

Equities

30 August 2011 | 10 pages

China Vanadium Titano-Magnetite Mining (0893.HK)

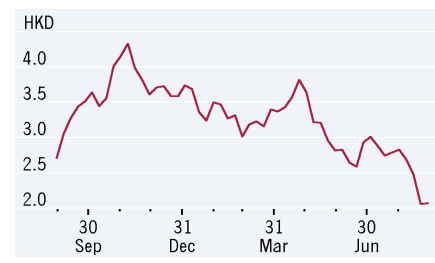
Maintain Buy on Cheap Valuations

- 1H11 result below Citi & in line with consensus** – Net profit of Rmb301 Mil in 1H was up 30% yoy, primarily driven by volume growth for iron concentrate and titanium concentrate. 92% of the revenue was collected from iron ore sales, and 8% from titanium concentrate. Realized prices for iron ore were flat to up 3% depending on the product. Sichuan local price didn't move much during the reporting period, and the floor price mechanism continued to work. Price for titanium concentrate more than doubled.
- Stringent cost management** – Unit cost for concentrate was almost flat yoy. Lower strip ratio for Xiushuihe mitigated cost hikes for raw materials and processing. Unit cost for pellet rose significantly, as the out-sourcing fee surged from about Rmb135/t to roughly Rmb227/t. China VTM's in-house pellet plant came on line in May. We expect pellet costs to fall in 2H on vertical integration of pellet production.
- More projects likely in Sichuan** – Sichuan has been short-listed as one of the two national iron ore production centres. A leader in the industry, China VTM has advantages in terms of either exploring for new assets or acquiring weaker players.
- US\$50 Mil Indo project considered non-core and excluded from NPV** – We view the Indo project to be non-core compared to VTM's main Sichuan-based businesses and a deviation in terms of risk profile. Our preference is for the company to focus on expansion via local ore mines, thus leveraging on its connections and expertise
- Maintain Buy, new target set at HK\$3.59/s** – We cut earnings by 22% and 20% for 11E and 12E to reflect static iron ore prices and higher costs. Our DCF-based target price is lowered to HK\$3.59/s (from HK\$5.10/s), with the total investment in the Indo project deducted from our calculated NPV on the view that it will not be value accretive.

- Company Update
- Target Price Change
- Estimate Change

Buy/Low Risk	1L
Price (30 Aug 11)	HK\$2.16
Target price	HK\$3.59
	from HK\$5.10
Expected share price return	66.2%
Expected dividend yield	2.5%
Expected total return	68.8%
Market Cap	HK\$4,482M
	US\$575M

Price Performance (RIC: 0893.HK, BB: 893 HK)



Statistical Abstract

Year to 31 Dec	Net Profit (RmbM)	Diluted EPS (Rmb)	EPS growth (%)	P/E (x)	P/B (x)	ROE (%)	Yield (%)
2009A	328	0.158	-4.7	11.2	1.5	21.5	0.0
2010A	533	0.257	62.7	6.9	1.3	20.2	2.7
2011E	645	0.311	20.9	5.7	1.1	21.6	3.1
2012E	683	0.329	6.0	5.4	1.0	19.6	3.3
2013E	730	0.352	6.8	5.0	0.8	18.0	3.5

Source: Powered by dataCentral

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Fiscal year end 31-Dec	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	11.2	6.9	5.7	5.4	5.0
EV/EBITDA adjusted (x)	6.1	3.0	2.6	1.7	1.1
P/BV (x)	1.5	1.3	1.1	1.0	0.8
Dividend yield (%)	0.0	2.7	3.1	3.3	3.5
Per Share Data (Rmb)					
EPS adjusted	0.158	0.257	0.311	0.329	0.352
EPS reported	0.158	0.257	0.311	0.329	0.352
BVPS	1.212	1.337	1.541	1.811	2.100
DPS	0.000	0.047	0.055	0.059	0.063
Profit & Loss (RmbM)					
Net sales	1,084	1,554	1,790	2,145	2,297
Operating expenses	-679	-865	-923	-1,105	-1,189
EBIT	405	689	867	1,040	1,108
Net interest expense	-9	-15	-2	0	2
Non-operating/exceptionals	41	27	-15	-17	-17
Pre-tax profit	437	701	850	1,024	1,093
Tax	-70	-117	-128	-256	-273
Extraord./Min.Int./Pref.div.	-39	-51	-78	-84	-90
Reported net income	328	533	645	683	730
Adjusted earnings	328	533	645	683	730
Adjusted EBITDA	459	803	1,042	1,228	1,299
Growth Rates (%)					
Sales	37.0	43.4	15.2	19.8	7.1
EBIT adjusted	21.0	70.2	25.7	20.0	6.5
EBITDA adjusted	27.1	74.9	29.7	17.9	5.7
EPS adjusted	-4.7	62.7	20.9	6.0	6.8
Cash Flow (RmbM)					
Operating cash flow	347	668	883	934	1,001
Depreciation/amortization	54	114	175	188	191
Net working capital	-74	-30	-15	-23	-10
Investing cash flow	-413	-1,488	-314	-304	-303
Capital expenditure	-386	-1,488	-314	-304	-303
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	1,775	93	-254	-137	-146
Borrowings	100	200	-125	0	0
Dividends paid	0	-107	-129	-137	-146
Change in cash	1,709	-726	315	493	552
Balance Sheet (RmbM)					
Total assets	3,073	3,733	4,547	5,280	5,997
Cash & cash equivalent	1,884	1,096	1,431	2,188	2,998
Accounts receivable	137	208	322	386	413
Net fixed assets	496	1,476	2,238	2,107	1,978
Total liabilities	467	944	1,271	1,373	1,417
Accounts payable	86	255	244	293	314
Total Debt	100	300	175	175	175
Shareholders' funds	2,607	2,789	3,275	3,906	4,580
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	42.4	51.7	58.2	57.3	56.5
ROE adjusted	21.5	20.2	21.6	19.6	18.0
ROIC adjusted	49.4	40.4	36.1	38.4	43.5
Net debt to equity	-68.4	-28.5	-38.4	-51.5	-61.6
Total debt to capital	3.7	9.7	5.1	4.3	3.7

