

China VTM (893 HK)

BUY

Good to buy

Basic Materials/China
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TP: HK\$3.70
(UNCHANGED)

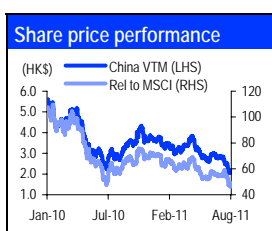
Company data		
Price (30 Aug)	(HK\$)	2.20
MSCI China		57.23
Market cap	(US\$m)	586
3-mth avg daily T/O	(US\$m)	1.95
Share outstanding	(m)	2,075
Free float	(%)	42
Major shareholder	Trisonic (49%)	
52-week rang	(HK\$)	2.00-4.37
Exchange rate	HK\$/US\$	7.7956

Performance (%)	1M	3M	6M
Absolute	(21.4)	(21.9)	(27.2)
Relative	(9.8)	(7.4)	(17.0)

* Relative to MSCI China

Investment indicators			
	2011F	2012F	2013F
PE (x)	6.1	5.6	5.0
PCFR (x)	4.7	4.2	3.8
EV/EBITDA (x)	3.4	3.0	2.8
PBR (x)	1.1	1.0	0.8
Dividend yield (%)	3.3	3.5	4.0
ROE (%)	20.1	18.6	17.7
ROA (%)	15.1	13.7	13.2
Net debt equity (%)	0.2	4.4	7.0
Relative to peers			Below
Relative to history			Below

Source: MF Global forecasts



Source: Company data, Bloomberg

Event

China VTM's 1H11 net profit of Rmb301m represents a YoY profit rise of 30%. Profit growth was against a backdrop of a 21% rise in sales revenue and steady gross margins of 51% during the period (versus 52% in 1H10). The net profit represents 48% of our earnings forecast for 2011. During a meeting with analysts, the company released its latest expansion plans. It aims to bring total iron concentrate capacity to 5mt by 2015, up 82% from the current 2.75mt. Capacity increases will be in tandem with upstream mining expansion. It is targeting a 51% increase in iron ore resources during that period. While foreseeing an upside risk to earnings based on latest expansion guidance, we maintain our forecast to reflect our conservatism. Trading at 5-6x PER for FY11-12, the stock is cheap. **BUY**.

Analysis

» **Driven by M&A.** At the end of 1H11, annual capacity of the company's major products included 2.75mt of iron concentrate; 1.36mt of iron pellets (through a pelletising process by using iron concentrate as raw material); and 0.28mt of high-grade titanium concentrates (a byproduct of iron concentrate). This represents capacity increases of 20% for iron concentrates, 278% for iron pellets and 56% for high-grade titanium concentrates versus 2010. Merger and acquisitions were the key force behind the expansion. As a result, output of iron concentrate and titanium concentrate grew 17% and 75%, respectively, YoY in 1H11. This, together with steady price increases (a small 3% rise for iron pellets but a increase of more than 100% for titanium concentrate), underscored top-line growth. The strong price growth on titanium concentrate was fuelled mainly by limited supply and robust demand from downstream chemical industries. Nevertheless, as a byproduct, titanium concentrate accounted for only 8.8% of total sales revenue in 1H11.

» **Market prospects in Sichuan.** The company is the second-largest titano-magnetite iron ore mining company in Sichuan. Guidance from management indicated a rising demand for iron pellets from the region over the past six months. Looking ahead, the Sichuan region will see total new steel capacity of about 11mt coming on stream between 2011 and 2012. This will translate into a new demand of 19mt for iron concentrate in the region.

» **New expansion plan.** Since its IPO in 2009, the company has added 264mt of resources, along with a capacity of 1.55mt iron concentrate, 1mt iron pellets and 0.22mt high-grade titanium concentrates through acquisitions and exploration. Latest expansion plans suggest iron ore resources will grow from the current 397mt to 600mt by 2015, up 51%. Given its proven track record, we expect the company to likely deliver this volume expansion on schedule.

Valuation and action

» **BUY reiterated.** China VTM is now trading at 5.6x PER, 1x PBR and 3x EV/EBITDA for FY2012F. The valuation represents a 30-60% discount to China metal and mining stocks' trading average. Besides, the company is trading at an EV/iron ore resource of US\$1.7/t, which is also at the lower end of regional iron ore peers' trading range. We consider the current low valuation unjustified given the company's solid fundamentals and good earnings prospects. We maintain a **BUY** with a blended-valuation-derived target price unchanged at HK\$3.70. Key risks to our call are high price volatility of iron concentrate and mining disruptions.

