

Company Update



Thomas Zhu
thomas.zhu@samsungfn.com
+852 3411 3717

Simon Francis
simon.francis@samsungfn.com
+852 3411 3713

Chris Chen
chris.chen@samsungfn.com
+852 3411 3750

■ AT A GLANCE

SELL HOLD **BUY** ★★

Target price	HK\$5.70 (+114%)		
Current price	HK\$2.66		
Bloomberg code	893 HK		
Market cap	US\$706m		
Shares out (float)	2.08bn (42%)		
52-week high/low	HK\$4.33/2.25		
ADT (3M)	US\$6.05m		
One year performance	1M	6M	12M
China Vanadium	-17%	-29%	-9%
Hang Seng China Ent	-4%	-3%	+10%

■ KEY CHANGES

	New	Old	Chg%
Recommendation	Buy	Buy	
Target price (HK\$)	5.70	5.5	+4%
EPS 12-11E (Rmb)	0.31	0.30	+3.5%
EPS 12-12E (Rmb)	0.39	0.38	+3.2%
EPS 12-13E (Rmb)	0.45	n.a.	n.a.

■ SAMSUNG vs THE STREET

No. of I/B/E/S estimates	7
Target price vs I/B/E/S mean	+19%
Estimates up/down (4 weeks)	0/0
1yr fwd EPS vs I/B/E/S mean	+1%
Estimates up/down (4 weeks)	0/0
I/B/E/S recommendation	Sbuy (1.40)

China Vanadium (893 HK)

Value emerges in the iron man

WHAT'S THE STORY?

Event: China Vanadium shares have dropped 27% since the firm announced a US\$20m investment in an Indonesian iron sands company on May 3. Primary coverage of China Vanadium is transferred to Thomas Zhu with immediate effect.

Impact: Trading at 7.0x 2011e P/E, 1.4x P/B, and 3.5x EV/EBITDA—all well below historical valuations, the shares offer great value. We project net cash of Rmb0.51/share by end-2011e, ie, 23% of current share price. The share-price correction looks overdone as: 1) the Indonesian investment is well compensated with high yields of 20-25% pa; 2) the investment is relatively small; and 3) management is extremely confident on project profitability after careful market studies and in-house experiments.

Action: Maintain BUY★★★ and raise our DCF-based target price to HK\$5.70 from HK\$5.50 following our earnings upgrades. We expect China Vanadium to deliver robust resources and production volume growth over the next two years. The firm should also benefit from higher selling prices in 2H11e as downstream demand picks up in the Sichuan region.

THE QUICK VIEW

Management remains extremely confident on the profitability of the Indonesian iron sands projects during our recent conversation. The company has followed similar projects for ~5 years and its market research shows that China will have over 10.0m tonnes of demand for iron sands concentrates in 2012. Management believes selling prices and production costs are highly competitive from trial production and in-house experiments. We expect China Vanadium to announce more project details if it decides to increase investments by August.

China Vanadium offers great value with decent production volume growth of 28% pa and earnings growth of 23% pa over the next two years, in our estimate. We maintain our BUY★★★ call, believing that further acquisitions and higher selling prices in 2H11e are the main catalysts. We lift our DCF-based target price by 4% to HK\$5.70.

The key risk to our view is weaker-than-expected iron ore prices.

■ SUMMARY FINANCIAL DATA

	12-09	12-10	12-11E	12-12E	12-13E
Revenue (Rmb m)	1,084	1,554	1,935	2,735	3,041
EBITDA	480	798	999	1,349	1,515
Net Inc	328	533	654	813	925
EPS (Rmb)	0.20	0.26	0.31	0.39	0.45
P/E	19.8	12.8	7.0	5.7	5.0
EV/EBITDA	15.6	7.2	3.5	1.9	1.1
Div Yld (%)	0.3	1.6	2.8	3.5	4.0
P/B	3.7	2.3	1.4	1.2	1.0
ROE (%)	21	20	22	22	21

Source: Company data, Samsung Securities estimates

China Vanadium (893 HK)

Investment in Indonesia

China Vanadium's share price has dropped 27% since the firm announced its investment in an iron sands company in Indonesia on May 3. It plans to invest US\$20m in exchangeable notes and has the option to buy another US\$30m by Aug 10. The notes have a maturity of three years and the yield to maturity is 20-25% pa. China Vanadium has the right to convert the notes into common shares of the target company.

