

**MTR CORPORATION LIMITED** (地鐵公司)

Sector	: Transportation
HKSE Code	: 0066
Market Price	: HK\$24.35 (05/08/2008)
HSI	: 21,949.75 (05/08/2008)
Shares Issued	: 5,644.905 million
Market Cap	: HK\$137,453.4 million
52-week Hi / Lo	: HK\$36.0 / HK\$18.0

Chairman : Raymond CH'EN Kuo-fung

Chief Executive Officer : CHOW Chung-kong

**SUMMARY OF THE INTERIM RESULTS FOR THE SIX MONTHS ENDED 30<sup>TH</sup> JUNE 2008**
**Interim Results Highlights**

	1H 2008 HK\$ million	1H 2007 HK\$ million	Change
• Turnover	8,527	4,852	+75.7%
• Operating expenses before depreciation	(3,731)	(2,055)	+81.6%
• EBITDA	4,796	2,797	+71.5%
• <b>Profit on property developments</b>	<b>348</b>	<b>1,664</b>	<b>-79.1%</b>
• Operating profit before depreciation	5,144	4,461	+15.3%
• Depreciation	(1,517)	(1,348)	+12.5%
• Interest and finance charges	(1,078)	(654)	+64.8%
• <b>Change in fair value of investment properties</b>	<b>2,080</b>	<b>2,450</b>	<b>-15.1%</b>
• <b>Profit attributable to shareholders</b>	<b>4,689</b>	<b>4,071</b>	<b>+15.2%</b>
• <b>Underlying profit</b>	<b>2,731</b>	<b>2,050</b>	<b>+33.2%</b>
• EPS (HK\$)	0.83	0.73	+13.7%
• Interim DPS (HK\$)	0.14	0.14	Unchanged
<b>Traffic</b>			
• Total passenger boardings – MTR Lines	585.2m	429.3m	+36.3%
• Total passenger boardings – Airport Express Line	5.23m	4.84m	+8.1%
• Avg. no. of passengers – MTR Lines (weekday)	3.44m	2.54m	+35.4%
• Avg. no. of passengers – Airport Express Line (daily)	28,700	26,700	+7.5%
• Avg. fare per passenger – MTR Lines	HK\$6.58	HK\$6.84	-3.8%
• Avg. fare per passenger – Airport Express Line	HK\$64.72	HK\$64.40	+0.5%

- MTR Corporation (“MTRC”) announced a forecast-beating 33.2% growth in underlying interim profit for 1H2008 mainly driven by the merger with the former Kowloon-Canton Railway Corp (“KCRC”) and better economy. The underlying earnings reached HK\$2.731 billion, compared with HK\$2.050 billion in 1H07. Since the HK\$45 billion merger with KCRC in Dec 2007, the net profit attributable to equity shareholders jumped to HK\$4.689 billion. The change in fair value of investment properties was HK\$2.080 billion in 1H08, down 15.1% y-o-y.
- As of 30<sup>th</sup> June 2008, total debt of MTRC reduced from HK\$34,050 million to HK\$29,978 million on repayment of loans and as a result, net debt to equity ratio dropped from 48.5% at FY2007 to 42.1% at 1H08. EPS rebounded 13.7% to HK\$0.83. Payout ratio fell to 16.9% from 19.2% in 1H06.

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- Fare revenue soared 72.2% to HK\$5.59 billion in 1H08. Earnings from property development slid 79.1% to HK\$348 million. EBITDA rose 71.5% y-o-y to HK\$4.796 million but margins fell to 56% from 57.6% in 1H 2007 because of the impact of fare cuts and the lower operating margins of the KCRC business. As a part of the merger, fares were cut 4.7% in 1H2008 and MTRC promised no fare rises until the end of June 2009.
- Operating expenses before depreciation, amortisation and merger expenses was up 81.6% y-o-y to HK\$3.731 billion in 1H08, due to the Rail Merger as well as increases in salaries, electricity tariff, fuel and other consumable materials. The interim dividend for 1H 2008 was maintained at HK\$0.14. The Board will consider progressive increase of dividend when recommending final dividend together with full year results. In terms of market share, MTRC commands 41.6% of overall franchised public transport market.

