

China Vanadium Titano - Magnetite Mining (00893.HK)

Iron ore business grows steadily, and the opportunities for titanium business have emerged

Investment Highlights

- ❖ **A Leading private mining company.** ChinaVTM Mining is engaged in the exploitation and washing of vanadium-titanium magnetite, and the production and marketing of iron ore concentrates, pellets and titanium concentrates. In 2011, its turnover totalled Rmb1.71bn, up 8.7% YoY, with gross margin of 48.3%. It is the largest privately-owned iron ore supplier in Sichuan and has great potential in the titanium industry, with production capacity only next to Pangang Group in Sichuan. In 2011, its output of vanadium-bearing iron concentrates was 2.22mn tonnes, in which 1.45mn tonnes were sold directly, while the rest were processed to 0.61mn tonnes of pellets. Its sales of titanium concentrates in the year were 0.2mn tonnes, in which 50% were medium-grade, and the other 50% were high-grade.
- ❖ **The market of iron and titanium products in Southwest China is of great potential.** The relatively closed regional market in Sichuan ensures the stability of iron ore prices. Supported by the Great Western Development strategy, the growth in Southwest China will bring considerable downstream demand for the iron & steel industry. Commissioning of the Pangang Group's iron & steel plant in Xichang results in an iron ore supply gap of 3mn tonnes, which will pose strong support to iron concentrates price in Southwest China.
- ❖ **Iron ore business grows steadily.** The Company not only built new production lines and upgraded the equipment in existing processing plants in an attempt to expand its production capacity, but also acquired the surrounding mining companies to enhance the resources reserves. The CAGR of the Company's production capacity of iron concentrates and pellets since 2008 is 22.5% and 69.8%, respectively. By the end of 2011, its resources reserves were 2.8 times of that in 2008. When its new iron pellets production line reaches the designed capacity, the proportion of intensive processing products will increase, and its product mix will be improved.
- ❖ **Titanium concentrates will be the new engine of the Company's earnings growth.** The supply of titanium concentrates was tight in the recent 2 years, and domestic prices remained high due to Vietnam's ban on export. The high prices are likely to be maintained for the next 2 years. As the major producing area of titanium concentrates in China, the annual production capacity of titanium concentrates in Panzhihua-Xichang region is 1.5mn tonnes, accounting for 50% of the total production capacity in China. ChinaVTM Mining's annual production capacity of titanium concentrates has reached 0.28mn tonnes after its production line in Xiushuihe processing plant reached the designed capacity. As it upgrades its titanium concentrates production lines, the output of high-grade titanium concentrates will increase further.

BUY (Initiation)

Share price: HK\$1.22

Target price: HK\$2.67

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Price Chart



Source: Bloomberg

Latest Key Data

MSCI-China	5,387
FF no of shares (mn)	54.6
FF (%)	26.33
FF market cap (HK\$ mn)	66.6
52-week high/low (HK\$)	3.01/1.03
12M daily turnover (HK\$ mn)	12
12M volatility (%)	66
PEG 2011-13E (x)	0.77
RoE avg 2011-13E (%)	18.37
PE 2012E/ (x)	7.0
Net debt/equity 2012E (%)	NC

Performance (%)

	1M	YTD	12M
Absolute	(4)	(20)	(59)
Rel to MSCI-China	(4)	(20)	(49)

Major Shareholders (%)

Trisonic International Limited	48.52
Credit Suisse Group AG	10.85
Sapphire Corp Ltd	9.20
Templeton Asset Management Ltd.	5.10

Auditor

ERNST & YOUNG

- ❖ **Potential risks:** Risks in resources exploitation and pressure on sales
- ❖ **Earnings forecast & rating.** The Company's 2011 EPS was Rmb0.29. We forecast that its 2012E-14E EPS will be Rmb0.31/0.35/0.38, respectively, with CAGR of 10.7%. Its iron ore business is likely to grow steadily, and titanium concentrates will be the new engine of its earnings growth. We apply 7x 2012E PE, the average PE in the industry, to the counter, equivalent to a target price of Rmb2.17, or HK\$2.67 per share. Initiate with a BUY.

FY-end Dec	2010	2011	2012E	2013E	2014E
Turnover (Rmb mn)	1,576	1,713	1,908	2,057	2,204
Chg (%)	45	9	11	8	7
Net profit (Rmb mn)	542	606	637	722	793
Chg (%)	65	12	5	13	10
EPS(Rmb)	0.26	0.29	0.31	0.35	0.38
P/E	3.8	3.4	3.2	2.9	2.6
OCF/Share (Rmb)	0.45	0.33	0.40	0.46	0.52
P/OCF (x)	2.8	3.9	5.8	5.0	4.4
EV/EBITDA	2.5	2.9	1.8	1.1	0.5
DPS (Rmb)	0.05	0.06	0	0	0
Yield (%)	5%	6%	0%	0%	0%

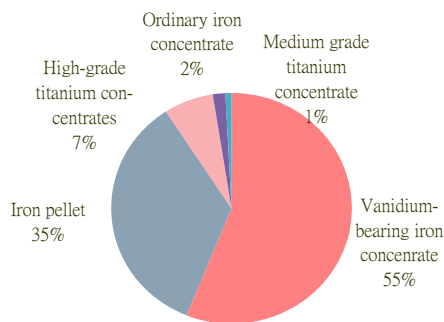
Source: CITIC Quantitative Investment Analysis System Note: Closing price as of 28 June 2012. The currency in this report is RMB unless specifically stated. The exchange rate applied is RMB/HKD=1:1.23.

