



Rating  
**Hold**

Asia  
China

Resources  
Metals & Mining

Company  
**China VTM Mining**

Reuters 0893.HK	Bloomberg 893 HK	Exchange HSI	Ticker 0893
ADR Ticker CVDMY	ISIN US16950D1072		

Date  
23 September 2013

Recommendation  
**Change**

Price at 23 Sep 2013 (HKD)	1.27
Price target - 12mth (HKD)	1.30
52-week range (HKD)	1.86 - 1.00
HANG SENG INDEX	23,503

## No near-term catalyst; downgrading to Hold

### Gloomy outlook; downgrading to Hold

With a gloomy iron ore price outlook for the coming quarters, China VTM's disappointing volume and its escalating cost, we cut the company's earnings by 52.7%/53.0% in 2013E/14E and target price from HKD2.00 to HKD1.3. Considering the company's net cash position to mitigate the negatives from its operations, we downgrade our rating from Buy to Hold.

### Gloomy iron ore price outlook

China steel production YoY growth has started to slow, while iron ore supply from the major producers (BHP, FMG, Rio Tinto, Vale) will likely have strong QoQ and YoY growth. We believe iron ore prices will likely weaken in the coming quarters.

### Disappointing volume due to Baicao suspension and project delay

We cut our concentrates output forecast by 26%/20%/25% in 2013E/14E/15E, on the back of the Baicao mine suspension (no more than 300kt and 250kt volume decline in 2H13 and 1H14), lower Pingchuan capacity, and some delay at the Haibaodang mine. We also lower the pellets volume significantly by 94%/78%/60% in 2013E/14E/15E, respectively, on the back of weak pellets demand from Chinese steel mills. We believe steel mills are still having a hard time, thus we expect a mild recovery in pellets volume in the coming years.

### Escalating cost with deeper extraction and lower pellet volume

Pellets unit cost reached RMB650/t in 1H13, up 18% YoY from RMB550/t in FY12, resulting from its extremely low volume in 1H13 (26kt vs. 375kt in FY12). With pellets volume likely to remain at low levels in the coming years, we have revised up its unit cost by 20%/15%/12% in 2013E/14E/15E, respectively. We also raise the iron concentrate and titanium concentrate unit costs on the back of deeper extraction and lower processing recoveries.

### Fairly valued, downgrading to Hold

Given the weak price, escalating cost and low production volume, we cut our 2013E/14E net profit forecasts by 53%/53% to RMB212m/RMB184m from RMB447m/RMB393m, respectively. Our new target price of HKD1.3 is based on DCF mine of life and implies 4% upside; we downgrade China VTM from Buy to Hold. The stock is currently trading at 11x 2014 DBE EPS (in line with historical average of 11x) and 0.53x 2014 DBE BVPS. 2014 DBE PBx is close to its one standard deviation below historical average at 0.54x, with declining ROAE of c.5% in 2014/15; we believe it is fairly valued. Key upside/downside risks relate to iron ore prices, unit costs of production and volume.

### Forecasts And Ratios

Year End Dec 31	2011A	2012A	2013E	2014E	2015E
Reported NPAT (CN¥m)	605.9	403.0	211.6	184.4	183.0
PER (x)	7.3	6.3	9.8	11.3	11.4
Yield (net) (%)	2.8	0.0	2.0	1.8	1.8

Source: Deutsche Bank estimates, company data

<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items

<sup>2</sup> Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

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### Key changes

Rating	Buy to Hold	↓	
Price target	2.00 to 1.30	↓	-35.0%

Source: Deutsche Bank

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	7.6	4.1	2.4
HANG SENG INDEX	7.5	16.0	13.3

Source: Deutsche Bank

### Forecast change in 2013/14

RMBm	New	Old	%Chg
2013E OP	326	603	-46%
2013E NP	212	447	-53%
2014E OP	245	524	-53%
2014E NP	184	393	-53%

Source: Deutsche Bank

### Related recent research

Asia Steel -- Looking for better entry point: downgrading steel stocks to Hold

Date  
18 Sep 2013

James Kan

Source: Deutsche Bank

Deutsche Bank AG/Hong Kong

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Model updated: 23 September 2013

