

Press Release

PR027/06
11 April 2006**MTR Corporation Signs
Memorandum of Understanding with The Government
on Terms of Proposed Rail Merger**

The MTR Corporation is pleased to announce that it has signed a non-binding Memorandum of Understanding (MOU)^① with the Government of the Hong Kong Special Administrative Region (the Government) today, setting out the terms of the proposed merger of the operations of the MTR Corporation (the Company) and the Kowloon-Canton Railway Corporation (KCRC), together with the acquisition of a Property Package. The MOU meets the five parameters^② set down by the Government while creating value for the shareholders of the Company. The rail merger, if implemented in accordance with the MOU, will offer benefits to the travelling public, shareholders and staff.

According to the MOU, the Company will make an upfront payment of HK\$4.25 billion for a Service Concession^③ and for certain rail assets purchased from KCRC, and HK\$7.79 billion to acquire a Property Package^④ that comprises development rights, investment properties and property management rights. Over the life of the Service Concession, the Company will offer KCRC an annual fixed payment of HK\$750 million, plus an annual variable payment based on revenues generated from KCR rail and rail-related operations.

If the merger is implemented, the MOU provides for:

- Reduced fares^⑤, abolition of the Second Boarding Charge and further discounts for medium and long distance journeys
- Introduction of an objective, transparent and predictable Fare Adjustment Mechanism^⑥
- Fully integrated interchange stations for Shatin to Central Link^⑦
- Job security for all frontline staff will not be affected as it relates to the proposed merger
- Improvement on existing interchange arrangements in the short term and provision of seamless interchange arrangements in the long term with future extensions

In addition, the Company commits not to increase MTR fares during the merger process, up to 24 months from today's announcement. Assuming the merger will be implemented, the commitment not to raise fares will remain in effect until 10 April 2008.

The Chairman of the Company, Dr Raymond K F Ch'ien, said the proposed merger is a balanced package that is fair to all stakeholders. "Immediately after the merger, Hong Kong's travelling public will be the first to benefit as passengers will enjoy significant fare reductions. There will be a minimum 10% discount on adult Octopus fares for long distance journeys while medium distance travellers using adult Octopus will enjoy a minimum 5% fare reduction.

All passengers using Octopus will experience the fare benefits immediately upon completion of the merger process. Notably for adult Octopus users:

- (a) The Second Boarding Charge will be abolished, resulting in fare reductions of HK\$1 to HK\$7 for passengers interchanging between the existing MTR and KCR networks
- (b) All fares will be reduced by HK\$0.2
- (c) Long distance journeys with fares at or above HK\$12 will be further reduced by HK\$1
- (d) For those long distance journeys with fares at or above HK\$12 where (a), (b) and (c) do not add up to a 10% saving, a further reduction will be offered to achieve the 10% saving
- (e) Medium distance journeys with fares from HK\$8.5 to HK\$11.9 will be reduced by a minimum of 5%. If (a) and (b) do not add up to a 5% saving, a further reduction will be offered to achieve the 5% reduction

Single journey ticket users not interchanging between the MTR and KCR systems will enjoy discounts on medium and long distance journeys immediately upon the merger. Within one year of the merged company's first day of operation, an integrated single journey ticket will be introduced. This will enable single journey ticket users interchanging between the two systems to also enjoy the reduced fares from elimination of the Second Boarding Charge as well as discounts on medium and long distance journeys. Interchange arrangements will also become more convenient through the removal of interchange gates at Kowloon Tong, Mei Foo and Nam Cheong stations.

Each day, 2.8 million passenger trips will benefit from the different levels of fare reductions.

After the merger, an objective, transparent and predictable Fare Adjustment Mechanism (FAM) will be used to adjust rail fares. The FAM will be linked to the changes in the composite Consumer Price Index, the Census and Statistics Department Nominal Wage Index (Transport Sector) and a productivity factor.

“We are committed to looking after the interests of all staff,” added Dr Ch’ien. “The MOU stipulates that job security for all frontline staff will not be affected as it relates to the proposed merger.” The definition of frontline staff^⑧ will be explained to employees by the two companies. Future staff arrangements will be fair and equitable.

