

MTR Corporation
66 HK

Target (HKD): 36.10 → 39.60

Upside: 13.5%

16 Mar price (HKD): 34.90

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell

Growing dividend and reduced uncertainties

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- DPS rose by 14.1% YoY for 2014, and has posted a CAGR of 13.9% since 2007
- Solid rail and related businesses and property sales profit should recover by 2018
- Reaffirm Buy with TP raised to HKD39.60

■ **What's new**

MTRC's underlying net profit from recurrent businesses rose by 7.9% YoY to HKD8,024m for 2014, with overall net profit rising by 34.5% YoY to HKD11,571m, on a 205% YoY rise in net profit from property sales. In our view, these results confirm that its recurrent businesses have continued to improve and that it has a strong commitment to continue to grow DPS, which bodes well for a potential further rerating.

■ **What's the impact**

Property sales profit entering a transition period. MTRC's results were better than expected as more of its property sales profit was realised in 2014 (profits from both the Austin and Grand Austin were booked in 2014). With Lohas Park Package III now its main remaining project in Hong Kong before 2018, we expect the group's property sales profit to fall in the next few years as profits from its property project in

Shenzhen will not be enough to offset such a decline. Accordingly, we cut our 2015E EPS by 14.3%.

Uncertainties surrounding future property sales profit are now being addressed, as MTRC has awarded 5 major sites since 2014 and we think this suggests an ongoing recovery in property sales profits from 2018 onwards. Meanwhile, its recurrent earnings are on track for sustained growth, due to steady growth in passenger patronage for existing lines, the completion of various new lines and an increased contribution from its rail projects in China and overseas.

Uncertainties about management changes have also been removed, as the group has now appointed Deputy CEO Lincoln Leong as its CEO, which should ensure continuity in its strategy and management, given that Mr Leong has been in a senior management role at MTRC since 2002.

Strong sign of the group's commitment to continue its progressive dividend policy. The company raised DPS by 14.1% YoY for 2014 against a 7.9% YoY rise in recurrent profit. We estimate MTRC's DPS has risen at a CAGR of 13.9% since 2007, which is probably among the highest for a major Hong Kong blue-chip.

■ **What we recommend**

MTRC shares have done well in recent months, but we still believe it has a strong franchise in both the rail and property businesses, and that its commitment to deliver sustained growth in DPS bodes well for some reduction in the discount in its SOTP valuation. We reaffirm our Buy (1) rating with a slightly higher 12-month TP (previously 6

months) of HKD39.60, based on a lower discount of 20% (versus 27.1% previously) applied to our end-2015E SOTP value of HKD49.45. The key risk to our call would be unfavourable regulatory changes.

■ **How we differ**

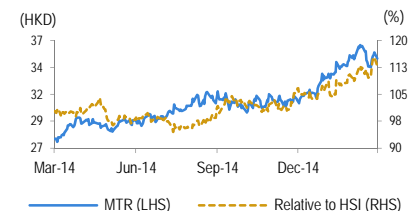
We believe MTRC is on track to enter a new chapter, with sustained growth in recurrent earnings and DPS, as well as a broadening earnings base. This, however, does not yet appear to have been fully recognised by the market.

Forecast revisions (%)

Year to 31 Dec	15E	16E	17E
Revenue change	(3.0)	(4.3)	n.a.
Net profit change	(14.3)	0.7	n.a.
Core EPS (FD) change	(14.3)	0.7	n.a.