Running the numbers

Asia  
China  
Metals & Mining

China VTM Mining

Reuters: 0893.HK Bloomberg: 893 HK

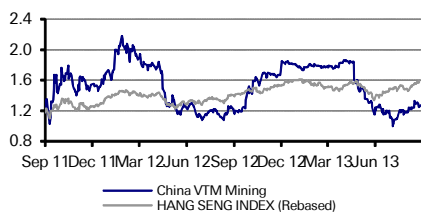
Hold

Price (23 Sep 13) HKD 1.27  
Target Price HKD 1.30  
52 Week range HKD 1.00 - 1.86  
Market Cap (m) HKDm 2,635  
USDm 340

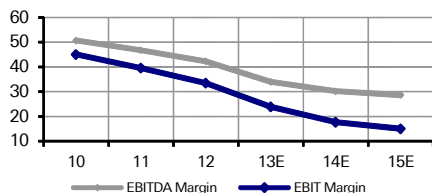
Company Profile

China VTM Mining (the Company) is primarily engaged in mining, ore processing and iron palletizing and sells its iron concentrates, iron pellets and titanium concentrates to steel producers and downstream users of titanium-related products.

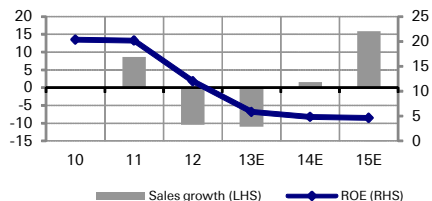
Price Performance



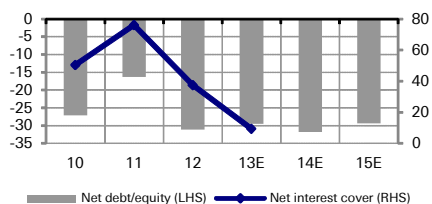
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2010	2011	2012	2013E	2014E	2015E
DB EPS (CNY)	0.26	0.29	0.19	0.10	0.09	0.09
Reported EPS (CNY)	0.26	0.29	0.19	0.10	0.09	0.09
DPS (CNY)	0.06	0.06	0.00	0.02	0.02	0.02
BVPS (CNY)	1.4	1.5	1.7	1.8	1.9	1.9
Weighted average shares (m)	2,075	2,075	2,075	2,075	2,075	2,075
Average market cap (CNYm)	6,795	4,435	2,543	2,080	2,080	2,080
Enterprise value (CNYm)	6,055	3,725	1,230	766	635	692

Valuation Metrics

P/E (DB) (x)	12.5	7.3	6.3	9.8	11.3	11.4
P/E (Reported) (x)	12.5	7.3	6.3	9.8	11.3	11.4
P/BV (x)	2.38	0.82	0.88	0.56	0.54	0.52
FCF Yield (%)	nm	9.2	36.5	0.3	8.5	nm
Dividend Yield (%)	1.9	2.8	0.0	2.0	1.8	1.8
EV/Sales (x)	3.8	2.2	0.8	0.6	0.5	0.4
EV/EBITDA (x)	7.6	4.7	1.9	1.7	1.5	1.5
EV/EBIT (x)	8.5	5.5	2.4	2.3	2.6	2.9

Income Statement (CNYm)

Sales revenue	1,576	1,713	1,534	1,366	1,387	1,607
Gross profit	930	950	829	657	615	687
EBITDA	799	800	648	463	418	461
Depreciation	73	101	118	116	153	200
Amortisation	17	22	18	21	20	19
EBIT	709	677	512	326	245	242
Net interest income/(expense)	-14	-9	-14	-35	7	8
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	18	79	32	20	0	0
Profit before tax	713	748	531	311	251	250
Income tax expense	117	135	120	95	63	62
Minorities	54	7	8	5	4	4
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	542	606	403	212	184	183
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	542	606	403	212	184	183

Cash Flow (CNYm)

Cash flow from operations	606	688	1,090	323	593	503
Net Capex	-1,397	-280	-162	-316	-416	-519
Free cash flow	-792	409	929	7	177	-16
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	0	-108	-122	0	-42	-37
Net inc/(dec) in borrowings	200	91	123	0	0	0
Other investing/financing cash flows	-194	-547	-227	0	0	0
Net cash flow	-786	-155	702	7	135	-52
Change in working capital	-126	-85	-481	31	-231	-97

Balance Sheet (CNYm)

