

## China VTM Mining (893.HK)

### Commodities Sector

16 March 2010

### FY10 In Line; M&A to Put More Irons in the Fire

We continue to see VTM as a major beneficiary of Western China development. The local nature of its operations and ASP floor set with customers make the stock a defensive play during current global uncertainty. We expect further mine acquisitions and higher Sichuan iron ore prices from 2H11, driven by demand from newly added steel capacity, to be major catalysts. Current valuation is only 6.9X FY12 P/E vs. steelmaking input players' 10.7X. Maintain Buy and target price of HK\$5.00.

**FY10 results in line with estimates.** Revenue and net profits grew 43.4% yoy and 62.7% yoy, only 2%-4% above our estimates. Final DPS of HK¢6.2 implied a 20% payout ratio, which should be maintained going forward.

**Further growth from M&A, supported by strong cash position.** VTM's iron resources will increase to 414mt once it completes the Aba Mining M&A, more than tripling since the IPO. Self-owned iron concentrate production capacity increased to 2.3mt by end-FY10, up 91% from end-FY09. Future growth will come from M&A, with resources and capacity targeted to further increase by 49% and 117%+ respectively over the next 3-5 years. This is supported by net cash of RMB795m at end-FY10, translating to 29% net cash-to-equity. Operating cash flows were strong; the cash-conversion cycle fell to -10 days in FY10.

**Stable iron prices and price floor ensure profitability in times of uncertainty.** Sichuan iron prices were stable throughout 2010 while Hebei prices fluctuated, due to Sichuan's transport bottlenecks, reflecting VTM's positioning as a local play. Also, the company's customer contracts include price floors of RMB600/t and RMB880/t for iron concentrate and iron pellets for 1H11, ~RMB10 higher than FY10. These underscore VTM's defensiveness. We expect Sichuan iron demand and ASPs to pick up in 2H11, once Panzhihua Iron & Steel's 4.2mt steel plant starts up.

**FY11 and FY12 EPS revised down 1%** on higher cost assumptions as (i) VTM now uses 18% grade iron ore, as opposed to 20% in the past and (ii) higher administrative expenses, partially offset by higher ASP for high-grade titanium concentrate.

**Maintain Buy** and target price of HK\$5.00. This translates to 11.0X FY12 P/E and 5.4X EV/EBITDA, largely in-line with steelmaking input players' current 10.7X and 6.2X respectively.

Figure 1: China VTM Mining – earnings summary

Year end 31 Dec.	FY08	FY09	FY10	FY11E	FY12E	FY13E
Revenue – RMBm	791.2	1,083.9	1,554.1	1,927.5	2,463.8	2,932.8
Net profit – RMBm	248.7	327.9	533.4	724.9	799.3	948.6
Net-profit growth – %	363.2	31.8	62.7	35.9	10.3	18.7
EPS – RMB fen	17.0	20.0	25.7	34.9	38.5	45.7
EPS growth – %	325.0	17.6	28.5	35.9	10.3	18.7
P/E – X	15.5	13.2	10.3	7.6	6.9	5.8
Dividend yield – %	0.0	0.0	1.9	2.6	2.9	3.5
P/B – X	N/A	2.2	2.0	1.6	1.3	1.1
EBIT margin – %	44.5	41.1	46.3	47.7	48.3	48.0
Issue shares - millions	N/A	2,075.0	2,075.0	2,075.0	2,075.0	2,075.0

Sources: Bloomberg and Sun Hung Kai Financial

12m rating

**Buy**

Maintained

Price

**HK\$3.13**

12m target price

**HK\$5.00**

(Maintained, 60% upside)

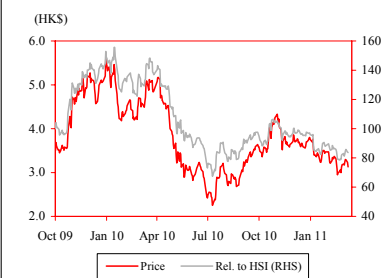
**View at a Glance**

Track record			3
Competitiveness			4
Earnings visibility			3

Scale of 1-5; 5 is the highest

**Performance (%)**

	1m	3m	12m
Absolute	(6.0)	(14.9)	(32.1)
Relative to HSI	(3.9)	(15.0)	(40.0)