Source: Daiwa forecasts

Share price performance



12-month range	27.55-36.10
Market cap (USDbn)	26.05
3m avg daily turnover (USDm)	13.32
Shares outstanding (m)	5,797
Major shareholder	HKSAR Government (76.4%)

Financial summary (HKD)

Year to 31 Dec	15E	16E	17E
Revenue (m)	41,957	43,922	46,105
Operating profit (m)	11,146	11,950	12,992
Net profit (m)	10,180	10,570	11,460
Core EPS (fully-diluted)	1.756	1.823	1.977
EPS change (%)	(12.0)	3.8	8.4
Daiwa vs Cons. EPS (%)	(1.2)	1.5	n.a.
PER (x)	19.9	19.1	17.7
Dividend yield (%)	3.2	3.4	3.7
DPS	1.120	1.200	1.280
PBR (x)	1.2	1.2	1.1
EV/EBITDA (x)	14.0	13.3	12.5
ROE (%)	6.2	6.2	6.6

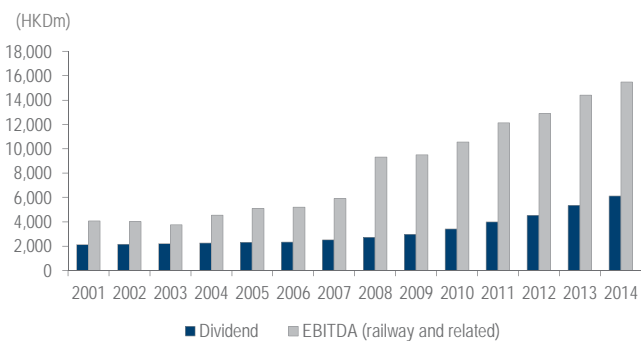
Source: FactSet, Daiwa forecasts

■ **MTRC: EBITDA from overseas and Mainland operations**

(HKDm)	2013	2014	YoY chg
Subsidiaries			
MTR Stockholm	92	127	38.0%
MTR Stockholm - one off gain	46	0	nm
Metro Trains Melbourne (MTM)	552	580	5.1%
MTR Shenzhen	78	146	87.2%
China property development, rental & management, MTR Express and Northwest Rail Link	23	(47)	nm
Sub-total	791	806	1.9%
Associates			
Beijing MTR	203	185	-8.9%
London Overground	33	38	15.2%
Tunnelbanan Teknik Stockholm (TBT)	17	5	-70.6%
Hangzhou MTR	(312)	(260)	-16.7%
Hangzhou MTR - one off item	0	(55)	nm
Sub-total	(59)	(87)	47.5%
Total	732	719	-1.8%
Ex-one off items from MTR Stockholm & Hangzhou MTR	686	774	12.8%

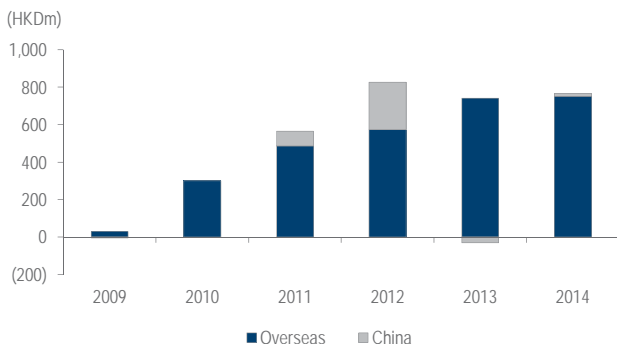
Source: Company, Daiwa

■ **MTRC: total dividend, railway and related EBITDA**



Source: Company, Daiwa

■ **MTRC: contribution from overseas and China projects**



Source: Company, Daiwa

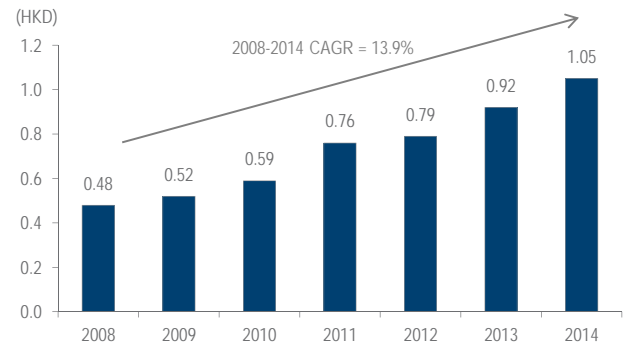
Note: subsidiaries' contribution is based on EBITDA while that for associate companies is based on pre-tax profit

