Hong Kong

Company Flash

14 March 2013

IRC

Operating loss in FY12/12A as expected

to summarize…

- IRC released FY12/12A result on Tuesday, turnover increased by 14% YoY to US$139.7m. The increase was due to change of accounting method for ilmenite. Based on previous method, turnover dropped by 1% YoY to US$121.2m.
- Operating loss increased by 4.7x YoY to US$53.7m, while net loss for the period was US$53.2m. 2H 12A loss was widened by 16% HoH to US$33.2m, the 2H loss consisted an impairment change on coal business of US$21m.
- Iron ore spot price stayed strong since the historical low in Sep 2012. Jan 2013 to date average spot price was US$151.8/t, 26% higher than 1Q 2013 average spot price. Reversed 1Q spot price will reflect on 2Q 2013 operating result.
- We have revised up on our target price to HK$1.26 on 1) one step toward K&S project commencement and 2) increased production output.

FY12/12A result summary. Turnover before ilmenite treatment adjustment dropped by 1% YoY to US$121.2m, which turnover form iron ore concentrate dropped by 0.4% YoY to US$110.0m despite exceeded target mining output. Iron concentrate ASP dropped by 22% YoY to US$112.1/t, while sales volume increased by 27% YoY to 980,543 tonnes. Mining segment reported a marginal profit of US$6.4m, dropped by 68%. In terms of engineer consultancy business, turnover dropped by 5% YoY to US$11.2m, while segment profit declined by 74% YoY to US$0.6m. The thin profit from mining and engineer business were insufficient to cover other operation expenses. Yet, IRC has incurred an impairment charge of US$21m during 2H 12A on its coal project nearby the K&S. The impairment charge widened the 12A net loss to US$53.2m, 2H 12A net loss was increased by 68% YoY to US$33.2m.

Table 1. Earnings summary

US$m	11A	12A	% chg	2H ilmenite
Turnover				
- Mining	110.4	110.0	(0.4%)	+18.5
- Engineering services	11.8	11.2	(5.1%)	
Segment profit				
- Mining	20.2	6.4	(68.3%)	
- Engineering services	2.4	0.6	(74.3%)	
Central admin expenses	(26.2)	(25.8)	(1.4%)	
Impairment charges		(27.1)	-	
(Other expenses)/ gain	5.2	(7.1)	-	
Net profit to shareholder	1.0	(53.2)	-	

Source: SBI E2-Capital

Mining cash cost breakdown. Total cash cost from mining operating dropped by US$7.6/t to US$102.4/t. The decline in operating cash cost was largely due to 1) increased contribution from sales of ilmenite concentrate by-product credit and 2) increase in production scale. Cost deduction arise from sales of ilmenite concentrate by-product credit increased by US$13.5/t (net realized sales proceeds from ilmenite increased by 1.6x YoY to US$24.4m) to US$25.2/t. Mining cash before ilmenite adjustment increased from US$77.9/t to US$81.2/t. Railway costs increased by 35% YoY to US$45.5m, equivalent to US$46.4/t (increased by US$2.6/t).

Table 2. Cash cost breakdown

US$/t	11A	1H 12A	2H 12A	12A
Iron ore ASP	143.3	121.8	104.8	112.1
Mining	30.5	36.3	27.0	31.1
Processing and production overheads	27.5	27.3	31.3	29.5
Transportation to plant	7.4	9.0	7.3	8.0
Site administration	12.5	13.4	8.6	12.6
By product credit	(11.7)	(20.8)	(28.7)	(25.2)
Transportation to boarder	43.8	45.3	47.3	46.4
Net pre-tax cash profit/ (loss)	33.3	11.3	12.0	9.7

Source: SBI E2-Capital

Ticker	**1029 HK**
Rating	**HOLD**
Price (HK$)	0.99
Target Price (HK$)	1.26
12m Price Range (HK$)	0.5 – 1.45
Market cap. (US$m)	443.5
Daily t/o (US$m)	1.5
Free float (%)	29.0

