Company Report

Daiwa Capital Markets

10 September 2010 (No. of pages: 39)

China Vanadium Titano - Magnetite Mining (893 HK)

Materials: China

6-mth rating: **1**

Target price: HK$4.50

Share price: HK$3.24 (9 Sep)

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Initiation of coverage: an undervalued iron-ore play in growing southwest

Coverage initiated with a 1 (*Buy*) rating

- We initiate coverage of China Vanadium Titano-Magnetite Mining (China VTM Mining) with a **1** (*Buy*) rating, due mainly to what we see as the company's attractive valuation, sustainable earnings growth, production-volume expansion, and gross-margin improvement going forward.

Undemanding valuation

- Our DCF-based six-month target price of HK$4.50 implies a 10.9x PER and 1.6x PBR on our 2011 forecasts, which are at 40% and 27% discounts to those for the global peer group.

Sustainable earnings growth ahead

- We forecast a 2010-12 earnings CAGR of 23% as a result of strong iron-ore demand related to steel-production growth in Sichuan driven by an increase in fixed-asset investment (FAI). We forecast the company's iron-product output to rise at a CAGR of 30.2% for 2010-12, and titanium-concentrate output at a CAGR of 18.3% driven by organic growth and acquisitions.

Gross-margin improvement

- We expect the gross margin to improve from 2010-12 due to a more optimised product mix and less outsourcing. In our view, the risks to our rating include lower-than-forecast product selling prices, high production costs, and disruptions to operations.

Reuters code		0893.HK

Market data

HSI		21,167.27
Market cap	(US$m)	865.24
EV	(US$m; 10E)	724.47
3-mth avg daily T/O	(US$m)	4.59
Shares outstanding	(m)	2,075
Free float	(%)	42.1
Major shareholder		Trisonic INTL LTD (48.4%)
Exchange rate	Rmb/US$	6.794
	HK$/US$	7.770

Performance (%)*	1M	3M	6M
Absolute	9.8	10.6	(28.0)
Relative	12.7	2.7	(27.8)

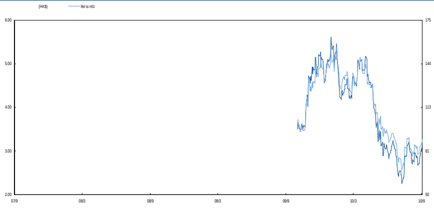
Source: Daiwa
Note: *Relative to HSI

Investment indicators

		2010E	2011E	2012E
PER	(x)	11.7	8.3	7.8
PCFR	(x)	9.6	6.5	5.4
EV/EBITDA	(x)	6.7	4.1	2.6
PBR	(x)	1.9	1.6	1.3
Dividend yield	(%)	0.0	0.0	0.0
ROE	(%)	16.5	18.8	16.7
ROA	(%)	12.8	14.6	13.1
Net debt equity	(%)	net cash	net cash	net cash

Source: Daiwa forecasts

Price and relative performance



Source: Bloomberg, Daiwa

Income summary

Year to 31 Dec	Revenue (Rmb m)	(%)	EBITDA (Rmb m)	(%)	Net profit (Rmb m)	(%)	EPS (Rmb)	(%)	*EPS (HK$)*	CFPS (Rmb)	DPS (Rmb)	*DPS (HK$)*
2008	791	*115.8*	378	*320.9*	249	*363.2*	0.166	*363.2*	*0.190*	0.282	0.000	*0.000*
2009	1,084	*37.0*	488	*29.1*	328	*31.8*	0.201	*21.3*	*0.230*	0.210	0.000	*0.000*
2010E	1,426	*31.6*	740	*51.4*	501	*52.7*	0.241	*19.9*	*0.276*	0.297	0.000	*0.000*
2011E	1,981	*38.9*	1,017	*37.5*	705	*40.8*	0.340	*40.8*	*0.389*	0.433	0.000	*0.000*
2012E	2,327	*17.5*	1,242	*22.0*	758	*7.5*	0.365	*7.5*	*0.418*	0.523	0.000	*0.000*

Source: Company, Daiwa forecasts

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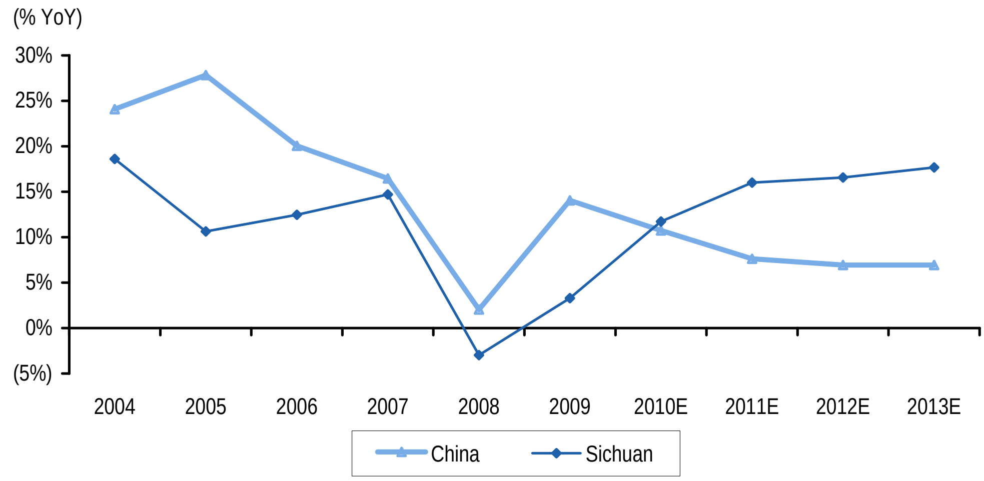
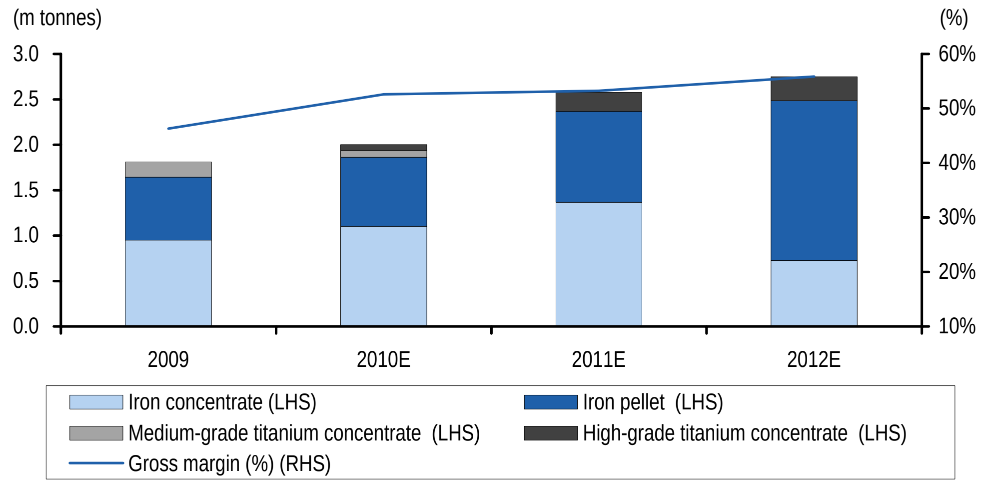
The three most important charts in this report ...

Crude-steel output: Sichuan's growth rate higher than that of China



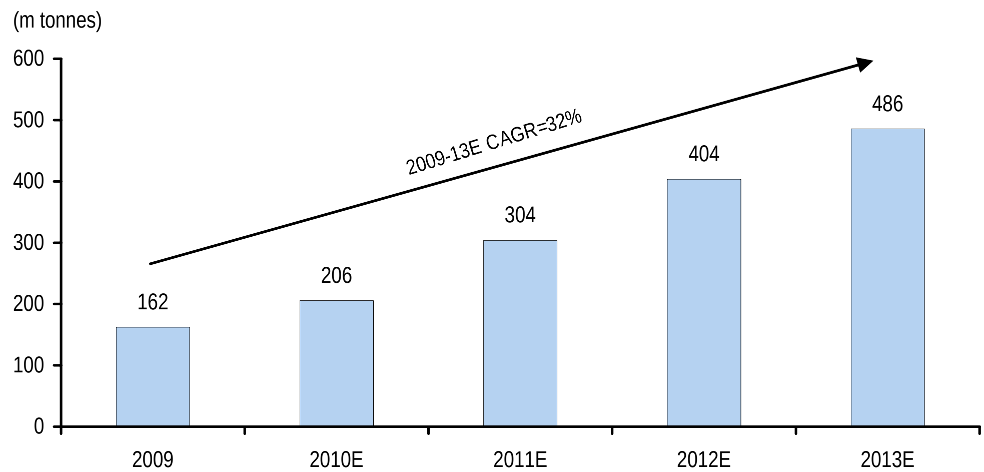
Source: China Year Book, Sichuan Metallurgy Economic Association, Daiwa forecasts

Iron-ore sales rising and product mix improving due to strong demand



Source: Company, Daiwa forecasts

Iron-ore resource growth from plentiful vanadium-bearing iron-ore resources in Sichuan



Source: Company, Daiwa forecasts

Executive summary

Coverage initiated with a 1 (*Buy*) rating

We initiate coverage of China VTM Mining with a **1** (*Buy*) rating and DCF-based six-month target price of HK$4.50, implying a 10.9x PER and 1.6x 2011 PBR based on our 2011 forecasts, which are at 40% and 27% respective discounts to its global peers' averages for 2011, based on the Bloomberg-consensus forecasts.

Benefiting from China's 'Go West' development

We forecast the company's EPS to rise at a CAGR of 23% for 2010-12 backed by brisk sales-volume growth, a gross-margin improvement and iron-resources expansion spurred by surging iron-ore demand from strong crude-steel output growth in Sichuan. We forecast crude-steel production in Sichuan to increase at a CAGR of 16.7% from 2010-13, outstripping the country's production CAGR of 7.2% over the same period, driven by an acceleration in FAI in Sichuan amid China's 'Go West' development plan in the current decade (March 2010 to March 2020).

Expansion of the customer base

The company has improved its customer base since 2008, which now includes one direct customer (a connected party which principally produces steel products) and six iron-ore distributors. The sales volume attributable to these distributors increased from 7% for 2006 to 79% for 2008, 75% for 2009 and we forecast will reach 77% for 2010.

Output capacity ramping up due to strong demand for iron ore

We forecast the company's iron-related product (iron concentrate and iron pellets) output to rise at a CAGR of 30.2% and its titanium-concentrate output to increase at a CAGR of 18.3% for 2010-12. To meet strong demand for iron ore, we forecast output capacity for iron concentrate to expand to 2.6m t.p.a. by 2010 from 1.9m t.p.a. in 2009, and that for iron pellets to increase to 2.26m t.p.a. by 2012 from 0.76m t.p.a. in 2009. To meet surging demand for titanium slag downstream, we forecast the company's output capacity for titanium concentrate to increase to 0.42m t.p.a. by 2011 from 0.05m t.p.a. in 2009. We see considerable potential for the company to expand its iron-ore resources at a CAGR of 32%, or up 200%, from 20109-13 to 486m tonnes by 2013.

Margin improvement ahead

We forecast the company's gross margin to increase to 52% for 2010 from 46% for 2009, reflecting its more optimised product mix and a moderate increase in production costs for iron-related products. We expect the company's gross margin to improve further in 2011-12.

Earnings-sensitivity analysis

For 2010, we estimate that every 1% change in ASP would impact the company's earnings by 2%, every 1% change in sales volume would impact its earnings by just above 1%, and every 1% change in the gross margin would impact the company's earnings by 2.3%.

China VTM Mining: SWOT analysis (%)

Strengths	Weaknesses
Abundant resources	Only targets the Sichuan market
High gross-margin products	
Large market share via acquisition	
Opportunities	**Threats**
New round of Western Development Policy in 2011-20	Failure to obtain mining rights
Sichuan reconstruction plan	Operating risk from natural disasters
Chengdu-Chongqing Economic Zone	
12th *Five-Year Plan* focus on western China development	

Source: Daiwa estimates

Company background

China VTM Mining is the first and only Hong Kong-listed China-based iron-ore producer, whose principal products include iron concentrate, iron pellets and titanium concentrate. The company produced 1.6m tonnes of iron concentrate, 0.69m tonnes of iron pellets and 0.21m tonnes of titanium concentrate during 2009. It is located in Sichuan Province, where about 83% of the vanadium-bearing iron-ore resources in China are found. The majority of the company's product sales are within western China.

China Vanadium Titano - Magnetite Mining – financial summary

Profit and loss (Rmb m)

Year to 31 Dec	2008	2009	2010E	2011E	2012E
Iron concentrate	496	530	703	938	510
Iron pellet	252	537	677	914	1,648
Others	43	17	46	130	169
Total revenue	791	1,084	1,426	1,981	2,327
Other income	17	41	16	0	0
COGS*	(338)	(540)	(608)	(835)	(934)
SG&A	(55)	(64)	(86)	(129)	(151)
Other op. expenses	(64)	(76)	(77)	(91)	(94)
EBIT	352	446	671	926	1,148
Net-interest inc./(exp.)	(3)	(9)	(23)	(12)	(12)
Assoc/forex/extraord./others	0	0	0	0	0
Pre-tax profit	349	437	649	914	1,136
Tax	(30)	(70)	(86)	(122)	(284)
Min. int./pref. div./others	(70)	(39)	(62)	(87)	(94)
Net profit (reported)	249	328	501	705	758
Net profit (adj.)	249	328	501	705	758
EPS (reported) (Rmb)	0.166	0.201	0.241	0.340	0.365
EPS (adj.) (Rmb)	0.166	0.201	0.241	0.340	0.365
DPS (Rmb)	0.000	0.000	0.000	0.000	0.000
EBIT (adj.)	352	446	671	926	1,148
EBITDA (adj.)	378	488	740	1,017	1,242

Balance sheet (Rmb m)

As at 31 Dec	2008	2009	2010E	2011E	2012E
Cash & short-term investment	133	1,884	1,411	2,210	3,245
Inventory	66	71	79	109	121
Accounts receivable	88	137	185	258	302
Other current assets	119	141	203	242	259
Total current assets	406	2,233	1,879	2,818	3,928
Fixed assets	357	496	1,472	1,580	1,687
Goodwill & intangibles	156	157	216	166	166
Other non-current assets	32	187	336	252	0
Total assets	951	3,073	3,902	4,816	5,781
Short-term debt	0	100	150	150	150
Accounts payable	108	86	97	134	149
Other current liabilities	182	275	310	378	505
Total current liabilities	290	461	558	661	805
Long-term debt	0	0	150	150	100
Other non-current liabilities	57	6	6	6	6
Total liabilities	347	467	714	817	910
Share capital	618	183	183	183	183
Reserves/R.E./others	(79)	2,331	2,851	3,575	4,352
Shareholders' equity	539	2,514	3,033	3,757	4,535
Minority interests	65	93	155	242	336
Total equity & liabilities	951	3,073	3,902	4,816	5,781
Net debt/(cash)	(133)	(1,784)	(1,111)	(1,910)	(2,995)