The target company has mining rights for an area of 5,000 hectares and exploration rights for an area of 10,000 hectares. China Vanadium expects the tenements to have JORC-standard iron ore reserves of at least 1.4bn tonnes at an average grade of 10% (Fe content) based on initial geological studies. The target company will appoint an independent technical adviser to prove the reserves.

Moreover, the target company plans to construct an iron sands concentrates production line of 10.0m tpa (58-60% Fe) by Jun 2012. China Vanadium has the option to buy 20% of the iron concentrates in Jun 2012-Dec 2013 and 2.0m tpa (wet tonnes) from 2014. The firm plans to sell these concentrates to China's coastal regions.

Figure 1: Iron sands project agreement

(m tonnes, dry basis)	2012	2013	2014
Project production	4.0	9.0	na
China Vanadium off-take	0.8	1.8	2.0m tonnes (wet basis)

Source: Company data, Samsung Securities estimates

We think one reason for the high yield of the exchangeable note is that this is a pre-production-stage project and production will not begin until mid-2012. Management believes the 20-25% annual yield is consistent with market yields for similar investments in Indonesia.

China Vanadium disclosed very limited details on the project as: 1) the investment is small and does not constitute a disclosable transaction under the rules of the Hong Kong Stock Exchange; 2) China Vanadium is still in talks with the target company for more comprehensive cooperation; and 3) the target company is still negotiating with other third parties for additional financing. We expect China Vanadium to announce more project details if it decides to increase investments by August.

Management is extremely confident on the profitability of the iron sands concentrates, saying that the company has followed the market for ~5 years. Coastal China will have over 10.0m tonnes of demand for iron sands in 2012 according to the firm's latest market research. China Vanadium believes that demand should increase further over the next few years. Management emphasized that China's demand for iron sands concentrates is much stronger nowadays than they first did the market research ~5 years ago.

The iron sands concentrates sell at a large discount to the iron concentrates from Australia, and steel makers can reduce costs by blending the iron sands concentrates with traditional iron concentrates. Trial production has proved that production costs for the iron sands are extremely competitive—this has also been proved by China Vanadium's in-house experiment. Management believes this is mainly because iron sands do not require any crushing.

Management assured us that the firm's key focus is still to develop vanadium-bearing iron ore resources in the Sichuan region. According to management, it is in the company's best interest to invest in the highly profitable Indonesian project, which can help the company develop new customer relationships especially in eastern China.

Value emerging

The share-price correction looks overdone and we think China Vanadium now offers great value. The stock is trading at 2011e P/E of 7.0x, P/B of 1.4x and EV/EBITDA of 3.5x. All these valuation metrics are well below historical levels. Net cash per share should be ~Rmb0.51 by end-2011e, representing 23% of current share price.

Figure 2: Key valuations and operations data

	2009	2010	2011e	2012e	2013e
P/E	19.7	12.7	7.0	5.6	5.0
P/B	3.2	2.4	1.4	1.1	0.9
EV/EBITDA	13.4	7.4	3.5	1.9	1.1
EPS growth	18%	28%	23%	24%	14%
Net margin	30%	34%	34%	30%	30%
ROE	21%	20%	22%	22%	21%
Net cash per share (Rmb)	0.86	0.44	0.51	1.00	1.40

Note: Annual average prices for historical years; current prices from 2011
Source: Bloomberg, Company data, Samsung Securities estimates

Raising our earnings estimates...

We raise our net income forecasts by 3% to Rmb654m in 2011e and by 3% to Rmb813m in 2012e.