Financial summary

Year to Dec	11A	12A	13F	14F
Turnover (US$m)	122.2	139.7	149.4	266.4
Net Profit (US$m)	1.6	(53.2)	(25.6)	0.2
Diluted EPS (US$ cent)	0.03	(1.61)	(0.49)	0.00
P/E (x)	540.8	-	-	4,402
P/B (x) pre-CB	0.6	0.6		0.6
EV/EBITDA (x)	59.3	(19.0)	62.4	22.8
Yield (%)	-	-	-	-
ROE (%)	0.0	-	-	0.0
ROCE (%)	0.0	-	-	0.0
N. Gear. (%)	Cash	13.0	30.0	42.0

Source: SBI E2-Capital

	12F	13F	14F
Consensus EPS (US$cent)	-	-	14.2
Previous earnings (US$m)	-	-	-
Previous EPS (US$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(10.5)	6.3	(23.8)
Actual price changes (%)	(12.4)	7.6	(18.9)

Source: Bloomberg

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Please refer to important disclosures at the end of this report

Forecast variance and change in accounting treatment for ilmenite. IRC's FY12/12A performance was mostly in-line with our forecast apart from the difference arias from the unexpected impairment charge in 2H. The impairment loss was in relation to the thermal coal project associated with K&S project, which company has invested US$21.0m. In Dec 2012, company has reassessed the project and decided to suspend the development of the thermal coal deposits due to the low market price. Yet, management has decided to abandon by-product credit accounting treatment for ilmenite concentrate since 2H 12A. Hence, ilmenite sales were recorded as a part of turnover as opposed to previously direct deduct from operating expenses. Despite the change in accounting method, there is no real impact to the bottom-line result. The lower-than-estimated mining turnover and higher-than-expected operating expenses were largely due to lower-than-modelled Iron ore ASP and higher-than-modelled ilmenite ASP, as mentioned in previous update. Table 3 shows result comparison between our forecast and FY12/12A result based on by-product credit treatment for ilmenite.