**VTM – Price Chart**


HSI	22,678
52W high/low (HK\$)	5.26/2.22
Shares in issue – millions	2,075.00
Market cap – HK\$m (US\$m)	6,495 (833)
Free float – %	42.28
3M avg. t/o – HK\$m (US\$m)	42.27 (5.42)
Major shareholder – %	
Trisonic International Ltd.	48.52

Sources: Bloomberg and Sun Hung Kai Financial

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Figure 2: China VTM Mining – earnings revision summary, and introducing 2013E estimates

Year end 31 Dec.	FY11E		FY12E		FY13E
	Previous	Revised	Previous	Revised	
Revenue – RMBm	1,927.9	1,927.5	2,490.0	2,463.8	2,932.8
Net profit – RMBm	730.5	724.9	809.2	799.3	948.6
EPS – RMB fen	35.2	34.9	39.0	38.5	45.7
P/E – X	7.5	7.6	6.7	6.9	5.8
Our EPS vs. consensus – % above / (below)		1		3	N/A

Sources: Bloomberg and Sun Hung Kai Financial

Figure 3: China VTM Mining – FY10 results review, key financials highlights

Period	2H10	1H10	2H09	1H09	2H10 hoh change (%)	FY10 yoy change (%)
Revenue (RMBm)	<b>868.2</b>	685.9	597.8	486.0	<b>26.6</b>	<b>43.4</b>
Gross profit (RMBm)	<b>470.8</b>	359.6	292.2	209.5	<b>30.9</b>	<b>65.5</b>
Net profit (RMBm)	<b>299.9</b>	233.6	194.4	133.4	<b>28.4</b>	<b>62.7</b>
EBIT (RMBm)	<b>398.4</b>	313.3	262.6	181.7	<b>27.1</b>	<b>60.2</b>
EBITDA (RMBm)	<b>453.1</b>	350.1	285.7	201.2	<b>29.4</b>	<b>65.0</b>
Gross margin (%; chg in ppts)	<b>54.2</b>	52.4	48.9	43.1	<b>1.8</b>	<b>7.1</b>
Net margin (%; chg in ppts)	<b>37.8</b>	37.3	36.3	30.8	<b>0.6</b>	<b>3.7</b>
EBIT margin (%; chg in ppts)	<b>52.2</b>	51.0	47.8	41.4	<b>1.2</b>	<b>6.8</b>
EBITDA margin (%; chg in ppts)	<b>45.9</b>	45.7	43.9	37.4	<b>0.2</b>	<b>4.8</b>

Sources: Company and Sun Hung Kai Financial

Figure 4: China VTM Mining – FY10 operational data summary

Period	2H10	1H10	2H09	1H09	2H10 hoh change (%)	FY10 yoy change (%)
<b>Iron concentrate</b>						
Total sales (RMBm)	<b>538.9</b>	336.8	290.3	239.4	<b>60.0</b>	<b>65.3</b>
Quantity (kt)	<b>810.0</b>	506.8	486.6	463.3	<b>59.8</b>	<b>38.6</b>
ASP* (RMB/t)	<b>632.1</b>	630.4	628.6	489.2	<b>0.3</b>	<b>19.6</b>
<b>Iron pellets</b>						
Total sales (RMBm)	<b>307.1</b>	330.1	296.6	240.5	<b>-7.0</b>	<b>18.6</b>
Quantity (kt)	<b>351.6</b>	376.2	360.8	332.5	<b>-6.5</b>	<b>5.0</b>
ASP (RMB/t)	<b>873.4</b>	877.4	822.1	723.3	<b>-0.5</b>	<b>13.0</b>
<b>Medium-grade titanium concentrate</b>						
Total sales (RMBm)	<b>5.1</b>	3.2	10.9	6.1	<b>59.3</b>	<b>-51.6</b>
Quantity (kt)	<b>46.5</b>	36.9	102.4	64.9	<b>26.0</b>	<b>-50.1</b>
ASP (RMB/t)	<b>108.8</b>	86.1	106.3	94.5	<b>26.4</b>	<b>-2.9</b>
<b>High-grade titanium concentrate</b>						
Total sales (RMBm)	<b>17.1</b>	15.8	-	-	<b>8.4</b>	<b>N/A</b>
Quantity (kt)	<b>30.8</b>	30.9	-	-	<b>-0.3</b>	<b>N/A</b>
ASP (RMB/t)	<b>556.1</b>	511.5	-	-	<b>8.7</b>	<b>N/A</b>

