

China / Hong Kong Company Update

MTR Corporation

Bloomberg: 66 HK EQUITY | Reuters: 0066.HK

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DBS Group Research . Equity

11 Aug 2023

BUY

Last Traded Price (10 Aug 2023): HK\$35.25 (HSI : 19,248)
Price Target 12-mth: HK\$45.00 (28% upside) (Prev HK\$49.65)

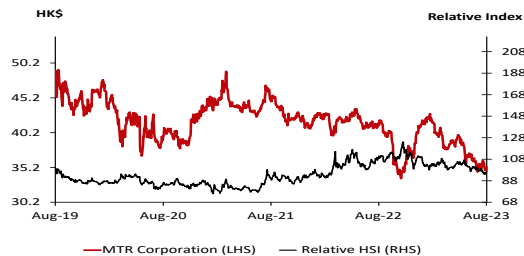
Analyst

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What's New

- 1H23 underlying profit fell 56% to HK\$3.15bn, 12% above our estimate amid stronger-than-expected recurrent earnings from Hong Kong
- Sound rebound in transportation and station commercial income
- Property development profit dived
- Reiterate BUY with HK\$45.00 TP

Price Relative



Forecasts and Valuation

FY Dec (HK\$ m)	2021A	2022A	2023F	2024F
Turnover	47,202	47,812	57,489	63,049
EBITDA	8,148	7,911	14,986	18,838
Pre-tax Profit	13,556	12,559	7,722	15,660
Underlying Profit	11,151	10,637	6,351	12,940
Underlying Profit Gth (%)	154.6	(4.6)	(40.3)	103.8
EPS (HK\$)	1.80	1.72	1.02	2.08
EPS Gth (%)	153.8	(4.7)	(40.4)	103.5
PE (X)	19.5	20.5	34.4	16.9
P/Cash Flow (X)	26.3	28.1	15.3	12.1
EV/EBITDA (X)	30.6	31.4	16.6	13.2
DPS (HK\$)	1.27	1.31	1.31	1.31
Div Yield (%)	3.6	3.7	3.7	3.7
Net Gearing (%)	18	23	23	22
ROE (%)	6.3	5.9	3.5	7.1
Est. NAV (HK\$):			49.2	52.3
Disc. to NAV (%)			(28)	(33)

Earnings Rev (%): (20) (38)
Consensus EPS (HK\$): 1.57 3.14
Other Broker Recs: B:8 S:1 H:2

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Recovery on track

Investment Thesis

A leveraged play on Hong Kong's economic growth. MTRC operates predominantly rail-based transportation systems with strong exposure to the residential and commercial sectors in Hong Kong. Moreover, railway expansion should bring in more property opportunities for MTRC. All of these make it a leveraged play on Hong Kong's economic growth.

Entering post-pandemic revenue recovery. Hong Kong has re-opened its borders with Mainland China since early 2023, prompting a post-COVID recovery of MTRC's key businesses including transportation, station commercial, and mall operations. This should, in turn, revive recurrent business profit.

Local economic recovery to drive share price higher. Continued post-pandemic recovery of local economy should be positive for its core business operations, providing upside on the stock. However, with growing residential exposure, the company's future earnings prospects and share price would become more sensitive to movements in residential prices.

BUY with HK\$45.00 TP. The stock is trading at a 28% discount to our appraised current NAV. Our TP is based on a target discount of 20% and 30% to our Jun- 24 estimated valuation of its development and investment properties, respectively.

Key Risks to Our View:

Any derailment of post-COVID economic recovery could drag the company's earnings.

At A Glance

Issued Capital (m shrs)	6,202
Mkt Cap (HKm/US\$m)	217,070 / 27,760
Major Shareholders (%)	
Financial Secretary Inc.	74.6
Free Float (%)	25.4
3m Avg. Daily Val. (US\$m)	11.0
GICS Industry: Real Estate / Equity Real Estate Investment	

MTR Corporation**WHAT'S NEW****Dragged by lower development profit**

Driven by substantially lower property development profit, MTRC's 1H23 underlying profit tumbled 56% y-o-y to HK\$3.15bn. Recurrent businesses returned to profitability with earnings of HK\$2.42bn (1H22: loss of HK\$678m). Despite lower underlying profit, interim DPS was flat at HK\$0.42.

Revenue from the Hong Kong transportation operation increased sharply by 61% to HK\$9.34bn, led by higher domestic patronage amid relaxation of social distancing measures, along with the resumption of Cross-boundary service and High-Speed Rail following the border reopening. Domestic service operations recorded a 40% y-o-y income increase in 1H23, as patronage rebounded 36% to >90% of pre-pandemic level. Patronage for cross-boundary service, which resumed operations in Jan-23, has returned to c.50% of the pre-covid level. High-speed rail was a bright spot with patronage exceeding the pre-covid level by 8% in 2Q23 following the resumption of full services in Apr-23, coupled with more destinations.