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Figure 1. 1H Results vs. Citi/Consensus

(Rmb Mil)	restated 1H10	1H11	YoY	2010	Citi 2011E	1H10 as % of 2010	1H11 as % of 2011E	Consensus 11E	1H11 as % consensus
Revenue	700	845	21%	1,554	1,790	45%	47%	1,871	45%
Cost of sales	(334)	(414)		(724)	(799)				
Gross profit	365	431	18%	830	991	44%	44%		
Selling and distribution costs	(19)	(23)		(44)	(49)				
Administrative expenses	(37)	(50)		(79)	(75)				
Other operating expenses	(28)	(4)		(18)	0				
Operating profit	282	354	26%	689	867	41%	41%	868	41%
Other income	31	20		27	(15)				
EBIT	312	374	20%	716	852	44%	44%	854	44%
Net interest expense	(10)	(8)		(15)	(2)				
Profit before tax	302	366	21%	701	850	43%	43%	853	43%
Income tax	(52)	(62)		(117)	(128)				
Profit after tax	251	304	21%	584	723	43%	42%		
Minority interest	(20)	(3)		(51)	(78)				
Net profit	231	301	30%	533	645	43%	47%	653	46%

Source: Citi Investment Research and Analysis, Company reports

Figure 2. Key Operational Data: 1H10 vs. 1H11

	1H10	1H11	YoY
Iron Ore Concentrates			
Production (Kt)	889	1,041	17%
Sales (Kt)	528	705	34%
ASP (Rmb/t)	664	666	0.2%
Revenue (Mil)	351	469	34%
Iron Ore Pellets			
Production (Kt)	362	300	-17%
Sales (Kt)	376	335	-11%
ASP (Rmb/t)	877	901	3%
Revenue (Mil)	330	302	-9%
Medium Grade TiO2			
Production (Kt)	40	72	79%
Sales (Kt)	37	54	47%
ASP (Rmb/t)	86	177	106%
Revenue (Mil)	3.2	9.6	203%
High Grade TiO2			
Production (Kt)	34	58	69%
Sales (Kt)	31	57	85%
ASP (Rmb/t)	512	1,132	121%
Revenue (Mil)	15.8	64.7	310%

Source: Citi Investment Research and Analysis, Company report

Figure 3. Forecast Revisions

(Rmb Mil)	2011E			2012E		
	old	new	% change	old	new	% change
Sales	2,074	1,790	-13.7%	2,397	2,145	-10.5%
EBIT	1,112	867	-22.1%	1,292	1,040	-19.5%
Net profit	830	645	-22.3%	852	683	-19.8%

Source: Citi Investment Research and Analysis

Figure 4. DCF analysis

		2006	2007	2008	2,009	2010E	2011E	2012E	2013E
EBITDA	Rmb m	62	89	378	500	829	1,027	1,212	1,282
Depreciation & amortisation	Rmb m	11	11	19	44	102	160	172	175
EBIT	Rmb m	51	78	360	456	728	867	1,040	1,108
Cash tax rate	Rmb m	1%	6%	7%	15%	16%	15%	25%	25%
Cash tax	Rmb m	(0)	(5)	(27)	(70)	(117)	(128)	(256)	(273)
Less chg in WC (ex cash)	Rmb m	0	137	(177)	(74)	(30)	(15)	(23)	(10)
Capex	Rmb m	(11)	(32)	(173)	(386)	(1,488)	(314)	(40)	(46)
Free cash flow to firm	Rmb m	50	190	2	(31)	(805)	571	893	953
WACC							13%		
NPV	Rmb m						5,243		
Indo investment	Rmb m						(319)		
NPV after Indo investment	Rmb m						4,924		
Net debt (start of year)	Rmb m						(1,256)		
Minority interest	Rmb m						79		
Equity	Rmb m						6,102		
Equity	US\$ m						956		
Equity per share	HK\$						3.59		
Total number of shares outstanding	Mil						2,075		

