IRC

Rally in price is yet to form a turnaround in 13F result

to summarize…

- IRC released its 4Q operating result, annual output achieved 118% and 100% of iron ore and ilmenite concentrate production target.
- The 9% drop in 4Q iron ore ASP reflects the weak 3Q spot price, while sales volume was in line with our expectation, 14% higher than the previous quarter.
- The annual ASP was 22% down to US$112.4/t on YoY basis, while such price might suggest operating loss as below mining cash cost of ~US$110/t.
- Iron ore import price has rebounded to ~US$150/t since Sep 2012 low at US$87/t. This price rebound is yet to form notable turnaround in the 1Q 2013 operating result.

What news? IRC released 4Q operating result on 16 Jan 2013. Production result continues to be consistent with management expectation. Annual production volume for iron ore and ilmenite concentrate reached 118% and 100% of year target to 969,436 tonnes and 125,095 tonnes respectively. In terms of price, the weak 3Q iron spot price has reflected in IRC's 4Q result. 4Q ASP for iron ore dropped by 22% YoY/ 9% MoM to US$100/t. The 2012 annual price of US$112.4/t suggested continued operating loss and net loss in 2H 2012. Our estimate net loss for 2012F is US$32.5m.

Comment on 4Q update. IRC continues delivering promised mining result. Annual mining output for iron and ilmenite concentrate increased by 21% and 97% YoY to due to fully ramped up mining capacity and completed instalment of new ilmenite separator. For the 4Q, mining output for iron ore concentrate has increased by 6% QoQ to 275,921 tonnes, whereas for ilmenite has increased by 9% QoQ to 36,383 tonnes. The result shows IRC has the capability to maintain full output even in the cold winter during Dec. As on completion of the new ilmenite separator, IRC has revised up the 2013F production target for 125,000 tonnes to 160,000 tonnes, while company has also revised iron ore output target from 820,000 tonnes to 900,000 tonnes for the year.

In terms of ASP. Despite the increase of mining output, IRC's 2012 performance was restricted by the downtrend in iron ore price. The 4Q iron ore ASP was dropped by 9% QoQ and 22% YoY. The decrease in ASP reflected the overall downtrend in spot price during the July to Sep period. As for the annualized ASP, the annual ASP has dropped by 22% YoY to US$112/t (from US$143/t). Such drop was due to the rally in price during 2011 contrary to the sluggish in commodity price during 2012. For ilmenite concentrate, ASP remained strong and maintained above US$250/t, 4Q price of US$263/t represented an increase of 29% YoY/ a drop of 7% QoQ. Current spot has shown an overall uptrend and reached above US$150/t, while the 4Q 2012 average spot price for 62% Fe iron ore was around US$120/t. Table 1 shows the 2012 quarterly operational result:

Table 1. Operating Result 1Q12A-4Q12A

	1Q 12A	QoQ	2Q 12A	QoQ	3Q 12A	QoQ	4Q 12A	QoQ
Prod volume								
iron ore	228,829	-2%	203,481	-11%	261,204	28%	275,921	6%
ilmenite	26,751	14%	28,694	7%	33,267	16%	36,383	9%
Sales volume								
iron ore	217,689	13%	206,332	-5%	260,033	26%	296,489	14%
ilmenite	25,970	43%	26,996	4%	24,312	-10%	43,928	80%
ASP								
iron ore (US$/t)	117	-11%	127	9%	110	13%	100	-9%

Source: SBI E2-Capital

Ticker	1029 HK
Rating	HOLD
Price (HK$)	1.26
Target Price (HK$)	1.12
12m Price Range (HK$)	0.5-1.59
Market cap. (US$m)	565.4
Daily t/o (US$m)	1.2
Free float (%)	29.02