A Leading privately-owned mining company

Located in Huili County, Liangshan autonomous prefecture, ChinaVTM Mining (00893.HK) was established in 2008. The Company specializes in the exploitation and washing of vanadium-titanium magnetite, and the production and sale of iron ore concentrates, pellets and titanium concentrates. Its customers are mainly the steel mills in Sichuan and Yunnan, and downstream users of titanium products. Iron concentrates, iron pellets and titanium concentrates are the Company's major products, which accounted for 58%, 34.6% and 7.4% of its total turnover in 2011, respectively. In 2011, it posted turnover of Rmb1,713mn, up 8.7% YoY, and gross profit of Rmb826.6mn, down 1.6% YoY. The Company logged a quite competitive gross margin of 48.3%.

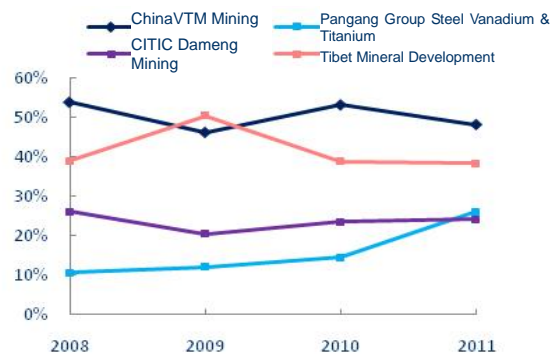
The Company's stable gross margin can be attributed to the high-quality mineral resources under its control. Compared with other open-cut mines, the stripping ratio and mining costs of the Company's mines are lower. The stripping ratios of its Baicao iron mine and Xiushuihe iron mine are 1.4 and 0.3 (stripping ratio refers to the ratio of the volume of overburden required to be handled in order to extract some volume of ore. The lower the ratio is, the lower the cost.), respectively, and the two mines' mining costs per tonne of iron concentrates are Rmb260/tonne and Rmb190/tonne, respectively. The two mines' stripping ratios and mining costs per tonne of iron concentrates are both lower than that of Lanjian iron mine (one of the major iron mines owned by Pangang Group Steel Vanadium & Titanium (000629)), which has a stripping ratio of 2.3 and mining costs of Rmb280/tonne.

Fig.1: ChinaVTM Mining 2011 turnover breakdown



Source: Company announcements, CSI

Fig.2: Gross margin of comparables

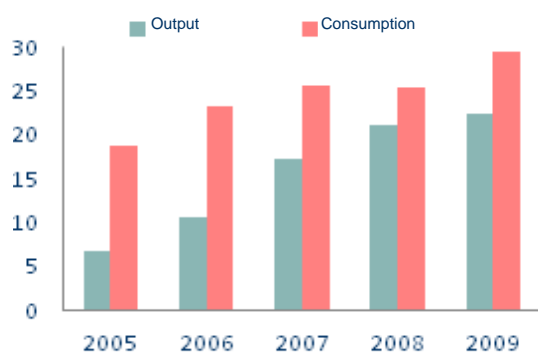


Source: Bloomberg, CSI

The biggest privately-owned iron ore supplier in Sichuan

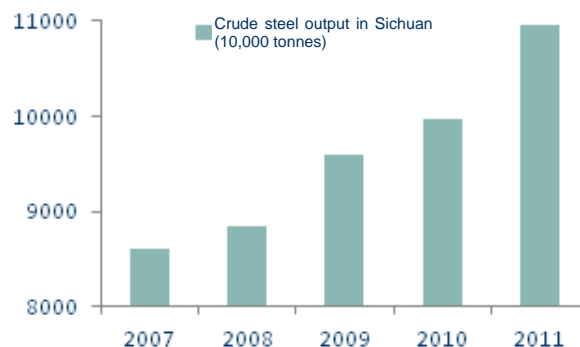
The iron ore resources in Sichuan amount to 3.1bn tonnes, accounting for 14% of the total amount in China. China's iron ore output in 2011 totalled 1.33bn tonnes, in which 135mn tonnes, or 10% of the total output, were produced in Sichuan. However, the demand for iron ore in Sichuan is growing constantly because of the rapid development of iron & steel industry in the province. Therefore, Sichuan is still an iron ore importer.

Fig.3: Output and consumption of iron concentrates in Sichuan



Source: Wind, CSI

Fig.4: Crude steel output growth in Sichuan



Source: Wind, CSI

The iron ore resources in Sichuan are abundant. In 2009, there were 54 iron mines in the province, most of which were small and privately-owned. Among the major iron ore producers, state-owned Pangang Group Company Ltd. has the largest market share, 36.2%, followed by ChinaVTM Mining, the biggest privately-owned iron ore supplier in Sichuan, which has a market share of 10.7%. As the integration in iron & steel industry accelerates, ChinaVTM Mining is likely to expand its market share through M&As, so that its leading position among privately-owned companies can be consolidated.