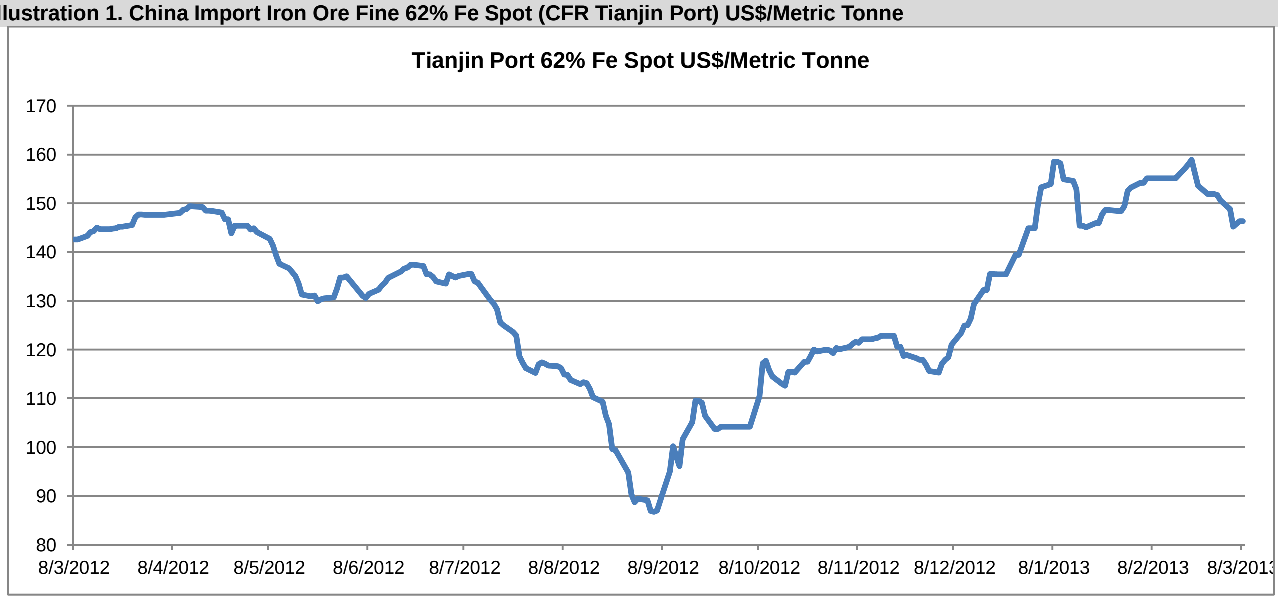
Table 3. Variance from our projection

US$m	FY12/12F	Diff	%	FY12/12A*	FY12/12A
Revenue	113.1		7%	121.2	139.7
- Mining	101.3	8.6	8%	109.9	128.5
- Engineering	11.8	(0.6)	-5%	11.2	11.2
Impairment charges	(6.0)	(21.0)	352%	(27.1)	(27.1)
Total operating expenses	(137.2)	(8.1)	10%	(145.3)	(163.8)
Other	(2.5)	0.6	-24%	(1.9)	(1.9)
Profit/(loss) for the year/period	(32.5)	(20.5)	63%	(53.0)	(53.0)
US$/t					
Iron ASP	116			112	
ilmenite ASP	255			277	
Mining + railway cash cost/t (net of ilmenite contribution)	106			102	

*Source: SBI E2-Capital, *Treated ilmenite as by-product credit*

Market outlook. Iron ore price stayed strong since the rebound from the historical low in Sep 2012. The benchmark price reached US$158.9/t on 20th Feb 2013, the highest in one year period. The rebound in 4Q was mostly attributable to the traditional reserve period as well as market speculation. Relative firm iron ore spot price in Feb is contrary to the seasonal softness in commodity price due to the weeks-long Lunar New Year Holiday. China ore import in Feb 2013 dropped by 14% from Jan 2013 to 56.4m tonnes, the weakest month since Oct 2012. The phenomenal was suspected by National Development of Reform Commission (NDRC), the macroeconomic management agency under the Chinese State Council. NDRC concerned the recent surge in iron ore price might be resulted from the three largest mining companies (BHP Billiton and Rio Tinto and Vale) and certain traders either delayed or controlled deliveries to create a false impression of temporary supply shortage. Market expects the iron ore price to fall over the 2013. The consensus estimates 2013F average iron ore price to be US$126.6/t. We maintain long–term price forecast in a range between US$130/t to US$140/t. As for IRC, strong price trend in Jan and Feb 2013 might induce turnaround in 2Q 2013F operating result. Jan 2013 to date average spot price reached US$151.8/t as a compared to 4Q 2012 average spot price of US$120.6/t.

Illustration 1. China Import Iron Ore Fine 62% Fe Spot (CFR Tianjin Port) US$/Metric Tonne

