	2,790

15 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(i) 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 have leased the assets to an overseas investor, who has prepaid all the rentals in relation to a lease agreement. Simultaneously, the Group and Corporation have 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 have an option to purchase the overseas investor's leasehold interest in the assets at a pre-determined date for a fixed or agreed amount and it is the intention of the Group and Corporation to exercise such purchase options. The rental prepayments received from the overseas investor have been placed in deposits or invested in debt securities, the repayments of which are expected to be sufficient to meet the Group's and Corporation's rental obligations and the amounts payable for exercising the purchase options under the lease agreements. 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 subject to these arrangements. The arrangements have been entered with investors in the United States.

As at 31 December 2007, a portion of the Group's and Corporation's assets (including assets replaced during the lease periods) with a total cost of $10,114 million (2006: $10,163 million) and net book value of $5,221 million (2006: $5,572 million) is covered by eight arrangements (2006: eight arrangements). Five 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 incidental to ownership of the underlying assets in respect of each arrangement and enjoy substantially the same rights to their use as before the arrangements were entered into, no adjustment has been made to fixed assets. As a result of the eight arrangements, the Group and Corporation have received cash of $10,805 million (2006: $10,805 million) and, assuming exercise of the purchase option in each arrangement, will be obligated to make long-term lease payments over the duration of the relevant leases with a total estimated net present value at the inception of the arrangements of $10,292 million (2006: $10,292 million), the obligations of which are expected to be funded by the proceeds to be generated from existing deposits and investments over the relevant lease periods.

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 $24 million (2006: $24 million) recognised for the year has been included in the transport services segment in the income statement.

15 Fixed assets and interest in leasehold land held for own use under operating leases (continued)

(j) Included in additions are amounts paid and payable to or received and receivable from the Government by the Corporation in respect of the following:

– $17 million (2006: $21 million) for land resumption work on the West Rail, Ma On Shan Rail and Tsim Sha Tsui Extension projects undertaken by the Government on behalf of the Corporation and for lease of land required for construction sites.

– Accrual of nil (2006: refund of $25 million) for land premiums payable by the Corporation in respect of the East Rail Extensions project.

(k) In compliance with IAS 16 and HKAS 16 which requires an annual review of the estimated useful lives of fixed assets, an extensive review was undertaken by in-house engineers of the estimated useful lives of all major fixed asset categories during the year. For the year ended 31 December 2007, there was no change in the estimated useful lives of the fixed assets that affects the depreciation charged to the income statement.

(l) The carrying value of the Group's and Corporation's interest in leasehold land held in Hong Kong is $5,909 million (2006: $5,497 million) under medium-term leases (less than 50 years) and $22 million (2006: $27 million) under long-term leases (50 years or above).

16 Construction in progress

(a) Construction in progress comprises:

The Group and the Corporation

2007

	Kowloon Southern Link $ million	East Rail Extensions $ million	Other assets $ million	Total construction in progress $ million
Balance as at 1 January 2007	2,840	10,493	311	13,644
Costs incurred during the year	2,200	838	494	3,532
Transfer to fixed assets or leasehold land	–	(11,314)	(353)	(11,667)
Balance as at 31 December 2007	5,040	17	452	5,509

16 Construction in progress (continued)

(a) Construction in progress comprises: (continued)

2006

	Kowloon Southern Link $ million	East Rail Extensions $ million	Other assets $ million	Total construction in progress $ million
Balance as at 1 January 2006	1,307	8,648	456	10,411
Costs incurred during the year	1,533	1,845	295	3,673
Transfer to fixed assets or leasehold land	–	–	(440)	(440)
Balance as at 31 December 2006	2,840	10,493	311	13,644

(b) As at 31 December 2007, land resumption costs and other costs totalling approximately $1 million (2006: $632 million) and $79 million (2006: $51 million) directly associated with the acquisition of leasehold land for the construction of the East Rail Extensions and the Kowloon Southern Link respectively are included in the balance of construction in progress. These costs will be transferred to interest in leasehold land when the land is vested in the Corporation by the Government, at which time the costs will begin to be amortised in accordance with relevant policies.

(c) Included in costs incurred during the year are amounts paid and payable to the Government by the Corporation in respect of the following:

- $40 million (2006: $46 million) for the lease of land required for construction sites for the East Rail Extensions and Kowloon Southern Link projects. 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.
- $18 million (2006: $19 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 and Kowloon Southern Link projects. The Corporation is obligated to reimburse such sums to the Government.

(d) The costs incurred during the year are arrived at after crediting nil (2006: $55 million) on-cost recovery from the Government for certain essential public infrastructure works and other works along the railways undertaken by the Corporation on its behalf pursuant to the entrustment agreements in respect of such entrustment works and 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 21).

16 Construction in progress (continued)

(e) During the year, project management fees of $28 million (2006: nil) were paid and payable to MTRCL by the Corporation for the management of design and construction of the Kowloon Southern Link project on its behalf pursuant to the Kowloon Southern Link Project Management Agreement.

(f) Included in costs incurred during the year are amounts totalling $49 million (2006: nil) representing the purchase of Additional Concession Property ("ACP") by MTRCL for the improvement and replacement of the Corporation's railway network pursuant to the Service Concession Agreement.

17 Deferred expenditure

(a) Deferred expenditure comprises:

The Group and the Corporation

2007

	Shatin to Central Link $ million	**Express Rail Link/ Northern Link $ million**	**Total deferred expenditure $ million**
Balance as at 1 January 2007	**1,188**	**201**	**1,389**
Expenditure during the year	**–**	**196**	**196**
Balance as at 31 December 2007	**1,188**	**397**	**1,585**

2006

	Shatin to Central Link $ million	Express Rail Link/ Northern Link $ million	Total deferred expenditure $ million
Balance as at 1 January 2006	1,188	22	1,210
Expenditure during the year	–	179	179
Balance as at 31 December 2006	1,188	201	1,389

17 Deferred expenditure (continued)

(b) The planning, design and construction of the Shatin to Central Link was suspended in 2005 pending the announcement by the Government of its decision on how and by whom the Shatin to Central Link, to which the Government remains committed in principle, would in fact be constructed. The Corporation's expenditure on the Shatin to Central Link is carried in the balance sheet at cost and if the Corporation in due course constructs the Shatin to Central Link, this amount will form part of the final cost of the completed project. If, however, another party were to construct the Shatin to Central Link, it is uncertain whether the Corporation would be able to recover any or all of the expenditure it has incurred on the project, and any shortfall in recovery would be written off to the Corporation's income statement in the appropriate future accounting period.

(c) As at 31 December 2007, land related costs totalling approximately $6 million (2006: $6 million) directly associated with the acquisition of leasehold land for the purpose of the Shatin to Central Link are included in the balance of deferred expenditure. These costs will be transferred to interest in leasehold land when the land is vested in the Corporation by the Government, at which time the costs will begin to be amortised in accordance with the relevant policies.

18 Properties under development

The Group and the Corporation

	2007 $ million	2006 $ million
Balance as at 1 January	**449**	1,537
Expenditure incurred during the year	**33**	6
Amounts recovered during the year	**–**	(1,094)
Transfer to other receivables	**(462)**	–
Balance as at 31 December	**20**	449

The balance of expenditure on properties under development is mainly related to the property design and development in respect of Hung Hom Mass Transportation Centre.

On the Appointed Day, the Corporation received from MTRCL an amount of $4.91 billion as proceeds for the economic benefit of the property development rights of eight development sites along the East Rail, the Ma On Shan Rail, the Light Rail and the Kowloon Southern Link. Separately, MTRCL agreed to reimburse the Corporation for enabling works costs incurred or to be incurred for by the latter in relation to the developments acquired by MTRCL once the joint venture of the respective property development site is formed. The balance of the enabling works due from MTRCL on the Appointed Day has been transferred to other receivables.

19 Investments in subsidiaries

	Corporation	
	2007 **$ million**	2006 $ million
Unlisted shares, at cost	**–**	–

Details of the subsidiaries listed by principal activities are as follows:

Name of company	**Place of incorporation and operation**	**Number of issued and fully paid ordinary shares**	**Par value of shares**	**Percentage of shares held by the Corporation**
Asset Leasing				
Buoyant Asset Limited	Hong Kong	100	$10	100%
Advanced Asset Limited	Hong Kong	100	$10	100%
Quality Asset Limited	Hong Kong	100	$10	100%
Kasey Asset Limited	Hong Kong	100	$10	100%
Circuit Asset Limited	Hong Kong	100	$10	100%
Shining Asset Limited	Hong Kong	100	$10	100%
Fluent Asset Limited	Hong Kong	100	$10	100%
Kudos Asset Limited[&]	Hong Kong	100	$10	100%
Unique Asset Limited[&]	Hong Kong	100	$10	100%
Bowman Asset Limited	Cayman Islands	1,000	US$1	100%
Statesman Asset Limited	Cayman Islands	1,000	US$1	100%
Interwind Asset Limited[@]	Hong Kong	100	$10	100%
Non-controlled subsidiaries				
Property development:				
West Rail Property Development Limited,	Hong Kong	51 "A"	$10	100%
and its 13 wholly owned subsidiaries[*]		49 "B"	$10	Nil
Property management:				
The Metropolis Management Company	Hong Kong	25,500 "A"	$1	100%
Limited[**]		24,500 "B"	$1	Nil

19 Investments in subsidiaries (continued)

& At 31 December 2007, the subsidiaries were in the process of winding up as the concerned leasing transaction was terminated in 2006.

