

## China Vanadium Titano-Magnetite Mining (893 HK)

Rating: **1**

### Iron ore acquisitions are positive steps to meet future growth targets

Materials: China

Target price: **HK\$4.50**

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<b>Price (16 Nov)</b>	<b>HK\$3.77</b>
Reuters code	0893.HK
ADR/GDR code	n.a.
Shares per ADR/GDR	n.a.

#### Market data

HSI		23,693.02
Market cap	(US\$bn)	1.01
EV	(US\$m: 10E)	865.14
3-mth avg daily T/O	(US\$m)	6.36
Shares outstanding	(m)	2,075
Free float	(%)	42.1
Major shareholder	Trisonic INTL LTD	(48.4%)
Exchange rate	Rmb/US\$	6.644
	HK\$/US\$	7.752

<b>Performance (%)*</b>	<b>1M</b>	<b>3M</b>	<b>6M</b>
Absolute	5.3	36.6	8.7
Relative	5.6	24.4	(9.0)

Source: Daiwa  
Note: \*Relative to HSI

#### Investment indicators

	2010E	2011E	2012E
PER (x)	13.4	9.5	8.8
PCFR (x)	10.9	7.5	6.2
EV/EBITDA (x)	7.8	5.0	3.3
PBR (x)	2.2	1.8	1.5
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
Relative to peers			In line
Relative to history			In line

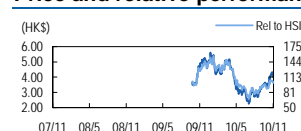
Source: Daiwa forecasts

#### Income summary (Rmb m)

Yr to 31 Dec	2009	2010E	2011E	2012E
Revenue	1,084	1,426	1,981	2,327
YoY (%)	37.0	31.6	38.9	17.5
EBITDA	488	740	1,017	1,242
YoY (%)	29.1	51.4	37.5	22.0
Net profit	328	501	705	758
YoY (%)	31.8	52.7	40.8	7.5
EPS (Rmb)	0.201	0.241	0.340	0.365
YoY (%)	21.3	19.9	40.8	7.5
EPS (HK\$)	0.235	0.282	0.396	0.426
CFPS (Rmb)	0.210	0.297	0.433	0.523
DPS (Rmb)	0.000	0.000	0.000	0.000
DPS (HK\$)	0.000	0.000	0.000	0.000

Source: Company, Daiwa forecasts

#### Price and relative performance



Source: Bloomberg, Daiwa

#### Forecasts revisions (%)

	FY10E	FY11E	FY12E
Revenue change	0.0	0.0	0.0
Net profit change	0.0	0.0	0.0
EPS change	0.0	0.0	0.0

Source: Daiwa forecasts

#### Fair value

Valuation (HK\$/shr)	4.50
Methodology	Our target is based on a DCF valuation.
Key assumption	Fair value is based on 2010 NPV valuation.

Source: Daiwa forecasts

### What has changed?

- The acquisition agreements include an additional 78.2mt of resources (38% of the current total) and are an integral part of the long-term strategy to more than double resources by the end of 2013. We reiterate our **1 (Buy)** recommendation.

### Impact

- The acquisitions total US\$89m (8% of market cap) comprising US\$66.8m to buy out the 7.23% minority interest in China Vanadium Titano-Magnetite Mining's (China VTM) main operating subsidiary, Huili Caitong (Not listed), and US\$22.3m for the entire equity interest in Aba Mining (Not listed). Subject to certain conditions, the acquisition is expected to be finalised in early 2011.
- The agreements constitute connected transactions as the founders and substantial shareholders of China VTM and companies they control hold over a 30% equity interest in Chuan Wei (Not listed), the seller of the abovementioned assets.
- Huili Caitong is the major operating subsidiary of China VTM. It contributed over 90% of total revenue and net profit for the past three financial years. Upon completion of the Huili Caitong acquisition agreement, Huili Caitong will become a wholly-owned subsidiary of China VTM.
- The assets of Aba Mining are the *Maoling Mine*, exploration extensions of the *Maoling Mine*, the *Yanglongshan Mine*, and a production line with an annual capacity of 150,000 tonnes of iron concentrates (8% of forecast 2010 China VTM production). Aba Mining's reserves total 20mt and resources 58.2mt.
- The iron content of the iron concentrates from the ore of the *Maoling Mine* are of grade 23% but could reach grade 65% or more through magnetic beneficiation, which would could be sold at a higher price compared with lower-grade material.
- The trial production of iron-ore concentrate of the *Maoling Mine* is expected to begin in December 2010 and reach 150,000 t.p.a. in 2012. It is currently expected that the *Yanglongshan Mine* will commence production in 2013 at a rate of 100,000 t.p.a., which would raise total production of Aba Mining to 250,000 t.p.a.
- Our forecast calls for total iron-concentrate production of 2.0mt in 2010, increasing to over 3.0mt in 2012 including the acquisitions mentioned above.