Cash flow (Rmb m)

Year to 31 Dec	2008	2009	2010E	2011E	2012E
Profit before tax	349	437	649	914	1,136
Depreciation and amortisation	27	43	68	91	94
Tax paid	(27)	(32)	(70)	(86)	(122)
Change in working capital	(139)	(78)	(32)	(20)	(22)
Other operational CF items	213	(27)	0	0	0
Cash flow from operations	423	342	616	899	1,086
Capex	(173)	(239)	(1,274)	(200)	(200)
Net (acquisitions)/disposal	0	1	0	0	0
Other investing CF items	(94)	(90)	(4)	0	0
Cash flow from investing	(267)	(328)	(1,278)	(200)	(200)
Change in debt	(30)	100	200	0	(50)
Net share issues/(repurchases)	0	1,773	0	0	0
Dividends paid	0	(24)	0	0	0
Other financing CF items	0	(111)	0	0	0
Cash flow from financing	(30)	1,737	200	0	(50)
Forex effect/others	0	(1)	(10)	0	0
Change in cash	126	1,751	(473)	699	836

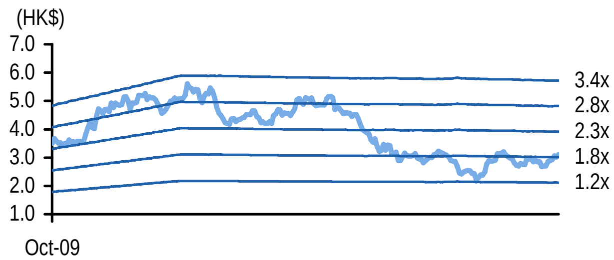
Key ratios

Year to 31 Dec	2008	2009	2010E	2011E	2012E
Sales – YoY %	115.8	37.0	31.6	38.9	17.5
EBITDA (adj.) – YoY %	320.9	29.1	51.4	37.5	22.0
Net profit (adj.) – YoY %	363.2	31.8	52.7	40.8	7.5
EPS (adj.) – YoY %	363.2	21.3	19.9	40.8	7.5
EBITDA margin % (adj.)	47.8	45.1	51.9	51.4	53.4
EBIT margin % (adj.)	44.5	41.1	47.1	46.8	49.3
Net-profit margin % (adj.)	31.4	30.2	35.1	35.6	32.6
ROAE (%)	46.1	13.0	16.5	18.8	16.7
ROAA (%)	26.1	10.7	12.8	14.6	13.1
ROCE (%)	58.2	16.5	19.3	21.5	22.4
ROIC (%)	68.3	45.5	28.0	38.4	45.9
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Effective tax rate (%)	8.6	16.0	13.3	13.3	25.0
Accounts receivable (days)	20.2	37.9	41.3	40.8	43.9
Payables (days)	43.1	32.7	23.4	21.3	22.2
Net interest cover (x)	115.4	48.2	29.6	75.1	93.1
Net dividend payout (%)	0.0	0.0	0.0	0.0	0.0

Key assumptions

Year to 31 Dec	2008	2009	2010E	2011E	2012E
Sales volume (Mt)	1.3	1.8	2.0	2.6	2.8
Average blended prices (Rmb/t)	600	599	713	769	846

PBR bands



Source: Company, Daiwa forecasts
Note: *COGS excludes depreciation and amortisation

Valuation and recommendation

We initiate coverage of China VTM Mining with a **1** (*Buy*) rating and six-month DCF-based target price of HK$4.50, equivalent to a 10.9x PER and 1.6x PBR based on our 2011 earnings forecasts.

We forecast EPS to rise at a CAGR of 23% for 2010-12 on the back of: 1) surging iron-ore demand from strong crude-steel production growth in Sichuan (a CAGR of 16.7% for 2010-13 versus 7.2% for China, based on our forecasts), 2) our iron-ore sales-volume CAGR forecast for the company of 15% for 2010-12, 3) a gross-profit margin improvement due to product-mix upgrades and increases in selling prices, and 4) our iron-ore resource CAGR forecast of 32%, or up 200%, for 2009-13 to 486m tonnes by 2013 from low-cost acquisitions and existing properties.

We rely on DCF as a valuation methodology to measure the NPV of future cash-flow streams under different iron-ore price and production-cost assumptions. We derive our target price from a 10-year cash-flow forecast ending in 2019 based on the company's current ore reserves in three mines, namely the *Baicao*, *Xiushuihe* and *Yangqueqing* (*YQQ*) mines, a 2% long-term growth rate, a long-term iron concentrate price of Rmb748/tonne (US$110/tonne) and an iron-pellet price of Rmb995/tonne (US$146/tonne). Our WACC of 12.5% is derived from: 1) a risk-free rate of 3.2% based on an annualised average yield on the China 10-year government bond, 2) market-risk premium of 9.7%, 3) a beta of 1.2, and 4) a debt-to-equity ratio of 25:75.

China VTM: DCF valuation (Rmb m)

	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E
Sales	1,084	1,426	1,981	2,327	2,471	2,657	2,817	2,959	3,107	3,246	3,376
YoY change (%)		32	39	17	6.2	7.5	6.0	5.1	5.0	4.5	4.0
EBIT	446	671	926	1,148	1,210	1,314	1,268	1,332	1,398	1,461	1,519
Less: tax	(70)	(86)	(122)	(284)	(299)	(325)	(263)	(276)	(290)	(303)	(315)
Less: MI	(39)	(62)	(87)	(94)	(99)	(107)	(87)	(91)	(96)	(100)	(104)
Add: DD&A	43	68	91	94	100	105	112	118	126	131	141
Add: change in WC	(20)	(32)	(20)	(22)	(3)	(10)	38	(2)	(2)	(2)	(2)
Add: capex	(239)	(1,274)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)
FCF	121	(715)	589	642	708	777	867	881	936	987	1,039
Discount factor		1.00	1.12	1.27	1.42	1.60	1.80	2.03	2.28	2.56	2.88

WACC		DCF valuation	
Risk-free rate	3.2%	Sum of PV of FCF	3,370
Market risk premium	9.7%	PV of terminal value	2,536
Equity beta	1.2	Enterprise value	5,906
Cost of equity	15.3%	Less: net debt 2009	(1,784)
Cost of debt (pre-tax)	5.6%	Equity Value	7,690
Cost of debt (after tax)	4.2%	No. of ordinary shares (m), fully diluted	2,075
Target debt weight	25.0%		
Target equity weight	75.0%	Value per share (Rmb)	3.71
Tax rate	25.0%	Exchange-rate forecast: Rmb:HK$	1.21
WACC	12.5%		
Terminal growth	2.0%	Value per share (HK$)	4.50

Source: Daiwa forecasts

The following table indicates the sensitivity of our DCF valuation to discount factors and terminal-growth rates.

Sensitivity of DCF valuation to changes in the discount and terminal-growth rate

		WACC						
		11.0%	11.5%	12.0%	12.5%	13.0%	13.5%	14.0%
	0.5%	4.86	4.66	4.48	4.31	4.16	4.01	3.88
	1.0%	4.95	4.74	4.54	4.37	4.20	4.06	3.92
	1.5%	5.04	4.82	4.61	4.43	4.26	4.10	3.96
Terminal growth rate	2.0%	5.15	4.91	4.69	4.50	4.32	4.16	4.01
	2.5%	5.26	5.01	4.78	4.57	4.38	4.21	4.06
	3.0%	5.39	5.12	4.87	4.65	4.45	4.27	4.11
	3.5%	5.54	5.24	4.98	4.74	4.53	4.34	4.17

Source: Daiwa forecasts

Valuation comparison

Our six-month target price of HK$4.50 is equivalent to a 10.9x PER and 1.6x PBR based on our 2011 earnings forecasts, which are at 20% and 26% discounts, respectively, to those for the global peer group based on the Bloomberg-consensus forecasts for 2011, which we see as undemanding, given that the stock is trading currently at a PER of 8.3x based on our 2011 EPS forecast. We believe China VTM Mining's sustainable earnings growth will be bolstered by: 1) strong iron-ore demand in Sichuan, 2) brisk sales-volume growth, 3) a gross-margin improvement, 4) iron-ore resource additions, and 5) a broadening of its customer base.

We forecast China VTM Mining's EV/tonne of iron reserves to equal US$8.4 by the end of 2010, which is lower than the global peer group median of US$15.6. We think China VTM Mining's resource acquisition costs are quite competitive among the global iron-ore operators due mainly to: 1) the highly fragmented iron-ore supply base in Sichuan, 2) that China VTM Mining has been designated by the provincial government as one of the key consolidators within the sector, and 3) the closed nature of the market (transportation, few strong market participants) which favours local consolidators over others located further away.

The following valuation charts showing EV/EBITDA multiples show that China VTM Mining's EV/EBITDA multiples are at the low end of the global peer group for 2010 and 2011, which we see as unjustified for the reasons cited above. The company also has a strong balance sheet with net cash of Rmb0.91bn as at 30 June 2010 and Rmb1.11bn by the end 2010, based on our forecasts. The company completed its Hong Kong share offering in October 2009.

Short-term share-price catalysts

We believe the company's short-term price catalysts include:

1) A potential upward revision to its iron-production volume. The company is currently conducting exploration work in the *Xiushuihe* adjacent mining area with iron-ore resources of 78m tonnes, and it expects to obtain a mining licence by the end of 2011. We forecast this iron-ore mine to increase the company's raw ore output by 4m t.p.a. based on a mine life of nine years.

2) The China Government's upcoming *12th Five-Year Plan* due to be announced later this year will have more details on the 'Go West' development strategy in 2011-15.

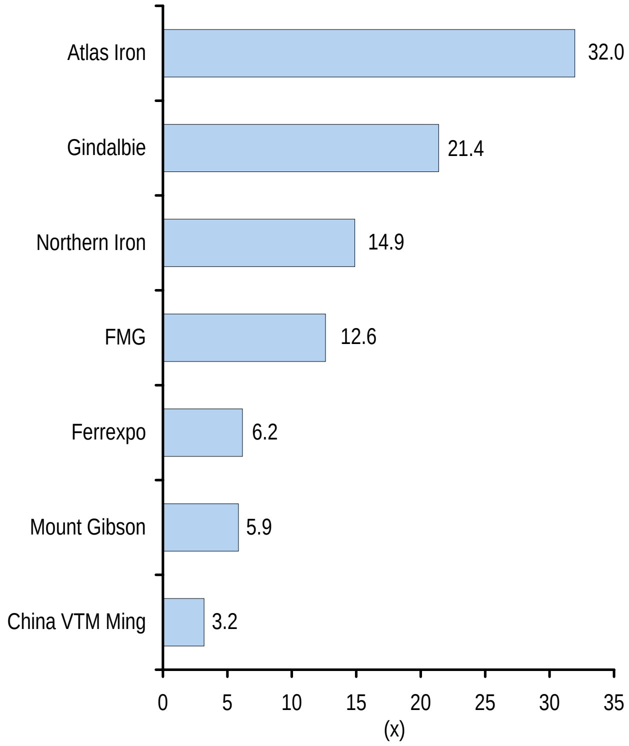
Currently, China VTM Mining's shares are trading at an 8.6x PER based on the Bloomberg-consensus forecasts for 2011, which is 21% below our target multiple for 2011, which we find inexpensive based on the outlook for the company and industry.

Global valuation comparison vs. global iron-ore miners

	Bloomberg code	Share price	Market cap (US$m)	PER (x) 2010E	PER (x) 2011E	PER (x) 2012E	PBR (x) 2010E	PBR (x) 2011E	PBR (x) 2012E	ROE (%) 2010E	ROE (%) 2011E	ROE (%) 2012E	EV (US$m)	Reserve (mt Fe)	EV/reserve (US$/t Fe)
International iron ore players:															
ATLAS IRON LTD	AGO AU	2.19	1,094	5	4.0	4.7	2.2	1.5	1.0	39.8	36.0	22.3	963.0	364.0	2.6
NORTHERN IRON LTD	NFE AU	1.75	473	n.a.	43.8	3.6	1.7	2.4	1.4	(2.9)	6.1	43.5	578.6	41.0	14.1
FERREXPO PLC	FXPO LN	302.40	2,860	6.8	6.1	6.4	3.6	2.3	1.7	52.0	42.3	32.2	3,128.6	476.0	6.6
TERRITORY RESOURCES LTD	TTY AU	0.27	66	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	121.1	3.0	40.4
CAPE LAMBERT RESOURCES LTD	CFE AU	0.38	217	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	203.1	n.a.	n.a.
GINDALBIE METALS LTD	GBG AU	0.92	723	n.a.	11	2.8	1.5	1.3	0.9	(2.1)	1.7	36.1	617.5	100.0	6.2
FORTESCUE METALS GROUP LTD	FMG AU	4.92	14,145	8.7	7.3	7.0	4.5	2.8	2.0	61.0	43.0	31.0	15,885.1	932.0	17.0
MOUNT GIBSON IRON LTD	MGX AU	1.74	1,738	5.2	3.8	3.9	1.4	1.1	0.9	30.6	31.4	24.4	n.a.	35.0	n.a.
NORTHLAND RESOURCES SA	NAU CN	2.35	n.a.	n.a.	n.a.	5.9	1.3	1.3	1.0	(8.7)	(11.4)	23.6	n.a.	107.0	n.a.
China A-share iron-ore players:															
SHANDONG JINLING MINING CO-A	000655 CH	17.23	1,512	24.0	18.8	15.5	5.6	4.7	3.9	21.3	21.7	19.3	1,436.2	33.0	43.5
GUANGDONG MINGZHU GROUP CO-A	600382 CH	8.11	409	13.7	15.0	14.0	2.6	2.2	1.9	15.5	14.7	13.7	457.8	11.9	38.3
Global average				10.6	13.8	7.1	2.7	2.2	1.6	22.9	20.6	27.3			15.6
China VTM Mining*	893 HK	3.24	865	11.7	8.3	7.8	1.9	1.6	1.3	16.5	18.8	16.7			7.0
China VTM Mining (At target valuation)*	893 HK	4.50		15.4	10.9	10.2	2.0	1.6	1.3	20.3	23.3	20.5			8.40
			Discount to peers (%)		40			27							55

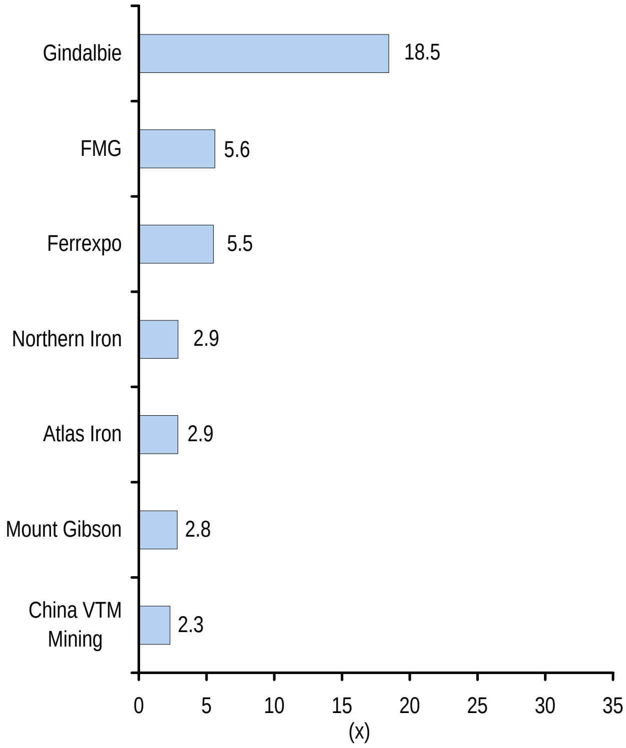
Source: Bloomberg, Company, *Daiwa forecasts
Note: Share prices as at 9 Sept 2010. **We calculated US$15.6/tonne as the global median of EV/reserve.