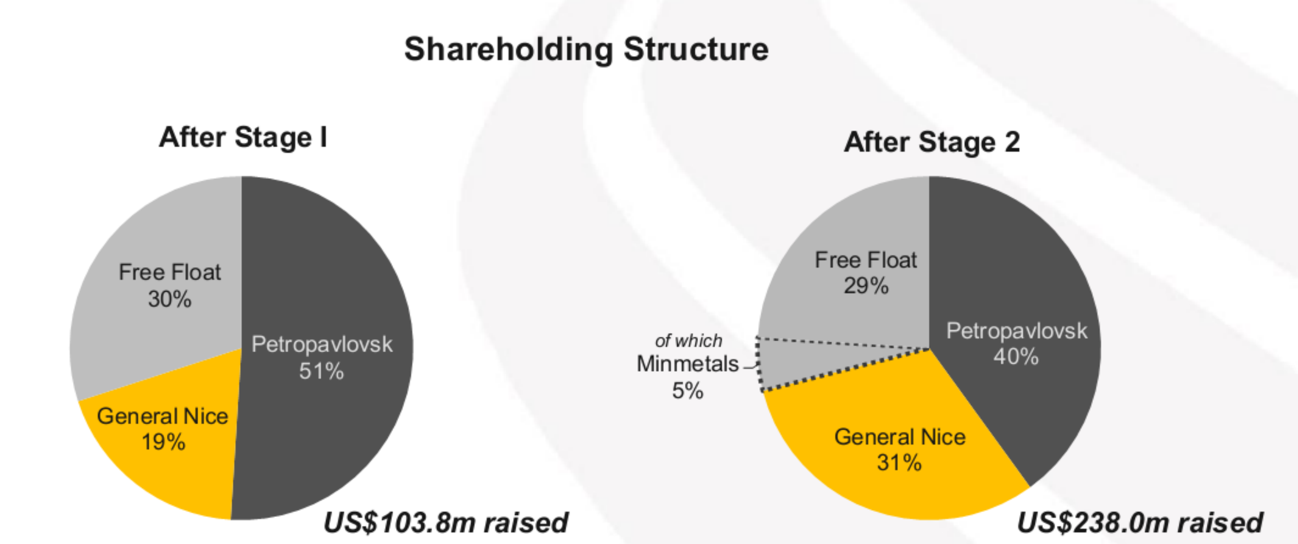


US$/t	1Q 12A	2Q 12A	3Q 12A	4Q 12A	Jan to date 13A
IRC ASP	117	127	110	100	
Spot ASP	144	138	112	121	152

Source: SBI E2-Capital

Newly secured off-take agreement with General Nice. IRC has granted an off-take to General Nice for a term of 15 years. The offt-take applies to all of the existing and future iron ore other than the Kuranakh project. Under the agreement, it is optional that IRC can choose either 1) marketing service at service fee 5% marketing commission on the first 65% sales or 2) Seaborne agreement that sales output is guaranteed off-take by investors at price 7% discount to Platts CFR China price. Meanwhile, General Nice and Minmetals agreed to subscribe for, up to 1,962.5m, new shares at subscription price HK$0.94. The share issue is divided into two tranches, first tranche transaction is expected to be completed by the end of April 2013 and the second tranche is expected to be completed by end of Sep 2013. The proceeds from new shares issue, amount up to HK$1,844.8m, are intended to apply for the financing of K&S CAPEX. Illustration 2 shows the shareholding structure upon completion of transaction.

Illustration 2. Shareholding structure



General Nice is engaged in resources development and production, logistics and trading, subsidiaries include Abterra Ltd. (199903007C) listed in Singapore and Loudong General Nice Resources (China) (988.HK) listed in HK. The company is one of the largest coking coal importers and coke exporters in China. Average annual export accounted for more than 20% of coke exports in China.

Minmetals Cheerglory is a wholly-owned subsidiary of the SOE international metals and mining corporations primarily engaged in exploration, mining, smelting, processing and trading for metals and minerals, subsidiaries include Minmetals (230 HK) listed in Hong Kong

Source: SBI E2-Capital

Our view and valuation. IRC has met its 2012 output target. Sluggish performance was largely due to weak commodity price during 2012. Spot price has shown a strong rebound since the historical low in Sep 12. Current spot price is trading at around US$145/t, while 13A year to date average spot price was US$151.8/t, substantially higher than 4Q 12A average spot of US$120.6/t. In our view, the 4Q weak spot price will continue to impact on 1Q 13F IRC operating result, but the reverse in 1Q 13F spot price will reflect in 2Q 13F. We expect IRC will not earn a meaningful profit before K&S project to be commenced production in 1H 14F. We have revised up on our target price by 13% to HK$1.26 on 1) one step toward K&S project commencement and 2) expanded mining capacity. We expect 13F net loss of US$25.6m base on current price assumption and bottom-line to be breakeven in 14F. Once the commencement of K&S production, we expect to see sharp increase in turnover and profit. Our net profit forecast for 15F and 16F are US$95.1m and US$195.5m respectively. We maintain HOLD with target price HK$1.26 base on diluted number of share. Table 4 shows our P&L estimate (adopted new accounting treatment for ilmenite) for the next three years:

Table 1. Shareholding Structure

US$'m	13F	14F	15F
Revenue	149.4	266.4	484.3
- Mining	137.6	254.6	472.5
- Engineering	11.8	11.8	11.8
Operating expenses	(164.0)	(245.0)	(353.6)
Share of results of joint ventures	3.5	3.5	3.5
Net operating loss	(11.1)	24.9	134.1
Financial expenses	(12.5)	(24.7)	(27.2)
Profit (Loss) before taxation	(23.6)	0.2	107.0
Taxation credit/(expense)	(2.0)	(0.0)	(11.8)
Profit/(loss) for the year/period	(25.6)	0.2	95.1

Source: SBI E2-Capital

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BUY : absolute upside of >10% over the next six months

HOLD : absolute return of -10% to +10% over the next six months

SELL : absolute downside of >10% over the next six months

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