### 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, sizeable discounts to the regional and domestic peer group. Our EPS forecast is in line with the Bloomberg consensus for 2011.

### Catalysts and action

- Regional iron-ore prices have increased to US\$164/t, up 13% from the recent low in early September. The favourable level of prices should allow the company to maintain a strong position in its year-end price negotiations.
- We look for further reserve acquisitions and iron-ore production growth to help drive earnings growth into 2012, which are not fully factored into our forecasts. Given the positive pricing and volume-growth outlook, we reiterate our **1 (Buy)** rating on the shares.

### 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.

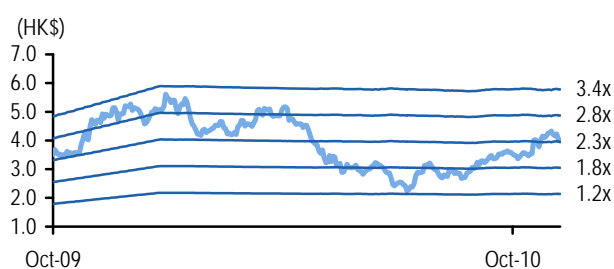
## China Vanadium Titano-Magnetite Mining – financial summary

Profit and loss (Rmb m)						Balance sheet (Rmb m)					
Year to 31 Dec	2008	2009	2010E	2011E	2012E	As at 31 Dec	2008	2009	2010E	2011E	2012E
Iron concentrate	496	530	703	938	510	Cash & short-term investment	133	1,884	1,411	2,210	3,245
Iron pellet	252	537	677	914	1,648	Inventory	66	71	79	109	121
Others	43	17	46	130	169	Accounts receivable	88	137	185	258	302
<b>Total revenue</b>	<b>791</b>	<b>1,084</b>	<b>1,426</b>	<b>1,981</b>	<b>2,327</b>	Other current assets	119	141	203	242	259
Other income	17	41	16	0	0	<b>Total current assets</b>	<b>406</b>	<b>2,233</b>	<b>1,879</b>	<b>2,818</b>	<b>3,928</b>
COGS	(338)	(540)	(608)	(835)	(934)	Fixed assets	357	496	1,472	1,580	1,687
SG&A	(55)	(64)	(86)	(129)	(151)	Goodwill & intangibles	156	157	216	166	166
Other op. expenses	(64)	(76)	(77)	(91)	(94)	Other non-current assets	32	187	336	252	0
<b>EBIT</b>	<b>352</b>	<b>446</b>	<b>671</b>	<b>926</b>	<b>1,148</b>	<b>Total assets</b>	<b>951</b>	<b>3,073</b>	<b>3,902</b>	<b>4,816</b>	<b>5,781</b>
Net-interest inc./(exp.)	(3)	(9)	(23)	(12)	(12)	Short-term debt	0	100	150	150	150
Assoc/forex/extraord./others	0	0	0	0	0	Accounts payable	108	86	97	134	149
<b>Pre-tax profit</b>	<b>349</b>	<b>437</b>	<b>649</b>	<b>914</b>	<b>1,136</b>	Other current liabilities	182	275	310	378	505
Tax	(30)	(70)	(86)	(122)	(284)	<b>Total current liabilities</b>	<b>290</b>	<b>461</b>	<b>558</b>	<b>661</b>	<b>805</b>
Min. int./pref. div./others	(70)	(39)	(62)	(87)	(94)	Long-term debt	0	0	150	150	100
<b>Net profit (reported)</b>	<b>249</b>	<b>328</b>	<b>501</b>	<b>705</b>	<b>758</b>	Other non-current liabilities	57	6	6	6	6
<b>Net profit (adj.)</b>	<b>249</b>	<b>328</b>	<b>501</b>	<b>705</b>	<b>758</b>	<b>Total liabilities</b>	<b>347</b>	<b>467</b>	<b>714</b>	<b>817</b>	<b>910</b>
<b>EPS (reported) (Rmb)</b>	<b>0.166</b>	<b>0.201</b>	<b>0.241</b>	<b>0.340</b>	<b>0.365</b>	Share capital	618	183	183	183	183
<b>EPS (adj.) (Rmb)</b>	<b>0.166</b>	<b>0.201</b>	<b>0.241</b>	<b>0.340</b>	<b>0.365</b>	Reserves/R.E./others	(79)	2,331	2,851	3,575	4,352
<b>DPS (Rmb)</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>0.000</b>	<b>Shareholders' equity</b>	<b>539</b>	<b>2,514</b>	<b>3,033</b>	<b>3,757</b>	<b>4,535</b>
<b>EBIT (adj.)</b>	<b>352</b>	<b>446</b>	<b>671</b>	<b>926</b>	<b>1,148</b>	Minority interests	65	93	155	242	336
<b>EBITDA (adj.)</b>	<b>378</b>	<b>488</b>	<b>740</b>	<b>1,017</b>	<b>1,242</b>	<b>Total equity &amp; liabilities</b>	<b>951</b>	<b>3,073</b>	<b>3,902</b>	<b>4,816</b>	<b>5,781</b>
						<b>Net debt/(cash)</b>	<b>(133)</b>	<b>(1,784)</b>	<b>(1,111)</b>	<b>(1,910)</b>	<b>(2,995)</b>