Global iron-ore 2010E EV/EBITDA multiple (x)



Source: Bloomberg, Company, Daiwa forecasts

Global iron-ore 2011E EV/EBITDA multiple (x)



Source: Bloomberg, Company, Daiwa forecasts

Overview

Sichuan to benefit from rising FAI over the next five-to-10 years

Sichuan is located in the southwest of China and serves as an economic and transportation hub in western China. Some 83.2% of China's vanadium-bearing iron-ore resources of around 8.9bn tonnes are located in the province.

Western China will kick off new investment of Rmb682.2bn in 2010

On 6 July, the National Development and Reform Commission (NDRC) launched new investments for 23 projects in western China with an announced total new investment of Rmb682.2bn in 2010, representing a 45% YoY increase.

'Go West' will be the key focus of the next five-year plan

During a celebration meeting of the country's previous 10-year 'Go West' development in March 2010, Mr. Hu, the president of the country, pointed out that development of the 'Go West' strategy would be one of the key tasks in the upcoming *12th Five-Year Plan*. During a western China development meeting in July 2010, the State Council said the western region would be an important industry base for energy, resources processing and equipment manufacturing. The People's Bank of China (PBOC) in August 2010 stated that its branches located in western China would financially support the development of western China.

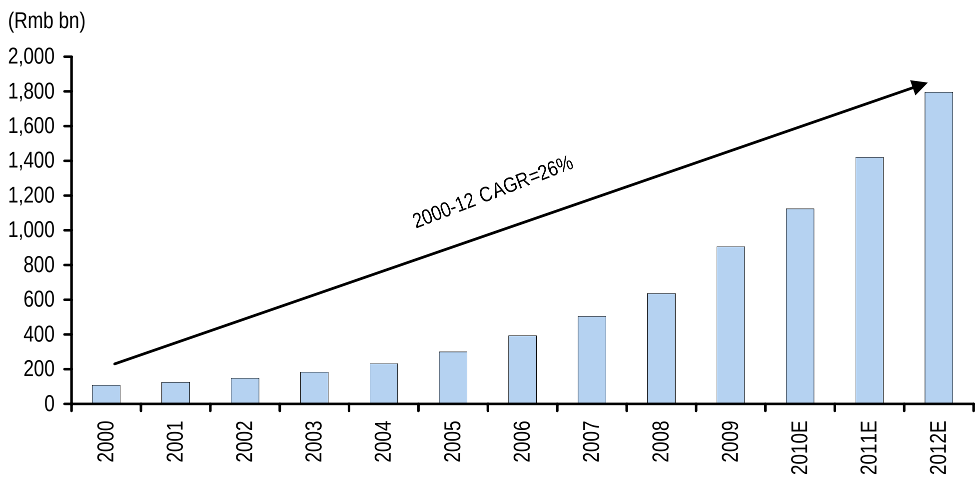
Over the past decade, Sichuan's GDP in terms of value has accounted for 4% of China's gross domestic product. However, during most periods over the past 10 years, annualised GDP growth for Sichuan has been higher than that for the overall country, thanks mainly to the unfolding of the country's 'Go West' policy over its first decade.

Sichuan looks set to benefit from a surge in FAI

With three periods designated over the 50-year course of the country's 'Go West' development plan (March 2000-March 2010, March 2010-March 2030, and March 2030-March 2050) Sichuan looks set to benefit from an acceleration in FAI to build the regional infrastructure over the next two decades (from March 2010-March 2030).

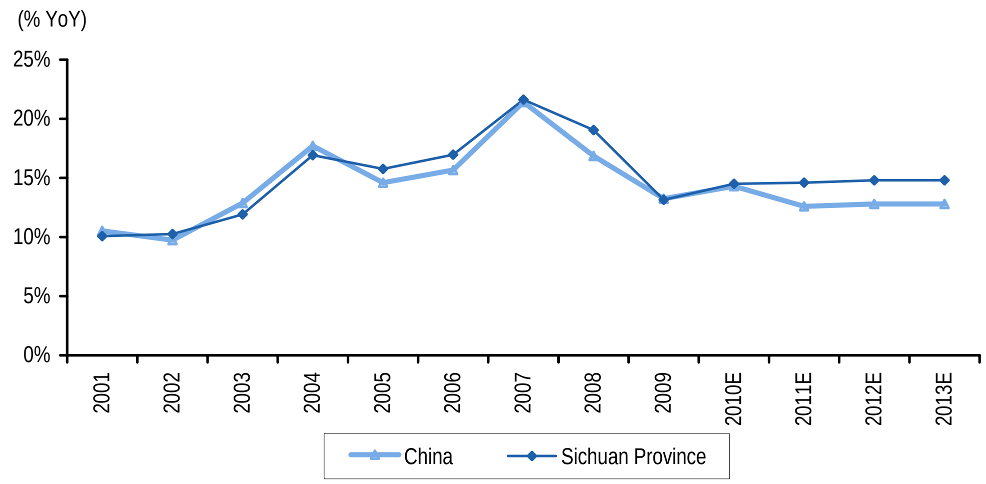
Granted, investments from China's Rmb4tn stimulus package announced in November 2008 will come to an end at the close of 2010, however, we believe the economy should continue to expand driven by new investments. We expect the under-developed western region to bolster GDP growth to a certain extent. Boosted by the post-earthquake restructuring plan and the 'Go West' development plan, we expect Sichuan's GDP growth to outperform that of the country overall on the back of an acceleration in FAI from 2010-12, which we forecast to rise at a CAGR of 26% over the period.

Sichuan FAI from 2000 to 2012



Source: CEIC, Daiwa forecasts

China GDP versus Sichuan Province GDP



Source: China Year Book, CEIC
Note: GDP data in the chart are calculated at current prices.

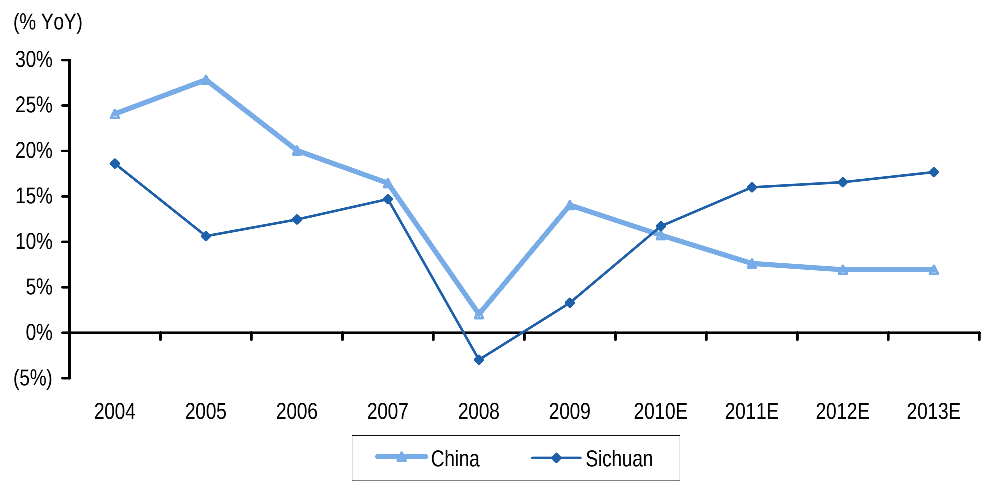
Crude-steel production growth in Sichuan versus that for China

According to the Sichuan Metallurgy Economic Association, about 6.6m tonnes of new crude-steel output capacity will be completed in 2H10, and about 12.9m tonnes of new capacity will commence operation by 2012, bringing total crude-steel capacity in Sichuan to 28m t.p.a. by the end of 2012.

We forecast crude-steel output in Sichuan to increase at a CAGR of 16.7% for 2010-13

Following this increase in crude-steel capacity, we forecast crude-steel production in Sichuan to rise at a CAGR of 16.7% from 2010-13, higher than our overall CAGR forecast for China of 7% during the period. We believe this is because of the stronger demand growth from infrastructure (railway, road and airports) and industry in southwest China versus that in northern and eastern China.

Crude-steel output: Sichuan's growth rate higher than that of China



Source: China Year Book, Custeel, Sichuan Metallurgy Economic Association, Daiwa forecasts

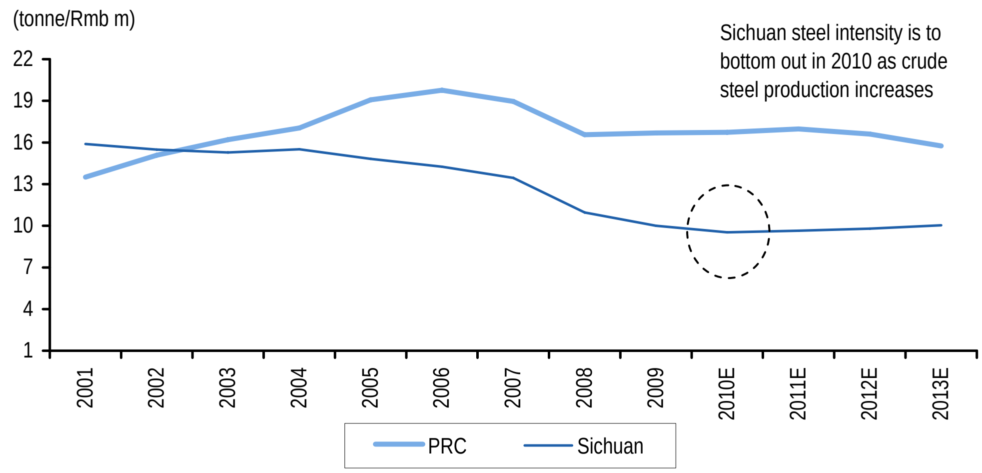
Based on historical data, GDP growth is highly correlated to crude-steel output growth. We therefore expect crude-steel output in Sichuan to rise strongly in the current decade following the province's GDP growth. We forecast Sichuan's GDP to rise at a CAGR of 14.7% from 2000-13 versus a 9.4% CAGR for the country.

Sichuan is short of steel capacity

Based on our calculations, Sichuan's crude-steel production intensity (crude-steel output per value of GDP) has been lower than the overall country's since 2003. We believe the low crude-steel production intensity is due mainly to the low level of crude-steel production in Sichuan. Crude-steel production in Sichuan rose at a CAGR of 9.2% from 2003-09 while that for China as a whole recorded a CAGR of

17.1%. We expect crude-steel production intensity for Sichuan to bottom out in 2010, as we forecast Sichuan's crude-steel production growth to outshine its GDP growth going forward.

Crude-steel intensity in Sichuan has lagged overall growth in China



Source: CEIC, Custeel, Daiwa forecasts
Note: tonne/Rmb m denotes crude-steel production (tonnes) in terms of GDP value (Rmb m).

Iron-ore consumption in Sichuan versus China

We expect China's iron consumption to ease off following moderate crude-steel production growth going forward. However, Sichuan's iron consumption will be boosted by strong crude-steel output growth because of rising FAI, which will benefit iron-ore producers in Sichuan.

As an expanding iron-ore producer in Sichuan, China VTM Mining has been expanding its market share significantly in terms of raw iron-ore output after acquiring iron resources in recent years. We forecast the company to further increase its market share going forward (see further details on page 14). We forecast the company's market share of raw iron-ore output in Sichuan to increase from 10.8% in 2009 to 12% for 2010, 16.4% in 2011, and 19.7% in 2012.

Iron-ore consumption (m tonnes)

	2006	2007	2008	2009	2010E	2011E	2012E
China crude-steel production	419.0	488.0	498.0	568.0	629.0	677.0	724.0
YoY change (%)		*16.5*	*2.0*	*14.1*	*10.7*	*7.6*	*6.9*
China iron-ore consumption	670.4	780.8	796.8	908.8	1006.4	1083.2	1158.4
YoY change (%)		*16.5*	*2.0*	*14.1*	*10.7*	*7.6*	*6.9*
Sichuan crude-steel production	12.3	14.1	13.7	14.2	15.8	18.3	21.4
YoY change (%)		*14.7*	*(3.0)*	*3.3*	*11.7*	*16.0*	*16.6*
Sichuan iron-ore consumption	23.4	26.8	26.0	26.9	30.0	34.8	40.6
Sichuan iron self-sufficiency ratio	90	90	90	90	90	90	90
YoY growth (%)		*15*	*(3)*	*3*	*12*	*16*	*17*
China VTM Mining production	0.3	0.5	1.2	1.6	2.0	2.4	2.8
YoY change (%)		80.8	124.1	37.4	22.0	21.3	19.8
Of which:							
Raw ore	1.0	1.8	4.8	6.2	6.9	10.2	13.0
YoY change (%)		*84.2*	*172.6*	*29.0*	*12.7*	*46.8*	*27.2*
Iron-concentrate production	0.3	0.5	1.2	1.6	2.0	2.4	2.8
YoY change (%)		*80.8*	*124.1*	*37.4*	*22.0*	*21.3*	*19.8*
Iron-pellet production (fed from iron concentrates)	0.2	0.2	0.3	0.7	0.8	1.0	1.4
YoY change (%)		*37.4*	*30.6*	*111.4*	*10.5*	*31.6*	*36.0*
China VTM Mining's share of raw iron-ore output in Sichuan (%)	2.1	4.0	10.8	10.8	12.0	16.4	19.7

Source: Custeel, CEIC, Daiwa forecasts

Rise in crude-steel and iron-ore production in Sichuan is policy-driven

Post-earthquake reconstruction plan

China announced its steel-industry revitalisation plan on 20 March 2009 to cover the period from 2009-11, which included Sichuan post-earthquake restructuring plan. According to the government's plan, the reconstruction plan will trigger investment of around Rmb1,700bn, translating into total consumption of 26.6m tonnes of finished steel, by our estimates (based on an intensity usage of 15.7m tonnes of steel for FAI of Rmb1tn), which is about 1.7 times Sichuan's crude-steel production for 2010, on our estimates.