China VTM: Valuation summary

Year to 31 Dec	--- Revenue ---		--- EBITDA ---		--- Net profit ---		EPS (HK\$)	EBITDA margin (%)	BVPS (HK\$)	ROE (%)	Net gearing (%)	P/E (x)	PBV (x)	Yield (%)
	(Rmb m)	(y-y %)	(Rmb m)	(y-y %)	(Rmb m)	(y-y %)								
2009A	1,084	37.0	544	4.1	328	31.8	0.23	50.2	1.43	19.2	cash	9.7	1.5	0.0
2010A	1,554	43.4	922	3.8	533	62.7	0.31	59.3	1.58	21.0	cash	7.2	1.4	2.8
2011F	1,827	17.5	1,102	3.4	624	16.9	0.36	60.3	1.97	20.1	0.2	6.1	1.1	3.3
2012F	2,094	14.6	1,328	3.0	672	7.8	0.39	63.4	2.25	18.6	4.4	5.6	1.0	3.5
2013F	2,267	8.3	1,481	2.8	752	11.8	0.44	65.3	2.64	17.7	7.0	5.0	0.8	4.0

Source: Company data, MF Global forecasts

China VTM: 1H11 results summary

FY Dec	1H10	2H10	1H11	----- Change -----	
	(Rmb m)	(Rmb m)	(Rmb m)	(y-y %)	(h-h %)
Turnover	700	854	845	20.8	(1.1)
Cost of sales	(334)	(389)	(414)	23.8	6.3
Gross profit	365	465	431	18.0	(7.2)
Selling expenses	(19)	(25)	(23)	22.1	(9.5)
Admin. exp.	(37)	(43)	(50)	38.3	17.6
Other operating inc./(exp.)	8	5	18	129.1	289.2
Operating profit	318	401	376	18.2	(6.3)
Finance cost	(11)	(6)	(10)	(15.2)	52.1
Associate profits	(4)	4	0	-	-
Pretax profit	302	399	366	21.1	(8.3)
Taxation	(52)	(66)	(62)	20.7	(4.9)
Minority interests	(20)	(31)	(3)	(84.3)	(90.0)
Net profit	231	303	301	30.2	(0.7)
Basic EPS (Rmb)	0.111	0.146	0.145	30.2	(0.7)
DPS (Rmb)	-	-	-		
Profit margin (%)					
Gross margin	52.2	54.4	51.0		
Operating margin	45.4	47.0	44.5		

Source: Company data

Company background

China VTM is the second-largest iron ore mining company in Sichuan. It is located in the Panxi (Panzhihua-Xichang) region, which has the largest vanadium-bearing titanomagnetite reserves in China. The company's principal business is mining, ore processing and iron pelletising, and the sale of iron concentrates, iron pellets and titanium concentrates to steel producers and other major iron ore customers in the region. The company operates five mines with total mineral resources of 332.5mt. Based on production rates in 2010, the company has a 9% domestic market share.