- **Revenue breakdown:**

	1H2008		1H2007		Change
	HK\$ million	%	HK\$ million	%	
Railway operations	5,592	65.6	3,247	66.9	72.2%
Station commercial & rail related businesses	1,645	19.3	735	15.1	123.8%
Property ownership, management & other businesses	1,290	15.1	870	17.9	48.3%
<b>Total</b>	<b>8,527</b>	<b>100.0</b>	<b>4,852</b>	<b>100.0</b>	

- Advertising revenue registered a 39.5% y-o-y growth to HK\$346 million (20.1% increase over the equivalent Pre-Merger Compared Revenue) sustained by higher passenger volumes and more innovative advertising formats, which included the renovated advertising “gallery” launched at the lower adit of Causeway Bay Station in May. Revenue from station retail grew 272.1% y-o-y to HK\$774 million (65.0% increase over the equivalent Pre-Merger Comparable Revenue). Revenue from telecommunications services increased 17.3% y-o-y to HK\$129 million; and revenue from consultancy services declined 22.0% y-o-y to HK\$64 million.
  - Revenue from property ownership, management and other businesses increased 48.3% y-o-y to HK\$1,290 million (26.7% increase over the equivalent Pre-Merger Comparable Revenue), supported by robust demand for both office and retail space as well as rental income. The average increase in rental of retail properties on renewal of leases or re-letting was 21% as compared to rentals achieved in the previous lettings. Pre-lease of Phase 2 of Elements reached over 70% with the opening date targeted to be in the fourth quarter of 2008. Ginza Mall, which opened in January 2007, set a new benchmark for service and quality standards of shopping malls in Beijing. At the end of June 2008, the MTRC’s attributable share of investment properties were 200,668 square metres of lettable floor area of retail properties, 41,215 square metres of lettable floor area of offices and 10,203 square metres for other usage.
- Property development profit declined 79.1% y-o-y to HK\$348 million versus HK\$1.664 billion in 1H07. The major contributors to the property development profit in the first half were sale of units at Harbour Green and The Arch, as well as deferred income recognition mainly from properties along the Airport Railway, such as Coastal Skyline and Caribbean Coast at Tung Chung Station and Elements in Kowloon Station. Pre-sales of The Capitol was successfully completed with all units sold, while pre-sales of The Palazzo in May 08 with over 80% sold. Profit of the presale will be recognized upon the issuance of Occupation Permits which is expected in 2H08. In MTRC’s property tender activities, following Expression of Interest received earlier, it will shortly tender Tsuen Wan 7, which is a West Rail Development site belonging to Government; MTRC acts only as an agent for the West Rail Development projects.



## Outlook & Prospect

- **A concern of dwindling property exposure on six new rail projects in Hong Kong** News reported that only two projects - the South Island Line and Kwun Tong line extension, come with property development rights for MTRC. The market has started discounting that future profits of MTRC would rely more on rail-related operations such as station advertising, retail space leases and property management and investment instead.
- **Downside risks of property development** The Palazzo is now 80% presold on average at HK\$9,000 per sq ft and the Capitol at HK\$5,300 per sq ft has been fully presold. Market expects that these will be booked in 2008. It is also expected that MTRC to have more launches starting in the second half, such as the residential property project at the Wu Kai Sha Station, selling at HK\$6,000 per sq ft and that this is mostly booked in 2009 along with Phase 1 of LOHAS, Package 2, which is estimated to be sold at HK\$7,000 per sq ft. However, in the last two months, the property transaction volumes have decreased dramatically, which may lead to lower selling prices or even delays of these new launches.
- **Increasing Capex** Management reiterated that capex will rise to HK\$18.2 billion over the next three years. The good thing is that its interest coverage ratio fell to 4.2x from 5.7x in June 2007.
- **Market expects rail margins to weaken in 2H 2008** Management guidance has indicated that EBITDA margins will fall in 2H 2008 after the recently announced increase in staff wages and that more rail repairs will be undertaken in the second half. Moreover, MTRC will also have more contract renegotiations in the second half for items such as cleaning services. Nevertheless, an encouraging factor is that about two-thirds or HK\$300 million of the estimated HK\$450 million in expected annual savings from the merger will be achieved this year.
- **Revenue from telecommunications services** The 3G upgrade project at East Tsim Sha Tsui Station, Ma On Shan Line and West Rail Line are in progress with expected completion by 2009.
- **Valuation** MTRC looks defensive with half of its NAV attributed to the utility-like rail business, yet current share price seems demanding, trading at 8% premium to NAV of HK\$22.5 per share Vs its historical average discount of 3%. Accordingly, we recommend buying the counter on weakness for defensive play.

***Recommendation: Buy on weakness***

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