Sources: Company and Sun Hung Kai Financial

\* Excluded reimbursement of transportation costs, assumed to be equal to selling &amp; distribution costs for comparison purposes

Figure 5: Targeted timeframe for new mine production

Mine	Iron ore resources (mt)	Expected date to receive mining permit
Cizhuqing	25.6	Jun-11
Yangqueqing	99.5	End-11
Maoling Mine expansion	34.2	2H12
Yanglongshan	33.6	2H12

Sources: Company and Sun Hung Kai Financial

## Valuation

Figure 6: Peer comparison

	P/E (X)		EV/ FY12	FY12 P/B	FY12 ROE	EPS growth (%)	
	FY11	FY12	EBITDA			(X)	FY11
<b>China steelmaking input producers</b>							
CMOC	16.0	16.3	8.8	1.4	12.7	75.1	(1.7)
Hidili Industry	9.4	8.4	6.8	1.3	15.9	69.1	11.6
Fushan Energy	13.2	12.0	5.9	1.4	13.4	21.4	10.5
<b>Sector average*</b>	<b>11.8</b>	<b>10.7</b>	<b>6.2</b>	<b>1.4</b>	<b>14.3</b>	<b>35.4</b>	<b>10.7</b>
<b>China steelmakers</b>							
Angang Steel	15.2	12.7	6.1	1.1	8.7	67.8	20.3
Maanshan Iron & Steel	14.6	11.1	5.0	0.9	8.1	69.5	32.4
Chongqing Iron & Steel	12.7	7.0	8.3	0.5	7.1	600.0	83.2
Shougang Concord.	7.2	6.0	7.7	0.8	13.5	69.9	19.4
Baoshan Iron & Steel	8.8	7.5	4.7	1.0	13.5	14.0	18.1
Wuhan Iron & Steel	15.9	10.7	6.4	1.2	10.9	40.1	49.3
<b>Sector average</b>	<b>10.3</b>	<b>9.0</b>	<b>5.4</b>	<b>1.0</b>	<b>11.6</b>	<b>40.4</b>	<b>14.6</b>
<b>China VTM Mining</b>	<b>7.6</b>	<b>6.9</b>	<b>3.4</b>	<b>1.3</b>	<b>21.1</b>	<b>35.9</b>	<b>29.9*</b>

Sources: Bloomberg and Sun Hung Kai Financial

\* Adjusted to exclude the one-off impact of expiration of tax holiday for comparison purpose

\* CMOC is not included to calculate the sector average given its much higher valuation

\*\* Figures other than those for VTM are based on consensus.

Figure 7: China VTM Mining – Forward P/E band since listing



Sources: Bloomberg and Sun Hung Kai Financial

Figure 8: China VTM Mining – Forward P/B band since listing



Sources: Bloomberg and Sun Hung Kai Financial

## Financial Statements

Figure 9: China VTM Mining – Profit and Loss Statement

Year end 31 Dec., RMBm	FY08	FY09	FY10	FY11E	FY12E	FY13E	FY08-13E CAGR (%)
Revenue	791.2	1,083.9	1,554.1	1,927.5	2,463.8	2,932.8	30.0
COGS	(364.1)	(582.1)	(723.7)	(884.6)	(1,145.4)	(1,381.6)	30.6
Gross profit	427.0	501.7	830.4	1,042.9	1,318.5	1,551.3	29.4
Operating expenses	(92.4)	(96.7)	(141.3)	(153.9)	(159.6)	(173.6)	13.4
Other operating income	17.1	40.6	30.0	30.0	30.0	30.0	11.9
Operating profit	351.7	445.6	719.1	919.0	1,188.9	1,407.6	32.0
Finance expenses	(3.0)	(7.8)	(17.8)	(17.8)	(17.8)	(17.8)	42.4
PBT	348.8	436.6	701.3	901.2	1,171.1	1,389.8	31.8
Tax	(30.1)	(69.7)	(117.3)	(157.7)	(351.3)	(416.9)	69.2
Net profit	248.7	327.9	533.4	724.9	799.3	948.6	30.7
EPS –RMB fen	17.0	20.0	25.7	34.9	38.5	45.7	21.9