Table 1: Top five iron ore producers in Sichuan

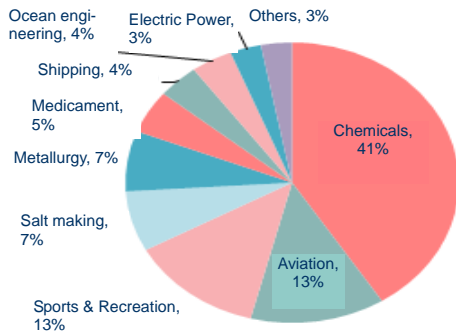
Company	Location	Output (1,000 tonnes)	Ownership	Market share
Pangang Group Company Ltd.	Panzhuhua	16,199	State owned	36%
ChinaVTM Mining	Liangshan	4,771	Private owned	11%
Sichuan Lomon Mining & Metallurgy Ltd.	Panzhuhua	4,601	Private owned	10%
Xiaoheiqing Jingzhi Mine of Panzhuhua Jingzhi Mining Co., Ltd.	Liangshan	2,436	Private owned	5%
Sichuan Huidong Manyingou Mining Group Company Ltd.	Liangshan	2,146	Private owned	5%

Source: Mysteel, CSI

An emerging player in the titanium industry

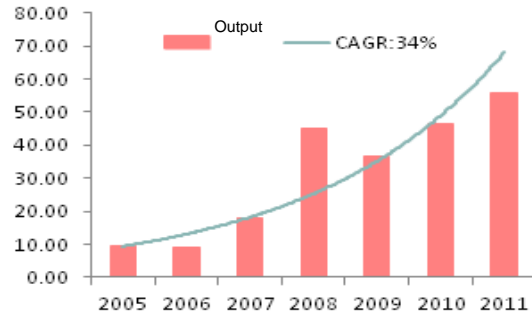
With high-strength and corrosion resistance, titanium products are widely used in paint, paper making, plastic, chemicals, aviation and metallurgy industries, implying great potential. With the development of high-tech industries, the titanium industry in China is in the ascendant. From 2005 to 2011, the domestic titanium output logged an annual growth of 34%, yet the domestic demand remains to be adequately satisfied. The amount of imported titanium products has been accounting for 50% of the total amount demanded in China.

Fig.5: China titanium product demand breakdown



Source: Wind, CSI

Fig.6: Domestic titanium output (Unit: 10,000 tonnes)



Source: Wind, CSI

Vanadium-titanium magnetite can also be used to produce ilmenite, which in turn provides 92% of the titanium minerals in the world. Sichuan has abundant titanium resources, most of which exist in the form of vanadium-titanium magnetite. There are around 70 titanium products manufacturers in the province. Their total annual production capacity of titanium concentrates, titanium slag and titanium dioxide is 1.5mn, 0.3mn and 0.6mn tonnes, respectively. The largest titanium concentrates producer in Sichuan is Pangang Group Company Ltd., occupying 30% market share.

The mineral resources owned by ChinaVTM Mining are mainly vanadium-titanium magnetite, which provides it with great advantage in the production of titanium products. The Company is able to effectively separate iron from titanium under the same process, which significantly lowers the cost. As it conducts M&A and upgrades the equipment, the production capacity will expand constantly. We estimate that its annual production capacity of high-grade titanium concentrates will reach 280,000 tonnes in 2012E, which helps it become an emerging player in titanium industry.

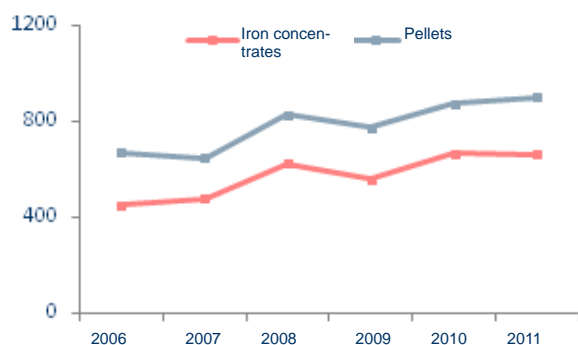
The market of iron and titanium products in Southwest China is of great potential

Iron ore prices: Prices in regional market are stable

ChinaVTM Mining's major products, namely iron concentrates and pellets, are mainly supplied to iron & steel enterprises in Southwest China provinces, such as Sichuan and Yunnan. The regional market is relatively closed, so the supply of raw materials such as iron concentrates and pellets mainly depends on local suppliers, except that some of ores are purchased from abroad. Since 2008, the average selling price of ChinaVTM Mining's vanadium-bearing iron concentrates has remained stable at above Rmb550/tonne. The price didn't drop significantly even during the financial crisis in 2009. Comparatively, the fluctuation of iron concentrates price in Tangshan, which is the major iron ore producing area in China, is larger than that in Sichuan and Yunnan. The stable iron ore price in Panzhihua-Xichang area (in Sichuan), where the Company is located, is one of the reasons for the Company's stable earnings. The average selling price of the Company's vanadium-bearing iron concentrates was Rmb661/tonne in 2011. We forecast that the price will remain between Rmb660/tonne and Rmb680/tonne, and it is unlikely to fluctuate significantly in the next 3 years.