Steel 'Adjustment and Revitalization' Plan

On 30 May 2009, the China Government announced the 'Adjustment and Revitalization Plan for the PRC Steel Industry' which promoted the use of (high strain) rebar of Grade III (400Mpa) or above in construction and set a target of increasing the consumption of high-strength steel products of Grade III or above to over 60% of the rebar consumed in China by 2011, which would trigger an increase in consumption of vanadium-bearing iron concentrate.

Chengdu Chongqing Economic Zone

The 'Development Plan of the Chengdu-Chongqing Economic Zone – Sichuan Consensus' released in July 2009, put forward a comprehensive reform programme for the economic zone, in particular, a plan to solve inland economic problems like backward infrastructure. By the end of 2020, Chongqing's urbanisation rate should have risen to 70% from the current 47%, and we believe Chengdu, the capital city of Sichuan, will follow suit. We believe the step-up in the urbanisation rate will trigger more demand for crude steel to feed downstream infrastructure buildings.

'Go West' plan is booming

March 2010 marks the 10^{th} year of the country's 'Go West' development policy (from March 2000 to March 2010). The development policy covers six provinces (Sichuan, Gansu, Guizhou, Qinghai, Shaanxi and Yunnan), five autonomous regions (Xinjiang, Guangxi, Inner Mongolia, Ningxia and Tibet), and one municipality (Chongqing). With three periods designated over the 50-year course of the country's 'Go West' development plan, Sichuan looks set to benefit from an acceleration in FAI to build the regional infrastructure over the next two decades (from March 2010-March 2030).

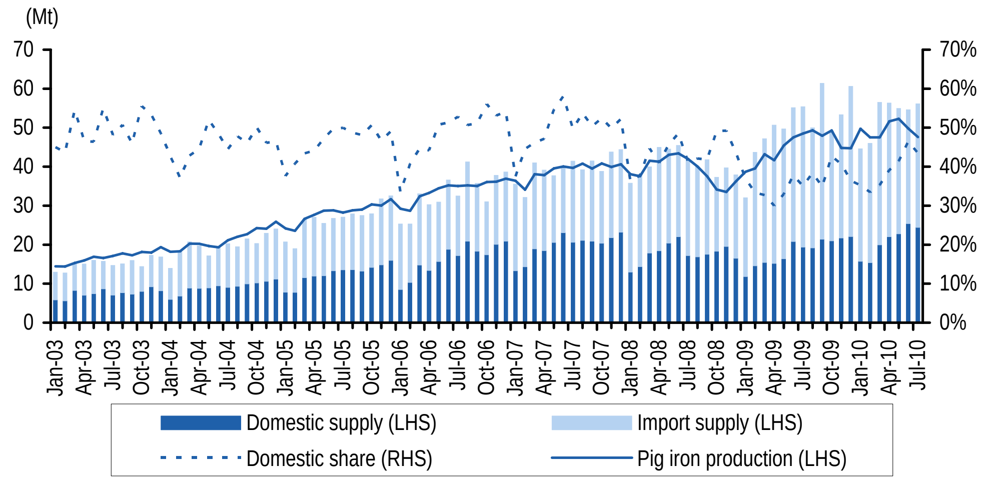
Iron-ore market overview

China relies heavily on imported iron ore

China has been increasing its imports of iron ore steadily over the past several years due to the rapid growth of crude-steel production and the lack of and low quality of (low grade) domestically available supply. We expect China to remain heavily reliant on imported iron ore for the long term depending upon the success of domestic mine development and the ability of the government to slow the overall growth rate and raise the quality of domestic-steel capacity. Steel supply remains fragmented and oriented towards lower-value long products for building/construction (about 60%) versus higher-value flat products (about 40%).

On a grade-adjusted basis, the demand for iron ore that was satisfied from domestic sources peaked at 60% in mid-2007 driven by high prices (see following chart). Domestic self-supply fell to a low of 30% in April 2009 during the financial crisis as lower iron-ore prices led to domestic mine closures. During that time, the demand for iron ore from rising steel production to meet government stimulus programmes was met from overseas. The recovery in prices and slowing growth rate of crude-steel production has led to fewer imports and the self-supply ratio increasing once again.

China: iron-ore supply (grade adjusted)



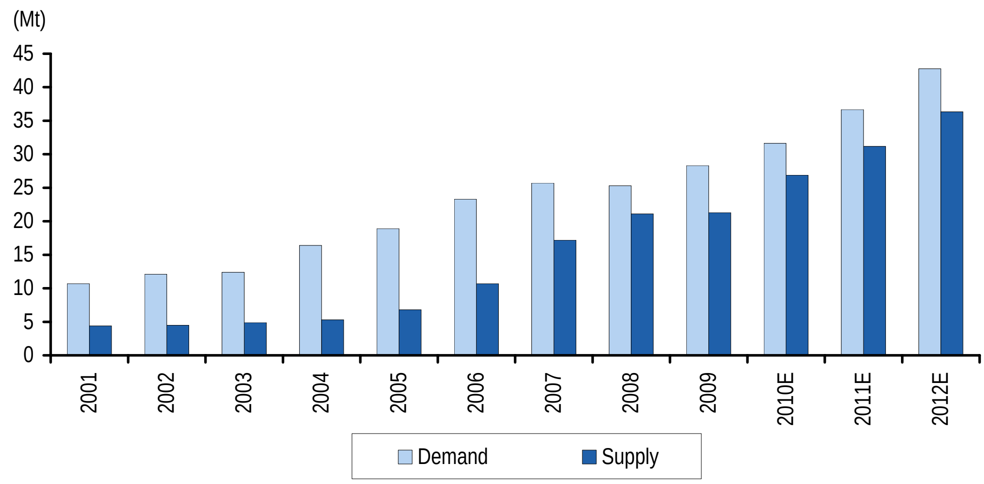
Source: Company, Daiwa forecasts

Sichuan 90% self-sufficient in iron ore

Compared with China overall, Sichuan is a largely self-supplied market due to its abundant resources. However, iron-ore supply has remained below the level of demand since at least 2001, if not earlier (see following chart). Over the past nine years (2001-09), supply has increased at a CAGR of 21.8% while demand has risen at a CAGR of 12.9%, which has narrowed but not reversed the imbalance.

About 10% of Sichuan’s iron-ore demand is imported from outside the province, but within China, as it is not economic to import ore from overseas due to the transport distances and cost. We look for demand to continue to outpace supply growth as iron-concentrate producers slowly ramp up production volume to meet the market demand.

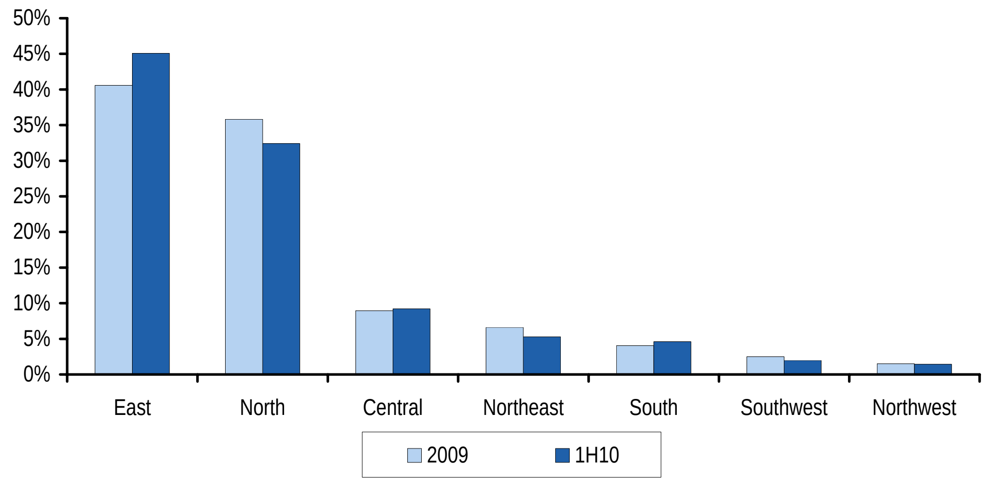
Sichuan: iron-ore demand and supply



Source: China Year Book, Custeel, Sichuan Metallurgy Economic Association, Daiwa forecasts

The following graph indicates China's iron-ore imports by region, which is dominated heavily by the east and north. The southwest (which includes Sichuan) imported only 2-2.5% of China's total imports in 2009 and 1H10 because: 1) steel mills use vanadium-bearing iron ore because it is more accessible, 2) imported iron-ore selling prices are much higher than vanadium-bearing iron-ore prices adjusted for iron content, and 3) provincial transportation bottlenecks increase the logistical cost of importing ore.

China: iron-ore imports by region



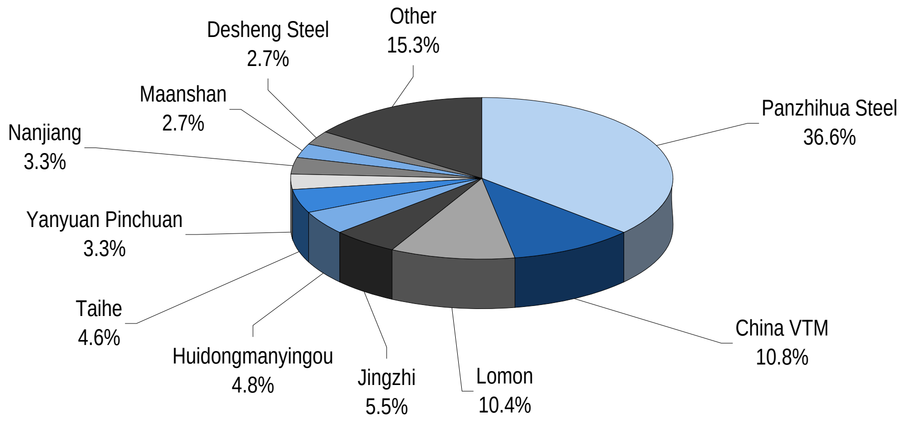
Source: Custeel

China VTM Mining is a significant and expanding iron-ore player in Sichuan

Market-share expansion

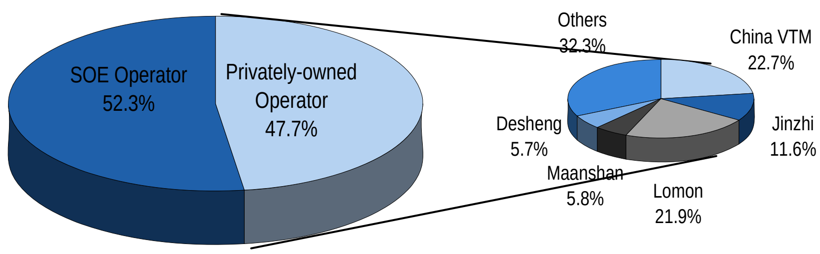
At the end of 2009, China VTM Mining was the second-largest iron-ore producer in Sichuan Province, with a 10.8% market share, and the largest non-state-owned producer, with a market share of 22.7%, based on raw iron-ore production (see following charts). We look for the company to further expand its market share in Sichuan Province through the acquisition of privately-owned iron mines. We forecast the company's market share of raw ore output to increase to 16.4% in 2011 from 10.8% in 2009. We see a strong possibility that China VTM Mining will acquire the Jinzhi mine in 2011, given the extension of its option to May 2011 to acquire the mine. The Jinzhi mine has about 100m tonnes of iron resources, and we estimate it has around 47m tonnes of recoverable iron-ore reserves.

Sichuan iron-ore producers' market shares (raw ore output, 2009)



Source: Sichuan Metallurgy Economic Association, Daiwa estimates

Sichuan iron-ore market shares for SOEs and private producers (raw ore, 2009)



Source: Sichuan Metallurgy Economic Association, Company, Daiwa estimates

Sichuan Province using vanadium-bearing iron ore

Steel mills in Sichuan Province use vanadium-bearing iron ore, due mainly to: 1) Sichuan Province has plentiful vanadium-bearing iron resources, and steel producers in the region have aligned their blast furnaces for this type of ore, 2) iron-ore resource development has increased strongly, maintaining a market share of roughly 90% of iron-ore consumption, helping to maintain strong regional usage, 3) the China steel-revitalisation plan for 2009-11 emphasises an increase in earthquake-resistant high-strength rebar products, which require more vanadium-bearing iron to produce. China is also encouraging further resource development to reduce its overall reliance on iron ore imported from overseas.

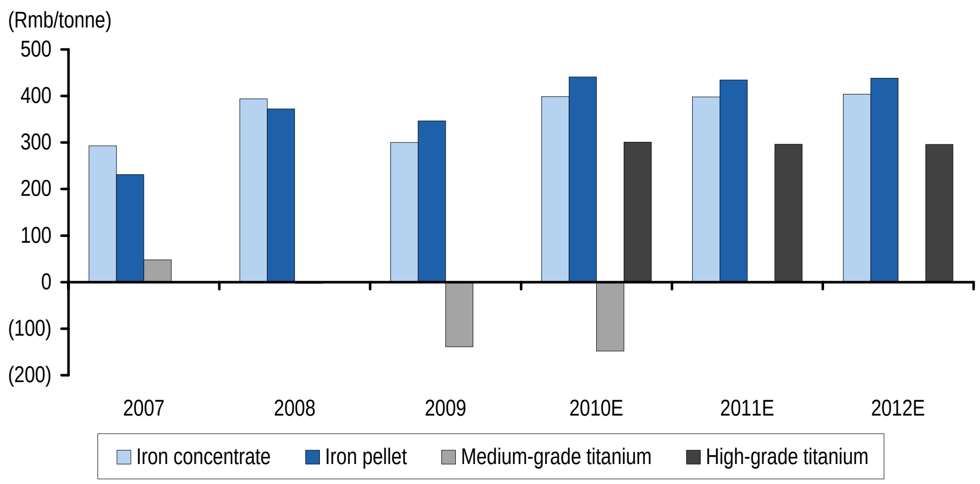
Company fundamentals

China VTM Mining is the first and only Hong Kong-listed PRC iron-ore mine operator, engaged principally in the production of iron concentrate, iron pellets and titanium concentrate. The company is located in Sichuan Province, which accounts for about 83% of the vanadium-bearing titano-magnetite iron-ore resources in China.