@ At 31 December 2007, the subsidiary was in the process of de-registration as the proposed leasing transaction did not materialise. The de-registration was completed on 1 February 2008.

* 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. 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.

** The subsidiary is held by the Corporation for the sole purpose of rendering property management services to a commercial property. The financial statements are excluded from the consolidation on the basis that, under the Equity Sub-participation Agreement which formed part of the merger transaction, the Corporation is obliged to act on MTRCL's instructions in respect of the exercise of any and all rights the Corporation has as a shareholder of the MMC. All the beneficial interests previously entitled to by the Corporation rest with MTRCL although there has been no direct disposition of the shares of MMC to MTRCL.

A summary of consolidated financial information of WRPDL and its subsidiaries based on the management accounts of these companies as of 31 December is as follows:

	2007 $ million	2006 $ million
Assets	**4,434**	4,046
Liabilities	**4,435**	4,048
Equity	**(1)**	(2)
Turnover	**–**	–
Profit after taxation for the year	**1**	–

20 Interest in associate

The interest in associate is as follows:

	Group		**Corporation**	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Unlisted shares, at cost	**–**	–	**9**	9
Share of net assets	**105**	66	**–**	–
Loan to associate	**33**	33	**33**	33
	138	99	**42**	42

(Expressed in Hong Kong dollars)

20 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 ordinary shares	Par value of shares	Percentage of shares held
Octopus Holdings Limited	42,000,000	$1	22.1%

The Corporation and four other local transport companies (including MTRCL) entered into an agreement in 1994 to develop and operate the Octopus cards system through a central body called Octopus Cards Limited.

On 21 October 2005, the Corporation and the other shareholders of Octopus Cards Limited divested themselves of all their shares in Octopus Cards Limited to a new holding company, Octopus Holdings Limited, in consideration for the issue to them of new shares in Octopus Holdings Limited.

Immediately after completion of the sale and purchase of shares in Octopus Cards Limited, the shareholders of Octopus Holdings Limited made a loan in aggregate amounting to $150 million to Octopus Holdings Limited, pursuant to a Subordinated Loan Agreement, with each shareholder lending an amount in proportion to its shareholding in Octopus Holdings Limited. The loan to associate from the Corporation bears interest at 5.5% per annum. It is unsecured and repayable in whole or in part at any time before 20 October 2010. During the year, the Group received an interest payment from Octopus Holdings Limited, amounting to $2 million (2006: $2 million).

During the year, the Group made payments to Octopus Cards Limited, amounting to $37 million (2006: $38 million) in respect of fees for the use of the Octopus cards system. These payments were 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 $7 million (2006: $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.

20 Interest in associate (continued)

A summary of financial information of the associate based on the consolidated management accounts of Octopus Holdings Limited as of 31 December is as follows:

	2007 100% $ million	2007 Group's effective interest (22.1%) $ million	2006 100% $ million	2006 Group's effective interest (22.1%) $ million
Assets	**2,466**	**545**	2,180	482
Liabilities	**1,990**	**440**	1,882	416
Equity	**476**	**105**	298	66
Turnover	**461**	**102**	405	90
Profit after tax for the year	**178**	**39**	118	27

21 Loan to non-controlled 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 holders of ordinary "A" shares are not entitled to any distribution by WRPDL other than a return of capital, and the holders of ordinary "B" shares are entitled to all dividends declared by WRPDL and a return of capital. In other words, the Corporation is not entitled to any earnings distribution, nor is it required to ultimately fund any losses which may be sustained by WRPDL and its subsidiaries.

All costs incurred up to the Appointed Day in relation to the West Rail property developments were 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 may be 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. The Government will receive the profits less losses from the developments whereby the Corporation will recover the on-costs for the handling of the property developments along the route.

21 Loan to non-controlled subsidiary (continued)

Since the Appointed Day, the Corporation, WRPDL and its subsidiaries have appointed MTRCL as an agent to handle the property developments and an agency fee is payable by each subsidiary of WRPDL to MTRCL as remuneration. The future funding of these property developments will be provided by MTRCL.

The loan to non-controlled subsidiary is expected to be recovered as follows:

The Group and the Corporation

	2007 $ million	2006 $ million
Within one year	**170**	153
After one year	**4,237**	3,869
	4,407	4,022

22 Investments

Investments comprise:

The Group and the Corporation

	2007 $ million	2006 $ million
Held-to-maturity debt securities		
– Listed outside Hong Kong	**235**	–
– Unlisted	**2,350**	–
Total carrying amount of investments	**2,585**	–
Total market value of listed investments	**236**	–

23 Stores and spares

Stores and spares are expected to be consumed as follows:

The Group and the Corporation

	2007 $ million	2006 $ million
Within one year	**–**	133
After one year	**–**	229
	–	362

On the Appointed Day, all the stores and spares were sold to MTRCL at cost.

24 Interest and other receivables

(a) Interest and other receivables comprise:

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Interest receivable	**13**	8	**13**	8
Amounts due from subsidiaries	**–**	–	**–**	12
Amount due from the Government	**67**	312	**67**	312
Debtors, deposits, prepayments and revenue in arrears	**99**	251	**99**	246
Amount due from MTRCL relating to property under development	**502**	–	**502**	–
	681	571	**681**	578

The amount due from the Government represents amounts receivable for certain essential public infrastructure works and other works along the railways undertaken on behalf of the Government pursuant to the respective entrustment agreements and project agreements with the Government.

The amount due from MTRCL relating to property under development represents property development enabling work cost incurred by the Corporation. The amount will be reimbursed from MTRCL once the joint venture for the respective property development site is formed in accordance with the Merger Framework Agreement.

(b) Interest and other receivables are expected to be recovered as follows:

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Within one year	**239**	531	**239**	538
After one year	**442**	40	**442**	40
	681	571	**681**	578

Notes to the Financial Statements

(Expressed in Hong Kong dollars)

24 Interest and other receivables (continued)

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

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Current	**612**	440	**612**	447
Less than one month overdue	**–**	2	**–**	2
One to three months overdue	**–**	3	**–**	3
More than three months overdue	**–**	1	**–**	1
Total debtors	**612**	446	**612**	453
Deposits, prepayments and revenue in arrears	**69**	125	**69**	125
	681	571	**681**	578

Normally, no credit is allowed except for revenue sharing arrangements in which the normal credit period is one month. For the amount due from the Government regarding the entrustment works undertaken by the Corporation on behalf of the Government, the normal credit period is 21 days pursuant to the respective entrustment agreements.

25 Cash and cash equivalents

Cash and cash equivalents comprise:

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Deposits with banks				
– Within three months to maturity when placed	**4,127**	1,405	**4,127**	1,337
– More than three months to maturity when placed	**2,474**	471	**2,474**	387
Cash at bank and in hand	**35**	71	**35**	71
Cash and cash equivalents in the balance sheets	**6,636**	1,947	**6,636**	1,795
Less: deposits with banks with more than three months to maturity when placed	**(2,474)**	(471)		
Cash and cash equivalents in the consolidated cash flow statement	**4,162**	1,476		

26 Interest and other payables

(a) Interest and other payables comprise:

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Interest payable	**462**	462	**462**	462
Deposits and advances	**296**	1,151	**296**	998
Creditors and accrued charges	**319**	846	**319**	842
Amount due to MTRCL	**145**	–	**145**	–
Amounts due to subsidiaries	**–**	–	**–**	5
	1,222	2,459	**1,222**	2,307

(b) Interest and other payables are expected to be settled as follows:

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Within one year	**906**	1,697	**906**	1,570
After one year	**316**	762	**316**	737
	1,222	2,459	**1,222**	2,307

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

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Due within one month or on demand	**400**	557	**400**	558
Due between one month to three months	**220**	219	**220**	219
Due between three months to six months	**27**	43	**27**	43
Due after six months	**127**	199	**127**	199
Total creditors	**774**	1,018	**774**	1,019
Deposits and advances	**296**	1,151	**296**	998
Accrued charges	**152**	290	**152**	290
	1,222	2,459	**1,222**	2,307

27 Accrued charges and provisions for capital projects

The balance includes accrued charges and provisions for claims related to capital projects. Accrued charges will be settled upon certification of work done. Provisions for claims relate mainly to the West Rail, East Rail Extensions and Kowloon Southern Link projects.

The balance includes an aggregate amount of $1,348 million (2006: $1,361 million) payable to the Government mainly for land premium, resumption and associated costs in relation to the West Rail, East Rail Extensions and Shatin to Central Link projects.

During the year, the Corporation made additional provisions for claims and land premium, resumption and associated costs of $95 million and reversed or utilised amounts totalling $196 million. As of 31 December 2007, provisions for claims and land premium, resumption and associated costs totalled $1,359 million.

Accrued charges and provisions for capital projects are expected to be settled or utilised as follows:

The Group and the Corporation

	2007 $ million	2006 $ million
Within one year	**1,029**	1,080
After one year	**906**	974
	1,935	2,054

28 Short-term bank loans and interest-bearing borrowings

(a) Interest-bearing borrowings comprise:

The Group and the Corporation

	2007 Carrying amount $ million	**2007** Fair value $ million	2006 Carrying amount $ million	2006 Fair value $ million
Capital market instruments				
HK dollar retail notes due 2008 and 2013 – see (c) below	**973**	**1,020**	963	1,010
US dollar notes due 2010 – see (d) below	**7,814**	**8,414**	7,779	8,323
US dollar notes due 2009 – see (e) below	**7,864**	**8,155**	7,866	8,078
HK dollar notes due 2013 – see (e) below	**816**	**816**	808	808
US dollar notes due 2014 – see (e) below	**390**	**449**	389	433
	17,857	**18,854**	17,805	18,652
Export credit loans – see (f) below	**–**	**–**	1,407	1,406
Interest-bearing borrowings	**17,857**	**18,854**	19,212	20,058
Short-term bank loans – see (g) below	**45**	**45**	–	–
	17,902	**18,899**	19,212	20,058

(b) The fair values of capital market instruments and export credit loans were determined using discounted cash flow techniques.