Upon the rail merger, all serving staff of the two Corporations will be employed by the merged company on their prevailing terms and conditions. In the meantime, the two companies will conduct in-depth studies on terms and conditions for the merged company and staff will be consulted during the process. With the expected expansion of the network and business growth of the merged company providing exciting new career opportunities, staff vacancies created after the merger are expected to exceed 1,300 in the first three years, which is greater than the estimated 650 to 700 positions that are part of the synergies identified. To address any potential mismatches in skills, the merged company will offer re-training and re-deployment for affected staff. Throughout the merger process, the Company will continue to listen to staff views.

The terms of the proposed merger are favourable to MTR shareholders and are expected to increase earnings per share (EPS). MTR Corporation’s property portfolio will also be further enhanced by the inclusion of property development sites alongside East Rail, Ma On Shan Rail, Light Rail and Kowloon Southern Link, as well as a portfolio of investment properties. With the combined expertise of the two rail operators and a strong balance sheet, the merged entity will be even better positioned for continued expansion into the Mainland of China. The transaction will reinforce MTR Corporation’s growth story and reaffirm its position as one of the quality blue chip stocks in Hong Kong.

Moving forward, the Company will work closely with the Government, KCRC, and the Legislative Council (LegCo) to ensure a smooth merger process. If the merger bill is passed by LegCo, the proposed deal will be presented to the MTR Corporation's minority shareholders for approval. The entire process is expected to take one year or more to complete.

— End —

① **Deal Terms**

- The deal terms provide a balanced package that is fair to all stakeholders
- Acquisition of the right to operate KCR operations for 50 years, which can be renewed
 - Upfront payment of HK\$4.25 billion for the Service Concession to manage KCR operations and rail-related businesses and to purchase certain rail assets, and HK\$7.79 billion for a Property Package
 - Fixed annual payment of HK\$750 million
 - Variable annual payment based on revenues generated from KCR's rail and rail-related operations
- Expected to be EPS and NPV accretive for MTR Corporation
- Meet the Five Parameters set by the Government

② **The Government's five parameters are:**

1. Adoption of a more objective and transparent fare adjustment mechanism;
2. Abolition of the second boarding charge and review of the fare structure with the objective of reducing fares;
3. Early resolution of interchange arrangements for rail projects under planning, notably the Shatin to Central Link;
4. Ensuring job security for the frontline staff of both corporations at the time of the merger; and
5. Provision of seamless interchange arrangements in the long term

③ **Service Concession**

- Full operating merger via a Service Concession to manage KCR operations and rail-related businesses for 50 years, which can be renewed
 - One-time Upfront Payment for the Service Concession to operate the KCR operations and purchase certain rail assets, in addition to fixed annual payment and variable annual payment
 - The merged company shall be responsible for the daily operations and maintenance of the KCR transport operations, and to fund all operating capital expenditure during the Service Concession period
 - The construction of the Kowloon Southern Link and the Lok Ma Chau Spur Line will continue to be funded by KCRC and operations of these lines will become part of the Service Concession arrangement
 - KCRC's existing debt obligations will remain with KCRC
- Service Concession and MTR's franchise will end at the same time

④ **Property Package**

- Property has been / will continue to be an integral part of the rail-and-property model contributing to the success of railway development in Hong Kong
- Property Package to be purchased by MTR Corporation includes:
 - Property development rights along East Rail, Ma On Shan Rail, Light Rail and Kowloon Southern Link
 - Investment properties related to East Rail and Light Rail currently held by KCRC
 - KCRC's existing and future property management rights

⑤ **Reduced Fares**

- Passengers will enjoy significant fare reductions
- All adult Octopus fares for long distance journeys at or above HK\$12 will be reduced by a minimum of 10%
- All adult Octopus fares for medium distance journeys from HK\$8.5 to HK\$11.9 will be reduced by a minimum of 5%