Station commercial income surged by 63% to HK\$2.42bn, mainly due to the resumption of Duty-Free business following the re-opening of cross-boundary stations in early-23. For station kiosks, rental decline upon renewals or new lettings narrowed to 8.4% from FY22's 14.6%. On the other hand, advertising revenue has rebounded 18.2% on increased advertising spend following the relaxation of pandemic-related measures.

Revenue from property rental and management improved slightly by 6% y-o-y to HK\$2.46bn on lower rental concessions granted and amortised, partially offset by negative rental reversions which stood at 12.6% in 1H23. In Jun-23, occupancy of retail malls remained high at 99% with Two IFC being 99% let (Dec-22: 94%).

Opened for business in Jul-23, The Wai in Tai Wai hosts >150 retail tenants with 0.65msf GFA. The SOUTHSIDE in Wong Chuk Hang, is targeted to open for business in 4Q23, with >50% of retail space being pre-leased. These two malls, which altogether expand the company's retail portfolio by c.30% in terms of attributable GFA, are set to beef up rental income.

With EBITDA margin expanding to 46.4% from 1H22's 27.8%, EBITDA from Hong Kong railways and related operations more than doubled to HK\$6.72bn (1H22: HK\$2.71bn).

Pre-tax development profit shrank 92% to HK\$783m which stemmed primarily from the initial profit booking of Villa Garda (LP11) in Tseung Kwan O and residual profit from various projects. In 2H23, MTRC will continue to book profit from Villa Garda.

MTRC intends to tender c.4,000 units within the next 12 months, with Tung Chung East Station Package 1 being the first tender.

EBIT from Mainland China business dipped 4% on lower contribution from SZL4, whereas that from international business plunged 59% mainly led by operational challenges in Stockholms pendetag and Malartag. If operational issues remain unresolved, the financial sustainability of Malartag may be impacted and provisions may be required.

Gearing stood at 22% in Jun-23. (Dec-22: 23%) Interest cost for 68% of debt was on a fixed rate basis as of Jun-23. Overall, the company remains financially sound.

We have adjusted the earnings for FY23 and FY24 to reflect the change in our assumption of property development profit booking.

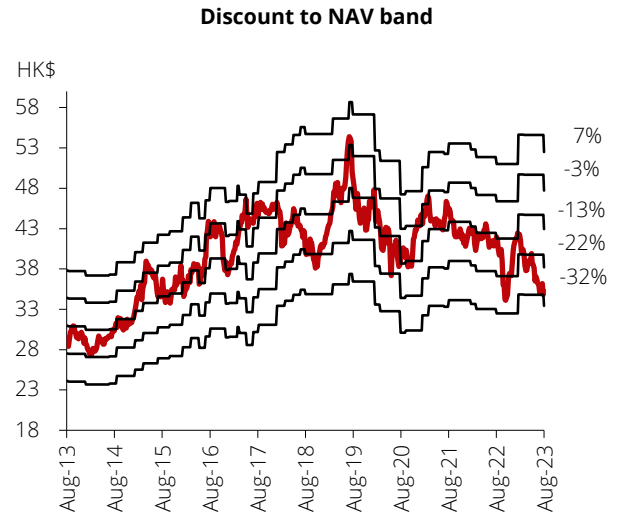
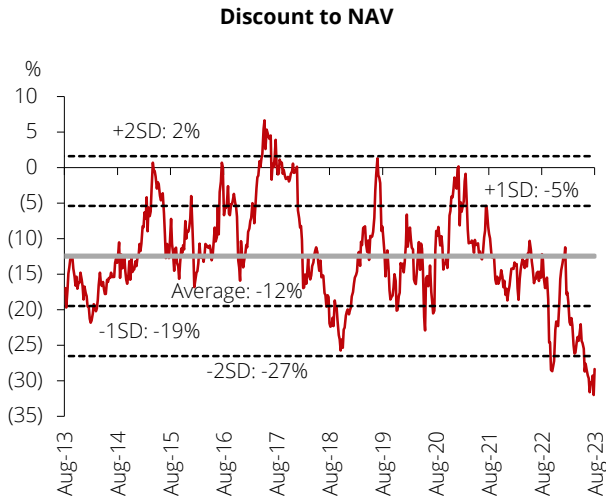
The stock is trading at 28% discount to our appraised current NAV. Valuation is inexpensive from a historical viewpoint. With core business operations recovering, the share price should trade higher, and hence our BUY rating. Our TP of HK\$45.00 is based on a target discount of 20% and 30% to our Jun-24 estimated valuation of its development and investment properties, respectively. Potential impairment provision for Malartag, however, remains an overhang.

Company Background

MTRC operates predominantly rail-based transportation systems, with exposure to the residential and commercial markets in Hong Kong. In recent years, the company has begun to expand its rail business to China and overseas.