■ **MTRC: 2014 results highlights**

(HKDm)	2013	2014	YoY chg
HK transport operations	15,166	16,223	7.0%
HK station commercial business	4,588	4,963	8.2%
HK property rental and management	3,778	4,190	10.9%
Mainland and overseas operations	13,246	12,627	-4.7%
Others	1,929	2,153	11.6%
Total revenue	38,707	40,156	3.7%
Total operating expenses	(24,308)	(24,733)	1.7%
EBITDA	14,399	15,423	7.1%
Property development	1,396	4,216	202.0%
Operating profit	15,795	19,639	24.3%
Depreciation	(3,372)	(3,485)	3.4%
Variable annual payment	(1,247)	(1,472)	18.0%
EBIT	11,176	14,682	31.4%
Interest and finance charges	(732)	(545)	-25.5%
Share of profits from associates	158	121	-23.4%
Profit before tax	10,602	14,258	34.5%
Tax and others	(1,819)	(2,496)	37.2%
Minority interest	(183)	(191)	4.4%
Underlying profit	8,600	11,571	34.5%
EPS (underlying, HKD)	1.48	1.99	34.5%
DPS (HKD)	0.92	1.05	14.1%

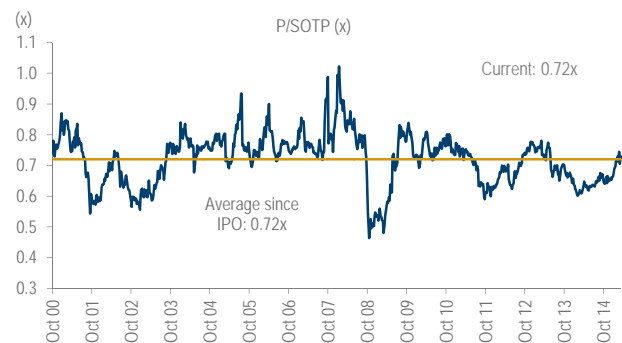
Source: Company, Daiwa

■ **MTRC: DPS history**



Source: Company, Daiwa

■ **MTRC: price/SOTP valuation**



Source: Datastream, Daiwa estimates

Financial summary

■ Key assumptions

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
No of passenger travelled (Mils)	1,261	1,367	1,553	1,600	1,676	1,736	1,793	1,861
Rental EBIT (HKDm)	2,710	2,819	3,027	3,547	3,945	4,117	4,362	4,655
Property sales profit (HKDm)	3,785	4,934	3,238	1,396	4,216	1,316	1,332	1,399

■ Profit and loss (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Railway	22,603	26,383	28,417	30,341	32,828	32,246	33,580	35,060
Station Commercial	3,715	3,873	4,028	4,588	4,963	5,261	5,603	5,984
Other Revenue	3,200	3,167	3,294	3,778	2,365	4,450	4,739	5,061
Total Revenue	29,518	33,423	35,739	38,707	40,156	41,957	43,922	46,105
Other income	0	0	0	0	0	0	0	0
COGS	(14,353)	(17,621)	(17,929)	(19,224)	(19,525)	(20,138)	(20,763)	(21,343)
SG&A	(3,834)	(3,896)	(4,279)	(4,618)	(4,849)	(5,091)	(5,346)	(5,680)
Other op. expenses	(3,534)	(3,635)	(4,539)	(5,085)	(5,316)	(5,582)	(5,864)	(6,090)
Operating profit	7,797	8,271	8,992	9,780	10,466	11,146	11,950	12,992
Net-interest inc./(exp.)	(1,237)	(921)	(879)	(732)	(545)	(576)	(611)	(675)
Assoc/forex/extraord./others	4,173	5,231	3,694	1,554	4,337	1,784	1,862	1,972
Pre-tax profit	10,733	12,581	11,807	10,602	14,258	12,354	13,201	14,289
Tax	(2,076)	(2,113)	(1,893)	(1,819)	(2,496)	(1,977)	(2,432)	(2,622)
Min. int./pref. div./others	0	0	(139)	(183)	(191)	(197)	(199)	(207)
Net profit (reported)	8,657	10,468	9,775	8,600	11,571	10,180	10,570	11,460
Net profit (adjusted)	8,657	10,468	9,775	8,600	11,571	10,180	10,570	11,460
EPS (reported)(HKD)	1.515	1.832	1.711	1.505	1.996	1.756	1.823	1.977
EPS (adjusted)(HKD)	1.515	1.832	1.711	1.505	1.996	1.756	1.823	1.977
EPS (adjusted fully-diluted)(HKD)	1.515	1.832	1.711	1.505	1.996	1.756	1.823	1.977
DPS (HKD)	0.590	0.760	0.790	0.920	1.050	1.120	1.200	1.280
EBIT	7,797	8,271	8,992	9,780	10,466	11,146	11,950	12,992
EBITDA	10,917	11,477	12,200	13,152	13,951	14,770	15,719	16,912