Figure 3: Earnings changes

(Rmb m)	Old			New			Change		
	2011e	2012e	2013e	2011e	2012e	2013e	2011e	2012e	2013e
Revenue	1,869	2,634	na	1,935	2,735	3,041	4%	4%	na
Net income	632	787	na	654	813	925	3%	3%	na
EPS (Rmb)	0.30	0.38	na	0.31	0.39	0.45	3%	3%	na

Source: Samsung Securities estimates

Selling prices: We raise vanadium iron concentrates' selling prices to Rmb620/t from Rmb605/t in 2011e and 2012e and to Rmb639/t from Rmb623/t in 2013e. Management is upbeat about the Sichuan iron ore market in 2H11, and we think China Vanadium will likely switch to spot market pricing to benefit from higher prices.

China Vanadium (893 HK)

We raise high-grade titanium concentrates' selling prices to Rmb1,050/t from Rmb800/t in 2011e and 2012e and to Rmb1,082/t from Rmb824/t in 2013e. Spot market prices rose from ~Rmb1,100/t (VAT inclusive) early this year to ~Rmb1,400/t at the end of May. Management believes titanium concentrates prices will remain high in 2H11e.

Costs: We now lift our YoY unit cost increase from 2% to 5% for all products in 2011e.

Capex: We raise 2011e capex from Rmb450m to Rmb650m to reflect management's more ambitious acquisition plans.

Balance sheet: We increase investments under non-current assets by Rmb132m to reflect the US\$20m investment in the iron sands company in Indonesia.

...and target price

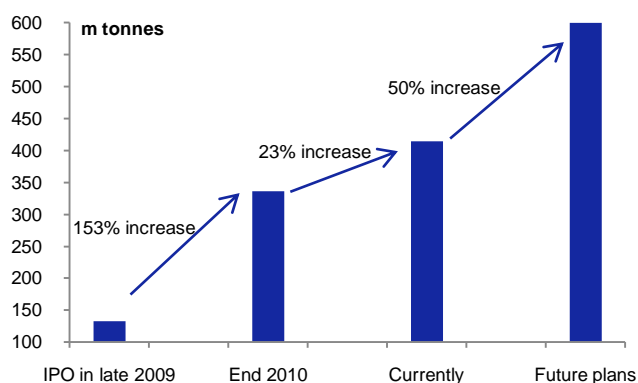
We lift our DCF-based target price to HK\$5.70 from HK\$5.50 to reflect our higher earnings estimates.

More growth ahead

The company plans to increase resources to ~600m tonnes from ~400m tonnes over the next 3-5 years. Our sense is that most of the resources growth should come through in 2H11-1H12e as management aims to acquire resources before increasing competition drives up prices. Management's good track record and abundant iron ore resources in Sichuan make us confident on their ability to deliver.

The firm had Rmb1.1bn in cash at the end of 2010—ie, plenty of war chests for acquisitions.

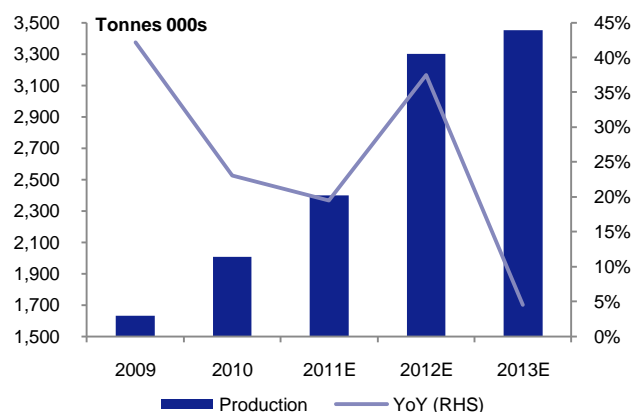
Figure 4: Iron ore resources



Source: Company data

We forecast iron concentrates production will increase 20% YoY to 2.4m tonnes in 2011e and another 38% YoY to 3.3m tonnes in 2012e. The growth will mainly be driven by production ramp-ups at recently acquired Maoling and Yanglongshan mines.