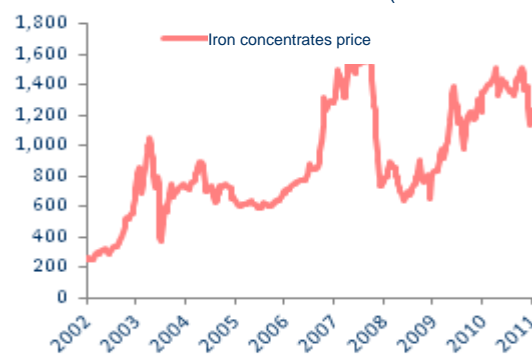
At the end of 2011, the iron & steel plant (located in Xichang) invested by Pangang Group Company Ltd., was put into operation, which brought additional 6mn tonnes of demand for iron concentrates to the Group. The annual production capacity of White Horse Iron Mine, which was designed to supply materials to the iron & steel plant, was only 3mn tonnes. Therefore, the project will lead to a supply gap of 3mn tonnes in Southwest China, which will pose strong support to iron concentrates price in the area.

Fig.7: Selling prices of ChinaVTM Mining's iron concentrates and pellets (Unit: Rmb/tonne)



Source: Company announcement, CSI

Fig.8: Iron concentrates price in Tangshan (Unit: Rmb/tonne)

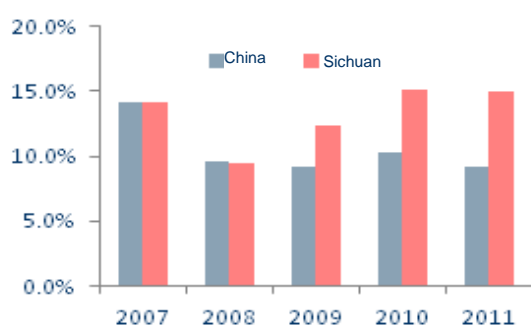


Source: Company annual report, CSI

Supportive policies warrant the long-term development

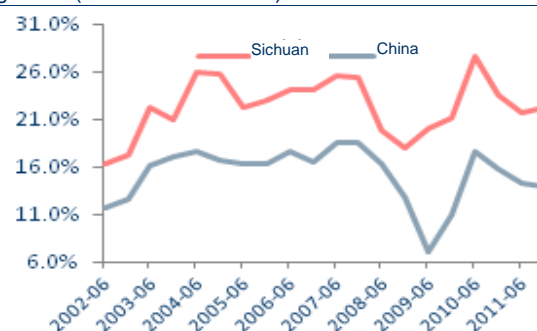
The economy of Southwest China has been developing rapidly since the implementation of the Great Western Development strategy, and the growth of GDP and value-added industrial output in Southwest China is always higher than that of the national average. As the Great Western Development proceeds, the GDP and value-added industrial output growth in Sichuan, which is perceived as the heart of industry in Southwest China, has been remaining above 10%. In the recent 2 years, the economic growth in Sichuan still maintained at 15%, in spite of the slowdown and the soft landing of Chinese economy. Supportive policies ensured the long-term industrial development, as well as the stable demand for iron and steel.

Fig.9 GDP growth comparison (Sichuan vs. China)



Source: CEIC, CSI

Fig.10: Comparison of value-added industrial output growth (Sichuan vs. China)



Source: CEIC, CSI

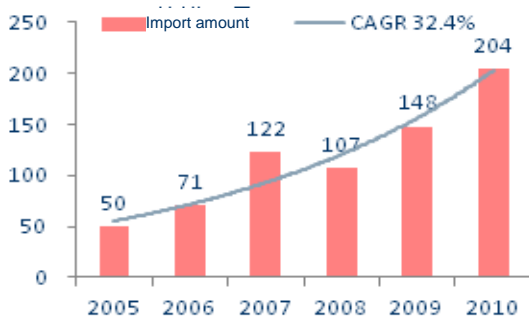
Currently, the Great Western Development still focuses on infrastructure facilities, implying the demand for structural steel will continue to rise. By the end of 2011, the annual production capacity of crude steel in western China was less than 100mn tonnes, indicating large room for development. In 1H11, National Development and Reform Commission (NDRC) issued *Regional Planning of Chengdu-Chongqing Economic Zone*, in an effort to accelerate the economic development in the zone, which brought new growth engines for the iron & steel industry. Meanwhile, NDRC announced an investment of Rmb600bn, targeting 23 infrastructure facilities in Western China, which boosted the demand for iron and steel. Feb 2012, the State Council approved the *12th Five-year Plan for Great Western Development* prepared by NDRC. According to the plan, in the next 5 years, the urbanization rate in Western China will exceed 45%, and the railways mileage will increase by 15,000 kilometers. Iron & steel industry in the region is likely to be stimulated by the plan.

Insufficient supply pushes up the prices of titanium ore concentrate

The prices of high-grade titanium concentrates fluctuated between Rmb500 to Rmb600 per tonne in 2008 and 2009, and started to rise in 2010. On June 22, 2011, the news that Vietnam was to stop the export of titanium ore hit the market, and the price of high-grade titanium concentrates ($TiO_2 > 47\%$) in Sichuan soared to Rmb2300/tonne, and retreated slightly after that.