(c) The Corporation issued 3% notes due 2008 with an aggregate nominal value of HK$300 million at a premium and 4.8% notes due 2013 with an aggregate nominal value of HK$700 million at a premium on 6 June 2003. All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.

(d) The Corporation issued 8% notes due 2010 with an aggregate nominal value 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 plc and the New York Stock Exchange, Inc. All the notes issued are unsecured and rank equally with all of the Corporation's other unsecured senior indebtedness.

28 Short-term bank loans and interest-bearing borrowings (continued)

(e) The Corporation issued 7.25% notes due 2009 with an aggregate nominal value of US$1 billion at a discount on 27 July 1999, 7.77% notes due 2014 with an aggregate nominal value of US$50 million at a discount on 17 November 1999, and 4.65% notes due 2013 with an aggregate nominal value 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 rank equally with all of the Corporation's other unsecured senior indebtedness.

(f) In April and May 2007, the Corporation fully repaid the export credit loan facility provided by Japan Bank for International Cooperation and Export Development Canada, respectively.

(g) As at 31 December 2007, short-term bank loans are unsecured, interest bearing at 5.075% per annum and repayable within three months of the balance sheet date.

(h) The covenants attached to the Corporation's interest-bearing borrowings are customary ones. Following the repayment of the export credit loan provided by Japan Bank for International Cooperation, there are no specific financial covenants attached to the Corporation's interest-bearing borrowings.

(i) The interest-bearing borrowings were repayable as follows:

	2007 $ million	2006 $ million
Within one year	**298**	305
After one year but within two years	**7,864**	600
After two years but within five years	**7,814**	16,431
After five years	**1,881**	1,876
	17,857	19,212

29 Deferred income

(a) The balance of deferred income at 31 December 2007 includes cash received from property developers for property development sites along East Rail and Ma On Shan Rail; cash receipts arising from the lease out and lease back arrangements; the upfront payment received less the cost of Purchased Rail Assets for the Service Concession; assets and liabilities assumed by MTRCL as part of the merger transaction; and the cost of Additional Concession Property ("ACP") funded by MTRCL less related amortisation. Under the Property Package, the Corporation shall continue to be responsible for the funding of the property enabling works for the eight development sites sold to MTRCL. The cash received from property developers will be utilised for costs to be incurred by the Corporation in respect of each property development. The unutilised balance will be credited to the income statement when the property enabling works are completed and accepted for development and after taking into account the outstanding risks and obligations in connection with the development, if any, retained by the Corporation. The balance relating to the lease out and lease back arrangements is being amortised and credited to the income statement over the applicable lease terms. The balance relating to the net upfront payment received for the Service Concession and assets and liabilities assumed by MTRCL is being amortised and credited to the income statement over the Concession Period. The balance relating to ACP is being amortised over the remaining Concession Period.

(b) Movements on deferred income comprise:

	Group		Corporation	
	2007 $ million	2006 $ million	**2007 $ million**	2006 $ million
Balance at 1 January	**527**	541	**492**	501
Net amount received and receivable/ (net amount paid and payable)	**(16)**	445	**(16)**	445
Net upfront payment received and assets and liabilities assumed by MTRCL for the Service Concession	**4,135**	–	**4,135**	–
Deferred income relating to ACP funded by MTRCL	**49**	–	**49**	–
Deferred income relating to the telecommunication business transferred to MTRCL	**(63)**	–	**(32)**	–
Recognised in the income statement	**(66)**	(459)	**(62)**	(454)
Balance at 31 December	**4,566**	527	**4,566**	492

29 Deferred income (continued)

(c) Deferred income is expected to be recognised in the income statement as follows:

	Group		Corporation	
	2007	2006	**2007**	2006
	$ million	$ million	**$ million**	$ million
Within one year	**108**	32	**108**	27
After one year	**4,458**	495	**4,458**	465
	4,566	527	**4,566**	492

30 Share capital

	2007		2006	
	No. of shares	**$ million**	No. of shares	$ million
Share capital:				
Authorised:				
Shares of $100,000 each	**425,000**	**42,500**	425,000	42,500
Issued and fully paid:				
At 31 December	**391,200**	**39,120**	391,200	39,120

Capital management

The Corporation's capital includes share capital and reserves.

The entire issued share capital of the Corporation is held by the Financial Secretary Incorporated.

The Corporation received $14.5 billion, $6.0 billion and $8.5 billion in April 1998, January 1999 and April 1999 respectively, constituting a total equity injection of $29.0 billion from the Government in connection with the development of the West Rail. In March 2001, the Corporation received $8.0 billion from the Government in connection with the development of the Tsim Sha Tsui Extension and the Ma On Shan Rail. Any further contributions of capital will be determined by the Government in consultation with the Corporation.

Pursuant to the relevant provisions of the Ordinance, the Corporation may declare dividends to the Government as its sole shareholder. The Financial Secretary may, after consultation with the Corporation and after taking into account the extent of its loans and other obligations, direct the Corporation to declare a dividend.

31 Reserves

The Group

	Investments revaluation reserve $ million	Retained profits $ million	Total $ million
Balance at 1 January 2006	(2)	20,535	20,533
Net deficit transferred to income statement on redemption and disposal	2	–	2
Profit for the year	–	278	278
Balance at 31 December 2006	–	20,813	20,813
Balance at 1 January 2007	**–**	**20,813**	**20,813**
Dividend approved and paid in respect of previous years	**–**	**(82)**	**(82)**
Profit for the year	**–**	**5,321**	**5,321**
Balance at 31 December 2007	**–**	**26,052**	**26,052**

The Corporation

	Investments revaluation reserve $ million	Retained profits $ million	Total $ million
Balance at 1 January 2006	(2)	20,509	20,507
Net deficit transferred to the income statement on redemption and disposal	2	–	2
Profit for the year	–	252	252
Balance at 31 December 2006	–	20,761	20,761
Balance at 1 January 2007	**–**	**20,761**	**20,761**
Dividend approved in respect of previous year	**–**	**(82)**	**(82)**
Profit for the year	**–**	**5,277**	**5,277**
Balance at 31 December 2007	**–**	**25,956**	**25,956**

31 Reserves (continued)

(a) Included in the retained profits of the Group is an amount of $96 million (2006: $57 million) being the retained profits attributable to an associate.

(b) Pursuant to the relevant provisions of the Ordinance, the reserves available for distribution comprise an amount out of the whole or part of the profits of the Corporation in any financial year after making allowance for any sums carried to the credit of the development reserve and any accumulated loss at the end of the financial year prior to the year in which the distribution is declared. The fair value change of financial assets and liabilities and investment properties, net of related deferred tax, recognised in retained profits are not available for distribution to the sole shareholder because they are not realised profits of the Corporation. As at 31 December 2007, the amount of reserves available for distribution to the sole shareholder amounted to $25,910 million (2006: $20,720 million).

32 Financial assets and liabilities

In the normal course of its business, the Group is exposed to a variety of financial risks: foreign exchange risk, interest rate risk, credit risk and liquidity risk. The Group uses derivative financial instruments to hedge certain risk exposures.

The Managing Board has approved policies in respect of foreign exchange risk, interest-rate risk, credit risk, use of derivative financial instruments and investment of surplus funds. As part of its risk management, the Group identifies and evaluates the financial risks and, where appropriate, hedges those risks in accordance with the policies established by the Managing Board.

The Group documents at the inception of each hedging transaction the relationship between the hedging instrument and hedged item, as well as its risk management objective and strategy for undertaking the transaction. The Group also documents its assessment, both at inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are effective in offsetting changes in fair values or cash flows of the hedged items.

(a) Credit risk

The Group's credit risk is primarily attributable to its investment in debt securities, its deposits and over-the-counter derivative financial instruments entered into for hedging purposes.

The Group has no significant concentrations of credit risk. It has policies in place that limit the amount of credit exposure to any financial institution with which the Group has transactions. The Group can only invest in debt securities issued by or place deposits with financial institutions that meet the established credit rating or other criteria. Derivative counterparties are limited to high-credit-quality financial institutions. The exposures to these credit risks are monitored on an ongoing basis.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial assets and liabilities, in the balance sheet.

32 Financial assets and liabilities (continued)

(a) Credit risk (continued)

	Group		Corporation	
	2007	2006	**2007**	2006
	$ million	$ million	**$ million**	$ million
Loan to non-controlled subsidiary	**4,407**	4,022	**4,407**	4,022
Investments	**2,585**	–	**2,585**	–
Interest rate swaps	**119**	90	**119**	90
Currency swaps	**5**	–	**5**	–
Forward foreign exchange contracts	**8**	2	**8**	2
Interest and other receivables	**681**	571	**681**	578
	7,805	4,685	**7,805**	4,692

(b) Interest rate risk

(i) Hedging

The Group's interest rate risk arises from its long-term borrowings. Borrowings at variable rates expose the Group to cash flow interest rate risk. Borrowings at fixed rates expose the Group to fair value interest rate risk. The Group aims to maintain the proportion of its fixed rate borrowings at between 30% and 75% of total borrowings. At 31 December 2007, 73% of total borrowings were at fixed rates.