Cash and other liquid assets	1,102	947	1,649	1,656	1,790	1,738
Tangible fixed assets	1,540	1,727	1,779	1,978	2,241	2,560
Goodwill/intangible assets	564	592	582	561	541	522
Associates/investments	0	208	239	239	239	239
Other assets	674	985	1,167	1,186	1,158	1,232
Total assets	3,880	4,458	5,416	5,620	5,970	6,291
Interest bearing debt	332	423	546	546	546	546
Other liabilities	711	815	1,323	1,311	1,514	1,685
Total liabilities	1,043	1,238	1,869	1,857	2,060	2,231
Shareholders' equity	2,807	3,199	3,517	3,729	3,871	4,017
Minorities	30	22	29	34	38	43
Total shareholders' equity	2,837	3,221	3,546	3,763	3,909	4,059
Net debt	-770	-524	-1,103	-1,110	-1,244	-1,192

Key Company Metrics

Sales growth (%)	nm	8.7	-10.5	-11.0	1.5	15.9
DB EPS growth (%)	na	11.8	-33.5	-47.5	-12.8	-0.8
EBITDA Margin (%)	50.7	46.7	42.2	33.9	30.1	28.7
EBIT Margin (%)	45.0	39.5	33.4	23.9	17.7	15.0
Payout ratio (%)	23.7	20.2	0.0	20.0	20.0	20.0
ROE (%)	20.4	20.2	12.0	5.8	4.9	4.6
Capex/sales (%)	88.6	16.3	10.5	23.1	30.0	32.3
Capex/depreciation (x)	15.6	2.3	1.2	2.3	2.4	2.4
Net debt/equity (%)	-27.1	-16.3	-31.1	-29.5	-31.8	-29.4
Net interest cover (x)	50.4	76.1	37.4	9.3	nm	nm

Source: Company data, Deutsche Bank estimates

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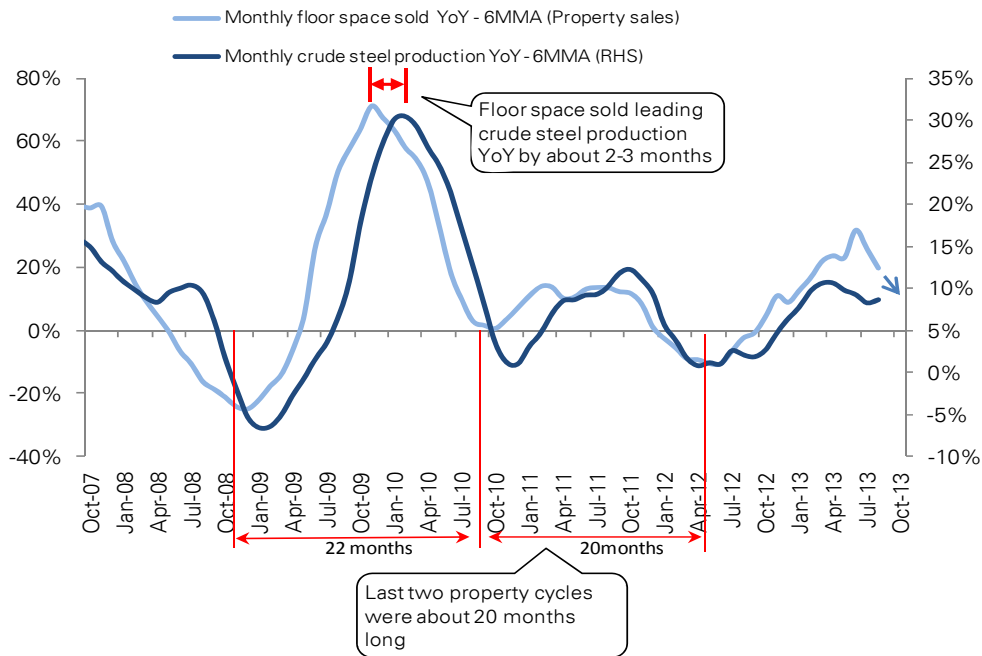


# No near-term catalysts

## Gloomy iron ore price outlook

We believe steel production growth will start to slow down along with the weakened property sales growth rate in the coming months. We have noticed in the past five years that during a typical 20-22 month property cycle, the YoY growth of steel production almost perfectly lags that of property sales (floor space) by 2-3 months on a six-month moving average basis (Figure 1).

