

## Equities

15 March 2011 | 9 pages

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

## 2010 Results: Solid Earnings; Eyes M&A

- Profits came in 5% ahead of consensus but 8% below our estimate** — Net profit jumped 63% yoy, thanks to 39% volume growth (iron concentrates) and margin expansion. Gross margin rose from 46% to 53%, with ASP reaching the company's historical peak.
- More vertically integrated** — China Vanadium raised capacities for iron concentrates and titanium concentrates from 1.9 Mt and 0.3 Mt to 2.5 Mt and 0.31 Mt, respectively. Pellet capacity remains the same at 0.76Mt.
- Realized price could rise further in 2H11** — ASP rose Rmb558/tonne in 09 to Rmb665/tonne in 10 for concentrates, and from Rmb775/tonne in 09 to Rmb875/tonne in 10 for pellets. The contractual floor price has been set at Rmb600/tonne for 1H11. Management expects prices to rise in 2H11 when new steel capacities in Sichuan start ramping up. Additional capacity is estimated at 10 Mt, with total capacity reaching 25Mt, implying iron ore demand of c. 40Mt and a supply gap of 10Mt.
- M&A potential** — The acquisition option of the Xiaoheiqing Jingzhi mine will expire in May 2011. If the acquisition can't be finalized, the option is expected to be extended further. The country assigned two national production centers for iron ore, i.e., Hebei and Panzhihua, which are rich in iron ore resources. Sichuan has iron ore reserves of 3.1bn tonnes (excl. vanadium-bearing titano-magnetite), approximately 13.8% of the national reserve in 2007. The company has already set its eyes on potential targets.
- Maintain Buy, target at HK\$5.10** — We remain positive on the stock, reiterating our Buy rating and target price of HK\$5.10

- Company Update
- Estimate Change

|                              |                        |
|------------------------------|------------------------|
| <b>Buy/Low Risk</b>          | 1L                     |
| Price (15 Mar 11)            | HK\$3.11               |
| Target price                 | HK\$5.10               |
| Expected share price return  | 64.0%                  |
| Expected dividend yield      | 1.6%                   |
| <b>Expected total return</b> | <b>65.6%</b>           |
| Market Cap                   | HK\$6,453M<br>US\$828M |

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



### Statistical Abstract

| Year to 31 Dec | Net Profit (RmbM) | Diluted EPS (Rmb) | EPS growth (%) | P/E (x) | P/B (x) | ROE (%) | Yield (%) |
|----------------|-------------------|-------------------|----------------|---------|---------|---------|-----------|
| 2009A          | 328               | 0.158             | -4.7           | 16.6    | 2.2     | 21.5    | 0.0       |
| 2010A          | 533               | 0.257             | 62.7           | 10.2    | 2.0     | 20.2    | 1.8       |
| 2011E          | 830               | 0.400             | 55.7           | 6.6     | 1.6     | 27.1    | 2.7       |
| 2012E          | 852               | 0.411             | 2.6            | 6.4     | 1.3     | 23.0    | 2.8       |
| 2013E          | 927               | 0.447             | 8.8            | 5.9     | 1.1     | 20.9    | 3.0       |