The Group enters into receive-fixed-pay-floating interest rate swaps to hedge the fair value interest rate risk arising from fixed rate borrowings as well as to achieve an appropriate mix of fixed and floating rate exposure.

At 31 December 2007, the Group had interest rate swaps with a notional contract amount of $800 million (2006: $800 million) which qualify as fair value hedges. These interest rate swaps are stated at fair value with changes in fair value being recognised in the income statement to offset the effect of the gain or loss on the related hedged portion of interest-bearing borrowings.

The net fair value of interest rate swaps entered into by the Group at 31 December 2007 was $15 million (assets) (2006: $7 million (assets)), which comprises assets of $15 million (2006: $7 million) and liabilities of nil (2006: nil) respectively.

Occasionally, the Group manages its cash flow interest rate risk by using receive-floating-pay-fixed interest rate swaps. There were no such swaps outstanding as at 31 December 2007.

32 Financial assets and liabilities (continued)

(b) Interest rate risk (continued)

(ii) Fair value through income statement

For interest rate swaps where the hedging relationships do not qualify as fair value hedges, changes in their fair values are recognised in the income statement.

At 31 December 2007, the Group had such interest rate swaps with a notional contract amount of $3,937 million (2006: $3,927 million) and net fair value of $102 million (assets) (2006: $42 million (assets)), which comprises assets of $104 million (2006: $83 million) and liabilities of $2 million (2006: $41 million).

(iii) Sensitivity analysis

The sensitivity analysis below has been conducted assuming that changes in interest rates of +/- 100 basis points (bps) had occurred at the balance sheet date and such changes had been applied to stress-test the interest rate risk for both derivative and non-derivative financial instruments in existence at that date. The 100 basis point increase or decrease represents management's assessment of a reasonably possible change in interest rates over the period until the next balance sheet date. The analysis was performed on the same basis for each balance sheet date presented below.

Other than for currency swaps where the forward exchange rates are slightly changed by a parallel shift in the interest rates of the underlying currencies, all other variables, in particular spot foreign currency rates, remain constant.

The estimated impact of a general increase/decrease of 100 basis points in interest rates, with all other variables held constant, on the Group's profit after tax is shown below:

	2007		2006	
	$ million +100 bps	**$ million -100 bps**	$ million +100 bps	$ million -100 bps
Loan to non-controlled subsidiary	**36**	**(36)**	33	(33)
Interest rate swaps	**(99)**	**104**	(128)	135
Currency swaps	**(1)**	**1**	10	(10)
Interest-bearing borrowings	**31**	**(33)**	33	(36)
Increase/(decrease) in profit after tax	**(33)**	**36**	(52)	56

32 Financial assets and liabilities (continued)

(c) Currency risk

The Group derives its revenues almost entirely in Hong Kong dollars and is, therefore, exposed to currency risk arising only from borrowings, purchases and capital expenditure payments in relation to the development of new railways that are denominated in foreign currencies.

The Corporation uses forward exchange contracts and currency swaps to hedge its foreign exchange risk. The Corporation's risk management policy is to hedge its foreign currency borrowings into either Hong Kong dollars or United States dollars and limit its exposure to United States dollars to no greater than 30% of its total borrowings. Any contract for purchases or capital expenditure denominated in foreign currencies and exceeding $10 million equivalent is required to be reported to Corporate Treasury, which uses forward contracts to hedge the related foreign currency risk as and when necessary.

The Corporation may have investments in debt securities and other financial assets from time to time. Where these investments are denominated in foreign currencies other than United States dollars or Hong Kong dollars, the Corporation hedges the exposure into either United States dollars or Hong Kong dollars.

(i) Recognised assets and liabilities

Changes in the fair value of currency swaps that economically hedge recognised monetary liabilities in foreign currencies are recognised in the income statement. The net fair value of currency swaps used by the Corporation as economic hedges of monetary assets and liabilities in foreign currencies at 31 December 2007 and recognised as net derivative financial liabilities was $29 million (2006: $456 million), comprising assets of $5 million (2006: nil) and liabilities of $34 million (2006: $456 million).

(ii) Fair value through income statement

Changes in the fair value of forward exchange contracts for which no hedge accounting is applied are recognised in the income statement. At 31 December 2007, the net fair value of forward exchange contracts recognised as net derivative financial assets or liabilities was $10 million (liabilities) (2006: $41 million (liabilities)), which comprises assets of $8 million (2006: $2 million) and liabilities of $18 million (2006: $43 million).

In respect of other receivables and other payables denominated in currencies other than the functional currency of the operations, the Corporation ensures that the net exposure is kept to an acceptable level by buying or selling foreign currencies at spot or forward rates where necessary.

All the Group's borrowings are denominated in either Hong Kong dollars or United States dollars. Given this, management does not expect that there will be any significant currency risk associated with the Group's borrowings.

Notes to the Financial Statements

(Expressed in Hong Kong dollars)

32 Financial assets and liabilities (continued)

(c) Currency risk (continued)

(iii) Exposure to currency risk

Based on the notional amounts of the financial assets and liabilities, the following table shows the Group's and the Corporation's exposure at the balance sheet date to currency risk arising from forecast transactions or recognised assets or liabilities denominated in a currency other than the functional currency of the Group.

The Group and the Corporation

	US dollars million	Euros million	Japanese yen million	Swiss francs million
	(Expressed in foreign currency)			
2007				
– Investments	**330**	**–**	**–**	**–**
– Interest and other receivables	**2**	**–**	**–**	**–**
– Cash and cash equivalents	**54**	**3**	**413**	**–**
– Currency swaps	**1,950**	**–**	**–**	**–**
– Forward foreign exchange contracts	**195**	**–**	**4,135**	**–**
– Interest and other payables	**(56)**	**–**	**–**	**–**
– Interest-bearing borrowings	**(2,050)**	**–**	**–**	**–**
Overall net exposure	**425**	**3**	**4,548**	**–**
2006				
– Interest and other receivables	1	–	–	–
– Cash and cash equivalents	178	2	87	7
– Currency swaps	1,950	–	–	–
– Forward foreign exchange contracts	164	4	7,883	–
– Interest and other payables	(56)	–	–	–
– Interest-bearing borrowings	(2,230)	–	–	–
Overall net exposure	7	6	7,970	7

32 Financial assets and liabilities (continued)

(c) Currency risk (continued)

(iv) Sensitivity analysis

The following table indicates the approximate change in the Group's profit after taxation in response to reasonably possible changes in the foreign exchange rates to which the Group has exposure at the balance sheet date. Such exposure relates to the portion of United States dollars borrowings which is unhedged, and other assets and liabilities, such as deposits and future contract payments, denominated in foreign currencies.

	Increase/(decrease) in foreign exchange rate	**2007 Increase/ (decrease) in profit after taxation $ million**	2006 Increase/ (decrease) in profit after taxation $ million
US dollars	1%	**21**	31
	(1%)	**(21)**	(31)
Euros	10%	**3**	5
	(10%)	**(3)**	(5)
Japanese yen	10%	**26**	42
	(10%)	**(26)**	(42)
Swiss francs	10%	**–**	4
	(10%)	**–**	(4)

The sensitivity analysis has been determined assuming that the reasonably possible changes in foreign exchange rates had occurred at the balance sheet date and had been applied to each of the Group's exposures to currency risk for both derivative and non-derivative financial instruments in existence at that date, and that all other variables, in particular interest rates, remain constant. The stated changes represent management's assessment of reasonably possible changes in foreign exchange rates over the period until the next balance sheet date. Results of the analysis as presented in the table above represent an aggregation of the effects of the Group's profit after taxation measured in the respective functional currencies, translated into Hong Kong dollars at exchange rates, based on direct quotes, prevailing at the balance sheet date for presentation purposes. The analysis was performed on the same basis for the years ended 31 December 2006 and 2007.

32 Financial assets and liabilities (continued)

(d) Liquidity risk

Liquidity risk represents the Group's ability to meet its contractual obligations. The Group evaluates its liquidity requirements on an ongoing basis. It employs projected cash flow analysis to forecast its future funding requirements. The Group's approach to managing liquidity is to ensure there will be sufficient liquidity to meet its liabilities when they fall due, under both normal and stressed conditions.

The Group aims to secure committed credit facilities well ahead of funding needs. This protects the Group against adverse market conditions which may result in difficulties in raising funds to meet payment obligations. The Group has put in place committed revolving facilities and uncommitted stand-by facilities to cater for short-term liquidity requirements.

The following table shows the time periods after the balance sheet date during which contractual payments, presented on an undiscounted basis, are due to be made. These payments include, inter alia, interest payments computed using contractual rates (for fixed rate instruments) and rates prevailing at the balance sheet date (for floating rate instruments), in respect of the Group's and the Corporation's non-derivative and derivative financial liabilities which are due to be paid.