Cash flow (Rmb m)						Key ratios					
Year to 31 Dec	2008	2009	2010E	2011E	2012E	Year to 31 Dec	2008	2009	2010E	2011E	2012E
Profit before tax	349	437	649	914	1,136	Sales – YoY %	115.8	37.0	31.6	38.9	17.5
Depreciation and amortisation	27	43	68	91	94	EBITDA (adj.) – YoY %	320.9	29.1	51.4	37.5	22.0
Tax paid	(27)	(32)	(70)	(86)	(122)	Net profit (adj.) – YoY %	363.2	31.8	52.7	40.8	7.5
Change in working capital	(139)	(78)	(32)	(20)	(22)	EPS (adj.) – YoY %	363.2	21.3	19.9	40.8	7.5
Other operational CF items	213	(27)	0	0	0	EBITDA margin % (adj.)	47.8	45.1	51.9	51.4	53.4
<b>Cash flow from operations</b>	<b>423</b>	<b>342</b>	<b>616</b>	<b>899</b>	<b>1,086</b>	EBIT margin % (adj.)	44.5	41.1	47.1	46.8	49.3
Capex	(173)	(239)	(1,274)	(200)	(200)	Net-profit margin % (adj.)	31.4	30.2	35.1	35.6	32.6
Net (acquisitions)/disposal	0	1	0	0	0	ROAE (%)	46.1	13.0	16.5	18.8	16.7
Other investing CF items	(94)	(90)	(4)	0	0	ROAA (%)	26.1	10.7	12.8	14.6	13.1
<b>Cash flow from investing</b>	<b>(267)</b>	<b>(328)</b>	<b>(1,278)</b>	<b>(200)</b>	<b>(200)</b>	ROCE (%)	58.2	16.5	19.3	21.5	22.4
Change in debt	(30)	100	200	0	(50)	ROIC (%)	68.3	45.5	28.0	38.4	45.9
Net share issues/(repurchases)	0	1,773	0	0	0	Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Dividends paid	0	(24)	0	0	0	Effective tax rate (%)	8.6	16.0	13.3	13.3	25.0
Other financing CF items	0	(111)	0	0	0	Accounts receivable (days)	20.2	37.9	41.3	40.8	43.9
<b>Cash flow from financing</b>	<b>(30)</b>	<b>1,737</b>	<b>200</b>	<b>0</b>	<b>(50)</b>	Payables (days)	43.1	32.7	23.4	21.3	22.2
Forex effect/others	0	(1)	(10)	0	0	Net interest cover (x)	115.4	48.2	29.6	75.1	93.1
<b>Change in cash</b>	<b>126</b>	<b>1,751</b>	<b>(473)</b>	<b>699</b>	<b>836</b>	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

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