

Industrials  
Conglomerates  
Equity – Hong Kong

## Underweight

Target price (HKD)	30.50
Share price (HKD)	34.80
Forecast dividend yield (%)	2.6
Potential return (%)	-9.7

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Performance	1M	3M	12M
Absolute (%)	1.8	12.6	23.4
Relative^ (%)	2.6	9.7	14.3

^Index Hang Seng Index

RIC	0066.HK
Bloomberg	66 HK
Market cap (USDm)	26,167
Market cap (HKDm)	202,912
Enterprise value (HKDm)	223,993
Free float (%)	24

5 March 2015

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# MTR Corp (66 HK)

UW: Back in the spotlight

- ▶ **MTR had negative news flow on the Shatin-Central Link (SCL) and Express Rail Link (XRL)**
- ▶ **Risks could be both on capex and regulations**
- ▶ **Reiterate UW with unchanged TP of HKD30.5; stock looks overpriced at 22x 2015e PE**

**What happened?** According to various media reports such as Ming Pao and The Standard that were published today, the HKSAR government has submitted documents to the Legislative Council which states that the completion of Shatin Central Link will be delayed for one year to 2021. Singtao also reported today that the Highways Department had requested MTR to review the Express Rail Link budget due as the Department believes there may be additional costs for the XRL on top of the current budget – the review is expected to be completed by 2Q15.

**A quick glance at the facts.** MTR has five expansion projects in Hong Kong, the West Island Line (WIL), South Island Line East (SIL), and Kwun Tong Line extension (KTL), XRL and SCL. MTR owns the first three lines while the HKSAR government owns the last two and will provide service concessions to MTR. All five lines had faced various budget overruns. In particular: (1) WIL and SIL had a HKD3bn overrun which MTR would bear; (2) SCL's cost overrun is estimated to be at least HKD4.1bn, which the HKSAR government would bear; and (3) XRL budget overrun of HKD6.5bn which is currently unclear whether the HKSAR government or MTR would bear.

**Potential capex and risks.** We have included the WIL and SIL HKD3bn in our model. For XRL, we previously argued there may be more liabilities for MTR than just the HKD6.5bn overrun, and we had estimated MTR's XRL liabilities could be HKD9.5bn (4% of NAV) although this could increase if MTR revises the capex budget upwards. We believe the SCL-related valuation impact would be limited for MTR given the HKSAR government bears the capex. Finally, if there is a perception that MTR's abilities as an operator is deteriorating, the Company may face a tougher regulatory environment.

**Reiterate UW; share price is sensitive to interest rates.** We make no changes to our model. We use a sum-of-the-parts valuation to derive our HKD38.1 NAV and apply an unchanged 20% conglomerate discount to arrive at our HKD30.5 target price. As the stock's potential return of -9.7% (including 2015e dividend yield) is below the Neutral band of our model (8.5% Hong Kong hurdle rate, plus or minus 5ppt), we reiterate our Underweight rating on the shares. The shares have appreciated 9% year to date (versus HSI up 4% over the same period): we believe this is due to the decline in interest rates at the start of the year – we estimate that, in the past 10 years, MTR has a correlation of -0.66 with the US Treasury 10-year bond yield. Given MTR's high valuation and consensus expectations of higher USD interest rates, we see downside risk to the MTR share price from current levels.

## Financials & valuation

### Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Profit &amp; loss summary (HKDm)</b>				
Revenue	38,707	41,349	44,117	55,395
EBITDA	13,106	13,906	15,123	16,523
Depreciation & amortisation	-3,372	-3,517	-4,252	-4,905
Operating profit/EBIT	11,130	13,466	12,264	12,175
Net interest	-732	-734	-1,020	-1,195
PBT	15,027	16,569	11,653	11,452
HSBC PBT	10,556	13,046	11,653	11,452
Taxation	-1,819	-2,479	-2,214	-2,176
Net profit	13,025	13,879	9,250	9,091
HSBC net profit	8,554	10,356	9,250	9,091

### Cash flow summary (HKDm)

Cash flow from operations	11,968	12,512	11,054	13,532
Capex	-14,106	-29,450	-16,050	-12,150
Cash flow from investment	-11,658	-26,373	-14,656	-11,593
Dividends	-4,580	-5,211	-5,211	-5,211
Change in net debt	2,279	18,916	8,609	3,036
FCF equity	-2,656	-17,539	-5,594	786