Figure 1: Property sales YoY vs. crude steel production YoY

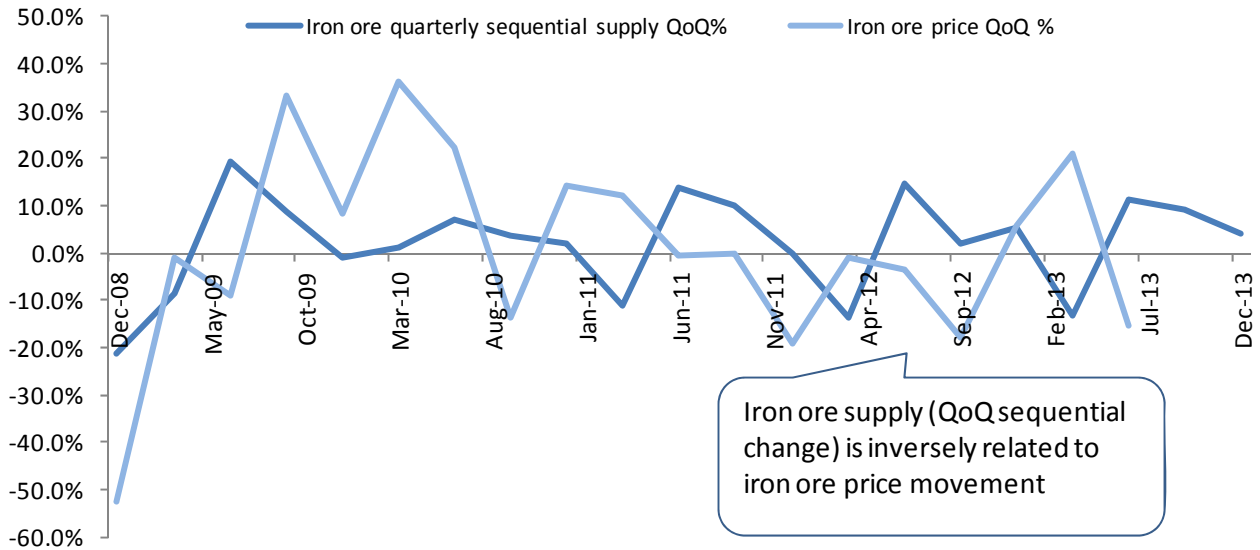


Source: Deutsche Bank, NBS, Wind

On the other hand, iron ore supply from the four majors (BHP, FMG, Rio Tinto, Vale) will likely witness strong QoQ and YoY growth. Historically, strong QoQ iron ore supply growth has typically caused iron ore price weakness. As shown in Figure 2, iron ore supply QoQ growth is normally inversely related to iron ore price movements.



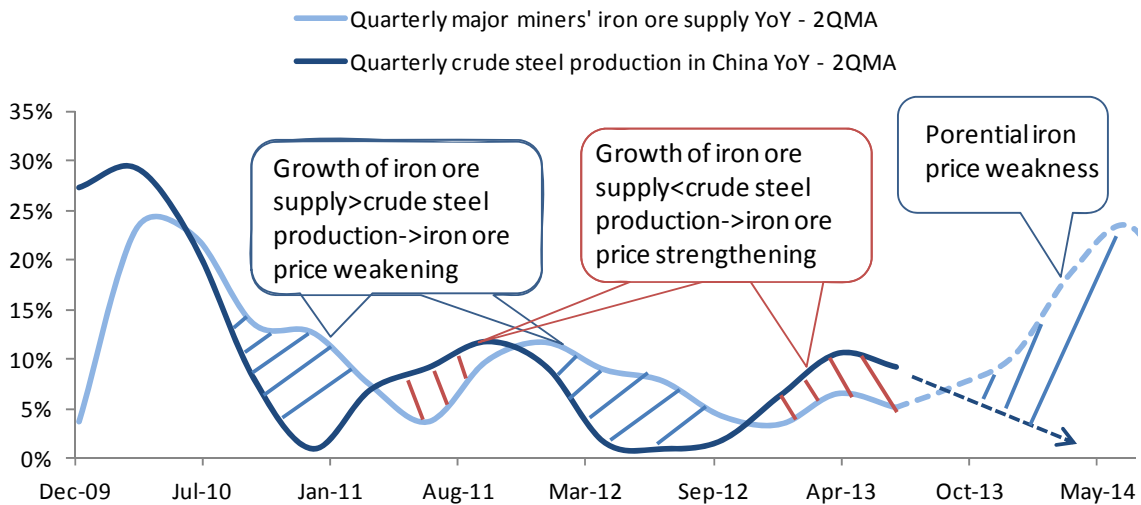
Figure 2: Iron ore sequential supply change vs. price movement



