

## China VTM Mining (893.HK) Titanium Concentrate – The New Earnings Driver

Company Report

Rating: **Buy**→

Price: **HK\$1.35**

TP: **HK\$2.8**↓

Upside: **105.8%**

30 Sept 2011

### Event:

Teleconference Takeaways

### Special Views:

(1) China's titanium concentrate saw supply shortage due to restricted titanium concentrate export from Vietnam, leading to a surge in domestic titanium concentrate prices;

(2) The Company's iron ore prices stayed steady given he relatively closed market;

(3) Cheap valuations offer long-term investment opportunity.

### Stock data (HK\$)

52w High (HK\$)	4.37
52w Low (HK\$)	1.13
Market cap (HK\$m)	2,801
No of shares (m)	2,075
Avg daily vol (m)	5.90
1-mth change (%)	-35.10
YTD change (%)	-63.51
50d MA	2.28
200d MA	3.01
14-day RSI	24.32

Source: Bloomberg

### 1-year share price



Source: Bloomberg

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### Summary:

- **Titanium concentrate will become the new earnings driver.** Domestic titanium concentrate prices have been surging since 2011 on Vietnam's export restriction. Average price of the Company's high-grade titanium concentrate reached RMB1138/tonne in 1H11, up over 100% from the same period last year. Revenue contribution from titanium concentrate rose to 8.8%. Production cost of its titanium concentrate was only around RMB400/tonne, implying a gross margin of over 60%, the highest among all of its products. It is estimated that its high-grade titanium concentrate production could reach 110,000 tonnes and over 150,000 tonnes in 2011 and 2012, respectively. Together with the strong titanium concentrate price due to supply shortage, we expect the product will become the new earnings driver in the future.
- **Titanium concentrate prices climb on tight supply.** The recent surge in titanium concentrate was mainly supported by supply shortage. The country currently consumes around 3.5m tonnes of titanium concentrate every year, of which some 2m tonnes were imported. Imports from Vietnam accounted for approx. 30% of the total domestic consumption. Since Vietnam announced in June 2011 that it will ban the export of titanium concentrate to China starting from late 2011, China will face a severe supply shortage of titanium concentrate in the future. As an expansion in domestic production capacity is rather unlikely and other countries may not largely increase their exports of titanium concentrate to China in the near future, we believe China will see tight supply in the next 2-3 years, driving up titanium concentrate prices.
- **The Company's iron ore prices stay steady given the relatively closed market.** Iron ore concentrates and iron pellets, the principle products of the Company, are mainly supplied to steel enterprises in Southwest China such as Sichuan. The market is relatively closed and their prices are mainly affected by the demand and supply relationship in the region. The second steel bases of Pansteel located in Xichang will commence operation in 2011YE. This project has a designed annual production capacity of 4m tons. It is expected that an additional 6m tons of iron ore concentrates are required in the production, but Pansteel Group could supply 3m tons only and the remaining 3m tons have to be relied on local market or imports. Therefore, we think iron ore supply in Southwest China will tighten after 2011YE and selling price of iron ore could stay steady.
- **Maintain "Buy".** Supply shortage in domestic titanium concentrate market will support the growth in titanium concentrate price. Meanwhile, the Company's iron ore prices stay steady given the relatively closed regional market. We believe the Company could achieve steady profit growth in the next 2 years. We trim its FY11F/FY12F EPS from RMB0.33/RMB0.42 to RMB0.32/RMB0.38, corresponding to FY11F/FY12F P/E of 3.5x/2.9x. Maintain "Buy" rating on cheap valuations while we cut its TP from HK\$4.7 to HK\$2.8 on prudent principle, equivalent to FY12F P/E of 6.0x.

### Valuations

	FY09	FY10	FY11F	FY12F	FY13F
Revenue (RMB m)	1,084	1,554	1,844	2,306	2,823
Net profit (RMB m)	328	533	667	788	940
Basic EPS (RMB)	0.20	0.26	0.32	0.38	0.45
Core EPS (RMB)	0.20	0.26	0.32	0.38	0.45
Change (%)	17.6%	30.0%	23.7%	18.0%	19.3%
P/E	5.8	4.4	3.5	2.9	2.4
DPS (RMB)	0.00	0.05	0.06	0.08	0.09
Dividend yield (%)	0.0%	4.6%	5.7%	6.9%	8.2%
NAVS (RMB)	1.3	1.7	1.6	1.9	2.3
P/B	0.9	0.7	0.7	0.6	0.5

Source: Company, BOCOM Int'l

**Chart 1: Estimated income statement (Unit: RMB m)**

	2009	2010	2011F	2012F	2013F
Sales revenue	1,084	1,554	1,844	2,306	2,823
Costs of principal operations	582	724	874	1,071	1,331
Gross profit	502	830	970	1,236	1,491
Distribution costs	28	44	37	46	56
Management fee	36	79	77	69	85
Finance costs	9	18	-17	15	34
Pre-tax profit	437	701	873	1,106	1,319
Income tax expenses	70	117	131	276	330
Profit in the year	367	584	742	829	989
Profit attributable to equity holders	328	533	667	788	940
EPS (RMB)	0.20	0.26	0.32	0.38	0.45

Source: BOCOM Int'l

**Chart 2: Estimated balance sheet (Unit: RMB m)**

	2009	2010	2011F
Cash and bank balance	1,884	1,096	467
Trade receivables	137	208	147
Inventories	71	70	70
Total current assets	2,233	1,473	868
Fixed assets	496	1,476	2,498
Total assets	3,073	3,733	4,177
Short-term borrowings			150
Total current liabilities	461	813	463
Long-term borrowings	0	125	325
Total liabilities	467	944	795
Share capital	183	183	183
Reserves	2,514	2,775	3,185
Minority interests	93	14	14
Total owners' equity	2,607	2,789	3,383
Total liabilities and owners' equity	3,073	3,733	4,177

Source: BOCOM Int'l

Chart 3: Estimates on key financial ratios

	2009	2010	2011F	2012F	2013F
Growth rate					
Revenue	37.0%	43.4%	18.6%	25.1%	22.4%
Profit from principle operations	17.5%	65.5%	16.8%	27.4%	20.7%
Net profit	15.1%	59.2%	27.0%	11.8%	19.3%
Profitability					
GM%	46.3%	53.4%	52.6%	53.6%	52.8%
NM%	33.9%	37.6%	40.2%	36.0%	35.0%
ROE	14.1%	20.9%	21.9%	20.5%	20.4%
ROIC	12.6%	18.2%	16.6%	18.6%	18.9%
Indemnity					
Gearing ratio	15.2%	25.3%	19.0%	22.6%	23.3%
Current ratio	4.8	1.8	1.9	1.1	1.0
Quick ratio	4.7	1.7	1.7	1.0	0.9

Source: BOCOM Int'l

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**Rating System**

**Company Rating**

Buy: Expect more than 20% upside in 12 months

LT Buy: Expect more than 20% upside but longer than 12 months

Neutral: Expect low volatility

Sell: Expect more than 20% downside in 12 months

**Sector Rating**

Outperform: Expect more than 10% upside in 12 months

Market perform: Expect low volatility

Underperform: Expect more than 10% downside in 12 months

**Analyst Certification**

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