32 Financial assets and liabilities (continued)

(d) Liquidity risk

The Group

	Carrying amount $ million	Total contractual cash flows $ million	Within 1 year or on demand $ million	More than 1 year but less than 2 years $ million	More than 2 years but less than 5 years $ million	More than 5 years $ million
2007						
Short-term bank loans	**45**	**46**	**46**	**–**	**–**	**–**
Interest and other payables	**1,222**	**(1,231)**	**(911)**	**(85)**	**(235)**	**–**
Interest rate swaps	**2**	**(3)**	**(2)**	**–**	**(1)**	**–**
Currency swaps						
– outflow	**34**	**(15,410)**	**(103)**	**(7,878)**	**(7,037)**	**(392)**
– inflow	**(5)**	**15,273**	**–**	**7,833**	**7,049**	**391**
Forward foreign exchange contracts						
– outflow	**18**	**(1,813)**	**(1,276)**	**(281)**	**(256)**	**–**
– inflow	**(8)**	**1,821**	**1,280**	**282**	**259**	**–**
Interest-bearing borrowings	**17,857**	**(21,185)**	**(1,601)**	**(9,128)**	**(8,450)**	**(2,006)**
	19,165	**(22,502)**	**(2,567)**	**(9,257)**	**(8,671)**	**(2,007)**
2006						
Interest and other payables	2,459	(2,467)	(1,823)	(167)	(332)	(145)
Interest rate swaps	41	(50)	(19)	(13)	(18)	–
Currency swaps						
– outflow	456	(15,512)	(102)	(103)	(14,914)	(393)
– inflow	–	15,218	–	–	14,828	390
Forward foreign exchange contracts						
– outflow	43	(1,880)	(1,064)	(791)	(25)	–
– inflow	(2)	1,846	1,053	770	23	–
Interest-bearing borrowings	19,212	(24,029)	(1,680)	(1,958)	(18,265)	(2,126)
	22,209	(26,874)	(3,635)	(2,262)	(18,703)	(2,274)

32 Financial assets and liabilities (continued)

(d) Liquidity risk (continued)

The Corporation

	Carrying amount $ million	Total contractual cash flows $ million	Within 1 year or on demand $ million	More than 1 year but less than 2 years $ million	More than 2 years but less than 5 years $ million	More than 5 years $ million
2007						
Short-term bank loans	**45**	**46**	**46**	**–**	**–**	**–**
Interest and other payables	**1,222**	**(1,231)**	**(911)**	**(85)**	**(235)**	**–**
Interest rate swaps	**2**	**(3)**	**(2)**	**–**	**(1)**	**–**
Currency swaps						
– outflow	**34**	**(15,410)**	**(103)**	**(7,878)**	**(7,037)**	**(392)**
– inflow	**(5)**	**15,273**	**–**	**7,833**	**7,049**	**391**
Forward foreign exchange contracts						
– outflow	**18**	**(1,813)**	**(1,276)**	**(281)**	**(256)**	**–**
– inflow	**(8)**	**1,821**	**1,280**	**282**	**259**	**–**
Interest-bearing borrowings	**17,857**	**(21,185)**	**(1,601)**	**(9,128)**	**(8,450)**	**(2,006)**
	19,165	**(22,502)**	**(2,567)**	**(9,257)**	**(8,671)**	**(2,007)**
2006						
Interest and other payables	2,307	(2,315)	(1,671)	(167)	(332)	(145)
Interest rate swaps	41	(50)	(19)	(13)	(18)	–
Currency swaps						
– outflow	456	(15,512)	(102)	(103)	(14,914)	(393)
– inflow	–	15,218	–	–	14,828	390
Forward foreign exchange contracts						
– outflow	43	(1,880)	(1,064)	(791)	(25)	–
– inflow	(2)	1,846	1,053	770	23	–
Interest-bearing borrowings	19,212	(24,029)	(1,680)	(1,958)	(18,265)	(2,126)
	22,057	(26,722)	(3,483)	(2,262)	(18,703)	(2,274)

32 Financial assets and liabilities (continued)

(e) Fair value

The fair values of all financial assets and liabilities are set out in the following tables except for those financial assets and liabilities with carrying amounts not materially different from their fair values as at balance sheet date.

The Group and the Corporation

	2007 Carrying amount $ million	**2007** Fair value $ million	2006 Carrying amount $ million	2006 Fair value $ million
Non-derivative financial assets				
– Loan to non-controlled subsidiary	**4,407**	**4,809**	4,022	4,468
– Investments	**2,585**	**2,590**	–	–
	6,992	**7,399**	4,022	4,468
Derivative financial assets				
– Interest rate swaps	**119**	**119**	90	90
– Currency swaps	**5**	**5**	–	–
– Forward foreign exchange contracts	**8**	**8**	2	2
	132	**132**	92	92
Non-derivative financial liabilities				
– Short-term bank loans	**(45)**	**(45)**	–	–
– Interest-bearing borrowings	**(17,857)**	**(18,854)**	(19,212)	(20,058)
	(17,902)	**(18,899)**	(19,212)	(20,058)
Derivative financial liabilities				
– Interest rate swaps	**(2)**	**(2)**	(41)	(41)
– Currency swaps	**(34)**	**(34)**	(456)	(456)
– Forward foreign exchange contracts	**(18)**	**(18)**	(43)	(43)
	(54)	**(54)**	(540)	(540)

(Expressed in Hong Kong dollars)

32 Financial assets and liabilities (continued)

(f) Estimation of fair value

The following summarises the major methods and assumptions used in estimating the fair values of financial assets and liabilities reflected in the tables set out in note 32(e) above.

(i) Investments

The fair value of financial assets traded in active markets was based on quoted market prices at the balance sheet date.

(ii) Interest rate swaps, currency swaps and forward exchange contracts

The fair value of interest rate swaps and currency swaps was based on the present value of the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account prevailing interest rates, foreign exchange rates and creditworthiness of the swap counterparties. The fair value of forward exchange contracts was based on the quoted market price at the balance sheet date, being the present value of the quoted forward price. Discounted cash flows techniques were used in determining the fair value of swaps.

(iii) Loan to non-controlled subsidiary and interest-bearing borrowings

Where applicable, fair value was calculated based on discounted cash flows of expected future principal and interest payments.

(iv) Discount rates used for determining fair value

The Corporation used the applicable yield curve at the balance sheet date plus an adequate constant credit spread to discount financial assets and liabilities. The interest rates used were as follows:

	2007	2006
Interest rate swaps, currency swaps	**3.42% – 4.87%**	3.99% – 5.54%
Loan to non-controlled subsidiary and interest-bearing borrowings	**3.29% – 5.61%**	3.69% – 6.39%

33 Notes to the consolidated cash flow statement

Reconciliation of operating profit after depreciation and amortisation to net cash inflow from operations

	2007 $ million	2006 $ million
Operating profit after depreciation and amortisation	**345**	312
Merger-related expenses	**(216)**	(20)
Depreciation and amortisation	**2,418**	2,288
Fixed assets written off	**30**	24
Increase in stores and spares	**(13)**	(19)
Decrease in other receivables	**317**	210
Increase/(decrease) in other payables	**8**	(131)
Net cash inflow from operations	**2,889**	2,664

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 route, East Rail Extensions and Kowloon Southern Link which are considered to be related party transactions under IAS 24 and HKAS 24 and these are disclosed in notes 1, 3(c), 7, 15(j), 16(b), (c) and (d), 17(b) and (c), 19, 21, 24 and 27 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, the Executive Directors who are not Members of the Managing Board, members of the Management Committee 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 7 to the financial statements.

MTRCL is considered to be a related party of the Corporation under IAS 24 and HKAS 24 as they share a common shareholder, the Government. The Corporation has entered into transactions with MTRCL since the Appointed Day which are considered to be related party transactions and these are disclosed in notes 2, 3(c), (i), (m) and (ac), 5, 9(a), 15(e) and (g), 16(e) and (f), 18, 19, 21, 23, 24, 26, 29 and 36 to the financial statements.

Major related party transactions entered into by the Group in prior years which are still relevant for the current year comprise:

(i) On 15 September 1998, the Government approved the construction of West Rail, Phase I to be undertaken by the Corporation. The West Rail Project Agreement, which set out how the project was to be undertaken and the respective obligations of the Government and the Corporation in terms of the financing, design, construction and operation of West Rail, Phase I, was signed on 23 October 1998. On 24 February 2000, the Corporation and the Government entered into a shareholding agreement for undertaking all property developments along the West Rail, Phase I route (note 21).

(ii) The Corporation entered into a project agreement for the East Rail Extensions with the Government in 28 February 2003. The project agreement provided for the financing, design, construction and operations of the East Rail Extensions and related services and facilities.

34 Related parties (continued)

(iii) The Corporation entered into a project agreement for the financing, design, construction and operation of Kowloon Southern Link with the Government on 6 October 2005. Under the terms of the KSL Project Agreement, the Corporation will be responsible for, and will finance the entire capital cost of constructing the Kowloon Southern Link, along with the costs of the removal, replacement, modification or improvement of existing facilities affected by or required as a consequence of the construction of the Kowloon Southern Link.

(iv) The Corporation accepted an offer from the Government to allow the Corporation to proceed with the development of the site at Ho Tung Lau, Wu Kai Sha and Tai Wai Maintenance Centre in March 2003, October 2005 and July 2006 respectively.

During the year, the Group entered into the following material related party transactions:

(i) In the construction of the new railway projects, certain essential project works are embedded within the infrastructure works to be undertaken by the Government or its related parties. The Government and its related parties have entered into entrustment agreements and certain services agreements with the Corporation under which the Corporation has agreed to carry out works on behalf of the Government and provide operational services such as maintenance and building management services. The works done and services provided by the Corporation are reimbursable and the details of amounts receivable and payable as at 31 December 2007 are provided in notes 24 and 27 respectively.

(ii) Octopus Cards Limited earned fees for the use of the Octopus cards system from the Corporation and paid ticket loading agent fees, handling fees and interest to the Corporation. Details of the transactions are disclosed in note 20 to the financial statements.