Company products

We expect China VTM Mining to optimise its product mix further by producing more value-added products. In 2010, we forecast the company's iron-pellet production to increase by 11% YoY, and expect it to discontinue medium-grade titanium concentrate production and switch to produce high-grade titanium concentrate. China VTM Mining's iron ore is relatively high in titanium content (10.5% TiO^2). The company is able to separate iron concentrate and titanium concentrate through a single production process at relatively low cost.

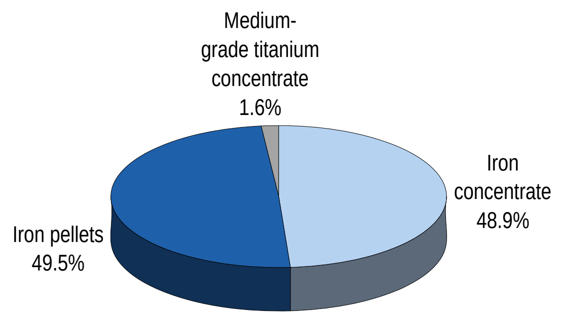
China VTM Mining: gross profit by product



Source: Company, Daiwa forecasts

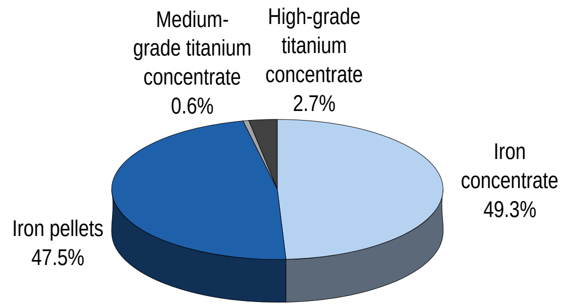
Sales generated from iron concentrate and iron pellets remain the key drivers of the company's sales revenue growth. We forecast turnover from iron concentrate, iron pellets and high-grade titanium concentrate to contribute 49.3%, 47.5% and 2.7% of the company's total turnover for 2010, respectively.

China VTM Mining: sales revenue breakdown by product in 2009



Source: Company

China VTM Mining: sales revenue breakdown by product in 2010E



Source: Company, Daiwa estimates

Iron concentrate

The company's iron concentrates are vanadium-bearing, with its titano-magnetite products produced directly from processing the ore extracted from mines. The iron concentrate produced by the Baicao, Xiushuihe and YQQ processing plants have an average iron content of 54-55%.

Vanadium-bearing ore is the major source of vanadium minerals. The addition of vanadium to steel is necessary to improve its strength, hardness and malleability. Steel containing 0.1% vanadium can be 10-20% stronger than steel that doesn't.

After the Sichuan earthquake in May 2008, the PRC Government promulgated the *Standard for classification of seismic protection in building construction*, which raised standards for the strength of steel used in building construction. China's *Adjustment and Revitalisation of the steel industry*, issued on 20 March 2009, requires nationwide utilisation of rebar with a strength of more than 400MPa (Grade III) to reach 60% or above by 2011. As vanadium is the only widely-used steel additive to increase steel strength, this could trigger more demand for vanadium-bearing iron ore.

Iron pellets

Iron pellets are generally made from iron concentrate mixed with bentonite clay, and are used in the production in the steel.

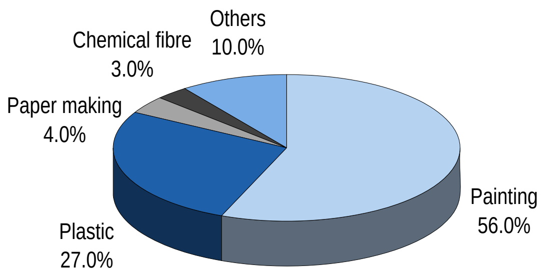
Titanium concentrate

According to the *Hatch* Report, demand for titanium and titanium-related products has been rising very rapidly in the PRC in recent years. To meet the increasing market demand for high-grade titanium-related products, the company has upgraded its processing technology and equipment to switch to producing high-grade titanium concentrate in 2010.

High-grade titanium concentrate can be processed to produce titanium pigment (TiO2) and titanium slag (titanium-related downstream products). Titanium slag can be further processed into titanium (exhibiting strength and erosion resistance), which is used widely in the shipping and aircraft industries.

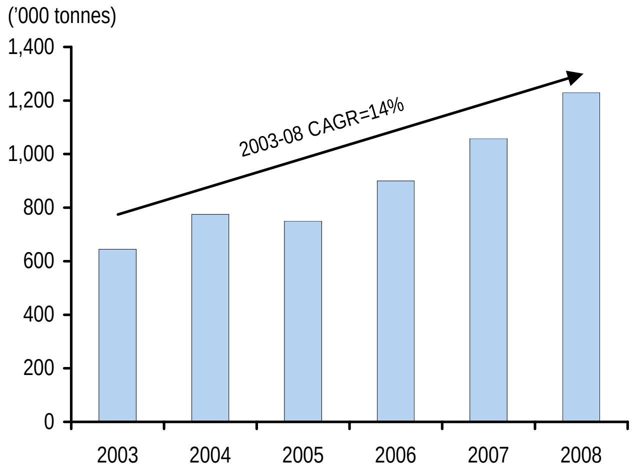
Downstream consumption of TiO^2 has been rising steadily over the past few years, at a 2003-08 CAGR of 14%. We believe China's large aeroplane projects going forward will improve the demand outlook for finished titanium products.

China: titanium pigment (TiO^2) consumption breakdown (2008)



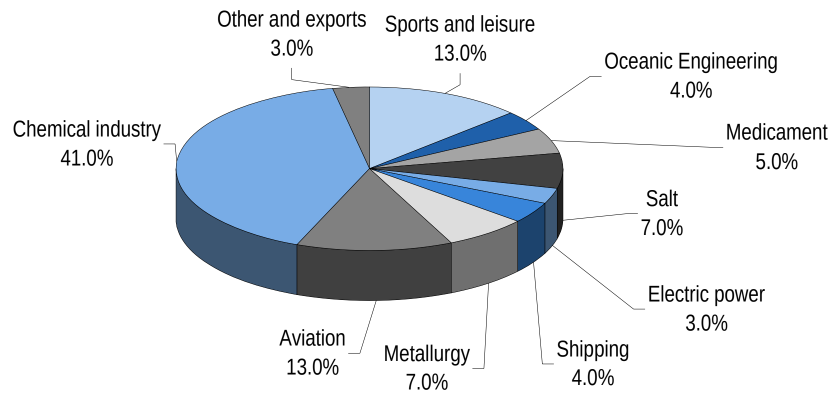
Source: *Journal of Electronic Science and Technology of China*, Hatch, Company

China: titanium finished products – downstream demand breakdown



Source: China Petroleum and Chemical Industry Association, Hatch, Company

China: breakdown of consumption of finished titanium products (2008)



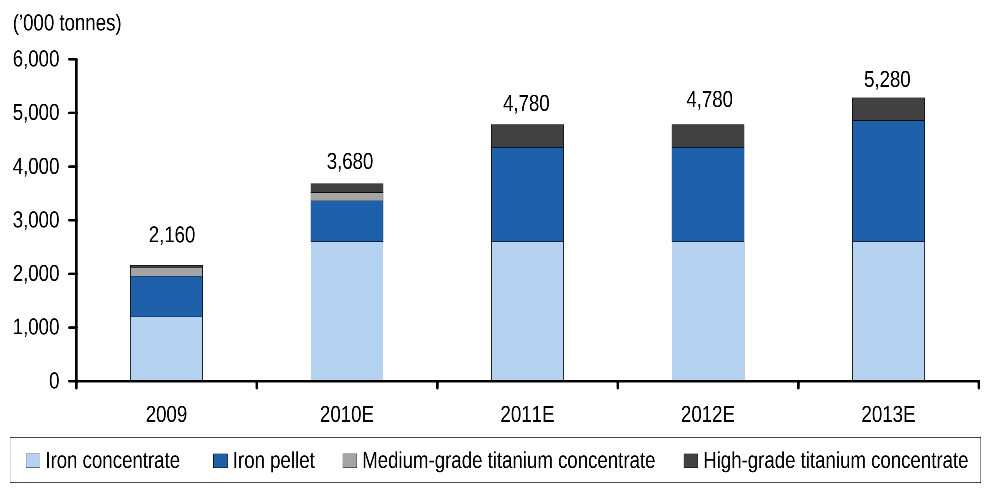
Source: China Nonferrous Metal Industry Association, Titanium Industry Council, Company

Production capacity increasing

We forecast the company's production capacity to increase to 4.78m t.p.a. in 2012, representing a 2009-12 CAGR of 30%, through expanding its existing facilities and new capacity expansion.

To meet the surging demand for iron ore, we forecast the company's output capacity for iron concentrate to expand to 2.6m t.p.a. by the end of 2010 from 1.9m t.p.a. in 2009, and for its output capacity for iron pellets to increase to 2.26m t.p.a. by the end of 2012, from 0.76m t.p.a. in 2009. To meet surging demand for titanium slag downstream, we forecast its output capacity for titanium concentrate to increase to 0.42m t.p.a. in 2011 from 0.05m t.p.a. in 2009.

China VTM Mining: output capacity growth

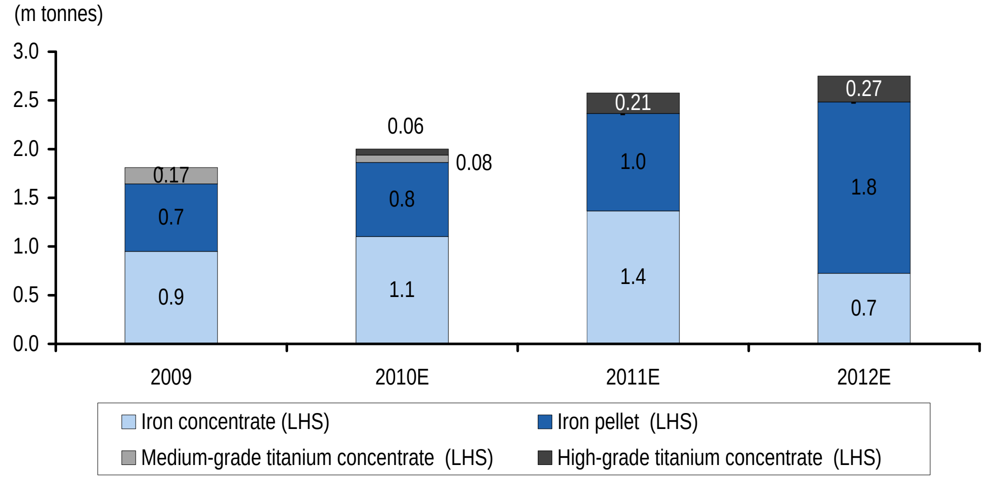


Source: Company, Daiwa forecasts

Sales volume to record double-digit-percentage growth

We forecast the company's iron-related products and titanium-concentrate production to record annual double-digit-percentage growth in 2010-12. We forecast the company's sales volume to increase at a CAGR of 17% in 2010-12 due to surging demand for iron ore in Sichuan Province. We forecast its sales volume for iron pellets to increase at a CAGR of 52% in 2010-12 due to 1m t.p.a. of new capacity that will commence production in 2H11. However, we forecast the sales volume for iron concentrate to decrease in 2012, as more than 70% of iron-concentrate output will be used for high gross-margin iron-pellet production. We look for sales volume of high-grade titanium concentrate to rise at a CAGR of 105% in 2010-12.

China VTM Mining: sales-volume breakdown by product



Source: Company, Daiwa forecasts

Broadening the customer base

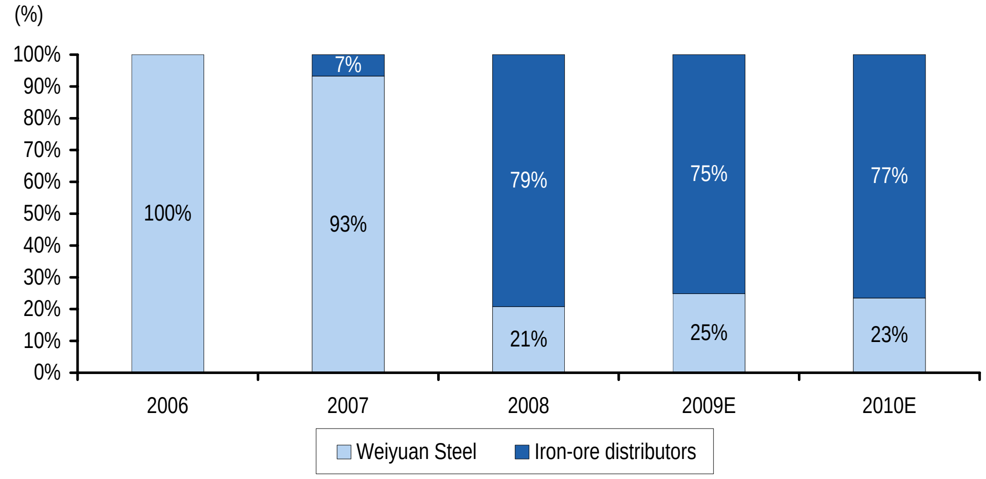
The company sells all of its products to customers located in Sichuan Province, due to limited inter-province transportation capacity. Going forward, with railways including Chengdu-Guiyang and Chengdu-Lanzhou starting operation, we expect the company to be also capable of expanding its sales outside of Sichuan.

In 2006-07, the company sold 93-100% of its products to a direct customer, namely Weiyuan Steel (a connected party in which company's majority shareholders own a 68% equity stake). At that time, sales to the direct customer accounted for 93-100% of the company's total sales volume.

Since 2008, company has expanded its customer base to distributors to reduce its reliance on the connected party. As a result, the company has improved its customer pool to include one direct customer and six iron-ore distributors since 2008. Sales volume generated from these distributors increased from 7% for 2006 to 79% for 2008, and we estimate to 75% for 2009 and 77% for 2010.

In our view, the company's customer-base diversification has been due mainly to: 1) strong production volume growth in 2006-09, during which sales volume increased at a CAGR of 71% from 0.36m tonnes to 1.81m tonnes, and 2) the company's operating subsidiaries are located near the Chengdu-Kunming railroad, which is the major transportation corridor in western China, leading to low logistics costs for customers.