Source: Citi Investment Research and Analysis

China Vanadium Titano-Magnetite Mining

Company description

China VTM Mining mines and processes iron ore in Huili County, the Panxi region of Sichuan Province, South West China. Its mining assets are two open pit vanadium-bearing titano-magnetite iron ore mines, with mine lives of 14 years and 5.8 years. As of 30 June 09, total JORC reserves (2P) were 78.7Mt, with the potential to increase the shorter of the two mine lives based on an extension of the mining area. A function of the ore type, the mines produce iron concentrate and a titanium concentrate. These are sold or the iron concentrate is further processed into iron pellets. The company has options to acquire five mines in the region, with estimated resources at 126.2Mt.

Investment strategy

We rate China VTM Mining shares Buy / Low Risk (1L). While we have a neutral view on the iron-ore sector, we are positive on China VTM given that the company is growing through organic expansion, exploration and acquisitions. We believe the risk/reward looks favorable at current valuations.

Valuation

We value China VTM at HK\$3.59/s. Our target price is derived from a DCF model in which we use a WACC of 13% (beta of 1.2) to discount the cash flows over the productive life of the company's mines. We deduct the Indonesia investment value from NPV as we do not expect the project to be value-accretive. We believe our 13% WACC adequately reflects an earnings risk discount to selected regional iron ore and coking coal peers.

Risks

We rate China VTM shares Low Risk, which differs from the Medium Risk assigned by our quantitative risk-rating system, which measures historical share price volatility. Our rating considers downside risks for iron ore are limited. Key downside risks that could prevent the shares from reaching our target price include the risk of geological forecasts not matching reality, higher-than-expected production costs, weather, and a slower-than-expected recovery in China's economy.

Appendix A-1

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China Vanadium Titano-Magnetite Mining (0893.HK)

Ratings and Target Price History
Fundamental Research

Analyst: Scarlett Y Chen, CFA
Covered since January 10 2011

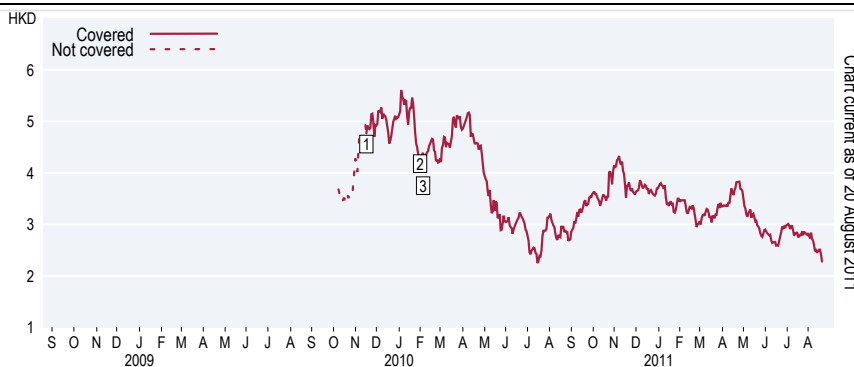


Chart current as of 20 August 2011

	Date	Rating	Target Price	Closing Price
1	17-Nov-09	*1L	*5.90	4.77

* Indicates change

	Date	Rating	Target Price	Closing Price
2	1-Feb-10	1L	*4.91	4.21

	Date	Rating	Target Price	Closing Price
3	4-Feb-10	1L	*5.10	4.39

Rating/target price changes above reflect Eastern Standard Time

China Vanadium Titano-Magnetite Mining (0893.HK)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Scarlett Y Chen, CFA
Covered since January 10 2011

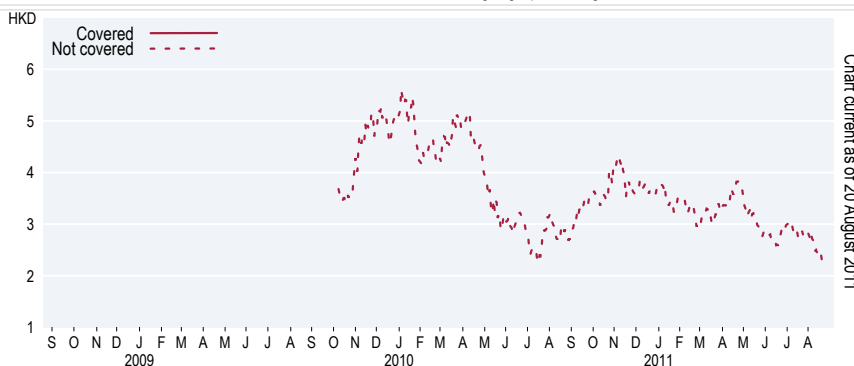


Chart current as of 20 August 2011

* Indicates change

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