Source: Powered by dataCentral

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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| Fiscal year end 31-Dec                   | 2009         | 2010          | 2011E        | 2012E        | 2013E        |
|--|--------------|---------------|--------------|--------------|--------------|
| <b>Valuation Ratios</b>                  |              |               |              |              |              |
| P/E adjusted (x)                         | 16.6         | 10.2          | 6.6          | 6.4          | 5.9          |
| EV/EBITDA adjusted (x)                   | 9.9          | 5.2           | 3.4          | 2.5          | 1.8          |
| P/BV (x)                                 | 2.2          | 2.0           | 1.6          | 1.3          | 1.1          |
| Dividend yield (%)                       | 0.0          | 1.8           | 2.7          | 2.8          | 3.0          |
| <b>Per Share Data (Rmb)</b>              |              |               |              |              |              |
| EPS adjusted                             | 0.158        | 0.257         | 0.400        | 0.411        | 0.447        |
| EPS reported                             | 0.158        | 0.257         | 0.400        | 0.411        | 0.447        |
| BVPS                                     | 1.212        | 1.337         | 1.614        | 1.951        | 2.319        |
| DPS                                      | 0.000        | 0.047         | 0.071        | 0.073        | 0.080        |
| <b>Profit &amp; Loss (RmbM)</b>          |              |               |              |              |              |
| Net sales                                | 1,084        | 1,554         | 2,074        | 2,397        | 2,591        |
| Operating expenses                       | -679         | -865          | -961         | -1,105       | -1,188       |
| <b>EBIT</b>                              | <b>405</b>   | <b>689</b>    | <b>1,112</b> | <b>1,292</b> | <b>1,403</b> |
| Net interest expense                     | -9           | -15           | -2           | 1            | 2            |
| Non-operating/exceptionals               | 41           | 27            | -17          | -18          | -18          |
| <b>Pre-tax profit</b>                    | <b>437</b>   | <b>701</b>    | <b>1,094</b> | <b>1,275</b> | <b>1,387</b> |
| Tax                                      | -70          | -117          | -164         | -319         | -347         |
| Extraord./Min.Int./Pref.div.             | -39          | -51           | -100         | -104         | -113         |
| <b>Reported net income</b>               | <b>328</b>   | <b>533</b>    | <b>830</b>   | <b>852</b>   | <b>927</b>   |
| Adjusted earnings                        | 328          | 533           | 830          | 852          | 927          |
| Adjusted EBITDA                          | 459          | 803           | 1,289        | 1,482        | 1,596        |
| <b>Growth Rates (%)</b>                  |              |               |              |              |              |
| Sales                                    | 37.0         | 43.4          | 33.4         | 15.6         | 8.1          |
| EBIT adjusted                            | 21.0         | 70.2          | 61.4         | 16.1         | 8.6          |
| EBITDA adjusted                          | 27.1         | 74.9          | 60.6         | 14.9         | 7.7          |
| EPS adjusted                             | -4.7         | 62.7          | 55.7         | 2.6          | 8.8          |
| <b>Cash Flow (RmbM)</b>                  |              |               |              |              |              |
| <b>Operating cash flow</b>               | <b>347</b>   | <b>668</b>    | <b>1,074</b> | <b>1,125</b> | <b>1,221</b> |
| Depreciation/amortization                | 54           | 114           | 177          | 190          | 193          |
| Net working capital                      | -74          | -30           | -33          | -20          | -12          |
| <b>Investing cash flow</b>               | <b>-413</b>  | <b>-1,488</b> | <b>-314</b>  | <b>-304</b>  | <b>-303</b>  |
| Capital expenditure                      | -386         | -1,488        | -314         | -304         | -303         |
| Acquisitions/disposals                   | 0            | 0             | 0            | 0            | 0            |
| <b>Financing cash flow</b>               | <b>1,775</b> | <b>93</b>     | <b>-291</b>  | <b>-170</b>  | <b>-185</b>  |
| Borrowings                               | 100          | 200           | -125         | 0            | 0            |
| Dividends paid                           | 0            | -107          | -166         | -170         | -185         |
| <b>Change in cash</b>                    | <b>1,709</b> | <b>-726</b>   | <b>470</b>   | <b>652</b>   | <b>732</b>   |
| <b>Balance Sheet (RmbM)</b>              |              |               |              |              |              |
| <b>Total assets</b>                      | <b>3,073</b> | <b>3,733</b>  | <b>4,798</b> | <b>5,677</b> | <b>6,588</b> |
| Cash & cash equivalent                   | 1,884        | 1,096         | 1,586        | 2,501        | 3,490        |
| Accounts receivable                      | 137          | 208           | 373          | 431          | 466          |
| Net fixed assets                         | 496          | 1,476         | 2,238        | 2,107        | 1,978        |
| <b>Total liabilities</b>                 | <b>467</b>   | <b>944</b>    | <b>1,353</b> | <b>1,445</b> | <b>1,501</b> |
| Accounts payable                         | 86           | 255           | 283          | 327          | 354          |
| Total Debt                               | 100          | 300           | 175          | 175          | 175          |
| <b>Shareholders' funds</b>               | <b>2,607</b> | <b>2,789</b>  | <b>3,446</b> | <b>4,231</b> | <b>5,086</b> |
| <b>Profitability/Solvency Ratios (%)</b> |              |               |              |              |              |
| EBITDA margin adjusted                   | 42.4         | 51.7          | 62.2         | 61.8         | 61.6         |
| ROE adjusted                             | 21.5         | 20.2          | 27.1         | 23.0         | 20.9         |
| ROIC adjusted                            | 49.4         | 40.4          | 46.0         | 47.1         | 54.3         |
| Net debt to equity                       | -68.4        | -28.5         | -40.9        | -55.0        | -65.2        |
| Total debt to capital                    | 3.7          | 9.7           | 4.8          | 4.0          | 3.3          |