China VTM Mining: customer breakdown by sales volume



Source: Company, Daiwa forecasts
Note: The breakdown ratio is based on the calculation of iron-concentrate and pellet sales volume

China VTM Mining: customer-base breakdown

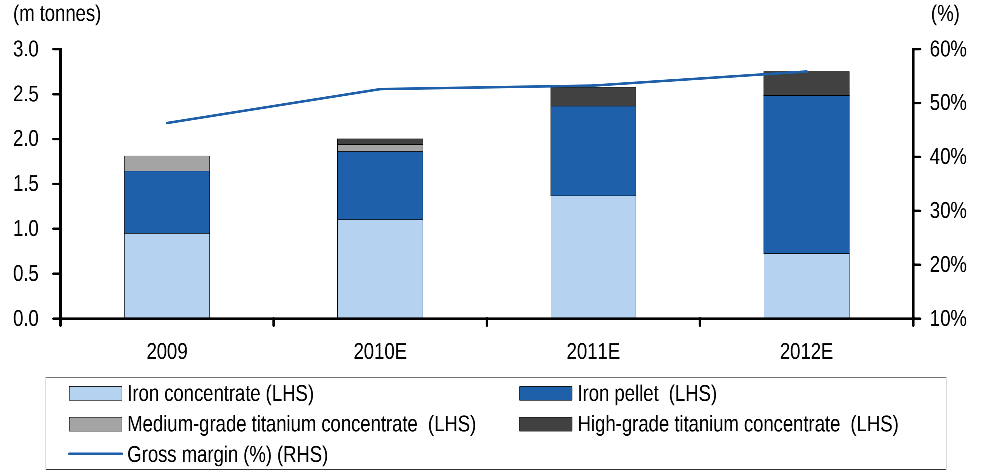
	2008		2009E		2010E	
	Actual sales volume (m tonnes)	Percentage of actual sales volume (%)	Contracted sales volume (m tonnes)	Percentage of contracted sales volume (%)	Contracted sales volume (m tonnes)	Percentage of contracted sales volume (%)
Iron concentrate:						
Director customer:						
Weiyuan Steel	0.26	19.4	0.45	24.8	0.47	23.5
Iron-ore distributors:						
Chengdu Yingchi	0.02	1.8	0.10	5.5	0.10	5.0
Deyang Henggu	0.21	15.9	0.10	5.5	0.10	5.0
Neijiang Jiaru	0.21	15.8	0.10	5.5	0.10	5.0
Chengdu Yushengtian	0.03	1.9	0.00	0.0	0.00	0.0
Independent third party D	0.00	0.0	0.06	3.3	0.00	0.0
Independent third party E	0.00	0.0	0.10	5.5	0.15	7.5
Independent third party F	0.00	0.0	0.04	2.2	0.13	6.5
Independent third party G	0.07	5.6	0.00	0.0	0.00	0.0
Independent third party H	0.00	0.0	0.00	0.0	0.00	0.0
Subtotal	0.80	60.4	0.95	52.5	1.05	52.4
Iron pellets:						
Director customer:						
Weiyuan Steel	0.02	1.4	0.00	0.0	0.00	0.0
Iron-ore distributors:						
Chengdu Yingchi	0.16	12.2	0.15	8.3	0.20	10.0
Deyang Henggu	0	0.0	0.15	8.3	0.15	7.5
Neijiang Jiaru	0	0.0	0.16	8.8	0.15	7.5
Chengdu Yushengtian	0.13	9.5	0.20	11.0	0.20	10.0
Independent third party E	0	0.0	0.03	1.7	0.08	4.0
Subtotal	0.31	23.1	0.69	38.1	0.78	39.0
Total	1.32	100.0	1.81	100.0	2.00	100.0

Source: Company, Daiwa forecasts

Margin improvement on upgrade to product mix

We expect the company's gross-profit margin to improve in 2010-12 due to a more optimised product mix and less outsourcing of concentrate processing. The optimised product mix is related to the production of higher value-added iron pellets and high-grade titanium concentrate (see following charts), as mentioned earlier. We look for the gross-profit margin to increase from 46% for 2009 to 52% for 2010, with further improvement likely upon further increases in production and sales of self-produced iron pellets.

Iron-ore sales rising and product mix improving due to strong demand

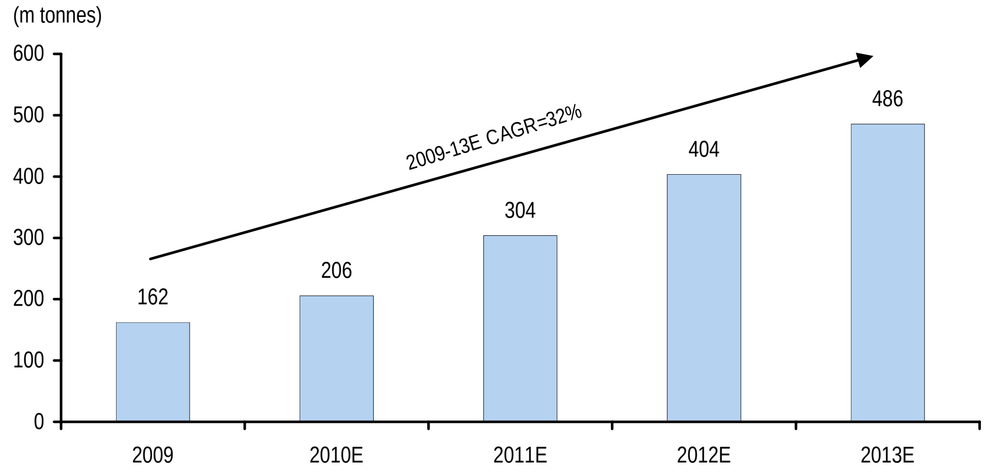


Source: Company, Daiwa forecasts

Strong resource-growth potential

By our estimates, the company's existing (available for mining) resources will increase by 44m tonnes, or 27% YoY, to 206m tonnes in 2010, supported by its acquisitions in the first half of this year of: 1) the YQQ mine with 18m tonnes, 2) the Cizuqing (CZQ) mine with 26m tonnes. We see great potential for the company to expand its iron-ore resources at a CAGR of 32% or up 200% over the 2009-13 period to 486m tonnes by 2013, backed by 1) the Xiushuihe mine iron resources expansion of 78m tonnes (the company expects to obtain the mining permit by the end of 2011 after the completion of exploration activities), 2) the YQQ neighbouring mine iron resources expansion by 82m tonnes, 3) the Jinzhi mine with 100m tonnes, 4) the Maoling mine with 10m tonnes, and 5) the Yanglongshan (YLS) mine with 10m tonnes.

Iron-ore resource growth from plentiful vanadium-bearing iron-ore resources in Sichuan



Source: Company, Daiwa forecasts

China VTM Mining: iron-ore resources

Mine name	Resource (m tonnes)	Reserves (m tonnes)	Ore type	Comment
Owned:				
Xiushuihe	40.0	18.7	Vanadium-bearing	In operation. The company obtained a two-year exploration permit covering another 78.2m tonnes of iron resources on 8 July 2009, and expects to obtain a mining permit in July 2011.
Baicao	122.0	60.0	Vanadium-bearing	In operation.
YQQ mine	18.0	8.4	Vanadium-bearing	In operation. Neighbouring iron-ore resources of 81.6m tonnes located between the YQQ mine and Baicao mine.
CZQ mine	26.0	12.2	Vanadium-bearing	The company has obtained an exploration permit for the mine.
Five option mines plus YLS:				
Jingzhi Mine	100.0	46.8	Vanadium-bearing	The company extended the option period for the Jinzhi mine acquisition by one year to 11 May 2011.
Maoling Mine	10.0	4.7	Hematite	The company will proceed with the Maoling acquisition if Maoling recommences operation by the end of 2010.
Luwan	7.9	3.7	Vanadium-bearing	Option mine for future acquisition.
Lagaluo	8.1	3.8	Vanadium-bearing	Option mine for future acquisition.
Huangcaoping	0.3	0.1	Vanadium-bearing	Option mine for future acquisition.
Yanglongshan Mine (YLS)	10.0	4.7	Hematite	The company retains the option to acquire YLS exploration rights

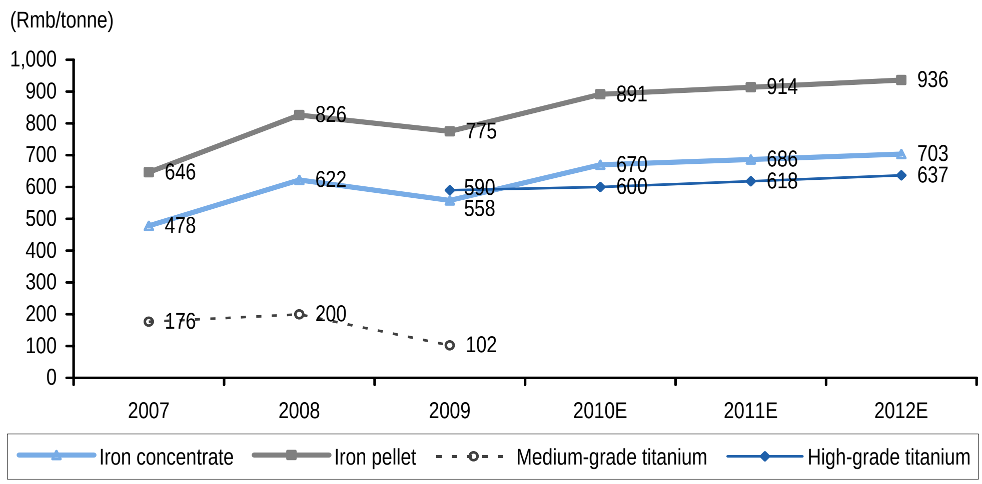
Source: Company, Daiwa forecasts

Selling prices likely to remain stable, supported by local demand

The following chart shows China VTM Mining's selling prices by product. We forecast selling prices of iron pellets and iron concentrate to increase by 2-3% YoY in 2011 and 2012 YoY, after rising by 15-20% YoY during 2010. We forecast selling prices of high-grade titanium concentrate to increase by 3% YoY for both 2011 and 2012, after being flat on a year-on-year basis during 2010.

The Daiwa regional iron-ore price forecast for Australian fines next year is US$129/tonne, up 0.6% YoY. For 2012, we look for the Australian fines price to decrease by 12% YoY to US$114/tonne. Our long-term price assumption of US$70/tonne is in line with our estimate of the long-term marginal cost of iron-ore production. Our forecast that iron prices in Sichuan Province will be higher than the regional price is due mainly to stronger crude-steel production growth and iron-ore demand within Sichuan, as well as the logistical costs of importing ore versus coastal regions.

China VTM Mining: selling price by product



Source: Company, Daiwa forecasts

Seaborne iron-ore contract-prices (FOB, US$)

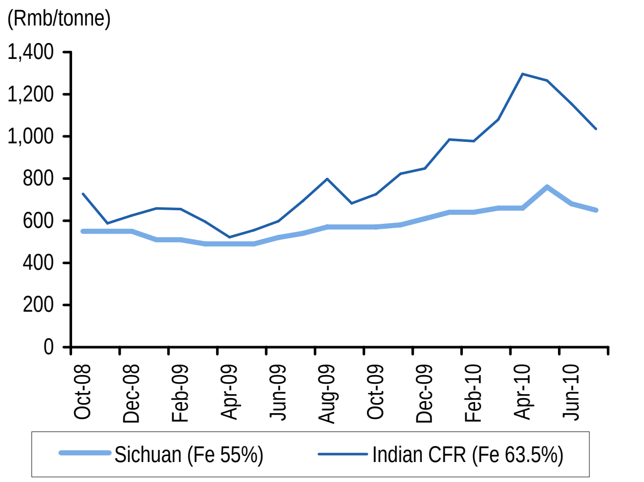
JFY ending March of year after	2005	2006	2007	2008	2009	2010E	2011E	2012E	2013E	2014E	2015E	LT
Iron ore (US$/dmt, 100% Fe, FOB)												
Vale itabira fines	38	66	72	119	85	168	169	149	134	121	109	95
BHP fines	43	73	80	145	97	203	204	179	161	145	131	110
BHP lumps	55	94	103	202	112	262	223	189	170	153	138	130
Iron ore adjusted to Fe grade FOB												
Vale itabira fines (66% grade)	25	43	48	83	59	117	118	104	93	84	75	66
BHP fines (63.5% grade)	27	46	51	92	62	129	129	114	102	92	83	70
Iron ore % chg. YoY												
Vale fines	71.5	19.0	9.5	65.0	(28.2)	97.1	0.6	(12.0)	(10.0)	(10.0)	(10.0)	(12.6)
BHP fines	71.5	19.0	9.5	79.9	(32.9)	108.7	0.6	(12.0)	(10.0)	(10.0)	(10.0)	(15.9)
BHP lumps	71.5	19.0	9.5	96.5	(44.5)	133.9	(15.0)	(15.0)	(10.0)	(10.0)	(10.0)	(5.7)

Source: Companies, Daiwa forecasts

Sichuan iron-ore price historically less volatile than those outside the province

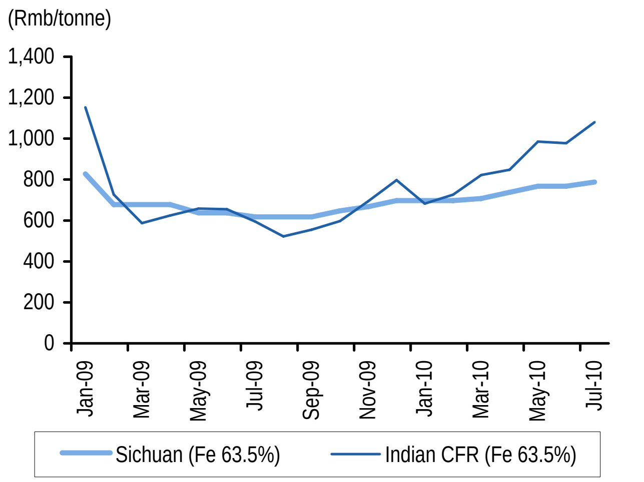
Iron-concentrate prices in Sichuan Province have been more stable over the past two years than regional prices, and instead are following longer-term trends because the province is largely self-sufficient and geographically remote for alternative sources. In the following charts, we compare the iron-ore price in Sichuan Province and the spot price in India (the one on the left without adjusting the prices for iron-ore grade and the other adjusted to the same grade of Fe 63.5%). During April and September 2009, spot iron-ore prices in India were quite volatile, down 12% MoM and 14% MoM, respectively, because of slowing imports from China, while prices in Sichuan Province remained stable. The Sichuan price also lags the regional spot price to the upside during periods of strong import demand from China.