Sources: Bloomberg and Sun Hung Kai Financial

Figure 10: China VTM Mining – Profit and Loss Statement (Year on Year Growth)

Year end 31 Dec., %	FY08	FY09	FY10	FY11E	FY12E	FY13E	FY08-13E CAGR (%)
Revenue	115.8	37.0	43.4	24.0	27.8	19.0	30.0
COGS	93.9	59.9	24.3	22.2	29.5	20.6	30.6
Gross profit	138.7	17.5	65.5	25.6	26.4	17.7	29.4
Operating expenses	(9.4)	4.6	46.1	8.9	3.7	8.8	13.4
Other operating income	1,152.2	136.9	(26.1)	0.0	0.0	0.0	11.9
Operating profit	349.8	26.7	61.4	27.8	29.4	18.4	32.0
Finance expenses	58.8	154.8	129.5	0.0	0.0	0.0	42.4
PBT	360.9	25.2	60.6	28.5	29.9	18.7	31.8
Tax	2,081.9	131.8	68.3	34.5	122.8	18.7	69.2
Net profit	363.2	31.8	62.7	35.9	10.3	18.7	30.7
EPS attributable to shareholders	325.0	17.6	28.5	35.9	10.3	18.7	21.9

Sources: Bloomberg and Sun Hung Kai Financial

Figure 11: China VTM Mining – Profit and Loss Statement (Common Size)

Year end 31 Dec., %	FY08	FY09	FY10	FY11E	FY12E	FY13E	FY08-13E Average
Revenue	100.0	100.0	100.0	100.0	100.0	100.0	100.0
COGS	(46.0)	(53.7)	(46.6)	(45.9)	(46.5)	(47.1)	(47.6)
Gross profit	54.0	46.3	53.4	54.1	53.5	52.9	52.4
Operating expenses	(11.7)	(8.9)	(9.1)	(8.0)	(6.5)	(5.9)	(8.3)
Other operating income	2.2	3.7	1.9	1.6	1.2	1.0	1.9
Operating profit	44.5	41.1	46.3	47.7	48.3	48.0	46.0
Finance expenses	(0.4)	(0.7)	(1.1)	(0.9)	(0.7)	(0.6)	(0.8)
PBT	44.1	40.3	45.1	46.8	47.5	47.4	45.2
Tax	(3.8)	(6.4)	(7.5)	(8.2)	(14.3)	(14.2)	(9.1)
Net profit	31.4	30.2	34.3	37.6	32.4	32.3	33.1

Sources: Bloomberg and Sun Hung Kai Financial

Figure 12: China VTM Mining – Balance Sheet

As at 31 Dec., RMBm	FY08	FY09	FY10	FY11E	FY12E	FY13E	FY08-13E CAGR (%)
Cash and securities	133.1	1,884.0	1,095.6	650.6	978.7	1,555.0	63.5
Accounts receivable	87.6	137.4	207.6	257.5	329.1	391.8	34.9
Inventory	65.6	70.9	69.6	85.0	110.1	132.8	15.2
Other current assets	119.3	140.9	100.1	124.1	158.6	188.8	9.6
Total current assets	405.7	2,233.3	1,472.8	1,117.2	1,576.5	2,268.4	41.1
Net fixed assets	380.4	544.7	1,528.0	2,077.1	2,431.1	2,762.5	48.7
Other long-term assets	165.2	295.5	732.6	1,247.4	1,412.3	1,377.1	52.8
Total assets	951.3	3,073.5	3,733.4	4,441.7	5,419.8	6,408.0	46.4
Short-term debt	0.0	100.0	175.0	175.0	175.0	175.0	N/A
Accounts payable	108.0	85.9	254.9	287.0	371.6	448.3	32.9
Other current liabilities	181.9	275.0	383.2	412.2	616.8	703.6	31.1
Total current liabilities	290.0	460.9	813.1	874.2	1,163.4	1,326.9	35.5
Long-term debt	0.0	0.0	125.0	125.0	125.0	125.0	N/A
Other long-term liabilities	57.2	5.7	6.1	6.5	7.3	8.1	(32.4)
Total liabilities	347.2	466.6	944.2	1,005.7	1,295.7	1,460.0	33.3
Shareholders equity	604.1	2,606.8	2,789.2	3,436.0	4,124.1	4,948.0	52.3
Minorities	64.8	92.8	14.5	31.3	48.0	68.3	1.1
Total equity and liabilities	951.3	3,073.5	3,733.4	4,441.7	5,419.8	6,408.0	46.4