Source: Deutsche Bank, NBS, Wind

Meanwhile, the mismatches between China steel production YoY and iron ore supply YoY have also been a good driver of iron ore price movement. As shown in Figure 3, in the coming quarters, the likely iron ore supply YoY growth will be much stronger than steel production YoY growth. As such, the iron ore price will likely weaken.

Figure 3: YoY growth of quarterly iron ore supply from major miners vs. crude steel production in China



Source: Deutsche Bank, Wind, NBS



## Tough for China VTM to outperform on stagnant demand, escalating cost and production suspension in Baicao mine

China VTM raised its privatization proposal in November 2012. However, the resolution proposed at the court meeting was not passed by the requisite majority and was disapproved by more than 10% of the votes on 15 May 2013. Also, neither the Offer nor the parties acted in concert with it in the course of the Proposal; the court may within 12 months of 15 May 2013 announce an offer or possible offer for the company without the consent of the executive.

We update our model based on its 1H13 results and our discussion with its management. We slash our 2013E and 2014E NPAT by 53% to RMB212m and RMB184m, respectively, as a result of a lower titanium concentrate price, higher unit cost of pellets and production suspension in Baicao mine in 2H13 and 1H14. Figure 4 provides details of our earnings forecasts and key assumptions.

Figure 4: China VTM's forecast change table

	2013E			2014E		
	New	Old	Change%	New	Old	Change%
Revenue	1,366	1,856	-26.4%	1,387	1,918	-27.7%
OP	326	603	-45.9%	245	524	-53.3%
NP	212	447	-52.7%	184	393	-53.0%

Source: Deutsche Bank estimates

**Production volume:** According to the company, economically mineable niobium and tantalum ore resources have been discovered in the Baicao mine. China VTM has suspended normal mining activities in the Baicao mine to preserve the potential niobium and tantalum ore resources. It expects no more than 300kt and 250kt volume decline in 2H13 and 1H14, respectively. As such, we cut our 2013E/14E concentrate output by 26% and 20%, respectively.

Although the Pingchuan mine is expected to ramp up on schedule in 2014, we revise down its capacity to 600ktpa from 800kt, according to our discussion with management. On the other hand, Haibaodang mine (Yixingda) is facing poor Fe grade yet better Ti grade during exploration. We expect some delay in this project and assume a 2015 start-up.

Other than the concentrates, we significantly cut pellets volume for 2013 and the next few years. In 1H13, pellets sales were only 25.7kt, a 93% YoY decline. According to management, the steel mills are facing tough times and are purchasing concentrates which are more affordable than pellets. We do not expect the situation to improve in the short term, thus we slash China VTM's pellets volume by 94%/78%/60% in 2013E/14E/15E, respectively.

**ASP:** Iron ore concentrate and pellet prices are generally in line with our expectation. However, we lower the high grade titanium concentrate price by c.30% as a result of weak demand. According to management, the titanium price has stabilized at c.RMB900/t (exclusive of VAT), slightly better than RMB874/t in 1H13.



**Unit cost:** We see a significant unit cost increase in pellets given its significant lower volume delivered in 1H13. With its output likely to continue at low levels in the coming years, we increase its unit cost by 20%/15%/12% in 2013E/14E/15E, respectively.

Meanwhile, with deeper extraction and lower processing recovery, we also raise the iron ore concentrate unit cost by 2%/2%/4% in 2013E/14E/15E, respectively. We also raise the high-grade titanium concentrate unit cost by 9%/9%/12% in 2013E/14E/15E to better reflect its actual unit cost after our talk with management.