### Balance sheet summary (HKDm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	185,937	211,120	222,168	228,663
Current assets	23,504	8,753	5,326	5,505
Cash & others	17,297	2,381	-1,228	-1,264
Total assets	215,823	226,282	234,106	241,017
Operating liabilities	28,186	29,396	28,098	28,050
Gross debt	24,646	28,646	33,646	36,646
Net debt	7,349	26,265	34,874	37,910
Shareholders' funds	152,557	157,702	161,741	165,620
Invested capital	163,958	188,097	200,623	207,382

### Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Y-o-y % change</b>				
Revenue	8.5	6.8	6.7	25.6
EBITDA	9.6	6.1	8.7	9.3
Operating profit	-7.2	21.0	-8.9	-0.7
PBT	-2.3	10.3	-29.7	-1.7
HSBC EPS	-9.9	21.1	-10.7	-1.7

### Ratios (%)

Revenue/IC (x)	0.2	0.2	0.2	0.3
ROIC	5.4	5.0	4.5	4.6
ROE	5.8	6.7	5.8	5.6
ROA	6.6	6.7	4.5	4.3
EBITDA margin	33.9	33.6	34.3	29.8
Operating profit margin	28.8	32.6	27.8	22.0
EBITDA/net interest (x)	17.9	19.0	14.8	13.8
Net debt/equity	4.8	16.6	21.5	22.8
Net debt/EBITDA (x)	0.6	1.9	2.3	2.3
CF from operations/net debt	162.9	47.6	31.7	35.7

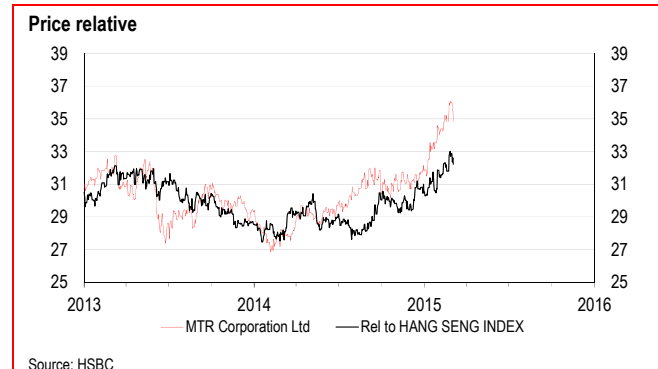
### Per share data (HKD)

EPS reported (diluted)	2.25	2.40	1.60	1.57
HSBC EPS (diluted)	1.48	1.79	1.60	1.57
DPS	0.92	0.92	0.92	0.92
Book value	26.39	27.28	27.98	28.65

### Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	4.6	4.7	5.2	4.2
EV/EBITDA	13.5	13.9	15.3	14.1
EV/IC	1.1	1.1	1.1	1.1
PE*	20.5	16.6	21.7	22.1
PB	1.1	1.1	1.2	1.2
FCF yield (%)	1.2	-8.0	-1.7	1.1
Dividend yield (%)	3.0	3.1	2.6	2.6

\*Based on HSBC EPS (diluted)



Note: Priced at close of 4 Mar 2015

## Valuation and risks

We value MTR using the sum-of-the-parts approach detailed in the table below. This yields a value of HKD38.1, to which we apply an unchanged 20% conglomerate discount, giving us our unchanged target price of HKD30.5.

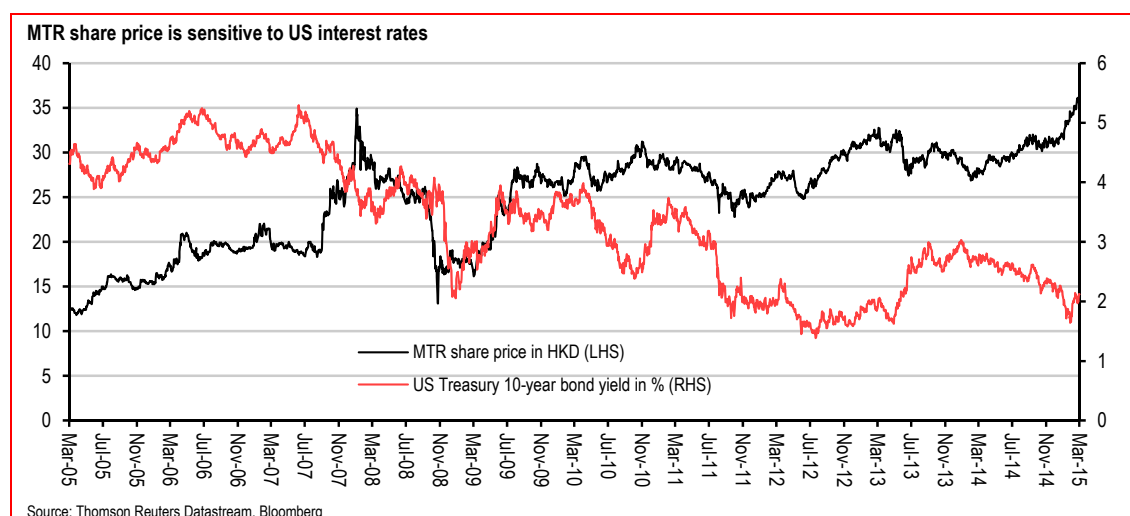
Under our research model, the Neutral band for non-volatile stocks equals the local market hurdle rate set by our Global Equity Strategy team, plus or minus 5ppt. The hurdle rate for Hong Kong stocks is 8.5%; this translates into a potential return of 3.5-13.5% required for MTR Corp shares to merit a Neutral rating. Our target price implies a potential return of -9.7% (including a forecast dividend yield of 2.6%), which is below the Neutral band of our model; therefore, we reiterate our Underweight rating on the shares. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