China VTM: Financial summary

Income statement (Rmb m)						Cashflow statement (Rmb m)					
FY DEC	2009A	2010A	2011F	2012F	2013F	FY DEC	2009A	2010A	2011F	2012F	2013F
Turnover	1,084	1,554	1,827	2,094	2,267	Pre-tax profit	437	701	820	992	1,109
Cost of goods sold	(582)	(724)	(852)	(919)	(954)	Dep. & amort.	42	86	127	153	168
Gross profit	502	830	975	1,175	1,313	Tax paid	(32)	(100)	(119)	(230)	(260)
Other opg (exp)/Inc	(56)	(111)	(128)	(151)	(167)	(Pft)/loss on disposal of FAs	0	(0)	-	-	-
Operating profit (EBIT)	446	719	847	1,024	1,146	Assoc. & JV Inc/(loss)	-	-	-	-	-
Other non opg (exp)/Inc	(0)	0	(0)	0	0	Non-cash wkg. cap.	(106)	55	(54)	99	77
Associates & JV Inc	0	0	0	0	0	Other operating CF	1	22	(14)	(20)	(24)
Net interest (exp)/Inc	(9)	(18)	(26)	(32)	(37)	Net operating CF	342	764	761	994	1,070
Pre-tax profit	437	701	820	992	1,109	Capital exp. (net)	(239)	(975)	(1,023)	(1,034)	(1,085)
Tax	(70)	(117)	(137)	(248)	(277)	Invts. in assoc. & JV	-	-	-	-	-
Minority interest	(39)	(51)	(59)	(72)	(80)	Div from assoc. & JV	-	-	-	-	-
Net profit	328	533	624	672	752	Other investing CF	(89)	(776)	(1)	0	0
EPS (Rmb/share)	0.20	0.26	0.30	0.32	0.36	Net investing CF	(328)	(1,750)	(1,024)	(1,034)	(1,085)
DPS (Rmb/share)	0.00	0.05	0.06	0.06	0.07	Div paid	(24)	-	(108)	(125)	(134)
EBITDA (Rmb m)	544	922	1,102	1,328	1,481	Chg in gross debt	100	200	141	90	91
Effective tax rate (%)	16.0	16.7	16.7	25.0	25.0	Capital issues	1,773	-	-	-	-
						Other financing CF	1,661	(432)	-	-	-
						Net financing CF	1,737	(232)	33	(34)	(43)
						Net cashflow	1,751	(1,218)	(231)	(74)	(58)
Balance sheet (Rmb m)						Ratio					
FY DEC	2009A	2010A	2011F	2012F	2013F	FY DEC	2009A	2010A	2011F	2012F	2013F
Net fixed assets	496	1,476	2,400	3,147	4,053	Growth					
Invts in assoc & JVs	-	-	-	-	-	Sales gth (%)	37.0	43.4	17.5	14.6	8.3
Other LT assets	344	784	793	783	773	Opg profit gth (%)	26.7	61.3	17.7	20.9	12.0
Cash & deposits	1,884	666	435	361	303	Net profit gth (%)	31.8	62.7	16.9	7.8	11.8
Inventory	71	70	88	97	94	Profitability					
Debtors	137	208	275	309	283	Gross margin (%)	46.3	53.4	53.3	56.1	57.9
Other current assets	141	530	558	579	595	EBITDA margin (%)	50.2	59.3	60.3	63.4	65.3
Total assets	3,073	3,733	4,548	5,276	6,101	Opg profit margin (%)	41.1	46.3	46.3	48.9	50.6
ST Debt	100	175	257	310	363	Net profit margin (%)	30.2	34.3	34.2	32.1	33.2
Other current liab	361	638	697	861	926	Return					
LT debt	-	125	184	221	259	ROAE (%)	19.2	21.0	20.1	18.6	17.7
Other LT liabilities	6	6	6	6	6	ROA (%)	16.3	15.7	15.1	13.7	13.2
Shareholder's equity	2,514	2,775	3,381	3,842	4,503	ROCE (%)	23.1	21.9	21.9	20.4	19.7
Minority interests	93	14	23	35	44	Div payout ratio (%)	0.0	20.2	20.0	20.0	20.0
Total cap. & liab.	3,073	3,733	4,548	5,276	6,101	Liquidity					
Non-cash wkg. cap	2,613	2,920	3,594	4,105	4,812	Interest cover (x)	49.2	41.4	33.0	33.1	31.7
Net cash/(debt)	1,784	366	(6)	(170)	(319)	Current ratio (x)	4.8	1.8	1.4	1.1	1.0
						Quick ratio (x)	4.7	1.7	1.3	1.1	0.9
						Net debt/equity (%)	cash	cash	0.2	4.4	7.0
						Opg CFPS (HK\$)	0.21	0.37	0.37	0.48	0.52
						Gross CFPS (HK\$)	0.27	0.35	0.39	0.43	0.48
						Valuation					
						PE (x)	9.7	7.2	6.1	5.6	5.0
						PB (x)	1.5	1.4	1.1	1.0	0.8
						EV/EBITDA (x)	4.1	3.8	3.4	3.0	2.8
						Dividend yield (%)	0.0	2.8	3.3	3.5	4.0
						EV/iron ore resource (US\$/t)	2.9	1.6	1.7	1.7	1.8

Source: Company data, MF Global forecasts

Recommendation and Target Price History (11 July 2011 to 30 August 2011)

China VTM - 893 HK			
Date	Recommendation	Share Price	Target Price
07/07/2011	BUY	HK\$2.97	HK\$3.70
30/08/2011	BUY	HK\$2.20	HK\$3.70

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