Sources: Bloomberg and Sun Hung Kai Financial

Figure 13: China VTM Mining – Balance Sheet (Common Size)

As at 31 Dec., %	FY08	FY09	FY10	FY11E	FY12E	FY13E	FY08-13E Average
<b>Total assets</b>							
Cash and securities	14.0	61.3	29.3	14.6	18.1	24.3	26.9
Accounts receivable	9.2	4.5	5.6	5.8	6.1	6.1	6.2
Inventory	6.9	2.3	1.9	1.9	2.0	2.1	2.8
Other current assets	12.5	4.6	2.7	2.8	2.9	2.9	4.7
Total current assets	42.6	72.7	39.5	25.2	29.1	35.4	40.7
Net fixed assets	40.0	17.7	40.9	46.8	44.9	43.1	38.9
Other long-term assets	17.4	9.6	19.6	28.1	26.1	21.5	20.4
Total assets	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<b>Total equity and liabilities</b>							
Short-term debt	0.0	3.3	4.7	3.9	3.2	2.7	3.0
Accounts payable	11.4	2.8	6.8	6.5	6.9	7.0	6.9
Other current liabilities	19.1	8.9	10.3	9.3	11.4	11.0	11.7
Total current liabilities	30.5	15.0	21.8	19.7	21.5	20.7	21.5
Long-term debt	0.0	0.0	3.3	2.8	2.3	2.0	1.7
Other long-term liabilities	6.0	0.2	0.2	0.1	0.1	0.1	1.1
Total liabilities	36.5	15.2	25.3	22.6	23.9	22.8	24.4
Shareholders equity	63.5	84.8	74.7	77.4	76.1	77.2	75.6
Minorities	6.8	3.0	0.4	0.7	0.9	1.1	2.1
Total equity and liabilities	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 14: China VTM Mining – Cash Flow Statement

Year end 31 Dec., RMBm	FY08	FY09	FY10	FY11E	FY12E	FY13E
Profit before tax	348.8	436.6	701.3	901.2	1,171.1	1,389.8
Depreciation and amortization	26.6	42.5	87.3	186.1	181.2	203.8
Change in WC	72.1	(106.1)	N/A	(59.4)	9.2	(2.6)
Other adjustments	(24.5)	(31.0)	#VALUE!	(107.2)	(184.7)	(350.7)
Cash flows from operations	423.0	342.1	764.4	920.7	1,176.8	1,240.3
Capex	(184.6)	(276.4)	(1,405.6)	(1,250.0)	(700.0)	(500.0)
Other adjustments	(82.5)	(51.4)	(344.8)	0.0	0.0	0.0
Cash flows from investing	(267.1)	(327.7)	(1,750.4)	(1,250.0)	(700.0)	(500.0)
Shares issues/(purchases)	0.0	1,661.7	0.0	0.0	0.0	0.0
Dividends	0.0	(20.0)	0.0	(113.9)	(145.0)	(159.9)
Change in debt	(30.0)	100.0	200.0	0.0	0.0	0.0
Cash flows from financing	(30.5)	1,736.6	(229.8)	(115.7)	(148.7)	(164.0)
Cash at beginning of year	7.6	133.1	1,884.0	1,095.6	650.6	978.7
Change in cash	125.5	1,750.9	(1,215.8)	(445.0)	328.0	576.4
Cash at end of year	133.1	1,884.0	1,095.6	650.6	978.7	1,555.0