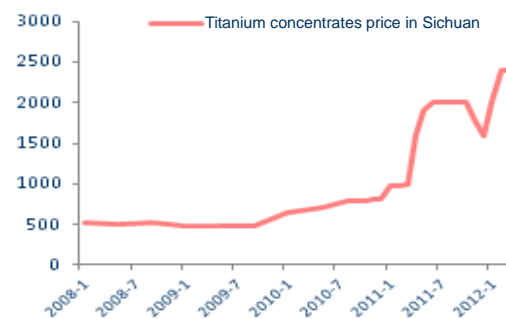
The annual production capacity of titanium concentrates in China is 3mn tonnes, but the actual annual output is around 2mn tonnes, and the import is 2mn tonnes, in which 40% are imported from Vietnam. According to the 02/CT-TTg document (the document is about strengthening the management of exploration, exploitation, processing, usage and export of the country's mineral resources) signed by Vietnam's Prime Minister on 9 Jan 2012, the country will stop the export of titanium concentrates by 30 Jun 2012E, which will result in a supply gap of more than 800,000 tonnes in China. This is poised to push up the prices of titanium concentrates in China.

Fig.11: Import amount of titanium concentrates in China (Unit: 10,000 tonnes)



Source: CEIC, CSI

Fig.12: Titanium concentrates price in Panzhihua-Xichang area (Unit: Rmb/ton)



Source: mysteel, CSI

Iron ore business grows steadily, and titanium business is of great potential

Iron ore: Output rises steadily, while reserves are of great potential

In order to realize sustainable growth, ChinaVTM Mining not only built new production lines and upgraded the equipment in existing processing plants, but also acquired the surrounding mining companies to further ramp up its production capacity. At present, in the Panzhihua-Xichang region, it owns Baicao, Xiushuihe, Hailong and Heigutian processing plants as well as two iron pellet plants. In Aba region, it has the Maoling processing plant. Currently, its annual production capacity of vanadium-bearing iron concentrates, ordinary iron concentrates, iron pellets and high-grade titanium concentrates reached 2,600k, 150k, 1,360k and 280k tonnes, respectively. With a clear business strategy, it will expand its production capacity constantly. We estimate that the CAGR of its iron concentrates production capacity in the next 3 years will be maintained at around 15%.

Table 2: Major production capacity expansion projects (2008-2011)

Time	Major production capacity expansion projects
2008-2009	Built iron concentrates production line with annual capacity of 500.0 thousand tonnes in Baicao processing plant
2009-2010	Built iron concentrates production line with annual capacity of 300 thousand tonnes in Xiushuihe processing plant
2009-2010	Upgraded the two production lines of medium-grade titanium concentrates in Xiushuihe and Baicao processing plants to high-grade titanium concentrates production lines
2009-2010	Built high-grade titanium concentrates production line with annual capacity of 100 thousand tonnes in Xiushuihe
2010-2011	Built iron pellets plant with annual production capacity of 1,000 thousand tonnes in Ailang Township, Huili County
2011	Acquired Aba Mining, which owned Maoling processing plant

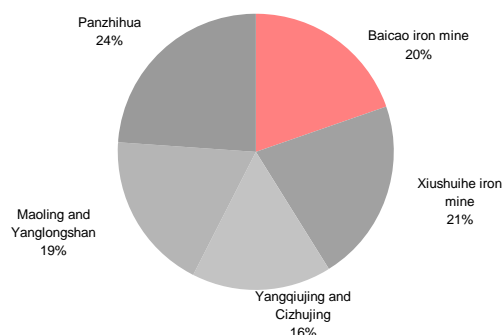
Source: Company annual report, CSI

Fig.13: Production capacity of iron concentrates and pellets in the recent 4 years (Unit: 1,000 tonnes)



Source: Company announcement, CSI

Fig.14: Shares of the resources reserves of mines owned by ChinaVTM Mining



Source: Company annual report, CSI

Regarding reserves, the Company owns and runs 4 vanadium-titanium magnetite mines (Baicao, Xiushuihe, Yangqueqing and Cizhuqing iron mines) in Sichuan, the province that has the most abundant vanadium-titanium magnetite reserves in China. It also owns two ordinary magnetite mines, Maoling and Yanglongshan iron mines. When it completed the acquisition of Aba Mining in May 2011, it had iron ore reserves of 320mn tonnes, with metal content of 60mn tonnes, which guarantees the operation in the next 20 years given its current output. Besides, the Company signed acquisition agreement with Panzhihua Yixingda in December, 2011, which will add at least 1mn tonnes of resources with minimum average iron content of 15% or above to its portfolio. The Company's mines are mainly located in Huili County, Sichuan, so the iron ore resources in surrounding areas are abundant. It is likely to expand its reserves by exploitation and acquisition.