35 Outstanding commitments

(a) Commitments outstanding in respect of capital expenditure not provided for in the financial statements were as follows:

	2007 **$ million**	2006 $ million
Investment properties		
– authorised and contracted for	**–**	2
– authorised but not contracted for	**–**	2
Property, plant and equipment		
– authorised and contracted for	**2,758**	3,860
– authorised but not contracted for	**1,086**	3,784
Interest in leasehold land held for own use under operating leases		
– authorised and contracted for	**164**	219
– authorised but not contracted for	**37**	38
Balance at 31 December	**4,045**	7,905

(b) The total future minimum lease payments under non-cancellable operating leases for property with varying terms and renewal rights are payable as follows:

	2007 **$ million**	2006 $ million
Within one year	**38**	38
After one year but within five years	**14**	49
Balance at 31 December	**52**	87

The operating leases are mainly related to work areas used for construction of new railways. During the year, amounts payable under operating leases totalling $33 million (2006: $46 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 ("RBS Scheme") was established on 1 February 1983 under trust. With effect from 16 November 1994, the RBS Scheme has been registered under Section 18 of the Occupational Retirement Schemes Ordinance.

All benefits payable under the RBS 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 RBS 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.

Where employees leave the RBS 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 RBS Scheme.

The Group also operates a Mandatory Provident Fund Scheme ("MPF Scheme") under the Hong Kong Mandatory Provident Fund Schemes Ordinance. The MPF Scheme is a defined contribution retirement plan administrated by independent trustees. Under the MPF Scheme, the employer and its employees are each required to make contributions to the plan at 5% of the employees' relevant income, subject to a cap of monthly relevant income of $20,000. The MPF Scheme was introduced on 1 April 2000 to employees who did not opt for or who were not eligible for RBS Scheme.

The Group's total retirement cost charged to the income statement includes the retirement costs for both RBS and MPF Schemes.

Pursuant to the Rail Merger Ordinance, all rights and obligations to which the Corporation was entitled or subject immediately before the Appointed Day in relation to the RBS Scheme were vested in MTRCL.

37 Debt facilities and programmes

(a) Total debt facilities and programmes comprise:

	2007 HK$/US$ million	2006 HK$/US$ million
In HK dollars		
Short-term uncommitted revolving credit facilities	**3,100**	2,200
Letters of credit	**20**	20
Overdraft facilities	**25**	25
Syndicated loan facilities	**8,000**	8,000
	11,145	10,245
In US dollars		
Medium term note programme	**3,000**	3,000
Letters of credit for leveraged leases	**314**	292
Export credit loan facilities	**–**	182
	3,314	3,474

(b) Total unutilised debt facilities and programmes available to the Corporation comprise:

	2007 $ million	2006 $ million
Short-term uncommitted revolving credit facilities	**3,055**	2,200
Letters of credit	**20**	20
Overdraft facilities	**25**	25
Syndicated loan facilities	**8,000**	8,000
US$3,000 million medium term note programme	**14,473**	14,418
US$292 million letters of credit for leveraged leases	**2,459**	2,279
Export credit loan facilities	**–**	10
	28,032	26,952

37 Debt facilities and programmes (continued)

(c) The unutilised debt facilities are expected to expire as follows:

	2007 $ million	2006 $ million
Floating rate		
– expiring within one year	**3,648**	2,620
– expiring after one year	**9,911**	9,914
Fixed/floating rate to be determined when issued		
– expiring after one year	**14,473**	14,418
	28,032	26,952

Notes to the Financial Statements

(Expressed in Hong Kong dollars)

38 Contingent liabilities

At 31 December 2007, the Group had contingent liabilities arising from the land resumption claims and certain contractors' claims in respect of the construction of the Kowloon Southern Link, 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 2007 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 2007. The Group is in the process of resolving these claims.

39 Impairment of assets

At 31 December 2007, the Group 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. The estimated cash flows of the railway network were calculated for a period consistent with the estimated useful lives of the core assets of the railway network and were discounted using the Corporation's weighted average cost of capital. In estimating the cash flows, it was assumed that the Service Concession will last for 50 years until its natural expiration and the Corporation will resume the railway operations after the return of railway network from MTRCL.

As a result of this assessment, management considers that the railway assets of the Group are not impaired at 31 December 2007 and, accordingly, that no provision for impairment of the Group's railway assets is required at that date.

40 Post balance sheet events

(a) On 27 February 2008, the Financial Secretary of the HKSAR Government announced his annual Budget which proposes a cut in the profits tax rate from 17.5% to 16.5% with effect from the fiscal year 2008-09 and a one-off reduction of 75% of the tax payable for the 2007-08 assessment subject to a ceiling of $25,000. In accordance with the Group's accounting policy set out in note 3(x), no adjustments have been made to these financial statements as a result of this announcement.

The management estimates that these proposed changes will reduce the opening balance of the Group's and the Corporation's net deferred tax liabilities as at 1 January 2008 by $230 million to $3,803 million. This opening balance adjustment to the deferred tax liabilities balance at 1 January 2008 will be recognised as a reduction in the Group's and the Corporation's income tax expense of $230 million in 2008. It is impracticable to estimate further the impact on future financial statements of the change in tax rate.

(b) On 11 March 2008 the Transport and Housing Bureau of the HKSAR Government issued a Legislative Council ("LegCo") Brief stating that the Executive Council and the Acting Chief Executive of the HKSAR had advised and ordered respectively that a service concession approach be adopted for the Shatin to Central Link ("the SCL") project. Approval will be sought from the Finance Committee of LegCo for funding of the design and construction, estimated at about $37.4 billion, of the SCL project under the Capital Works Reserve Fund, similar to other Government-funded public works projects. Completion of the SCL is planned for 2015 in part and 2019 in the whole and, upon completion, the Government may vest the SCL in or lease it to the Corporation for a nominal amount. The Brief also states that the Corporation would, in turn, include the SCL in the Service Concession granted to MTRCL, and receive service concession payments in accordance with the agreed mechanism and established system with MTRCL for sharing revenue generated by its existing railway assets under the Rail Merger.

41 Comparative figures

As a result of adopting HKFRS 7, Financial instruments: Disclosures, and the amendments to HKAS 1, Presentation of financial statements: capital disclosures, certain comparative figures have been adjusted to conform with changes in disclosures in the current year and to show separately comparative amounts in respect of items disclosed for the first time in 2007. Further details of these developments are disclosed in note 4.

(Expressed in Hong Kong dollars)

42 Accounting estimates and judgements

(a) Key sources of estimation uncertainty

Note 32 contains information about the assumptions and their risk factors relating to financial instruments. Other key sources of estimation uncertainty include the assessment of useful lives for depreciation of fixed assets (see note 3(j)), assessment of provisions and contingent liabilities (see notes 3(y), 27 and 38), determination of the recoverability of deferred tax assets (see note 11(d)), assessment of the possibility of implementation of Shatin to Central Link project (see note 17(b)) and assessment of the outstanding risk and obligations in recognition of profit from property development (see note 29).

(b) Critical accounting judgements in applying the Group's accounting policies

Critical accounting judgements in applying the Group's accounting policies include the classification of revenue and expenditure as capital or revenue in nature (see note 3(i)(i)), the classification of revenue and cost-recovery, the classification of operating leases or lease-out and lease-back transactions, transfers from construction in progress to fixed assets (see note 3(m)), assessment of controlled and non-controlled subsidiaries (see note 3(c)), the categorisation of financial assets and liabilities, adoption of hedge accounting (see note 32) and impairment of assets (see note 39).

43 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting year ended 31 December 2007

Up to the date of issue of these financial statements, the IASB and HKICPA have issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 December 2007 and which have not been adopted in these financial statements.

The Group is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Group's and the Corporation's results of operations and financial position.

In addition, the following developments may result in new or amended disclosures in the financial statements:

	Effective for accounting periods beginning on or after
IFRS 8 and HKFRS 8, Operating segments	1 January 2009

Consolidated Income Statement

for the year ended 31 December 2007 (Expressed in foreign currencies)

	Note	2007 US$ million	2007 GBP million	2007 JPY million
Turnover	5	**715**	**356**	**79,129**
Operating costs before depreciation and amortisation	6	**(361)**	**(180)**	**(39,954)**
Operating profit before depreciation and amortisation	7	**354**	**176**	**39,175**
Depreciation and amortisation	8	**(310)**	**(154)**	**(34,283)**
Operating profit after depreciation and amortisation		**44**	**22**	**4,892**
Gain on sale of property development rights		**624**	**311**	**69,020**
Gain on sale of investment properties and other property, plant and equipment		**169**	**84**	**18,687**
Gain on sale of property management and telecommunication business		**6**	**3**	**681**
Merger-related expenses		**(27)**	**(14)**	**(3,063)**
Interest and finance income	9(a)	**61**	**30**	**6,749**
Interest and finance expenses	9(b)	**(169)**	**(84)**	**(18,758)**
Share of profit of associate		**5**	**2**	**553**
Profit before unrealised gains		**713**	**354**	**78,761**
Gains on changes in fair value of derivative financial instruments and hedged borrowings	10	**69**	**35**	**7,670**
Net valuation gains on investment properties	15	**1**	**1**	**128**
Profit before taxation		**783**	**390**	**86,559**
Income tax	11(a)	**(101)**	**(50)**	**(11,116)**
Profit for the year wholly attributable to the sole shareholder of the Corporation	12	**682**	**340**	**75,443**

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$15.66 and JPY1=HK$0.07053

Consolidated Balance Sheet

at 31 December 2007 (Expressed in foreign currencies)