The key **upside risk** to our rating and estimates is a sharp fall in USD interest rates, which could compress cap rates and drive up asset values.

### HSBC appraised value of MTR

HKDm	EV	Net debt	Equity value	HKD/ share	% Equity	Pre-disc 2015e PE	Post-disc 2015e PE	Assumptions
HK rails	68,367	-22,592	45,775	7.9	21%	21.6x	17.2x	DCF @ 8.0% WACC, long-term passenger growth of 2%, long-term fare growth of 1% 5.0% net cap rate for shops, PE 10x for Octopus, EV/EBIT of 14.5x (MTR LT average) for other businesses
Station	90,004	-1,914	88,089	15.2	40%	29.6x	23.7x	
Non-HK rails	8,052	0	8,052	1.4	4%	7.9x	6.3x	
Inv Prop	70,461	-1,515	68,945	11.9	31%	26.6x	21.2x	
Dev Prop	21,086	-6,253	14,834	2.6	7%	38.7x	30.9x	DCF @ 11% WACC 5.0% net cap rate
HO costs	-5,654	0	-5,654	-1.0	-3%			HK sites by DCF @ 8% WACC, 35% EBIT margin and flat prices. China site at cost.
<b>Total</b>	<b>252,315</b>	<b>-32,274</b>	<b>220,041</b>	<b>38.1</b>	<b>100%</b>	<b>24.8x</b>	<b>19.9x</b>	

Note: Disc = Discount  
Source: HSBC estimates



# Disclosure appendix

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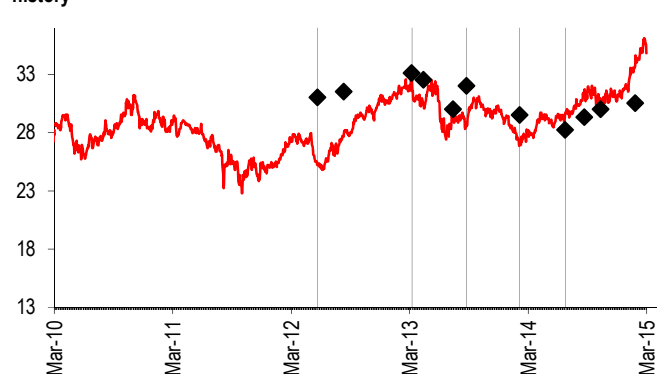
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## Share price and rating changes for long-term investment opportunities

MTR Corporation Ltd (0066.HK) share price performance HKD vs HSBC rating history



Source: HSBC

### Recommendation & target price history

From	To	Date
N/A	Overweight	24 May 2012
Overweight	Neutral	11 March 2013
Neutral	Overweight	26 August 2013
Overweight	Neutral	6 February 2014
Neutral	Underweight	26 June 2014
Target price	Value	Date
Price 1	31.00	24 May 2012
Price 2	31.50	13 August 2012
Price 3	33.10	11 March 2013
Price 4	32.50	16 April 2013
Price 5	30.00	16 July 2013
Price 6	32.00	26 August 2013
Price 7	29.50	6 February 2014
Price 8	28.20	26 June 2014
Price 9	29.30	25 August 2014
Price 10	30.00	14 October 2014
Price 11	30.50	29 January 2015

Source: HSBC

## HSBC & Analyst disclosures

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Company	Ticker	Recent price	Price date	Disclosure
MTR CORPORATION LTD	0066.HK	34.80	04-Mar-2015	2, 6

Source: HSBC

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