Table 3: Major resources enhancement projects (2008-2011)

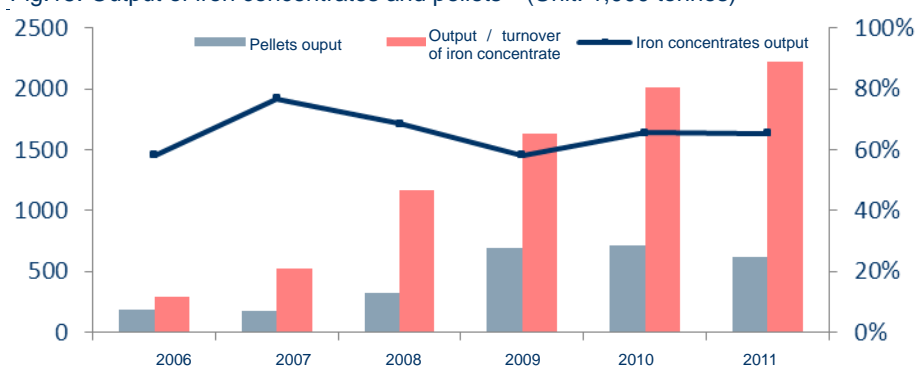
Time	Major resources enhancement projects	Resources added (Mn tonnes)
Jan 2010	Acquired the mining right of Yangqueqing Iron Mine	1,700
Feb 2010	Acquired the exploration right of Cizhuqing Mine and the certain assets of an iron concentrate production facility located at Xiaohaiqing Town	200
May 2011	Acquired Aba Mining, which owned Maoling Iron Mine and Yanglongshan Iron Mine	6,080
Aug 2011	entered into a cooperative agreement with Pingchuan Iron Mining Company and Nanyu in relation to the development of the Dashanshu Section	5,000
Dec 2011	Acquired Panzhihua Yixingda	10,000

Source: Company annual report, CSI

Product mix improves as the proportion of intensive processing products increases

In 2011, 65%, or 1,452k out of 2,221k tonnes of the Company's output of vanadium-bearing iron concentrates were sold directly. Only 1/3 of the output was sold after being processed to pellet. On 6 May 2011, the phase 1 construction of the new iron pellets plant was completed, which increased the Company's annual production capacity of iron pellets to 1,360k tonnes. The plant's annual production capacity of iron pellets is likely to reach 1,500k tonnes when all the construction is completed. The share of turnover contributed by the direct sale of iron concentrates will drop to 40%-50% due to the increase of iron pellets production capacity. The improvement in product mix eases the pressure on sales brought by the rise of iron concentrates output. Besides, the Company's products are able to fulfil the various downstream demand, which helps it expand the market share and enhance its competitiveness.

Fig.15: Output of iron concentrates and pellets (Unit: 1,000 tonnes)



Source: Company's annual reports, CSI

Grasping the opportunities to improve profitability by increasing titanium concentrates output

Panzhuhua-Xichang region is the major producing area of titanium concentrates in China. Most of the iron mines in the region produce vanadium-titanium magnetite. The annual production capacity of titanium concentrates there is 1.5mn tonnes, accounting for 50% of the total production capacity in China. Pangang Group Company Ltd. is the major titanium concentrates supplier in the region. Its titanium concentrates output in 2011 was around 0.5mn tonnes. ChinaVTM Mining's annual production capacity of titanium concentrates has reached 0.28mn tonnes after its titanium concentrates production line in Xiushuihe processing plant reaches the designed capacity. The Company produced 107,000 tonnes of high-grade titanium concentrates and 103,000 tonnes of medium-grade titanium concentrates in 2011. It intends to further increase the proportion of high-grade titanium concentrates output in the future.

The Company has started to produce high-trade titanium concentrate since 2010. In 2010, high-trade titanium concentrates contributed 2.1% of its total turnover. As the increase of both production capacity and output in 2011, the proportion rose significantly to 7.4%. The gross margin of titanium concentrates is 65%, higher than the Company's overall gross margin. The share of titanium concentrates turnover in the Company's total turnover will continue to rise, as the Company further expands its titanium concentrates production capacity and domestic titanium concentrates prices stay at high ground. Titanium concentrates may become the new engine for the company's earnings growth.

Besides, the Chinese government is issuing plans for vanadium-titanium industry. According to the *12th Five-year Plan for Vanadium & Titanium Industrial Bases and Resources Utilization* prepared by NDRC, the Panzhuhua-Xichang region is likely to be listed among the first batch of vanadium & titanium Industrial bases in China. Meanwhile, *12th Five-year Plan for Economic and Social Development in Sichuan* attaches great importance to Panzhuhua, and the largest modern vanadium & titanium industrial park in China will be built in the region. With geographic and resources advantages, ChinaVTM Mining will play an important role in the vanadium & titanium industrial park.

Potential risks

Fail to turn acquired resources reserves into production capacity

The strip between Yangqueqing and Xiushuihe mines, which are acquired by the Company, contains abundant mineral resources of approximately 70mn tonnes, but the expansion of exploitation facilities may not be completed by the end of 2012E. The Yanglongshan mine acquired in 2011 is under exploration, so the mine won't generate output until 2014E. The acquisition of Panzhihua Yixingda added abundant iron ore reserves to the Company's portfolio, but its production equipment for iron concentrates and pellets may not be able to match the production capacity.

Output increase puts great pressure on sales

Pangang Group Company Ltd., which operates in the same region as the Company does, is equipped with both iron ore production line and iron & steel production line (which means its iron ore output can be consumed internally), but the ChinaVTM Mining's iron ore output is all sold to other customers. Moreover, its customers are mainly distributors and the sales contracts signed are all short-term contracts. Therefore, if its output increases and it fails to control sales costs and output/sales ratio, its earnings may be undermined.