	Note	2007 US$ million	2007 GBP million	2007 JPY million
Assets				
Fixed assets	15			
– Property, plant and equipment		8,623	4,295	953,637
Interest in leasehold land held for own use under operating leases	15	760	379	84,092
Construction in progress	16	706	352	78,109
Deferred expenditure	17	203	101	22,473
Properties under development	18	3	1	284
Interest in associate	20	18	9	1,956
Loan to non-controlled subsidiary	21	565	281	62,483
Derivative financial assets	32(e)	17	8	1,872
Investments	22	331	165	36,651
Interest and other receivables	24	87	43	9,655
Cash and cash equivalents	25	851	425	94,088
		12,164	6,059	1,345,300
Liabilities				
Short-term bank loans	28	6	3	638
Interest and other payables	26	157	78	17,326
Accrued charges and provisions for capital projects	27	248	124	27,435
Derivative financial liabilities	32(e)	7	3	766
Interest-bearing borrowings	28	2,289	1,139	253,184
Deferred income	29	585	292	64,738
Deferred tax liabilities	11(d)	517	258	57,181
		3,809	1,897	421,268
Net Assets		8,355	4,162	924,032
Capital and Reserves				
Share capital	30	5,015	2,498	554,658
Reserves	31	3,340	1,664	369,374
Total equity		8,355	4,162	924,032

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$15.66 and JPY1=HK$0.07053

Corporation Balance Sheet

at 31 December 2007 (Expressed in foreign currencies)

	Note	2007 US$ million	2007 GBP million	2007 JPY million
Assets				
Fixed assets	15			
– Property, plant and equipment		**8,623**	**4,295**	**953,637**
Interest in leasehold land held for own use under operating leases	15	**760**	**379**	**84,092**
Construction in progress	16	**706**	**352**	**78,109**
Deferred expenditure	17	**203**	**101**	**22,473**
Properties under development	18	**3**	**1**	**284**
Interest in associate	20	**6**	**3**	**595**
Loan to non-controlled subsidiary	21	**565**	**281**	**62,483**
Derivative financial assets	32(e)	**17**	**8**	**1,872**
Investments	22	**331**	**165**	**36,651**
Interest and other receivables	24	**87**	**43**	**9,655**
Cash and cash equivalents	25	**851**	**425**	**94,088**
		12,152	**6,053**	**1,343,939**
Liabilities				
Short-term bank loans	28	**6**	**3**	**638**
Interest and other payables	26	**157**	**78**	**17,326**
Accrued charges and provisions for capital projects	27	**248**	**124**	**27,435**
Derivative financial liabilities	32(e)	**7**	**3**	**766**
Interest-bearing borrowings	28	**2,289**	**1,139**	**253,184**
Deferred income	29	**585**	**292**	**64,738**
Deferred tax liabilities	11(d)	**517**	**258**	**57,181**
		3,809	**1,897**	**421,268**
Net Assets		**8,343**	**4,156**	**922,671**
Capital and Reserves				
Share capital	30	**5,015**	**2,498**	**554,658**
Reserves	31	**3,328**	**1,658**	**368,013**
Total equity		**8,343**	**4,156**	**922,671**

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$15.66 and JPY1=HK$0.07053

Consolidated Statement of Changes in Equity

for the year ended 31 December 2007 (Expressed in foreign currencies)

	Note	2007 US$ million	2007 GBP million	2007 JPY million
Total equity at 1 January		**7,684**	**3,827**	**849,752**
Net profit for the year	31	**682**	**340**	**75,443**
Dividend approved and paid during the year	13(b)	**(11)**	**(5)**	**(1,163)**
Total equity at 31 December		**8,355**	**4,162**	**924,032**

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$15.66 and JPY1=HK$0.07053

Consolidated Cash Flow Statement

for the year ended 31 December 2007 (Expressed in foreign currencies)

	Note	2007 US$ million	2007 GBP million	2007 JPY million
Operating activities				
Net cash inflow from operations	33	**370**	**184**	**40,961**
Upfront payment for Service Concession		**545**	**271**	**60,258**
Net payment for liabilities and assets transferred to MTRCL		**(93)**	**(46)**	**(10,321)**
Receipt on sale of property development rights after netting off $70 million relating to enabling work costs reimbursement		**620**	**309**	**68,623**
Net cash outflow relating to property development		**(5)**	**(2)**	**(539)**
Hong Kong profits tax paid		**–**	**–**	**(14)**
Net cash inflow from operating activities		**1,437**	**716**	**158,968**
Investing activities				
Increase in deposits with banks with maturity more than three months when placed		**(256)**	**(128)**	**(28,399)**
Payments for capital expenditure:				
– East Rail Extensions project		**(132)**	**(66)**	**(14,575)**
– Kowloon Southern Link project		**(239)**	**(119)**	**(26,443)**
– other capital projects and purchase of fixed assets		**(109)**	**(54)**	**(12,023)**
Interest received		**7**	**3**	**751**
Loan to non-controlled subsidiary		**(5)**	**(2)**	**(525)**
Payment for the purchase of investments		**(330)**	**(165)**	**(36,495)**
Receipts on sales of fixed assets		**–**	**–**	**14**
Receipts on sale of investment properties and other property, plant and equipment after netting off $162 million for the transfer of cash and cash equivalents of certain subsidiaries to MTRCL		**343**	**171**	**37,970**
Receipts on sale of property management businesses		**5**	**3**	**567**
Net cash outflow from investing activities		**(716)**	**(357)**	**(79,158)**
Net cash inflow before financing		**721**	**359**	**79,810**
Financing activities				
Net cash outflow on repayment of loans		**(174)**	**(87)**	**(19,283)**
Dividend paid		**(11)**	**(5)**	**(1,163)**
Interest paid		**(178)**	**(89)**	**(19,793)**
Net cash outflow relating to derivative financial instruments		**(13)**	**(6)**	**(1,389)**
Finance expenses paid		**(1)**	**–**	**(99)**
Net cash outflow from financing activities		**(377)**	**(187)**	**(41,727)**
Net increase in cash and cash equivalents		**344**	**172**	**38,083**
Cash and cash equivalents at 1 January		**189**	**94**	**20,927**
Cash and cash equivalents at 31 December		**533**	**266**	**59,010**
Analysis of the balances of cash and cash equivalents				
Cash at bank and in hand	25	**4**	**2**	**496**
Deposits with banks with maturity of less than three months when placed	25	**529**	**264**	**58,514**
		533	**266**	**59,010**

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$15.66 and JPY1=HK$0.07053

Ten-year Statistics

FINANCIAL (HK$ million)	**2007**	2006	2005	2004
Income Statement				
Revenue from operations	**5,581**	5,622	5,383	4,976
Transport	**4,524**	4,746	4,612	4,281
Property	**987**	876	771	695
Service concession income	**70**	–	–	–
Operating profit before depreciation and amortisation	**2,763**	2,600	2,356	2,172
Gain on sale of property development rights	**4,868**	–	–	–
Gain on sale of investment properties and other property, plant and equipment	**1,318**	–	–	–
Gain on sales of property management and telecommunication business	**48**	–	–	–
Merger-related expenses	**(216)**	(20)	–	–
Net interest and finance (income)/expenses	**847**	316	298	41
Profit on property development	**–**	427	–	–
Profit/(loss) before unrealised gains/losses	**5,555**	430	(185)	465
Net profit/(loss)				
Before property development & related profits tax	**5,321**	(74)	317	513
After property development	**5,321**	278	317	513
Dividend	**–**	82	–	172
Balance Sheet				
Fixed assets (including interest in leasehold land held for own use under operating leases)	**73,191**	65,400	66,943	67,746
Construction in progress	**5,509**	13,644	10,411	6,991
Deferred expenditure	**1,585**	1,389	1,210	1,462
Properties under development	**20**	449	1,537	1,892
Loan to non-controlled subsidiary	**4,407**	4,022	3,863	3,576
Investments	**2,585**	–	449	4,323
Cash and cash equivalents	**6,636**	1,947	3,394	3,531
Other assets	**951**	1,124	1,945	1,865
Total assets	**94,884**	87,975	89,752	91,386
Interest-bearing borrowings	**17,857**	19,212	19,474	19,748
Deferred tax liability	**4,033**	3,250	3,198	3,251
Other liabilities	**7,822**	5,580	7,427	8,325
Total liabilities	**29,712**	28,042	30,099	31,324
Equity	**65,172**	59,933	59,653	60,062
Key financial data				
Capital expenditure	**3,574**	3,317	3,835	9,025
Return on equity (%)	**8**	–	1	1
Revenue per employee excluding project staff	**1.067**	1.058	1.050	0.994
Debt/equity ratio	**1:3.7**	1:3.1	1:3.1	1:3.0
Debt to total capitalisation (%)	**22**	24	25	25
Interest cover (times)	**5.8**	2.2	1.9	1.8

Comparative figures before 2005 have not been restated to conform to the current year's presentation due to the adoption of IFRS. The main adjustments that would make the ten-year statistics comply with IFRS are in connection with income tax, depreciation of certain fixed assets and employee benefits.