Sources: Bloomberg and Sun Hung Kai Financial

Figure 15: China VTM Mining – Key Ratios

Year end 31 Dec.	FY08	FY09	FY10	FY11E	FY12E	FY13E	FY08-13E Average
<b>Profitability ratios</b>							
Gross margin – %	54.0	46.3	53.4	54.1	53.5	52.9	52.4
Operating margin – %	44.5	41.1	46.3	47.7	48.3	48.0	46.0
Net margin – %	31.4	30.2	34.3	37.6	32.4	32.3	33.1
ROAA – %	32.2	16.3	15.7	17.7	16.2	16.0	19.0
ROAE – %	55.9	20.4	19.8	23.3	21.1	20.9	26.9
<b>Other ratios</b>							
A/R/sales – %	11.1	12.7	13.4	13.4	13.4	13.4	12.9
Capex/sales – %	23.3	25.5	90.4	64.9	28.4	17.0	41.6
Capex/depreciation – %	979.7	889.5	1,609.8	671.8	386.4	245.4	797.1
Net debt/equity (net cash) – %	(22.0)	(68.4)	(28.5)	(10.2)	(16.5)	(25.4)	(28.5)
Inventory/sales – %	8.3	6.5	4.5	4.4	4.5	4.5	5.5
Effective tax rate – %	8.6	16.0	16.7	17.5	30.0	30.0	19.8
Inventory turnover – days	49.0	42.8	35.4	31.9	31.1	32.1	37.0
A/R turnover – days	20.3	37.9	40.5	44.0	43.4	44.9	38.5
A/P turnover – days	79.3	60.3	86.1	109.9	102.7	106.6	90.8
Cash conversion cycle – days	(10.1)	20.4	(10.2)	(33.9)	(28.2)	(29.6)	(15.3)
<b>ROAA component analysis</b>							
Revenue/average assets – %	102.5	53.9	45.7	47.2	50.0	49.6	58.1
COGS/average assets – %	(47.2)	(28.9)	(21.3)	(21.6)	(23.2)	(23.4)	(27.6)
Gross profit/average assets – %	55.3	24.9	24.4	25.5	26.7	26.2	30.5
Operating expenses/average assets – %	(12.0)	(4.8)	(4.2)	(3.8)	(3.2)	(2.9)	(5.1)
Other operating income/average assets – %	2.2	2.0	0.9	0.7	0.6	0.5	1.2
Operating profit /average assets – %	45.6	22.1	21.1	22.5	24.1	23.8	26.5
Finance expenses/average assets – %	(0.4)	(0.4)	(0.5)	(0.4)	(0.4)	(0.3)	(0.4)
PBT/average assets – %	45.2	21.7	20.6	22.0	23.8	23.5	26.1
Tax/average assets – %	(3.9)	(3.5)	(3.4)	(3.9)	(7.1)	(7.1)	(4.8)
Net profit/average assets – %	32.2	16.3	15.7	17.7	16.2	16.0	19.0
<b>ROAE component analysis</b>							
Revenue/average equity – %	177.8	67.5	57.6	61.9	65.2	64.7	82.4
COGS/average equity – %	(81.8)	(36.3)	(26.8)	(28.4)	(30.3)	(30.5)	(39.0)
Gross profit/average equity – %	96.0	31.3	30.8	33.5	34.9	34.2	43.4
Operating expenses/average equity – %	(20.8)	(6.0)	(5.2)	(4.9)	(4.2)	(3.8)	(7.5)
Other operating income/average equity – %	3.8	2.5	1.1	1.0	0.8	0.7	1.7
Operating profit/average equity – %	79.0	27.8	26.7	29.5	31.5	31.0	37.6
Finance expenses/average equity – %	(0.7)	(0.5)	(0.7)	(0.6)	(0.5)	(0.4)	(0.5)
PBT/average equity – %	78.4	27.2	26.0	29.0	31.0	30.6	37.0
Tax/average equity – %	(6.8)	(4.3)	(4.3)	(5.1)	(9.3)	(9.2)	(6.5)
Net profit/average equity – %	55.9	20.4	19.8	23.3	21.1	20.9	26.9

Sources: Bloomberg and Sun Hung Kai Financial

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