Figure 5: Iron concentrates production

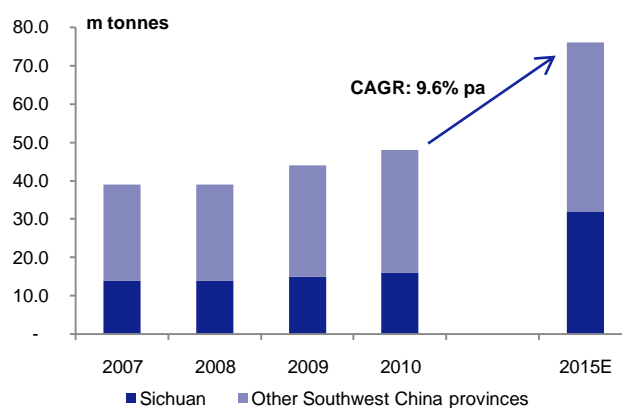


Source: Company data, Samsung Securities estimates

Higher selling prices in 2H11e

China Vanadium expects iron ore prices to pick up in Sichuan in 2H11e, driven by: 1) increased infrastructure construction demand following approval of the Chengdu-Chongqing Economic Zone in May; 2) new steel-making capacity of ~4.2m tpa at Pangang Steel in 4Q11; and 3) continued government efforts to promote vanadium-bearing iron ores to increase the strength of steel. Management estimates that spot market prices for iron pellets will reach ~Rmb910/t in 2H11, ie, ~Rmb20/t higher than the firm's contract price for 1H11. Our sense is that China Vanadium will probably switch to spot market pricing in 2H11e to benefit from higher selling prices.

Figure 6: Pig iron production in Southwest China



Source: Company data

Management is also upbeat about the titanium market. Current selling prices are ~Rmb1,300/t, ie, ~Rmb300/t higher than the beginning of 2011. The company expects further upside in 2H11 thanks to strong downstream demand for titanium products.

China Vanadium (893 HK)

Figure 7: Summary Financials

	12-09	12-10	12-11E	12-12E	12-13E
Profit & Loss (Rmb m)					
Revenue	1,084	1,554	1,935	2,735	3,041
COGS	-582	-724	-930	-1,350	-1,483
Gross profit	502	830	1,006	1,385	1,558
Gross profit margin (%)	46	53	52	51	51
Selling, general & admin	-64	-124	-130	-183	-204
Operating profit	438	707	876	1,201	1,355
Operating margin (%)	40	45	45	44	45
Interest expense	-4	-15	-8	-4	-4
Interest income	0	3	11	25	39
Others	3	6	-5	-5	-5
Profit before tax	437	701	874	1,218	1,385
Taxation	-70	-117	-140	-304	-346
Minorities	-39	-51	-81	-100	-114
Net income	328	533	654	813	925
Net income margin	30	34	34	30	30
Adjusted net income	328	533	654	813	925
Adjusted EPS, Rmb	0.20	0.26	0.31	0.39	0.45
DPS, Rmb	0.01	0.05	0.06	0.08	0.09
Dividend payout ratio (%)	6	20	20	20	20
EBITDA	480	798	999	1,349	1,515
EBITDA margin (%)	44	51	52	49	50

	12-09	12-10	12-11E	12-12E	12-13E
Balance Sheet (Rmb m)					
Current assets	2,304	1,542	1,841	3,156	4,075
Cash and cash equivalents	1,884	1,096	1,158	2,186	3,009
Trade receivables	137	208	212	300	333
Inventory	71	70	127	185	203
Other current assets	212	170	343	485	530
Fixed assets	496	1,476	2,004	2,105	2,195
Other non-current assets	344	784	521	513	505
Total assets	3,144	3,803	4,365	5,774	6,775
Current liabilities	-461	-813	-922	-1,390	-1,520
Borrowings due in <1 year	-100	-175	-50	-50	-50
Trade payables	-86	-255	-229	-333	-345
Other current liabilities	-275	-383	-642	-1,007	-1,124
Long-term liabilities	-6	-131	-55	-55	-55
Borrowings due >1 year	-6	-131	-55	-55	-55
Other long-term liabilities	0	0	0	0	0
Total liabilities	-467	-944	-977	-1,445	-1,575
Shareholders' equity	2,514	2,775	3,298	3,948	4,688
Total debt and sh. equity	3,144	3,803	4,365	5,774	6,775