- Detailed fare reduction arrangements for adult Octopus users:
 - (a) The Second Boarding Charge will be abolished, resulting in fare reductions of HK\$1 to HK\$7 for passengers interchanging between the existing MTR and KCR networks
 - (b) All fares will be reduced by HK\$0.2
 - (c) Long distance journeys with fares at or above HK\$12 will be further reduced by HK\$1
 - (d) For those long distance journeys with fares at or above HK\$12 where (a), (b) and (c) do not add up to a 10% saving, a further reduction will be offered to achieve the 10% saving
 - (e) Medium distance journeys with fares from HK\$8.5 to HK\$11.9 will be reduced by a minimum of 5%. If (a) and (b) do not add up to a 5% saving, a further reduction will be offered to achieve the 5% reduction

- Single journey ticket users not interchanging between the MTR and KCR systems will enjoy discounts on medium and long distance journeys immediately upon the merger
- Within one year of the merged company's first day of operation, an integrated single journey ticket will be introduced. This will enable single journey ticket users interchanging between the two systems to also enjoy the reduced fares from elimination of the Second Boarding Charge as well as discounts for medium and long distance journeys
- Fare reductions will apply to MTR (excluding Airport Express), West Rail, East Rail (excluding Lo Wu/Lok Ma Chau trips) and Ma On Shan Rail
- 2.8 million passenger trips will benefit each day
- Vast majority of the fare reductions will be funded by merger synergies

| Example move-ments (for adult Octopus) | Existing fare | Removal of 2nd boarding charge | Octopus fare reduction | Long distance discount | | Medium distance reduction to achieve 5% | New fare | Total Reduc-tion |
|--|---------------|--------------------------------|------------------------|------------------------|-----------------------|---|----------|------------------|
| | | | | HK\$1 | Top up to achieve 10% | | | |
| City One Shatin – Kwun Tong | \$11.8 | \$3.5 | \$0.2 | - | - | - | \$8.1 | 31.4% (\$3.7) |
| Central – Tai Po Market | \$17.3 | \$1.5 | \$0.2 | \$1.0 | - | - | \$14.6 | 15.6% (\$2.7) |
| Central – Tung Chung | \$20.1 | - | \$0.2 | \$1.0 | \$0.9 | - | \$18.0 | 10.4% (\$2.1) |
| Tuen Mun – Mei Foo (KCR) | \$13.5 | - | \$0.2 | \$1.0 | \$0.2 | - | \$12.1 | 10.4% (\$1.4) |
| Mong Kok (MTR) – Central | \$10.0 | - | \$0.2 | - | - | \$0.3 | \$9.5 | 5.0% (\$0.5) |

- The dollar amount of concessionary fare reductions will be half of the adult fare reductions
- Senior citizens using elder Octopus will enjoy HK\$2 flat fare for any single rail journey on Sundays and public holidays for one year after the completion of the merger process. This applies to MTR (excluding Airport Express), West Rail, East Rail (excluding Lo Wu/Lok Ma Chau trips) and Ma On Shan Rail
- Existing student fare concessions will be maintained, i.e. students will continue to enjoy fare discount of about 50% when travelling on the MTR system

⑥ **Fare Adjustment Mechanism (FAM)**

- Fares for the merged railway will be adjusted according to an objective, transparent and predictable Fare Adjustment Mechanism agreed with the Government
 - $\Delta \text{Fare} = 0.5 * \Delta \text{CCPI} + 0.5 * \Delta \text{Wage Index} - t$
 - CCPI: Composite Consumer Price Index
 - Wage Index: Census and Statistics Department Nominal Wage Index (Transport Sector)
 - t: a productivity factor. t = 0 for the first 5 years, t = 0.1% from Year 6
- FAM does not apply to Airport Express, Ngong Ping 360, Intercity and Freight
- Assessment of fare adjustment will be conducted annually according to the formula
- FAM is subject to review every 5 years upon request by Government or MTR Corporation

⑦ **Shatin to Central Link (SCL)**

- SCL will comprise two components:
 - Tai Wai – Hung Hom
 - Hung Hom – Central
- Implementation of the SCL is subject to a separate decision by Government

⑧ **Definition of Frontline Staff**

- Frontline staff are those full-time non-managerial staff who are employed regularly and directly in the operations and maintenance of trains, stations, buses and vehicles; infrastructure maintenance; stores operations and security operations. Non-managerial staff refer to staff below Grade MG1 in the case of MTR and staff below Grade 8 in the case of KCRC, who are employed on either continuous terms or contract terms for a duration of 2 years or more