Figure 5: China VTM key assumptions

	2010	2011	2012	2013E	2014E	2015E
<b>ASP (RMB/t)</b>						
Iron concentrates - New	665	671	621	611	565	546
- Old	665	671	621	587	560	532
<i>Change%</i>				4%	1%	3%
Iron pellets - New	875	891	844	838	787	766
- Old	875	891	844	821	791	759
<i>Change%</i>				2%	0%	1%
High-grade titanium conc. - New	534	1,084	1,175	881	828	806
- Old	534	1,084	1,175	1,226	1,181	1,134
<i>Change%</i>				-28%	-30%	-29%
<b>Unit cost (RMB/t)</b>						
Iron concentrates - New	267	310	320	350	368	382
- Old	267	310	316	343	360	366
<i>Change%</i>				2%	2%	4%
Iron pellets - New	453	535	550	650	670	683
- Old	453	535	550	543	581	607
<i>Change%</i>				20%	15%	12%
High-grade titanium conc. - New	406	471	560	570	599	622
- Old	406	471	560	522	548	556
<i>Change%</i>				9%	9%	12%
<b>Sales volume (mt)</b>						
Iron concentrates - New	1,317	1,479	1,517	1,863	1,808	1,967
- Old	1,317	1,479	1,517	1,535	1,625	2,156
<i>Change%</i>				21%	11%	-9%
Iron pellets - New	713	613	499	50	200	400
- Old	713	613	499	850	900	1,000
<i>Change%</i>				-94%	-78%	-60%
High-grade titanium conc. - New	67	108	147	210	250	280
- Old	67	108	147	210	250	280
<i>Change%</i>				0%	0%	0%
<b>Production volume (mt)</b>						
Iron concentrates - New	2,008	2,249	2,214	1,763	2,008	2,367
- Old	2,008	2,249	2,100	2,385	2,525	3,156
<i>Change%</i>				-26%	-20%	-25%

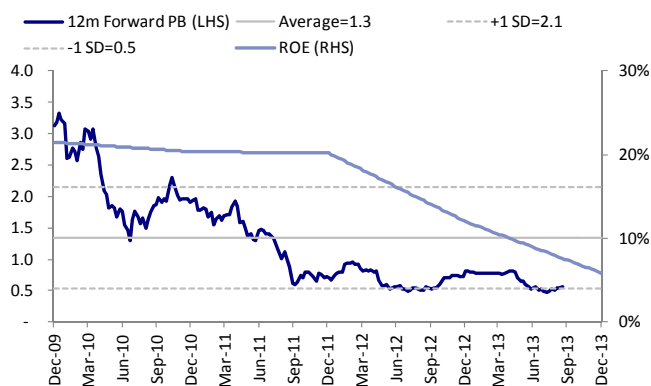
Source: Deutsche Bank estimates, Company data



## Downgrading to Hold, target price HKD1.3

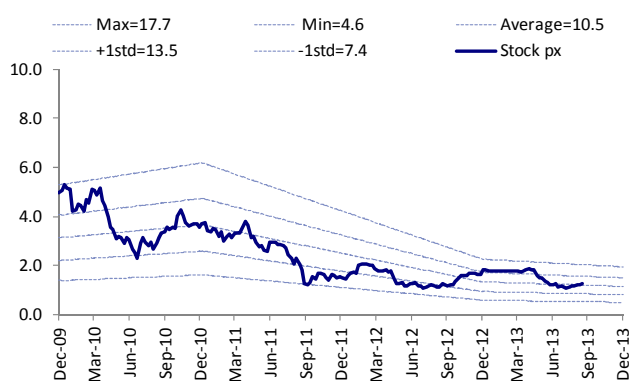
Our target price of HKD1.3 is based on a life-of-mine DCF, with a WACC of 9.8%, cost of equity of 11.5% and after-tax cost of debt of 5.8%. Our cost of equity uses a risk-free rate of 3.1%, a market risk premium of 5.6% and a beta of 1.5. Our target price translates into 0.55x 2014E PB and 11.5x 2014E PE. The implied PE is generally in line with the historical average at 11x. The implied P/B is close to its one standard deviation below the historical average at 0.54x, with declining ROAE of only c.5% in 2014/15; we believe it is fair. With 4% upside, we downgrade China VTM from Buy to Hold.

Figure 6: China VTM – 12-month forward P/B vs. ROE



Source: Deutsche Bank

Figure 7: China VTM – 12-month forward PE band



Source: Deutsche Bank

**Key risks:** 1) weaker/stronger-than-expected steel capacity expansion in Southwest China; 2) weaker/stronger-than-expected pellets demand; 3) slower/faster-than-expected ramp-up of the Pingchuan and Yixingda projects; 4) shorter/longer-than-expected production halt in Baicao mine; 5) lower/better-than-expected niobium and tantalum resources in Baicao mine.