■ Cash flow (HKDm)

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Profit before tax	10,733	12,581	11,807	10,602	14,258	12,354	13,201	14,289
Depreciation and amortisation	3,120	3,250	3,208	3,372	3,485	3,624	3,769	3,920
Tax paid	(1,011)	(1,600)	(1,799)	(1,343)	(1,872)	(1,483)	(1,824)	(1,967)
Change in working capital	65	680	654	895	950	2,935	2,958	3,020
Other operational CF items	16,678	5,216	6,737	5,200	9,600	2,428	2,079	2,162
Cash flow from operations	29,585	20,127	20,607	18,726	26,421	19,858	20,183	21,425
Capex	(12,336)	(18,462)	(11,125)	(13,356)	(13,513)	(14,310)	(14,560)	(14,690)
Net (acquisitions)/disposals	166	353	367	341	390	400	400	400
Other investing CF items	(1,923)	243	253	258	265	280	280	280
Cash flow from investing	(14,093)	(17,866)	(10,505)	(12,757)	(12,858)	(13,630)	(13,880)	(14,010)
Change in debt	0	0	0	0	0	0	0	0
Net share issues/(repurchases)	18	19	20	0	0	0	0	0
Dividends paid	(1,872)	(2,148)	(4,519)	(4,772)	(5,097)	(5,505)	(5,945)	(6,421)
Other financing CF items	(980)	(3,104)	(3,450)	(3,496)	(2,866)	(2,910)	(2,930)	(2,935)
Cash flow from financing	(2,834)	(5,233)	(7,949)	(8,268)	(7,963)	(8,415)	(8,875)	(9,356)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	12,658	(2,972)	2,153	(2,299)	5,600	(2,187)	(2,573)	(1,941)
Free cash flow	17,249	1,665	9,482	5,370	12,908	5,548	5,623	6,735