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## 2010 Results Review

Figure 1. 2010 Results — CIRA vs. Consensus Forecasts (Rmb Mil)

|                                | 2009         | 2010         | YoY | 2010 Citi    | 10 actual<br>vs. Citi | Consensus    | 10 actual<br>vs. Consensus |
|--------------------------------|--------------|--------------|-----|--------------|-----------------------|--------------|----------------------------|
| <b>Revenue</b>                 | <b>1,084</b> | <b>1,554</b> | 43% | <b>1,546</b> | 1%                    | <b>1,429</b> | 9%                         |
| Cost of sales                  | (582)        | (724)        |     | (708)        |                       |              |                            |
| <b>Gross profit</b>            | <b>502</b>   | <b>830</b>   | 66% | <b>839</b>   | -1%                   | <b>751</b>   | 11%                        |
| Selling and distribution costs | (28)         | (44)         |     | (40)         |                       |              |                            |
| Administrative expenses        | (36)         | (79)         |     | (17)         |                       |              |                            |
| Other operating expenses       | (33)         | (18)         |     | (15)         |                       |              |                            |
| <b>Operating profit</b>        | <b>405</b>   | <b>689</b>   | 70% | <b>767</b>   | -10%                  | <b>706</b>   | -2%                        |
| Other income                   | 41           | 27           |     | (12)         |                       |              |                            |
| <b>EBIT</b>                    | <b>446</b>   | <b>716</b>   | 61% | <b>755</b>   | -5%                   | <b>671</b>   | 7%                         |
| Net interest expense           | (9)          | (15)         |     | 5            |                       |              |                            |
| <b>Profit before tax</b>       | <b>437</b>   | <b>701</b>   | 61% | <b>760</b>   | -8%                   | <b>684</b>   | 2%                         |
| Income tax                     | (70)         | (117)        |     | (114)        |                       |              |                            |
| <b>Profit after tax</b>        | <b>367</b>   | <b>584</b>   | 59% | <b>646</b>   | -10%                  |              |                            |
| Minority interest              | (39)         | (51)         |     | (68)         |                       |              |                            |
| <b>Net profit</b>              | <b>328</b>   | <b>533</b>   | 63% | <b>578</b>   | -8%                   | <b>509</b>   | 5%                         |

Source: Company reports, Bloomberg, Citi Investment Research and Analysis estimates

Figure 2. Operational Data Review

|                                    | Output (Kt) |       |      | Sales (Kt) |      |      | Revenue (Rmb mil) |      |      | ASP (Rmb/tonne) |      |     |
|------------------------------------|-------------|-------|------|------------|------|------|-------------------|------|------|-----------------|------|-----|
|                                    | 2009        | 2010  | YoY  | 2009       | 2010 | YoY  | 2009              | 2010 | YoY  | 2009            | 2010 | YoY |
| Iron concentrates                  | 1,631       | 2,008 | 23%  | 950        | 1317 | 39%  | 530               | 876  | 65%  | 558             | 665  | 19% |
| Iron pellets                       | 688         | 713   | 4%   | 693        | 728  | 5%   | 537               | 637  | 19%  | 775             | 875  | 13% |
| Medium-grade titanium concentrates | 152         | 101   | -34% | 167        | 83   | -50% | 17                | 8    | -52% | 102             | 99   | -3% |
| High-grade titanium concentrates   |             | 67    |      |            | 62   |      |                   | 33   |      |                 | 534  |     |

