

## Company

22 August 2010 | 8 pages

# China Vanadium Titano-Magnetite Mining (0893.HK)

 Equity 

## 1H10 Result In Line With Expectations, As Guided

- 1H10 NI at RMB 234m vs. CIRA RMB 232m, 40% of CIRA FY10 earnings** – 1H10 NI was up 75% YoY and 13% HoH. We see the result as in line with expectations given the guidance from management through 1H10 and the volume growth due in 2H10. GP margins are up to 52% in 1H10 from 49% in 2H09.
- Iron ore pellet and concentrate volumes in line** – The company delivered 44% of our FY10E production in the 1H. Pellet sales are running marginally ahead of our expectations. The high-grade titanium dioxide line is running behind our forecast; however, the company has guided to a much higher output for 2011 at 420ktpa.
- Sichuan Steel Mills to add 10Mt capacity by 2012 vs. 18.4Mt output in '09** – Management guided to 3.8Mtpa post July-10, 1.1Mt from Desheng, 1.2Mt from Dazhou and 1.5Mt from Chongqing I&S. Panzhihua I&S is to add in 4Mtpa by end-'11 and the parent company mill, Chuan Wei, is to add 2.2Mt in 2012. These mills will use vanadium bearing iron ore.
- Resource and M&A update** – It has announced the extension to the Jinzhi asset, which currently ends in May-'11. Current resources at 366Mt could increase to 476Mt given the M&A potential.
- Value gap; our DCF valuation is HK\$3.5 at static floor prices RMB589/t** – We draw only positive conclusions from the call. We see core value for the shares in line with our DCF valuation at current prices, which incorporates no incremental value for M&A. We see the shares pricing in a 19% discount to this level.

<b>Buy/Low Risk</b>	<b>1L</b>
Price (20 Aug 10)	HK\$2.95
Target price	HK\$5.10
Expected share price return	72.9%
Expected dividend yield	1.7%
<b>Expected total return</b>	<b>74.6%</b>
Market Cap	HK\$6,121M US\$787M

### Price Performance (RIC: 0893.HK, BB: 893 HK)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RmbM)	(Rmb)	(%)	(x)	(x)	(%)	(%)
2007A	54	0.036	133.0	72.0	19.0	42.5	0.0
2008A	249	0.166	363.2	15.5	7.2	67.0	0.0
2009E	341	0.164	-0.9	15.7	2.1	22.4	0.0
2010E	578	0.279	69.5	9.2	1.8	21.1	1.9
2011E	835	0.402	44.4	6.4	1.5	25.1	2.8