Earnings forecast, valuation and investment rating

Earnings forecast

We forecast that in the next 3 years, iron concentrates and pellets will still contribute the major part to the Company's turnover. The growth in iron concentrate and pellet outputs, along with the production and sale of titanium concentrates, will be the major driver of the Company's growth. Our key assumptions are as follows:

Table 4: Operation data assumptions

	2010	2011	2012E	2013E	2014E	Reasoning of the assumptions
Sales volume (1,000 tonnes)						
Vanadium-bearing iron concentrates	1317	1453	1600	1700	1800	The production capacity of iron concentrates and iron pellets is expanded gradually, and the steady growth of downstream demand ensures the rise of sales
Ordinary iron concentrates	-	27	30	30	33	
Iron pellets	728	666	680	700	720	
The upgrade of titanium concentrates production lines will be completed in 2012, and the Company will stop producing medium-grade titanium concentrates by then. All the production capacity will be used to produce high-grade titanium concentrates						
Medium-grade titanium concentrates	83	81	20	0	0	
High-grade titanium concentrates	62	105	211	230	232	
Selling price (Rmb/tonne)						
Vanadium-bearing iron concentrates	665	661	650	660	670	
Ordinary iron ore concentrates	-	1224	1150	1200	1250	
Iron pellets	875	891	880	890	910	
Medium-grade titanium concentrates	99	154	161	160	163	Insufficient supply, along with Vietnam's restriction on titanium concentrates export will further push up the price of titanium concentrates
High-grade titanium concentrates	534	1084	1100	1200	1300	

Source: Company annual report, CSI

Absolute valuation: DCF model

The fair value for ChinaVTM Mining derived from our DCF model is Rmb4.78 or HK\$5.88 per share (based on an exchange rate of Rmb1=HK\$1.23).

Table 5: WACC key assumptions and DCF valuation results

	WACC calculation		Equity value calculation (Rmb mn)
Risk-free rate	5%	Enterprise value	9,378
Risk premium	9%	Cash and cash equivalents	947
Debt cost	5.5%	Total interest-bearing debt	423
Tax rate	18%	Equity value	9,913
Beta	1.45	Total shares	2,075
Equity cost	18.5%	Value per share	Rmb4.78
Weight of debt	30%		
Weight of equity	70%		
WACC	13.99%		
TV Growth rate	0.2%		

Source: CSI

Relative valuation: PE ratio

ChinaVTM Mining's major business is mineral exploitation and processing of iron ore products and titanium products. We selected companies that are listed on Hong Kong Stock Exchange and engaged in the same business for comparison. ChinaVTM is expanding and developing quickly. Considering the average PE in the industry and the small market capitalization of the Company, we apply 7x 2012E PE to the counter.

Table 6: Valuation of comparables

Company	Ticker	Closing price (HK\$)	Mkt value (HK\$ bn)	PE/(x)			PB/(x)			EV/EBITDA/(x)		
				11	12E	13E	11	12E	13E	11	12E	13E
CMOC	3993.HK	2.8	13.8	11.7	10.2	8.6	1.2	0.9	0.8	18.0	7.1	8.6
Zhaojin Mining	1818.HK	8.8	25.7	17.6	10.8	9.8	4.4	3.1	2.7	12.6	13.0	10.2
Xinxin Mining	3833.HK	1.8	4.0	19.7	10.2	8.0	0.7	0.5	0.6	20.3	-	-
CITIC Dameng	1091.HK	0.8	2.5	8.5	6.4	4.2	1.4	1.0	0.8	17.3	4.2	2.8
MIN Resources	1208.HK	3.3	17.3	4.1	3.2	3.3	1.0	0.8	0.8	2.9	3.5	3.3
CVRD	6210.HK	141.0	757.0	9.6	5.5	6.3	3.1	2.4	1.4	7.5	4.8	5.0
Average				10.8	7.7	6.7	1.9	1.4	1.1	11.9	6.0	5.4
ChinaVTM Mining		1.22	2.55	3.4	3.2	2.9	0.6	0.5	0.4	2.9	1.8	1.1

Source: Bloomberg Note: Closing share prices as of 27 Jun 2012

Table 7: Market value per tonne of steel among iron ore companies

Company	Market value (US\$ mn)	M&I Reserves (mt)	Output (mt)	Market value/M&I	Market value/Output
CVRD	128,767.20	8,761.79	322.60	14.7	399.2
Rio Tinto	132,047.10	6,404.82	245.00	20.6	539.0
BHP Billiton	207,626.64	3,627.24	149.00	57.2	1,393.5
FMG	16,814.52	2,004.15	53.90	8.4	312.0
Average	-	-	-	25.2	660.9
ChinaVTM Mining	358.31	317.41	2.22	1.1	161.4

Source: Bloomberg, Mingtalmanac

Conclusion and rating

The Company's iron ore business is likely to grow steadily, and its titanium concentrate may see notable growth. We forecast that its 2012/2013/2014E EPS will be Rmb0.31/0.35/0.38, respectively (its 2011 EPS was Rmb0.29). We apply a 7x 2012E PE to the counter, equivalent to a target price of Rmb2.17, or HK\$2.67 per share. We initiate coverage on the Company with a BUY rating.