Sichuan iron-concentrate (Fe 55%) price vs. Indian imported price (Fe 63.5%) (Rmb/tonne, incl. VAT)



Source: Custeel

Sichuan iron-concentrate (Fe 63.5%) price vs. Indian imported price (Fe 63.5%) (Rmb/tonne, incl. VAT)



Source: Custeel

Sales to customers – nearly 100% on contracts

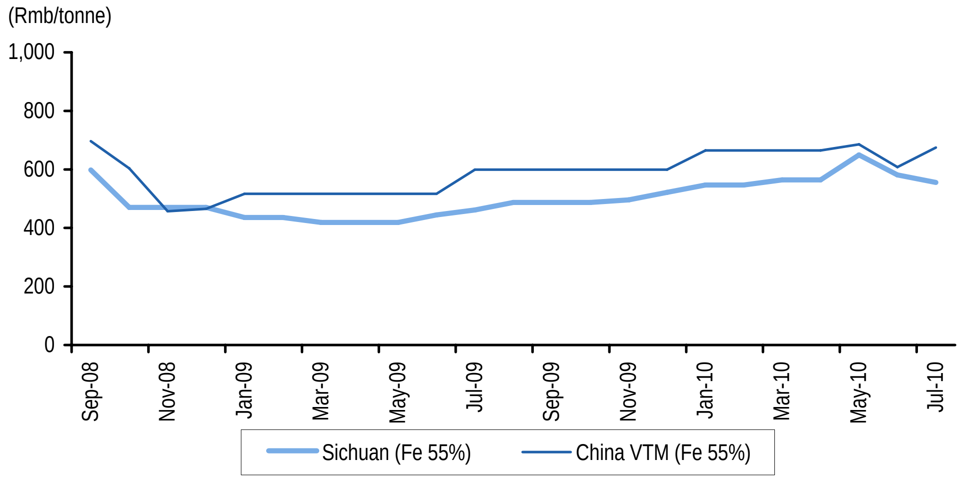
Company sells iron ore at contract prices

The company sells almost all of its iron-ore products on contracts that contain a floor with 50% upside exposure to spot-iron-ore price increases. The current two-year contract period is set to expire at the end of 2010. Management is evaluating its strategy for the next contract period, and while remaining comfortable with the previous contract, is considering increasing its exposure to the spot market given the positive market outlook. We see the company's bargaining position as strong, given its market share and the favourable outlook for iron-ore demand growth in Sichuan Province and the western region.

Company enjoys 50% buffer above contract price

The contract expiring at the end of 2010 is based primarily on the Sichuan market price of the given iron-ore product at the time of delivery. If the market price of the iron ore product falls below the contract sales price, the contract sales price remains unchanged. However, if the market price of the iron-ore product rises above the contract sales price, the contract sale price will be adjusted by up to 50% of the difference between the market price and the contract sales price.

China VTM Mining iron-concentrate selling price vs. Sichuan price (Rmb/tonne, excl. VAT)



Source: Custeel, Daiwa forecasts

Production-cost advantage

We estimate that the company's production cost of iron concentrate is lower than the average production cost in China because: 1) the company's iron-ore mines are all open-pit, with relatively thick ore at shallow depths, and 2) its mines were acquired at competitive prices, as we discussed previously in the Valuation comparison section.

Based on our estimates, the company's production cost of iron concentrate at a grade-adjusted 66% iron content is about Rmb442/tonne (US$65/tonne) (including DD&A), while China's average production cost for the same iron content is in the Rmb600-700/tonne (US$88-102/tonne) range.

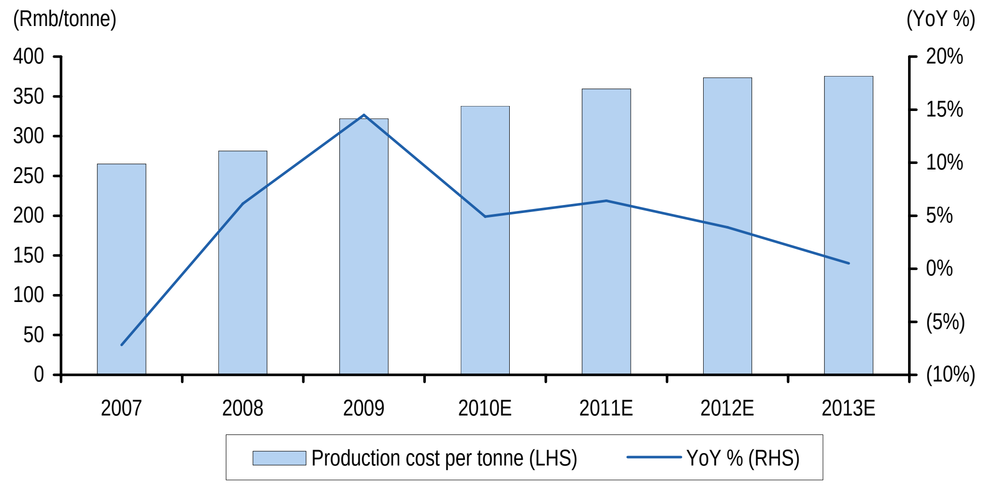
Production-cost increases likely to moderate ahead

We forecast the company's average production cost to increase at a CAGR of 5.2% over the 2010-12 period, which would represent a moderation from the 2007-10 CAGR of 8.9%, as a result of high start-up costs and low operating efficiency. We look for costs to moderate ahead due to: 1) increasing efficiency as production volume increases, and 2) iron-concentrate and pelletising processing fees to third parties decreasing as in-house processing capacity increases. We forecast the company's proportion of self-produced iron pellets to increase from 29% in 2009 to 47% in 2010, 60% in 2011, and 71% in 2012.

We forecast the company's iron-concentrate production-cost growth to ease from 2010, as it has acquired two iron-concentrate processing plants, Hegutian and Hailong (which used to be the company's third-party processors), with annual output capacity of 0.8m tonnes and 0.3m tonnes, respectively. We forecast production at the two plants to contribute 44% of the company's concentrate production in 2010. Given its existing (and the acquisition of these) processing facilities, we believe company is well positioned to control its production costs for iron concentrate.

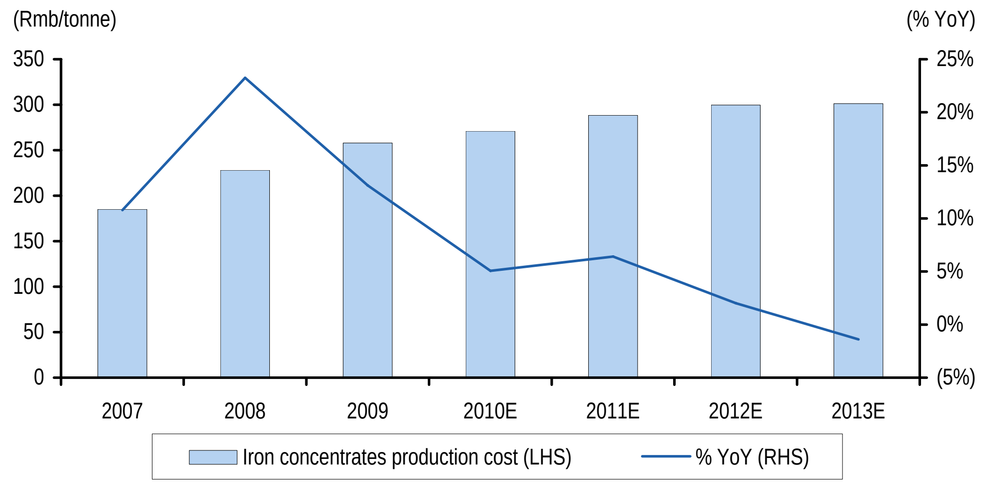
In terms of iron pellets, company is presently building a new iron-pellet production facility to increase its production to reduce outsourcing contracting fees paid to third parties (thus, securing more gross profit from the high-value-added products). The facility is located close to the Xiushuihe and Hegutian iron-concentrate processing plants with an annual capacity of 1m tonnes, and is scheduled to start operation in 2H11. Although production cost will increase during the period that the new capacity is ramping up production, we look for production costs to increase by a low-single-digit percentage given a high operating rate in 2012 and thereafter as we expect the proportion of self-produced products to increase significantly by then. We also see a strong possibility that the company will expand its iron-pellet facility capacity by 0.5m t.p.a. in 2012.

China VTM Mining: average production cost



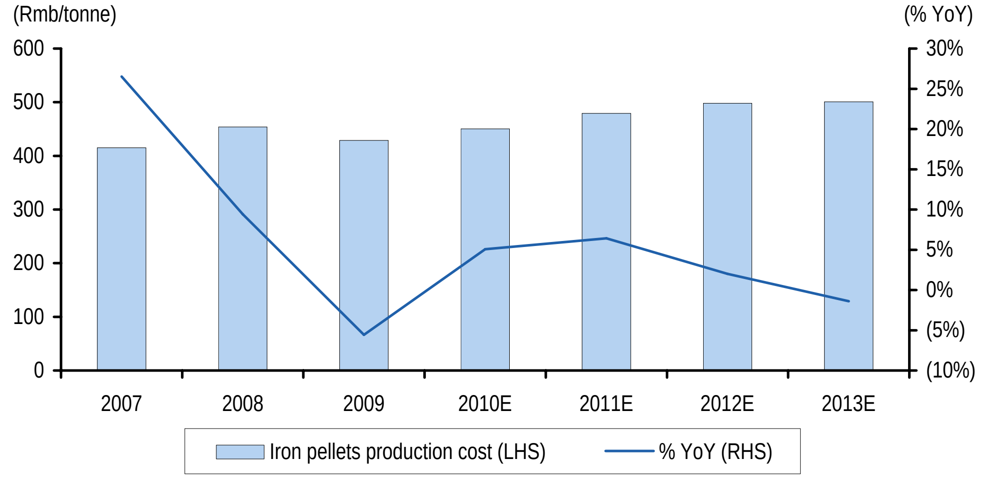
Source: Company, Daiwa forecasts

China VTM Mining: iron-concentrate production cost



Source: Company, Daiwa forecasts

China VTM Mining: iron-pellet production cost



Source: Company, Daiwa forecasts

Financials

Earnings sensitivity analysis

For 2010, we estimate that every 1% change in the annual selling price would have a 2% impact on the company's earnings, each 1% change in sales volume would impact the company's earnings by slightly above 1%, and each one-percentage-point change in the gross-profit margin would affect the company's earnings by 2.3%.

Healthy balance sheet

At the end of 2009, the company had Rmb1,784m net cash, with a low gearing ratio of 3.8%. We believe the healthy balance sheet would further facilitate the company's iron-resource acquisitions going forward.

Effective tax rate

As a foreign investment enterprise, the company is entitled to a tax holiday in 2007-08 and to a 50% tax reduction for 2009-11 to 12.5%. Its effective tax rate would return to the normal 25% in 2012.

Dividend policy

The company has not declared or paid any dividends since listing in August 2010, except for declaring a special dividend of Rmb20m in February 2009. We believe management may consider a 20% dividend-payout ratio beginning in 2011, although we have assumed no dividend payments in our financial forecasts.

ROE

We forecast the company's ROE to stabilise at 17% for 2010, and improve further to 19% for 2011, backed by increases in both the net-profit margin and its leverage.

Company profile

Management description

The company's chairman, Mr. Jiang Zhongping, used to work as a technician, head of the quality-control department, and the chief manager of the audit department of Chuan Wei Group (a connected party engaged principally in steel and cement production). He has over 19 years' experience in steel production and quality control.

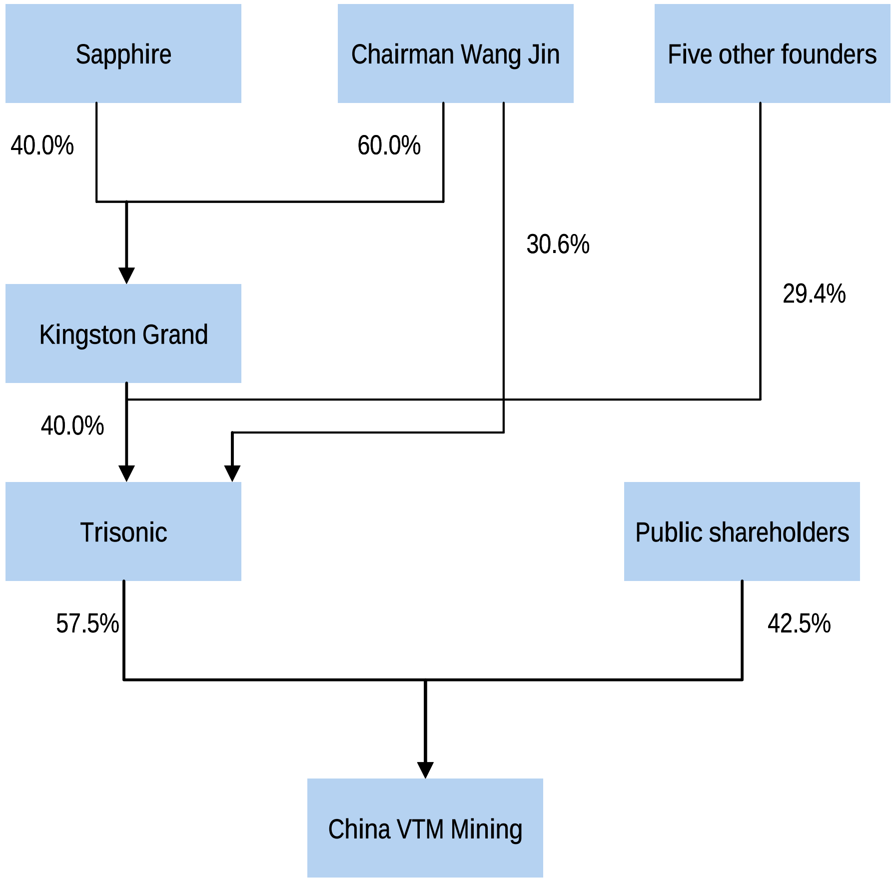
The chairman of the board Mr. Wang Jin, one of company's founders, as well as a non-executive director, has been the chairman of Chuan Wei Group since 1998. Mr. Wang has over 20 years' experience in steel production, raw-material procurement and operations management in the steel industry. He serves currently as a deputy of the PRC National People Congress, a director of the China Confederation of the Iron and Steel Industry, and a vice-chairman of the Sichuan Chamber of Commerce.

Shareholder re-organisation in May

On 18 May 2010, the board of directors announced that pursuant to the re-organisation carried out by Trisonic, Sapphire and the founders: 1) Sapphire transferred 25m shares, equivalent to 40.0% of the total issued share capital of Kingston, to the founders for an aggregate amount of US$30.08m (being the consideration for Sapphire's indirect interest in the other operation subsidiaries of Trisonic excluding the company) and Rmb231.344m (being the consideration for Sapphire's indirect shareholding of about 9.20% of the total issued share capital of the company), and 2) Trisonic transferred 190m shares, representing about 9.2% of the total issued share capital of the company, to Sapphire for Rmb231.344m. The purpose of the re-organisation was to simplify the corporate structure.