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Discount to NAV



Source: Bloomberg Finance L.P., DBS HK

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Result Summary

FY Dec (HK\$m)	1H22	1H23	Chg (%)	Comments
Hong Kong transport operations	5,815	9,342	61	1H23: Higher domestic patronage and resumption of cross-boundary and high-speed rail service operations
Hong Kong station commercial business	1,481	2,415	63	1H23: Due to resumption of Duty Free businesses following re-opening of cross-boundary stations
Property rental and management businesses	2,307	2,456	6	1H23: Due to lower rental concessions granted and amortised, partly offset by negative rental reversions
Mainland of China & International subsidiaries	13,150	13,079	(1)	
Mainland of China property development	138	0	n.a.	
Other businesses	142	282	99	
Turnover	23,033	27,574	20	
Expenses relating to Hong Kong transport operations				
- Staff costs and related expenses	(3,155)	(3,363)	7	
- Energy and utilities	(877)	(1,175)	34	
- Operational rent and rates	(77)	(77)	0	
- Stores and spares consumed	(253)	(263)	4	
- Maintenance and related works	(1,019)	(1,154)	13	
- Railway support services	(89)	(154)	73	
- General and administration expenses	(343)	(349)	2	
- Other expenses	(118)	(127)	8	
	(5,931)	(6,662)	12	
Expenses relating to Hong Kong station commercial business	(244)	(255)	5	
Expenses relating to property rental and management business	(434)	(458)	6	
Expenses relating to railway subsidiaries outside of Hong Kong	(12,227)	(12,547)	3	
Expenses relating to other businesses	(253)	(240)	(5)	
Project study and business development expenses	(173)	(156)	(10)	
Expenses relating to Mainland China property development subsidiary	(89)	(9)	(90)	
Operating profit before Hong Kong property development, fair value measurement of investment properties, depreciation, amortisation and variable annual payment	3,682	7,247	97	
Profits on property development	9,277	783	(92)	1H23: Mainly from LOHAS Park Package 11 (1H22: Mainly from LOHAS Park Package 10, THE SOUTHSIDE Package 1 and Package 2)
Change in fair value of investment properties	(2,389)	1,005	n.a.	
Operating profit before depreciation and amortisation and variable annual payment	10,570	9,035	(15)	
Depreciation and amortisation	(2,773)	(3,046)	10	
Variable annual payment	(198)	(1,052)	431	
Impairment loss	(962)	0	n.a.	
Operating profit before interest and finance charges	6,637	4,937	(26)	
Interest and finance charges	(458)	(589)	29	
Share of profits or loss of associates	490	632	29	1H23: partly due to higher profit sharing in Octopus Holdings Limited amid boundary reopening
Profit before taxation	6,669	4,980	(25)	
Income tax	(1,741)	(627)	(64)	
Minority interests	(196)	(175)	(11)	
Net profits	4,732	4,178	(12)	
Underlying profits	7,108	3,152	(56)	
Interim DPS (HK\$)	0.42	0.42	0	

Source: MTRC

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Key Assumptions (%)

FY Dec	2023F	2024F
Residential price - HK	5	0
Office rental - HK	(5)	0
Retail rental (Shopping centre) - HK	5	5

Source: DBS HK

Segmental Breakdown (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Revenues (HK\$ m)					
HK transportation operations	11,895	13,177	13,404	19,509	21,998
HK station commercial business	3,269	3,208	3,077	5,082	6,410
HK Property rental and management business	5,054	5,036	4,779	5,102	5,544
Mainland China and International subsidiaries	21,428	25,398	26,189	27,270	28,437
Other business	894	383	363	527	660
Total	42,540	47,202	47,812	57,489	63,049

Source: DBS HK

Income Statement (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Turnover	42,540	47,202	47,812	57,489	63,049
EBITDA	5,180	8,148	7,911	14,986	18,838
Depr / Amort	(5,365)	(5,430)	(5,769)	(6,123)	(6,294)
EBIT	(185)	2,718	2,142	8,864	12,544
Profit on property developments	6,491	11,097	11,589	1,201	5,865
Variable cost paid to KCRC	(238)	(260)	(323)	(2,202)	(2,594)
Associates Inc	605	968	1,095	1,129	1,245
Interest (Exp)/Inc	(1,004)	(967)	(982)	(1,270)	(1,400)
Exceptionals	0	0	(962)	0	0
Pre-tax Profit	5,669	13,556	12,559	7,722	15,660
Tax	(1,300)	(2,231)	(1,625)	(1,088)	(2,378)
Minority Interest	11	(174)	(297)	(283)	(342)
Underlying Profit	4,380	11,151	10,637	6,351	12,940
Sales Gth (%)	(22)	11	1	20	10
Net Profit Gth (%)	(59)	155	(5)	(40)	104
EBITDA Margins (%)	12	17	17	26	30
EBIT Margin (%)	0	6	4	15	20
Tax Rate (%)	23	16	13	14	15