Source: Powered by dataCentral

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Fiscal year end 31-Dec	2007	2008	2009E	2010E	2011E
<b>Valuation Ratios</b>					
P/E adjusted (x)	72.0	15.5	15.7	9.2	6.4
EV/EBITDA adjusted (x)	61.8	14.9	9.0	4.4	2.9
P/BV (x)	19.0	7.2	2.1	1.8	1.5
Dividend yield (%)	0.0	0.0	0.0	1.9	2.8
<b>Per Share Data (Rmb)</b>					
EPS adjusted	0.036	0.166	0.164	0.279	0.402
EPS reported	0.036	0.166	0.164	0.279	0.402
BVPS	0.135	0.360	1.207	1.435	1.766
DPS	0.000	0.000	0.000	0.050	0.072
<b>Profit &amp; Loss (RmbM)</b>					
Net sales	367	791	1,075	1,546	2,074
Operating expenses	-291	-457	-633	-780	-961
<b>EBIT</b>	<b>76</b>	<b>335</b>	<b>442</b>	<b>767</b>	<b>1,112</b>
Net interest expense	-2	-3	-2	5	4
Non-operating/exceptionals	1	17	16	-12	-17
<b>Pre-tax profit</b>	<b>76</b>	<b>349</b>	<b>456</b>	<b>760</b>	<b>1,100</b>
Tax	-1	-30	-68	-114	-165
Extraord./Min.Int./Pref.div.	-21	-70	-47	-68	-100
<b>Reported net income</b>	<b>54</b>	<b>249</b>	<b>341</b>	<b>578</b>	<b>835</b>
Adjusted earnings	54	249	341	578	835
Adjusted EBITDA	88	361	496	858	1,239
<b>Growth Rates (%)</b>					
Sales	73.7	115.8	35.9	43.8	34.1
EBIT adjusted	49.0	339.6	32.0	73.5	45.1
EBITDA adjusted	41.7	311.8	37.3	72.9	44.5
EPS adjusted	133.0	363.2	-0.9	69.5	44.4
<b>Cash Flow (RmbM)</b>					
<b>Operating cash flow</b>	<b>-97</b>	<b>423</b>	<b>368</b>	<b>707</b>	<b>1,028</b>
Depreciation/amortization	12	27	54	91	127
Net working capital	-180	72	-74	-30	-33
<b>Investing cash flow</b>	<b>-36</b>	<b>-267</b>	<b>-413</b>	<b>-788</b>	<b>-164</b>
Capital expenditure	-32	-173	-386	-788	-164
Acquisitions/disposals	-14	-87	0	0	0
<b>Financing cash flow</b>	<b>137</b>	<b>-30</b>	<b>1,775</b>	<b>-116</b>	<b>-167</b>
Borrowings	-1	-30	100	0	0
Dividends paid	0	0	0	-116	-167
<b>Change in cash</b>	<b>4</b>	<b>125</b>	<b>1,730</b>	<b>-196</b>	<b>698</b>
<b>Balance Sheet (RmbM)</b>					
<b>Total assets</b>	<b>593</b>	<b>951</b>	<b>3,174</b>	<b>3,840</b>	<b>4,759</b>
Cash & cash equivalent	8	133	1,864	1,668	2,365
Accounts receivable	0	88	194	278	373
Net fixed assets	123	357	699	1,408	1,462
<b>Total liabilities</b>	<b>307</b>	<b>347</b>	<b>566</b>	<b>701</b>	<b>852</b>
Accounts payable	79	108	147	211	283
Total Debt	30	0	100	100	100
<b>Shareholders' funds</b>	<b>286</b>	<b>604</b>	<b>2,608</b>	<b>3,139</b>	<b>3,907</b>
<b>Profitability/Solvency Ratios (%)</b>					
EBITDA margin adjusted	23.9	45.7	46.1	55.5	59.7
ROE adjusted	42.5	67.0	22.4	21.1	25.1
ROIC adjusted	36.1	72.4	52.6	51.6	56.3
Net debt to equity	7.8	-22.0	-67.6	-49.9	-58.0
Total debt to capital	9.5	0.0	3.7	3.1	2.5

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Figure 1. Income Statement Actual vs. Expectations

	1H09	2H09	1H10	YoY	HoH	1H10 as 10E	2009	2010E
Revenue	486	589	686	41%	16%	44%	1,075	1,546
Cost of sales	(277)	(299)	(326)	18%	9%	46%	(575)	(708)
Gross profit	210	290	360	72%	24%	43%	500	839
Gross margin (%)	43%	49%	52%	22%	6%	97%	46%	54%
EBIT	182	276	302	66%	9%	40%	458	755
EBIT margin (%)	37%	47%	44%	18%	-6%	90%	43%	49%
Net profit	133	208	234	75%	13%	40%	341	578
Net profit margin (%)	27%	35%	34%	24%	-3%	91%	32%	37%

Source: Citi Investment Research and Analysis and Company Reports

Figure 2. Output and Sales Volumes, Kt,

	1H09	2H09	1H10	YoY	HoH	1H10 as 10E	2009	2010E
<b>Iron Ore Concentrates</b>								
Production	743.5	888	865.9	16%	-3%	44%	1631.3	1,972
Sales	463.3	487	506.8	9%	4%	42%	949.9	1196
<b>Iron Ore Pellets</b>								
Production	313.8	374	361.6	15%	-3%	48%	687.6	760
Sales	332.5	360.8	376.2	13%	4%	50%	693.3	760
<b>Medium Grade TiO2</b>								
Production	62.7	89.7	40.2	-36%	-55%	55%	152.4	73
Sales	64.9	102.4	36.9	-43%	-64%	51%	167.3	73
<b>High Grade TiO2</b>								
Production	0		34			14%		249
Sales	0		30.9					