Profit & Loss (Consolidated)

FY-end Dec (Rmb mn)	2010	2011	2012E	2013E	2014E
Turnover	1,576	1,713	1,908	2,057	2,204
Cost of sales	(736)	(886)	(992)	(1,029)	(1,080)
Gross profit	840	827	916	1,028	1,124
Operating expenses	(47)	(46)	(52)	(56)	(61)
Administrative expenses	(89)	(102)	(114)	(123)	(132)
Other operating expenses	(38)	(19)	0	0	0
Finance costs	(18)	(21)	(22)	(21)	(22)
Other income and gains	70	110	49	53	58
Share of profit of associates	(4)	0	0	0	0
Pre-tax profit	713	748	777	881	968
Income tax expenses	(117)	(135)	(140)	(159)	(174)
Minority interests	(54)	(7)	0	0	0
Net profit	542	606	637	722	793
EBITDA	794	800	945	1,080	1,197
EBIT	704	678	750	850	932

Cash Flow Statement (Consolidated)

FY-end Dec (Rmb mn)	2010	2011	2012E	2013E	2014E
Net profit	596	613	636	720	791
Dep'n and amortization	109	152	195	230	265
Change in working capital	(104)	(63)	5	11	29
Others	5	(13)	1	2	0
Operating cash flow	606	688	837	963	1088
CAPEX	(1397)	(280)	(315)	(315)	(310)
Others	(194)	(766)	68	(96)	(93)
Investing cash flow	(1591)	(1046)	(247)	(411)	(403)
Proceeds from share issuance	0	0	0	0	0
Change in borrowings	200	91	(8)	25	17
Dividend paid	0	(108)	0	0	0
Others	(430)	(100)	(18)	0	0
Financing cash flow	(230)	(117)	(8)	25	17
Exchange effect	(3)	0	0	0	0
Net cash flow	(1219)	(475)	581	576	699

Key Major Assumptions:

FY-end Dec	2010	2011	2012E	2013E	2014E
Output of vanadium-bearing iron concentrates (1,000 tonnes)	1317	1453	1,600	1,700	1,800
Output of iron pellets (1,000 tonnes)	728	666	680	700	720
Output of high-grade titanium concentrates (1,000 tonnes)	62	105	211	230	232
price of vanadium-bearing iron concentrates (Rmb/tonne)	665	661	650	660	670
Price of iron pellets (Rmb/ton)	875	891	880	890	910
Price of high-grade titanium concentrates (Rmb/tonne)	534	1,084	1,100	1,200	1,300

Source: company announcement, CSI

Balance Sheet (Consolidated)

FY-end Dec (Rmb mn)	2010	2011	2012E	2013E	2014E
Cash and cash equivalents	1,102	947	1,528	2,104	2,802
Inventory	71	137	153	158	166
Trade and other receivables	208	134	157	169	181
Other current assets	101	261	159	171	184
Total current assets	1,481	1,479	1,997	2,603	3,333
Property, plant and equipment [※]	1,540	1,727	1,867	1,973	2,039
Investment in JCE	0	1	1	1	1
Intangible assets	548	577	588	600	612
Leasehold land and land use rights	53	52	52	52	52
Other non-current assets	258	623	522	585	646
Total non-current assets	2,399	2,979	3,031	3,211	3,350
Total assets	3,880	4,458	5,027	5,814	6,683
Short-term and the current portion of long-term bank borrowings	175	322	290	308	319
Trade payables, accruals and other payables	261	341	326	338	355
Other current liabilities	435	456	411	441	485
Total current liabilities	871	1,119	1,028	1,087	1,159
Interest-bearing bank and other loans	157	101	124	132	137
Other long-term liabilities	14	18	18	18	18
Total non-current liabilities	171	119	142	150	155
Total liabilities	1,043	1,238	1,170	1,237	1,314
Issued capital	183	183	183	183	183
Reserves #	2,654	3,038	3,674	4,395	5,186
Total equity	2,837	3,221	3,857	4,578	5,369
Total equity and liabilities	3,880	4,459	5,027	5,815	6,683
Total cap. employed	3,009	3,340	4,000	4,728	5,524
Working capital	609	673	668	657	628
Net gearing (%)	NC	NC	NC	NC	NC

Financial Summary

FY-end Dec	2010	2011	2012E	2013E	2014E
Growth (%)					
Gross profit	67.5	(1.5)	10.8	12.3	9.3
EBITDA (ex-asso)	65.6	0.7	18.2	14.2	10.9
EBIT (ex-asso)	60.9	(3.7)	10.7	13.3	9.7
Net profit	65.3	11.8	5.0	13.2	9.8
Margins (%)					
Gross profit	53.3	48.3	48.0	50.0	51.0
EBITDA (ex-asso)	50.4	46.7	49.5	52.5	54.3
EBIT (ex-asso)	44.7	39.6	39.3	41.3	42.3
Net profit	37.8	35.8	33.3	35.0	35.9
Others					
Effective tax rate	16.4	18.0	18.0	18.0	18.0
RoCE	18.0	18.1	15.9	15.3	14.4
RoAE	19.9	20.0	18.0	17.1	15.9
RoAA	15.6	14.5	13.4	13.3	12.7
Interest coverage (x)	39	32	34	40	42

※Excluding construction in progress

#Including non-controlling interest of Rmb 30mn and Rmb 22mn in 2010 and 2011, respectively

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Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~ -10%
	Underperform	Relative performance over MSCI-China Index > -10%

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