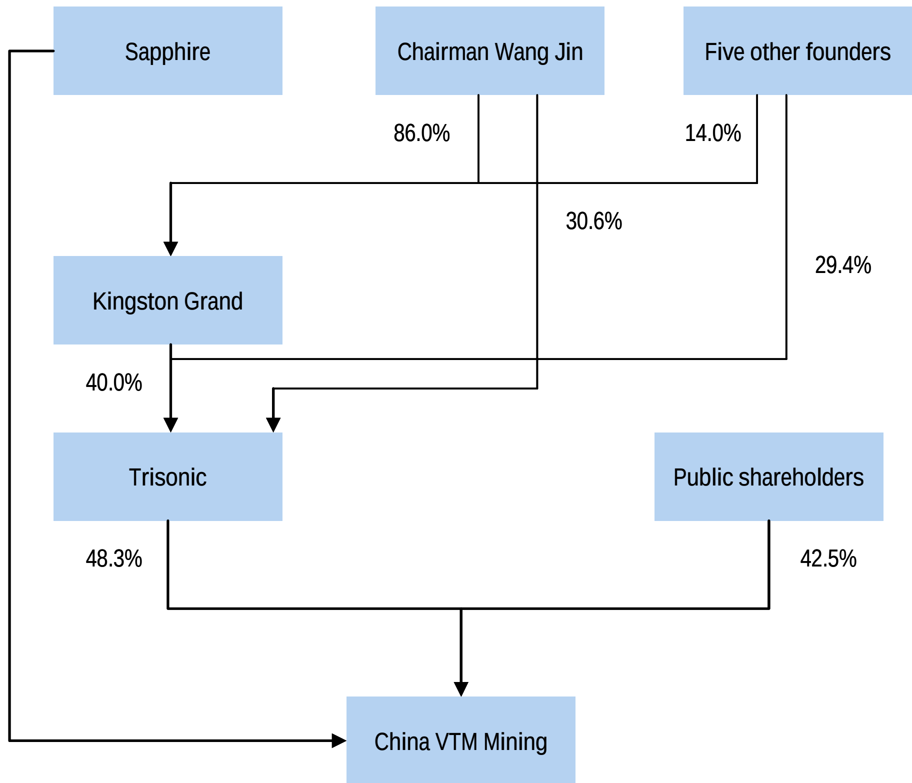
However, the restructuring didn't change the percentage stakes held by either Sapphire or the founders. Neither Sapphire nor the founders have sold any shares of China VTM Mining since its listing.

Shareholdings prior to Sapphire restructuring



Source: Company

Shareholdings prior to Sapphire restructuring

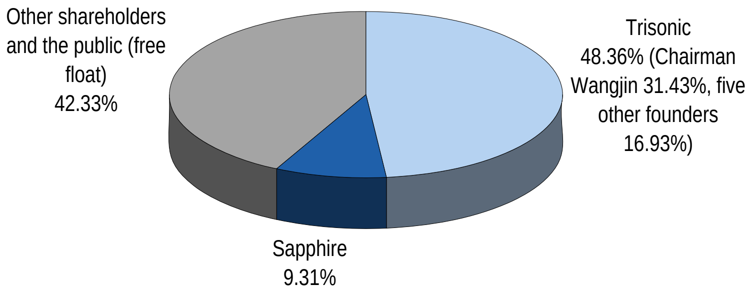


Source: Company

Shareholding structure

Following the completion of the group's shareholding restructuring, Trisonic increased its stake from 48.31% originally to 48.36% through purchases in the open market. In addition, Sapphire, which held a 9.2% stake in company, has increased its shareholding to 9.31% through open-market purchases.

China VTM Mining: shareholding structure (as of 18 May 2010)



Source: Company

Investment risks

Uncertainties associated with mining and processing operations

The company's mining and processing operations are subject to a number of operating risks and hazards that are beyond company's control. Natural disasters, such as earthquakes, floods and snowstorms may delay the production and delivery of products and/or increase the costs associated with mining and processing operations, and transportation. We regard the operating risks and hazard risk for the company as moderate.

Acquisition plan for additional mineral reserves may not succeed

The company intends to acquire exploration and mining rights in the future to expand its mineral reserves. However, it could encounter intense competition during the expansion process, and may fail to select or value targets appropriately. We believe the risk that the company will not succeed in its mineral-reserve acquisition is moderate.

Dependence on reliable and adequate transportation capacity

Iron ore and iron-related products are bulky, heavy and difficult to transport in the large quantities required by downstream users. Fluctuations in transportation costs may have a detriment effect on demand for the company's products. We believe the risk of the company's unstable transportation capacity and costs is low.

Appendix I – China 'Go West' development policy

March 2010 marks the 10th anniversary of the country's 'Go West' development policy between March 2000 and March 2010. This covers six provinces (Sichuan, Gansu, Guizhou, Qinghai, Shaanxi, and Yunnan), five autonomous regions (Xinjiang, Guangxi, Inner Mongolia, Ningxia, Tibet), and one municipality (Chongqing).

The western area makes up 71% of the PRC by area, but accounted for only 23% of the country's GDP in 2008. The urbanisation rate of western China lags the country's average significantly, with the former's GDP per capita around 40-80% lower than the country's average GDP per capita between 2001 and 2008.

Why does China have to 'Go West'?

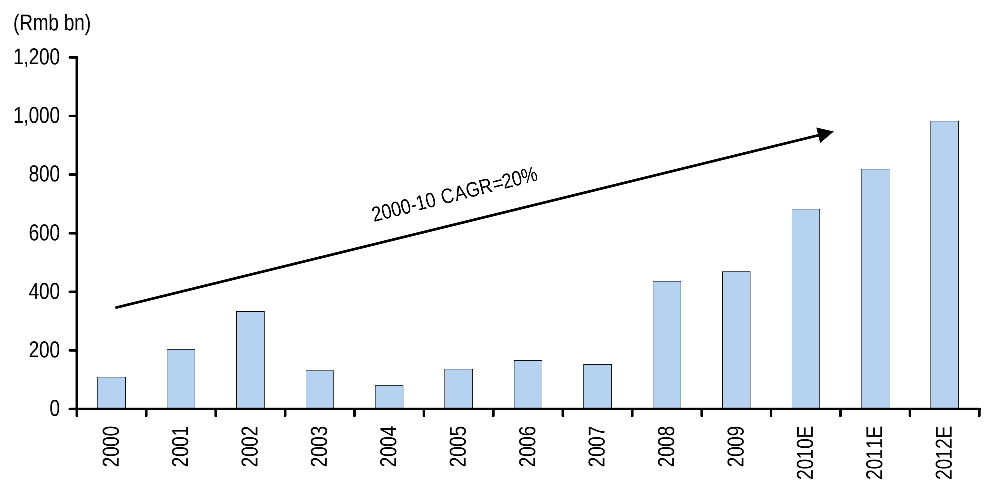
We expect the government to start withdrawing its stimulus policies gradually by the end of 2010. To avoid a big slide in FAI that could have an adverse impact on the country's economic growth, China's next step is to seek new catalysts in underdeveloped regions to bolster economic growth.

We see the underdeveloped region of western China as an emerging driver that could boost the country's economic growth over the next one-to-two decades. China's nominal GDP over the past decade was driven largely by eastern Yangtze River Delta and southern Zhujiang Delta growth acceleration. The economic growth rates for these regions are likely to ease in the future due to infrastructure maturation. Partly as a result of first batch of 'Go West' policy over the past 10 years, GDP in western China rose at a CAGR of 15% in 2000-09, slightly higher than country's CAGR of 14.7%.

At a celebration meeting of the country's past 10-year 'Go West' development in March 2010, Mr. Hu, the president of the country, pointed out that the 'Go West' development strategy will be one of the key areas of focus in the upcoming *12th Five-Year Plan*. At a western development meeting in July 2010, the State Council said that the western region would be an important industry base for energy, resources processing and equipment manufacturing in the March 2010-March 2020 decade. In August 2010, the PRC central bank talked about its western branch providing financial support for western China's development.

On 6 July 2010, the NDRC said that the country would launch invest Rmb682.2bn in 23 projects in the western from 2010, representing a 45% YoY increase. We believe is the start of a new round of investment plans for the future. Between 2000 and 2010, investment in new infrastructure projects in western China is set to increase at a CAGR of 20.2% (see following chart).

Investment of new infrastructure projects amid 'Go West' policy in 2000-10



Source: various media reports, Daiwa forecasts

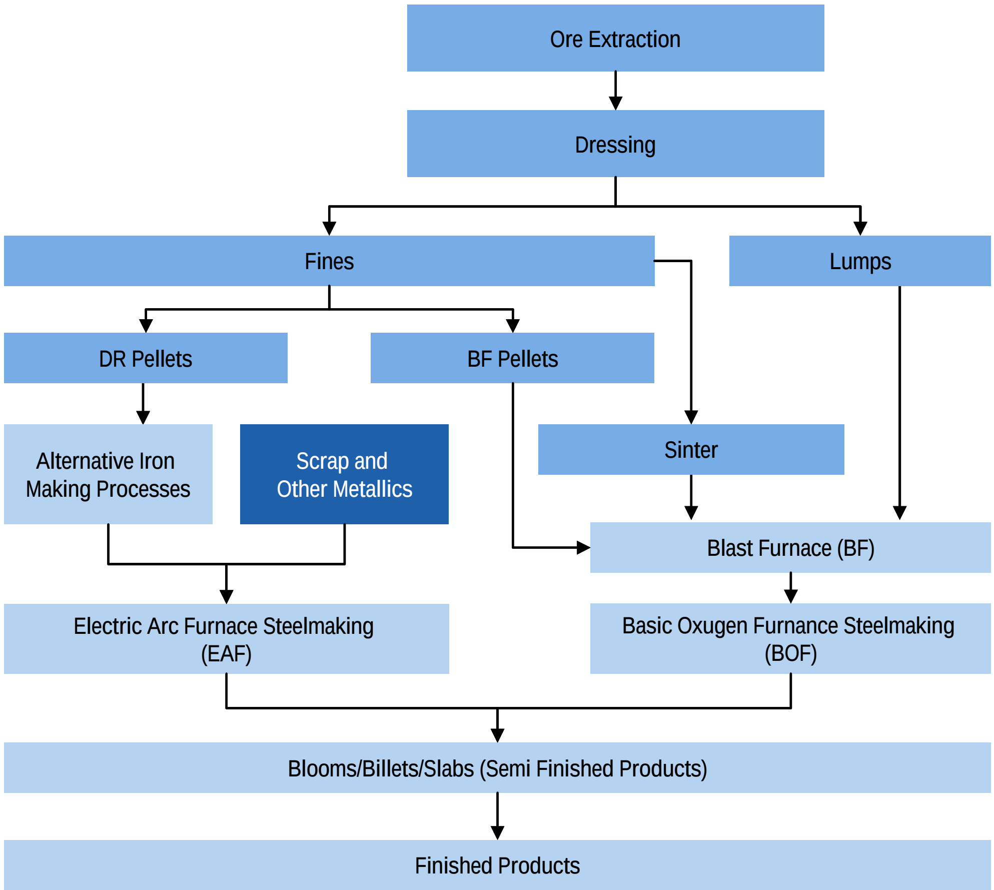
Between 2001 and 2009, FAI in Sichuan Province rose at a CAGR of 26.6%, which was higher than the 23.8% for the country overall. In particular, Sichuan's FAI growth perked up in 2004, and outperformed the country's growth rate afterwards.

Railway projects in the western region to be accelerated

China plans to accelerate its railway building over the next couple of years. In particular, the country intends to extend its western-region railways to 50,000 km by 2020 from 30,000 km by 2008, according to China railway official, Mr. Yan Hexiang, deputy director of the development planning department of the Ministry of Railways (MOR) in November 2009. The ministry will accelerate the current building projects, and push for the early construction of lines such as those connecting Chengdu and Guiyang, Chongqing and Guiyang, and Kunming and Nanning. Sichuan intends to invest Rmb40bn (equating to 6% of the PRC's railway FAI in 2009) per annum in railways up to 2020.

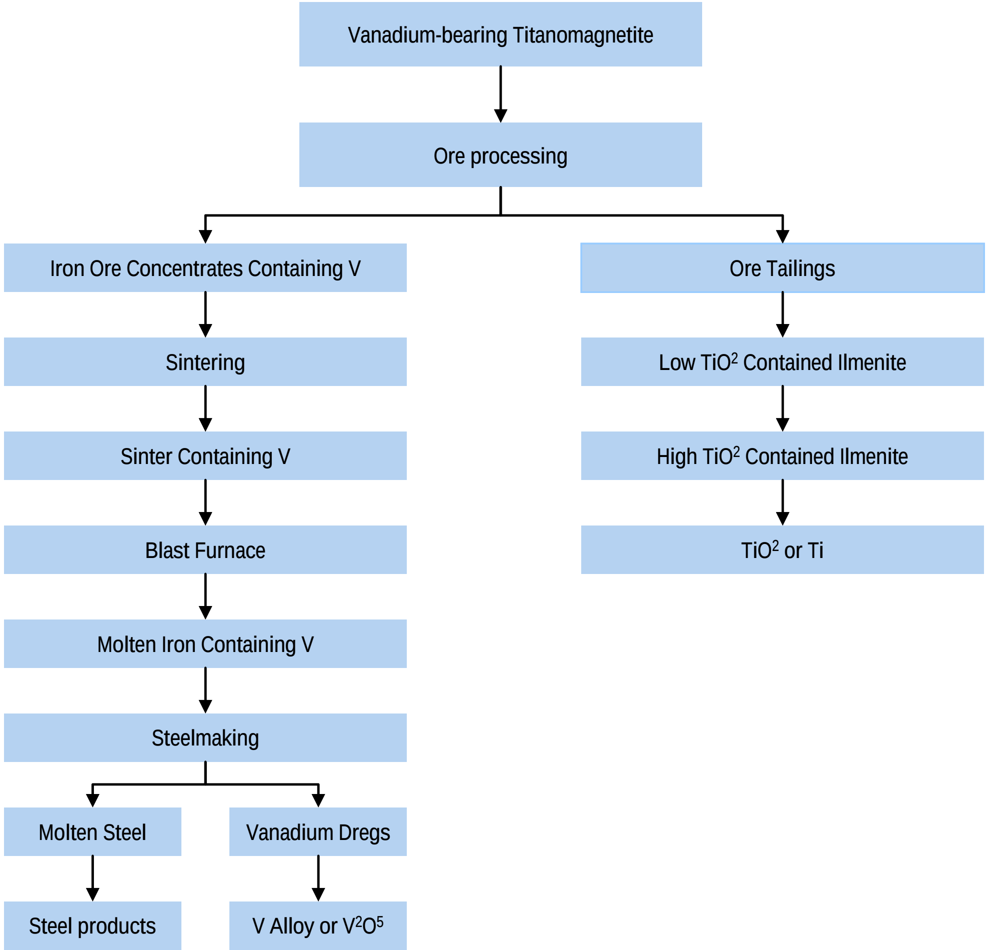
Appendix II – process routes

Process routes from ore to steel



Source: Company

Process routes and utilisation of vanadium-bearing titano-magnetite



Source: Company

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