	2003	2002	2001	2000	1999	1998
	4,426	4,830	4,797	4,731	4,426	4,137
	3,819	4,213	4,139	4,089	3,817	3,554
	607	617	658	642	609	583
	–	–	–	–	–	–
	2,297	2,659	2,572	2,571	2,249	2,032
	–	–	–	–	–	–
	–	–	–	–	–	–
	–	–	–	–	–	–
	–	–	–	–	–	–
	(353)	(618)	(490)	(302)	(222)	(164)
	–	94	24	87	71	88
	1,909	2,662	2,436	2,289	1,844	1,717
	1,381	2,116	2,411	2,201	1,832	1,565
	1,381	2,210	2,435	2,288	1,903	1,639
	620	620	–	–	–	–
	51,857	14,051	13,745	13,236	13,301	12,336
	15,101	42,298	26,939	17,400	9,451	3,836
	900	156	4,216	1,104	326	234
	1,448	1,153	739	91	87	482
	3,232	2,048	1,316	602	114	44
	12,244	19,165	27,752	27,789	22,270	5,027
	2,677	5,528	6,473	8,597	11,589	9,510
	1,745	1,709	1,357	1,600	1,153	476
	89,204	86,108	82,537	70,419	58,291	31,945
	20,013	17,753	16,831	16,395	8,299	–
	3,131	2,604	–	–	–	–
	5,855	6,239	6,126	5,123	3,404	1,692
	28,999	26,596	22,957	21,518	11,703	1,692
	60,205	59,512	59,580	48,901	46,588	30,253
	11,122	12,308	14,595	10,829	8,444	3,286
	2	4	4	5	4	5
	0.950	1.222	1.240	1.248	1.183	1.127
	1:3.0	1:3.4	1:3.5	1:3.0	1:5.6	–
	25	23	22	25	15	–
	2.9	3.4	3.3	3.4	7.9	–

Ten-year Statistics

OPERATING (million)	**2007**&	2006	2005	2004
East Rail including Tsim Sha Tsui Extension, Ma On Shan Rail and Lok Ma Chau Spur Line*				
Electric Multiple Unit Operations:				
Total number of passengers	**315**	335	325	292
Domestic	**231**	247	239	207
Cross-boundary	**84**	88	86	85
Daily average number of passengers	**0.939**	0.918	0.892	0.799
Revenue car-km operated	**89.12**	92.00	91.56	79.35
Total passenger-km travelled	**4,945**	4,824	4,731	4,385
Safety performance (unit)				
Number of passengers & public injured	**242**	270	247	216
Passengers & public injured per million passengers carried	**0.74**	0.74	0.71	0.74
Through Train Operations				
Total number of passengers	**3.0**	3.3	3.1	3.0
Light Rail				
Total number of passengers	**125**	136	136	132
Daily average number of passengers	**0.372**	0.374	0.373	0.360
Revenue car-km operated	**8.91**	10.04	11.09	11.29
Safety performance (unit)				
Number of passengers & public injured	**22**	40	23	18
Passengers & public injured per million passengers carried	**0.18**	0.29	0.17	0.14
West Rail**				
Total number of passengers	**71**	73	65	48
Daily average number of passengers	**0.213**	0.200	0.179	0.131
Revenue car-km operated	**29.35**	30.87	32.55	34.17
Safety performance (unit)				
Number of passengers & public injured	**33**	37	36	38
Passengers & public injured per million passengers carried	**0.46**	0.51	0.55	0.79

* East Rail Tsim Sha Tsui Extension, Ma On Shan Rail and Lok Ma Chau Spur Line commenced operation on 24 October 2004, 21 December 2004 and 15 August 2007 respectively.

** West Rail commenced operation on 20 December 2003.

& The statistical figures cover the period from 1 January 2007 to 1 December 2007 prior to the Rail Merger.

2003	2002	2001	2000	1999	1998
278	296	292	288	275	269
196	204	205	204	200	204
82	92	87	84	75	65
0.762	0.812	0.799	0.788	0.755	0.737
78.68	78.92	75.57	73.78	72.58	71.40
4,183	4,540	4,487	4,466	4,263	4,204
181	180	191	192	186	168
0.65	0.61	0.65	0.67	0.67	0.62
2.1	2.3	2.1	2.0	1.7	1.4
106	114	117	118	115	114
0.291	0.314	0.319	0.323	0.314	0.314
10.71	10.76	10.68	10.68	10.25	10.29
27	33	35	27	51	42
0.25	0.29	0.30	0.23	0.44	0.37
1	–	–	–	–	–
0.107	–	–	–	–	–
1.15	–	–	–	–	–
3	–	–	–	–	–
2.33	–	–	–	–	–

Ten-year Statistics

OPERATING (million)	**2007**[&]	2006	2005	2004
Bus				
Total number of passengers*	**30**	30	27	20
Bus-km operated*	**5.76**	7.31	6.29	6.95
Safety performance (unit)				
Number of passengers & public injured	**7**	7	8	8
Passengers & public injured per million passengers carried	**0.14**	0.15	0.18	0.21
Freight				
Freight volume				
Southbound goods (tonnage)	**0.2**	0.4	0.4	0.5
Northbound goods (tonnage)	**0.1**	0.2	0.2	0.3
Livestock (head)	**–**	–	0.1	0.4
Employees at year end (number)				
Transport	**–**	4,524	4,372	4,227
Property	**–**	131	111	109
Capital Projects	**–**	733	754	867
Corporate & other services	**2**	661	642	671
	2	6,049	5,879	5,874

* 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.

& The statistical figures, except for the numbers of employees at year end, cover the period from 1 January 2007 to 1 December 2007 prior to the Rail Merger.

2003	2002	2001	2000	1999	1998
26	26	21	16	16	38
7.70	6.78	6.20	5.43	5.17	6.03
4	4	8	6	4	14
0.1	0.09	0.21	0.18	0.12	0.37
0.6	0.7	0.6	0.7	0.7	0.7
0.4	0.5	0.4	0.4	0.5	0.5
0.7	0.9	0.9	1.1	1.2	1.3
3,914	3,228	3,218	3,202	3,179	3,169
97	92	75	74	68	61
1,211	1,557	1,303	1,077	841	518
649	633	574	514	494	442
5,871	5,510	5,170	4,867	4,582	4,190

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.
Agricultural Bank of China
American Express Bank Limited
Australia and New Zealand Banking Group Limited
Banco Bilbao Vizcaya Argentaria, S.A.
Bank of America, National Association
Bank of China (Hong Kong) Limited
Bank of Communications
Bank of East Asia, Limited, The
Bank of New York, The
Bank of Nova Scotia, The
Bank of Tokyo-Mitsubishi UFJ, Ltd., The
Barclays Bank Plc.
Bayerische Hypo-und Vereinsbank Aktiengesellschaft
Bayerische Landesbank
BNP Paribas
Calyon
Canadian Imperial Bank of Commerce
China Construction Bank Corporation
Chong Hing Bank Limited
Citibank, N. A.
Commerzbank AG
Commonwealth Bank of Australia
Credit Suisse
Dah Sing Bank Limited
DBS Bank Ltd.
Deutsche Bank AG
DZ Bank AG Deutsche Zentral-Genossenschaftsbank
Fortis Bank
Fubon Bank (Hong Kong) Limited
Hang Seng Bank Limited
HSBC
HSH Nordbank AG
Industrial and Commercial Bank of China (Asia) Limited
ING Bank N.V.
Intesa Sanpaolo S.p.A.
JPMorgan Chase Bank, National Association
KBC Bank N.V.
Lehman Brothers
Malayan Banking Berhad
Merrill Lynch & Co., Inc.
Mizuho Corporate Bank, Ltd.
Morgan Stanley
Nanyang Commercial Bank, Limited
National Australia Bank, Limited
Oversea-Chinese Banking Corporation Limited
Rabobank
Royal Bank of Scotland Plc, The
Shanghai Commercial Bank Limited
Societe Generale
Standard Chartered Bank (Hong Kong) Limited
Sumitomo Mitsui Banking Corporation
Svenska Handelsbanken AB (publ)
Tai Fung Bank Limited
UBS AG
United Overseas Bank Limited
WestLB AG
Wing Hang Bank Limited
Wing Lung Bank Limited

List of Consultants

Name of Contract	Contract No.	Consultant	Division	Awarded Amount (Lump Sum) (in HK$)
1. Express Rail Link Financial Study	GC200701	N M Rothschild & Sons (Hong Kong) Ltd.	Finance	$9,800,000
2. Express Rail Link Preparatory Work for Forming Joint Venture	NOL/ERL-110	McKinsey & Co. Inc. Hong Kong	Capital Projects	$5,300,000
3. Design and Construction Management Consultancy Services for Addition and Alteration Works of Station Trading Areas and Commercial Facilities at Mong Kok Station	EA200701	Design 2 (HK) Ltd.	Capital Projects	$3,936,000
4. Engineering Services for Middle Road Subway Extension	KDC103	Maunsell Consultants Asia Ltd.	Capital Projects	$3,450,000
5. Air Ventilation Assessment Study for Property Developments along Ma On Shan Rail, Light Rail and West Rail	PDR-AVA	Maunsell Consultants Asia Ltd.	Property	$910,000
6. Appointment of an Information Agent	–	Lucid Issuer Services	Finance	$468,000

Glossary of Financial Terms and Further Information

Glossary of Financial Terms

Operating margin (before depreciation and amortisation)

Operating profits before depreciation and amortisation divided by turnover.

Operating margin (after depreciation and amortisation)

Operating profits after depreciation and amortisation divided by turnover.

Return on equity

Net profit after taxation divided by the sum of share capital and reserves.

Revenue per employee excluding project staff

Turnover divided by the number of employees excluding project staff at the end of the year.

Debt/equity ratio

Total interest-bearing borrowings (excluding short-term bank loans) divided by the sum of share capital and reserves.

Debt to total capitalisation

Total interest-bearing borrowings (excluding short-term bank loans) expressed as a percentage of the sum of total interest-bearing borrowings (excluding short-term bank loans) and equity.

Interest cover

Operating profit before depreciation and amortisation plus profit from property development, share of profit of associate and gross interest income before capitalisation divided by gross interest expenses before capitalisation.

Further Information

If further information is required, please contact:

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