Source: Company reports, Citi Investment Research and Analysis

Figure 3. Reserves and resource summary

| Reserve summary  | Tonnage<br>(Mt) | Tfe(%) | Grades               |                                   | Contained Metals |                       |                                    |
|--|-----------------|--------|----------------------|-----------------------------------|------------------|-----------------------|------------------------------------|
|  |                 |        | TiO <sub>2</sub> (%) | V <sub>2</sub> O <sub>5</sub> (%) | TFe (Kt)         | TiO <sub>2</sub> (Kt) | V <sub>2</sub> O <sub>5</sub> (Kt) |
| <b>Baicao Mine</b>   |                 |        |                      |                                   |                  |                       |                                    |
| Proved   | 18.8            | 25.0   | 10.5                 | 0.22                              | 4,692.5          | 2,670.0               | 57.1                               |
| Probable   | 32.8            | 25.9   | 10.2                 | 0.22                              | 8,490.0          | 3,520.0               | 77.0                               |
| <b>Xiushuihe Mine including the extension area</b>             |                 |        |                      |                                   |                  |                       |                                    |
| Proved   | 40.7            | 24.6   | 9.5                  | 0.22                              | 10,018.3         | 2,512.7               | 88.5                               |
| Probable   | 26.3            | 23.8   | 8.6                  | 0.20                              | 6,257.1          | 1,588.3               | 51.7                               |
| Resource summary (includes reserves)                           | Tonnage<br>(Mt) | Tfe(%) | Grades               |                                   | Contained Metals |                       |                                    |
|  |                 |        | TiO <sub>2</sub> (%) | V <sub>2</sub> O <sub>5</sub> (%) | TFe (Kt)         | TiO <sub>2</sub> (Kt) | V <sub>2</sub> O <sub>5</sub> (Kt) |
| <b>Baicao Mine</b>   |                 |        |                      |                                   |                  |                       |                                    |
| <b>Measured and Indicated</b>                                  |                 |        |                      |                                   |                  |                       |                                    |
| Higher-grade   | 61.5            | 27.0   | 11.4                 | 0.23                              | 16,636.0         | 6,988.2               | 141.5                              |
| Lower-grade  | 20.6            | 17.1   | 7.2                  | 0.13                              | 3,509.8          | 1,475.5               | 26.7                               |
| <b>Inferred</b>  |                 |        |                      |                                   |                  |                       |                                    |
| Higher-grade   | 24.3            | 29.2   | 11.9                 | 0.25                              | 7,083.9          | 2,886.9               | 60.7                               |
| Lower-grade  | 7.1             | 17.8   | 7.8                  | 0.14                              | 1,256.7          | 550.7                 | 9.9                                |
| <b>Xiushuihe Mine including the extension area</b>             |                 |        |                      |                                   |                  |                       |                                    |
| <b>Measured and Indicated</b>                                  |                 |        |                      |                                   |                  |                       |                                    |
| Higher-grade   | 81.9            | 25.6   | 9.6                  | 0.22                              | 20,910.9         | 5,269.0               | 180.2                              |
| Lower-grade  | 8.0             | 17     | 5.3                  | 0.13                              | 1,358.6          | 378.5                 | 10.2                               |
| <b>Inferred</b>  |                 |        |                      |                                   |                  |                       |                                    |
| Higher-grade   | 2.9             | 30.5   | 11.5                 | 0.26                              | 869.3            | 327.8                 | 7.4                                |
| Lower-grade  | 4.5             | 17.3   | 4.8                  | 0.12                              | 776.8            | 215.5                 | 5.4                                |
| <b>Cizhuqing Mine Resource under the PRC National Standard</b> | Tonnage<br>(Mt) | Tfe(%) | Grades               |                                   | Contained Metals |                       |                                    |
|  |                 |        | TiO <sub>2</sub> (%) | V <sub>2</sub> O <sub>5</sub> (%) | TFe (Kt)         | TiO <sub>2</sub> (Kt) | V <sub>2</sub> O <sub>5</sub> (Kt) |
| 331+332  | 12.8            | 22.4   | 9.6                  | 0.17                              | 2,869.4          | 1,235.6               | 23.6                               |
| 333  | 12.7            | 20.4   | 8.4                  | 0.17                              | 2,605.2          | 1,073.3               | 20.1                               |
| <b>Yangqueqing Mine Estimated Resource</b>                     | 17.9            |        |                      |                                   |                  |                       |                                    |

Source: Company reports

## China Vanadium Titano-Magnetite Mining

### 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 Panzihua 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.

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

#### Ratings and Target Price History Fundamental Research

Analyst: Scarlett Y Chen, CFA  
Covered since January 10 2011



Chart current as of 12 March 2011

|   | 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

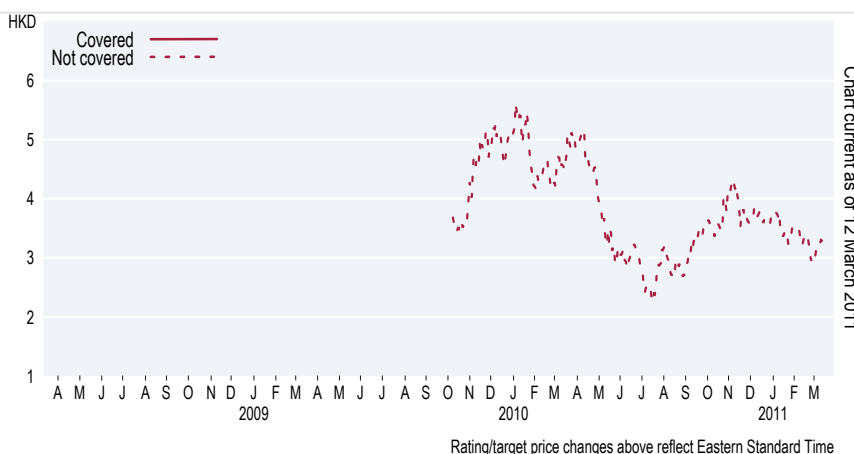
**China Vanadium Titano-Magnetite Mining (0893.HK)**

**Ratings and Target Price History**

**Best Ideas Research**

**Relative Call (3 Month)**

Analyst: Scarlett Y Chen, CFA  
 Covered since January 10 2011



\* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Chart current as of 12 March 2011

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Data current as of 31 Dec 2010

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|--|-----------------|------|------|-----------------|------|------|
|  | Buy             | Hold | Sell | Buy             | Hold | Sell |
| Citi Investment Research & Analysis Global Fundamental Coverage            | 52%             | 37%  | 11%  | 0%              | 100% | 0%   |
| % of companies in each rating category that are investment banking clients | 45%             | 44%  | 40%  | 0%              | 44%  | 0%   |

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