Source: Citi Investment Research and Analysis and Company Reports

## China Vanadium Titano-Magnetite Mining

### Company description

China VTM Mining mines and processes iron ore in Huili County, the Panxi region of Sichuan Province, South West China. Its mining assets are two open pit vanadium-bearing titano-magnetite iron ore mines, with mine lives of 14 years and 5.8 years. As of 30 June 09, total JORC reserves (2P) were 78.7Mt, with the potential to increase the shorter of the two mine lives based on an extension of the mining area. A function of the ore type, the mines produce iron concentrate and a titanium concentrate. These are sold or the iron concentrate is further processed into iron pellets. The company has options to acquire five mines in the region, with estimated resources at 126.2Mt.

### Investment strategy

We rate China VTM Mining shares Buy / Low Risk (1L). The stock is a pure Chinese iron-ore play and is growing through organic expansion, exploration and acquisitions. We have a positive view on the iron-ore market for 2010 but acknowledge the near-term challenges faced by the sector, including weak steel prices and a weak winter season. We believe the risk/reward looks favorable at current valuations.

## Valuation

We value China VTM at HK\$5.1/s. Our target price is derived by applying 5x 2011E EV/EBITDA to the standalone assets for a resulting value of HK\$4.5/share, to which we add HK\$0.65/share in M&A option value for the Panzhihua Jingzhi asset. Our fair value for the operations equates to 14.0x 2010E earnings and 9.7x 2011E earnings, which are below respective multiples for the peer group and sector. We think discounts to selected regional iron ore and coking coal peers are warranted to adjust for earnings risks, the lack of a track record, and industry dynamics. To value the Jingzhi asset, we have conservatively assumed Baicao Mine's inferior core quality and costs, a debt-equity structure of 50-50% and the same target P/E as we use for China VTM's existing business.

## Risks

We rate China VTM shares Low Risk, which differs from the default Speculative Risk assigned by our quantitative risk-rating system to stocks that have a history of less than 260 days. Our rating considers downside risks of the commodity are limited, and the company's fundamentals have locked in floor prices for 2010. Key downside risks that could prevent the shares from reaching our target price include the risk of geological forecasts not matching reality, higher-than-expected production costs, weather, and a slower-than-expected recovery in China's economy.

## Appendix A-1

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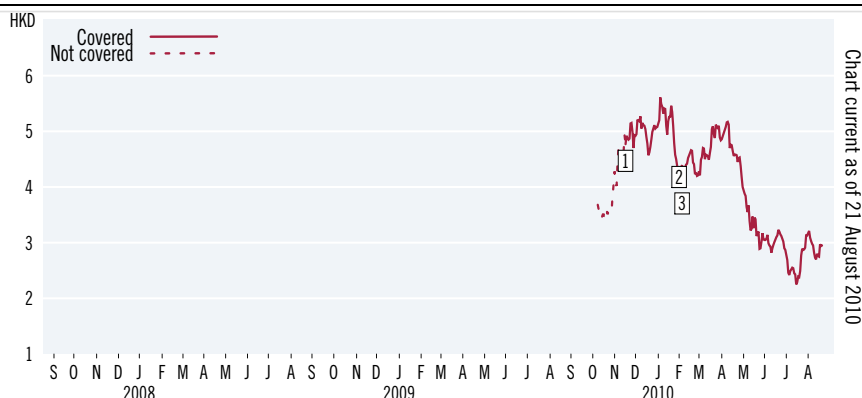


Chart current as of 21 August 2010

	Date	Rating	Target Price	Closing Price
1	17-Nov-09	*1L	*5.90	4.77

	Date	Rating	Target Price	Closing Price
2	1-Feb-10	1L	*4.91	4.21

	Date	Rating	Target Price	Closing Price
3	4-Feb-10	1L	*5.10	4.39

\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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