# Appendix 1

## Important Disclosures

Additional information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
China VTM Mining	0893.HK	1.27 (HKD) 23 Sep 13	NA

\*Prices are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies

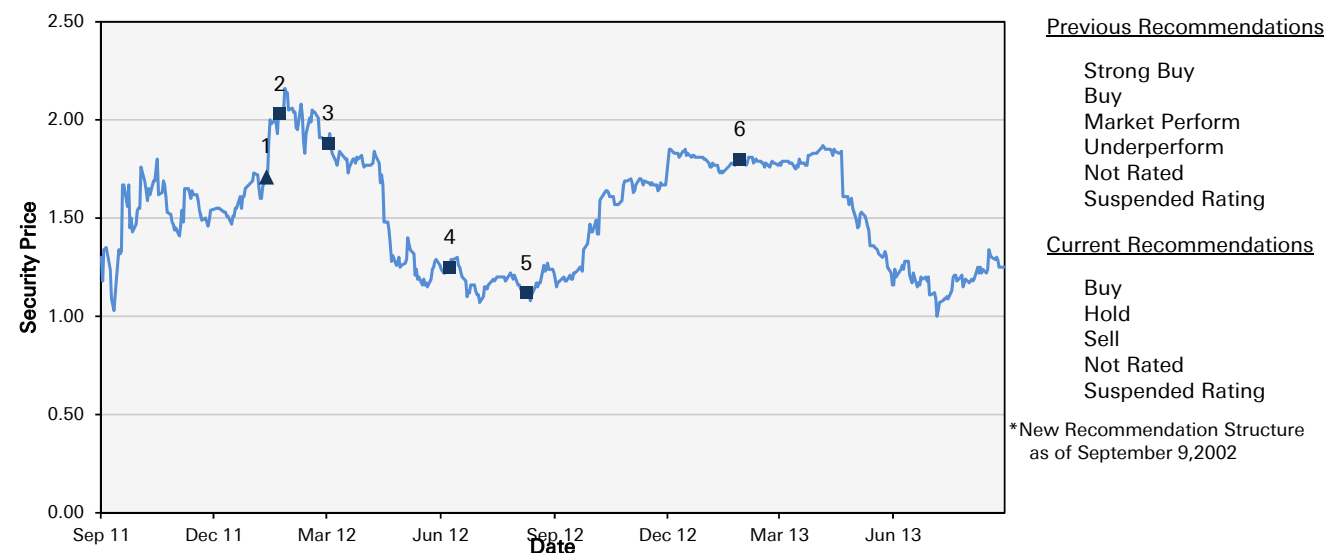
For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/Disclosure.egsr?ricCode=0893.HK>

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### Historical recommendations and target price: China VTM Mining (0893.HK)

(as of 9/23/2013)



1. 06/02/2012:	Upgrade to Buy, Target Price Change HKD2.50	4. 03/07/2012:	Buy, Target Price Change HKD2.10
2. 17/02/2012:	Buy, Target Price Change HKD2.40	5. 03/09/2012:	Buy, Target Price Change HKD1.60
3. 27/03/2012:	Buy, Target Price Change HKD2.30	6. 22/02/2013:	Buy, Target Price Change HKD2.00





Equity rating key

**Buy:** Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus pro-jected dividend yield ) , we recommend that investors buy the stock.

**Sell:** Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

**Hold:** We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.

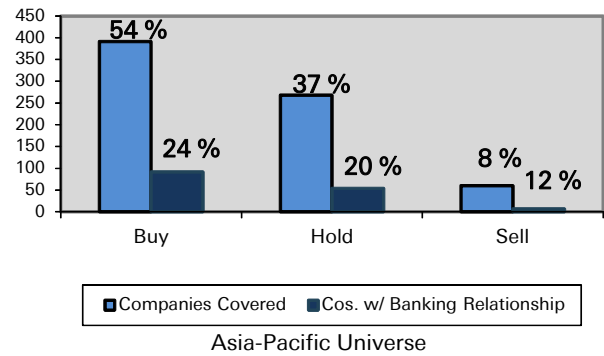
2. Ratings definitions prior to 27 January, 2007 were:

Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships





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