

Equities

19 March 2012 | 8 pages

China Vanadium Titano-Magnetite Mining (0893.HK)

Alert: 11 Profit Slightly Below, Margins Should Improve in 12E

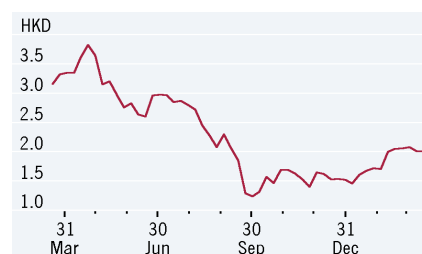
- 11 profit 6% below Citi forecast due to lower margins** – Stripping cost rises as inflation surges, attributing COGS/t by Rmb 8-10/t per ton of concentrate. The company switched from producing medium-grade titanium concentrates to producing high-grade titanium concentrates, with beneficiation cost per tonne averaged up. The new pelletizing plant is ramping up, not yet to be fully utilized; as a result, fixed cost per tonne trends up.
- Margins of pellets to improve in 12E** – If the new pelletizing plant improves utilization from 12% in 2011 to some 70%, COGS/t of concentrate should decline by Rmb 60/t, from Rmb 541/t to Rmb 480/t, while the company reported Rmb 453/t in 2010.
- High-grade titanium concentrate sees prices rising continuously** – Average selling price doubled from Rmb 534/t in 10 to Rmb 1,084/t in 11. Selling price recorded in Mar almost reached Rmb 1,800/t. Supply constraint and prosperous demand explain this. We expect the strong momentum to continue.
- More M&A opportunities from Dashanshu and Haibaodang** – The two might add total resources of 125 Mt attributable to the company, though Haibaodang has lower Fe grade than the existing asset. Haibaodang retains iron ore resources of 15% Fe grade and should produce titanium iron ore concentrate of Fe 55% when being beneficiated.
- Appealing valuation, trading at EV/ton of resource at Rmb 7/t or PE 5x 12E** – Maintain Buy and target at HK\$3.59/sh, which is derived from DCF valuation. Downside risks may emerge from the softening steel demand with the backdrop of economy slowdown, which could dampen the selling price of iron ore.
- Post-result investor presentation to be held at 9:30am, 20 March 2012, Taishan Room, Level 5, The Island Shangri-La Hong Kong.

Company Update

Buy	1
Price (19 Mar 12)	HK\$1.92
Target price	HK\$3.59
Expected share price return	87.0%
Expected dividend yield	2.9%
Expected total return	89.8%
Market Cap	HK\$3,984M US\$513M

Price Performance

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



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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Figure 1. 2011 results review

(Rmb Mil)	Restated		YoY	Citi 2011E	11 vs. Citi	Consensus 11E	11 vs. Consensus
	2010	2011					
Revenue	1,576	1,713	9%	1,790	-4%	1,685	2%
Cost of sales	(736)	(886)	20%	(799)			
Gross profit	840	827	-2%	991	-17%	847	-2%
Selling and distribution costs	(47)	(46)		(49)			
Administrative expenses	(89)	(102)		(75)			
Other operating expenses	(39)	(19)		0			
Operating profit	666	659	-1%	867	-24%	725	-9%
Other income	62	98		(15)			
EBIT	727	756	4%	852	-11%	747	1%
Net interest expense	(14)	(9)		(2)			
Profit before tax	713	748	5%	850	-12%	728	3%
Income tax	(117)	(135)		(128)			
Profit after tax	596	613	3%	723	-15%		
Minority interest	(54)	(7)		(78)			
Net profit	542	606	12%	645	-6%	580	4%

Source: Company reports, Bloomberg, Citi Investment Research and Analysis

China Vanadium Titano-Magnetite Mining

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

The key risks to our investment thesis on China VTM are; 1) Geological forecasts not matching reality; 2) Higher-than-expected production costs; 3) Weather; and 4) A slower-than-expected recovery in China's economy.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

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



	Date	Rating	Target Price	Closing Price
1	17-Nov-09	*1L	*5.90	4.77
2	1-Feb-10	1L	*4.91	4.21

	Date	Rating	Target Price	Closing Price
3	4-Feb-10	1L	*5.10	4.39
4	30-Aug-11	1L	*3.59	2.20

	Date	Rating	Target Price	Closing Price
5	7-Oct-11	Stock rating system changed		
6	7-Oct-11	*1	3.59	1.32

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

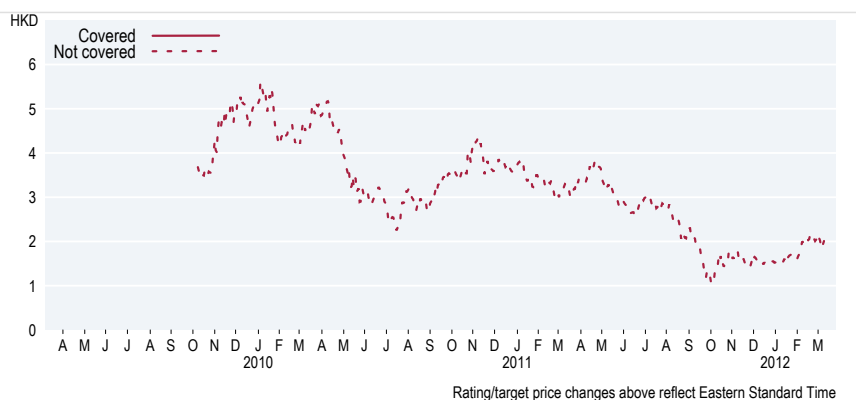
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Ratings and Target Price History

Best Ideas Research

Relative Call (3 Month)

Analyst: Scarlett Y Chen, CFA
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Data current as of 31 Dec 2011

	12 Month Rating			Relative Rating		
	Buy	Hold	Sell	Buy	Hold	Sell
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