	12-09	12-10	12-11E	12-12E	12-13E
Cash Flow (Rmb m)					
Pre-tax profit	437	701	874	1,218	1,385
Depreciation & amortisation	43	91	123	148	161
Increase in working capital	-106	485	55	239	51
Others	-31	-83	-417	-649	-738
Net cash from operating activities	342	1,194	636	956	859
Capex	-239	-975	-642	-242	-242
Associates & investments	0	0	0	0	0
Others	-89	-776	124	132	0
Net cash in investing	-328	-1,750	-518	-110	-242
Dividends paid	-24	0	-108	-131	-163
New debts / debts (repaid)	100	200	-250	0	0
Issue of shares	1,662	0	0	0	0
Others	0	-430	303	312	369
Net cash in financing	1,737	-230	-55	182	207
Net increase in cash	1,751	-788	62	1,028	824

Source: Company data, Samsung Securities estimates

	12-09	12-10	12-11E	12-12E	12-13E
Ratio Analysis					
PER (x)	19.8	12.8	7.0	5.7	5.0
Price to book (x)	3.7	2.3	1.4	1.2	1.0
Price to sales (x)	6.0	4.4	2.4	1.7	1.5
EV/EBITDA (x)	15.6	7.2	3.5	1.9	1.1
EV/Sales (x)	6.9	3.7	1.8	0.9	0.6
Dividend yield (%)	0.3	1.6	2.8	3.5	4.0
Revenues growth (%)	37	43	25	41	11
EBITDA growth (%)	21	66	25	35	12
EPS growth (%)	18	28	23	24	14
ROE (%)	21.5	20.2	21.5	22.4	21.4
ROA (%)	15.8	15.4	16.0	16.0	14.7
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash
Net debt to total capital (%)	net cash	net cash	net cash	net cash	net cash
Total debt to equity (%)	4.1	11.0	3.1	2.5	2.1
Interest cover (x)	110.9	61.5	nm	nm	nm
Interest and current liabs cover (x)	0.9	0.9	1.0	0.9	0.9
Current assets/current liabilities	5.0	1.9	2.0	2.3	2.7
Curr asset less cash/curr liab	0.9	0.5	0.7	0.7	0.7

	12-09	12-10	12-11E	12-12E	12-13E
Effective capacity, tonnes 000s	2,906	3,511	4,430	4,704	4,854
Sales volume, tonnes 000s					
Iron concentrates	950	1,317	1,420	1,900	1,900
Iron pellets	693	728	904	1,229	1,229
Titanium concs - medium grade	167	83	0	0	0
Titanium concs - high grade	0	62	150	250	300
Selling prices, Rmb/t					
Iron concentrates	558	665	620	620	639
Iron pellets	775	875	919	919	947
Titanium concs - medium grade	102	99	100	100	100
Titanium concs - high grade	0	534	1,050	1,050	1,082
Cost of sales, Rmb000/t					
Iron concentrates	258	267	280	289	295
Iron pellets	429	453	476	490	500
Titanium concs - medium	239	250	263	270	276
Titanium concs - high	440	453	476	490	505

Shareholding Structure			
Shareholders	Code	No. of shares	%
Trisonic Int'l Ltd	893 HK	1,198	58%
Other public shares	893 HK	877	42%
Total shares in issue		2,075	100%

China Vanadium (893 HK)

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BUY	Expected to increase in value by 10% or more within 12 months
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