Source: DBS HK

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Balance Sheet (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
Fixed Assets	220,932	221,032	229,491	229,553	230,166
Long-term Investments	468	1,479	959	959	959
Other LT Assets	13,074	13,190	43,815	40,261	45,621
Intangibles Assets	63	58	55	55	55
Deferred Tax Asset	470	599	606	606	606
Associates/JVs	11,592	12,442	12,338	13,467	14,712
Bank Balance/Cash & Liquid	20,906	20,970	16,134	18,635	18,665
Inventory	3,814	2,768	4,149	4,149	4,149
Debtors	13,313	14,797	13,889	14,889	15,889
Other Non Cash Current	5,942	4,747	5,645	5,645	5,645
Total Assets	290,574	292,082	327,081	328,219	336,468
ST Debt	3,357	1,650	1,592	2,500	3,300
Creditors	36,837	40,077	69,692	69,992	70,292
Other Current Liab	1,996	3,567	4,789	4,789	4,789
LT Debt	46,983	42,102	46,254	46,346	46,546
Deferred Tax Liabilities	14,125	14,418	14,700	14,700	14,700
Other LT Liabilities	10,295	10,231	10,142	10,087	10,028
Minority Interests	193	323	626	909	1,252
Shareholder's Equity	176,788	179,714	179,286	178,896	185,562
Total Cap. & Liab.	290,574	292,082	327,081	328,219	336,468
Share Capital (m)	6,163	6,181	6,191	6,214	6,214
Net Cash/(Debt)	(39,887)	(33,159)	(41,994)	(40,438)	(41,349)
Working Capital	1,785	(2,012)	(36,256)	(33,963)	(34,033)
Net Gearing (%)	23	18	23	23	22

Source: DBS HK

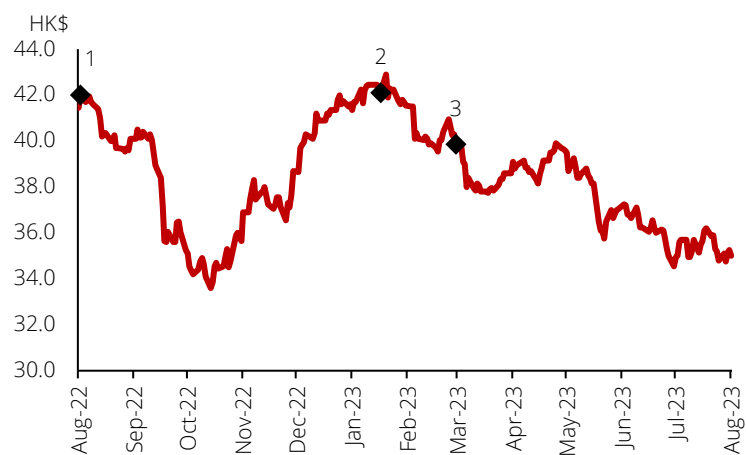
Cash Flow Statement (HK\$ m)

FY Dec	2020A	2021A	2022A	2023F	2024F
EBIT	(185)	2,718	2,142	8,864	12,544
Tax Paid	(2,306)	(804)	(1,016)	(1,088)	(2,378)
Depr/Amort	5,365	5,430	5,769	6,123	6,294
Chg in Wkg.Cap	(4,165)	88	(549)	(700)	(700)
Other Non-Cash	2,063	40	411	0	0
Operating CF	772	7,472	6,757	13,199	15,760
Net Capex	(9,661)	(8,922)	(20,053)	(6,604)	(8,044)
Investments	0	0	0	0	0
Associates & JVs	(210)	(23)	(431)	0	0
Others	9,196	14,919	18,497	4,048	656
Investing CF	(675)	5,974	(1,987)	(2,556)	(7,388)
Net Chg in Debt	10,377	(6,377)	4,917	1,000	1,000
New Capital	77	67	0	0	0
Dividend	(6,808)	(7,165)	(8,562)	(8,116)	(8,132)
Other Financing CF	(802)	(1,056)	(926)	(1,025)	(1,209)
Financing CF	2,844	(14,531)	(4,571)	(8,141)	(8,342)
Chg in Cash	2,941	(1,085)	199	2,501	30

Source: DBS HK

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Target Price & Ratings 12-mth History



S.No.	Date	Closing Price	Target Price	Rating
1	12-Aug-22	HK\$41.45	HK\$46.45	BUY
2	27-Jan-23	HK\$42.35	HK\$49.65	BUY
3	10-Mar-23	HK\$39.85	HK\$49.65	BUY

Source: DBS HK

Analyst: Jeff Yau

Percy Leung

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DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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