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ **Balance sheet (HKDm)**

As at 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Cash & short-term investment	16,961	16,100	18,664	17,297	18,893	16,706	14,134	12,193
Inventory	1,936	3,757	3,016	1,105	1,076	850	3,250	1,650
Accounts receivable	3,057	3,964	4,474	3,621	3,797	4,035	4,356	4,485
Other current assets	5,632	6,613	6,723	1,935	2,438	2,480	2,510	2,532
Total current assets	27,586	30,434	32,877	23,958	26,204	24,071	24,250	20,860
Fixed assets	144,057	152,068	155,894	163,156	171,202	178,401	183,134	191,620
Goodwill & intangibles	384	344	256	115	105	130	135	140
Other non-current assets	9,638	15,027	17,888	28,594	30,187	30,340	30,750	31,120
Total assets	181,665	197,873	206,915	215,823	227,698	232,942	238,269	243,740
Short-term debt	316	0	355	47	546	0	0	0
Accounts payable	15,491	16,402	15,119	13,793	16,421	16,890	17,458	17,852
Other current liabilities	3,221	2,721	2,415	2,723	3,697	3,820	3,945	4,025
Total current liabilities	19,028	19,123	17,889	16,563	20,664	20,710	21,403	21,877
Long-term debt	20,741	23,168	23,222	24,464	19,961	20,507	20,507	20,507
Other non-current liabilities	24,603	26,537	21,324	22,094	23,591	23,856	24,120	24,320
Total liabilities	64,372	68,828	62,435	63,121	64,216	65,073	66,030	66,704
Share capital	43,734	44,062	44,281	44,442	45,280	45,280	45,280	45,280
Reserves/R.E./others	73,416	84,797	99,992	108,115	118,045	122,428	126,794	131,588
Shareholders' equity	117,150	128,859	144,273	152,557	163,325	167,708	172,074	176,868
Minority interests	143	186	207	145	157	161	165	168
Total equity & liabilities	181,665	197,873	206,915	215,823	227,698	232,942	238,269	243,740
EV	206,554	209,569	207,435	209,674	204,086	206,277	208,854	210,797
Net debt/(cash)	4,096	7,068	4,913	7,214	1,614	3,801	6,373	8,314
BVPS (HKD)	20.506	22.555	25.253	26.703	28.174	28.930	29.683	30.510

■ **Key ratios (%)**

Year to 31 Dec	2010	2011	2012	2013	2014	2015E	2016E	2017E
Sales (YoY)	57.0	13.2	6.9	8.3	3.7	4.5	4.7	5.0
EBITDA (YoY)	14.9	5.1	6.3	7.8	6.1	5.9	6.4	7.6
Operating profit (YoY)	19.5	6.1	8.7	8.8	7.0	6.5	7.2	8.7
Net profit (YoY)	18.5	20.9	(6.6)	(12.0)	34.5	(12.0)	3.8	8.4
Core EPS (fully-diluted) (YoY)	18.5	20.9	(6.6)	(12.0)	32.6	(12.0)	3.8	8.4
Gross-profit margin	51.4	47.3	49.8	50.3	51.4	52.0	52.7	53.7
EBITDA margin	37.0	34.3	34.1	34.0	34.7	35.2	35.8	36.7
Operating-profit margin	26.4	24.7	25.2	25.3	26.1	26.6	27.2	28.2
Net profit margin	29.3	31.3	27.4	22.2	28.8	24.3	24.1	24.9
ROAE	7.7	8.5	7.2	5.8	7.3	6.2	6.2	6.6
ROAA	4.8	5.5	4.8	4.1	5.2	4.4	4.5	4.8
ROCE	5.8	5.7	5.6	5.7	5.8	6.0	6.3	6.7
ROIC	5.1	5.3	5.3	5.2	5.3	5.6	5.6	5.8
Net debt to equity	3.5	5.5	3.4	4.7	1.0	2.3	3.7	4.7
Effective tax rate	19.3	16.8	16.0	17.2	17.5	16.0	18.4	18.3
Accounts receivable (days)	33.9	38.3	43.1	38.2	33.7	34.1	34.9	35.0
Current ratio (x)	1.4	1.6	1.8	1.4	1.3	1.2	1.1	1.0
Net interest cover (x)	6.3	9.0	10.2	13.4	19.2	19.4	19.6	19.2
Net dividend payout	38.9	41.5	46.2	61.1	52.6	63.8	65.8	64.7
Free cash flow yield	8.5	0.8	4.7	2.7	6.4	2.7	2.8	3.3

Source: FactSet, Daiwa forecasts

■ **Company profile**

MTRC is the only rail company in Hong Kong. In December 2007, it merged with the KCRC and now operates a rail network that encompasses the whole of Hong Kong. The company's traditional business model is characterised as "rail and property", which allows it to award property development rights to developers to raise funds to finance the construction of new subway lines.

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