Financial summary

Year to Dec	11A	12F	13F	14F
Turnover (US$m)	122.2	113.1	119.8	236.8
Net Profit (US$m)	1.6	(32.5)	(29.7)	(6.1)
EPS (US$ cent)	0.03	(0.97)	(0.88)	(0.18)
P/E (x)	317.4	-	-	-
P/B (x) pre-CB	0.38	0.39	0.41	0.41
EV/EBITDA (x)	-	-	52.6	17.2
Yield (%)	-	-	-	-
ROE (%)	0	(4)	(4)	(1)
ROCE (%)	0	(3)	(2)	2
N. Gear. (%)	Cash	7	30	42

Source: SBI E2-Capital

	12F	13F	14F
Consensus EPS (US$)	(0.01)	(0.01)	-
Previous earnings (US$m)	-	-	-
Previous EPS (US$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	32.4	89.9	(12.3)
Actual price changes (%)	37.0	110.0	6.8

Source: Bloomberg

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2012F result preview. Given the first 4 quarters result, the annual ASP and sale volume for iron ore concentrate were US$112/t and 980,543 tonnes whereas ASP and sales volume for ilmenite concentrate were US$277/t and 121,238 tonnes respectively. The result implied revenue from mining would be US$110.2m, decreased by 0.2% YoY, and was higher than our forecast of US$101.3m due to more than expected mining output. As for the operating result, mining usually bears three major costs 1) mining cash cost, 2) transportation cash costs and 3) administrative expense. As for IRC, based on 1H result, the realized mining cash cost and railway cash cost were US$66.5/t and US$46/t respectively. i.e. cash breakeven at ~US$110/t. For 2H, we expect there will be slight improvement in mining cash cost due to 1) increase in ore output 2) increase in contribution from ilmenite (by product credit) leading decrease in average mining cash cost. We expect the railway cash cost would be maintained at similar level as previous period. As a result, 2012 realized ASP of US$112 denoted a marginal cash profit and implied high potential operating loss as well as net loss. Table 3 shows our estimate of 2H result.

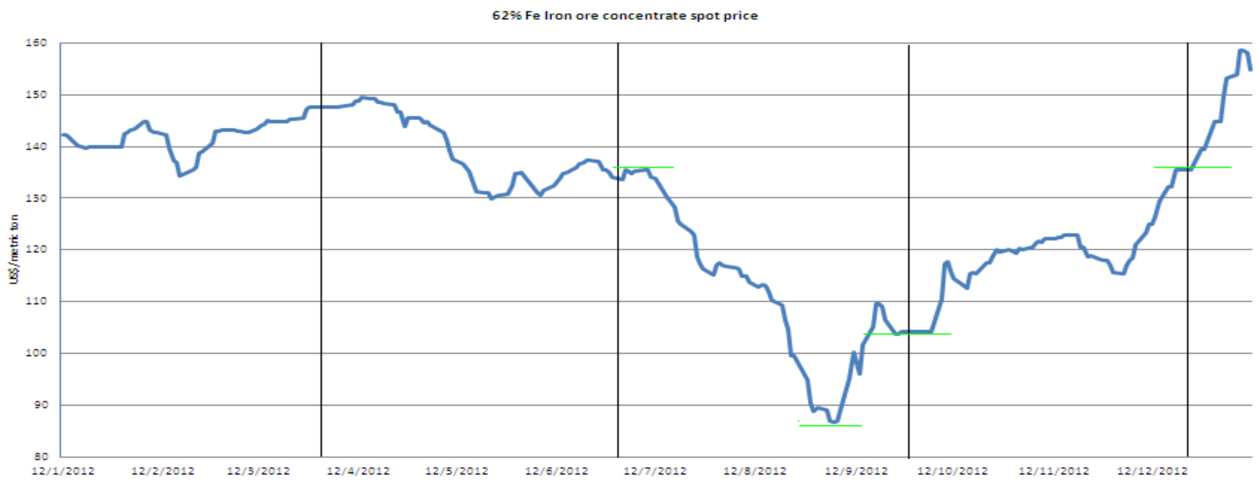
Table 3. Our previous assumption for FY12/12F result.

	1H 12/12A	2H 12/12F	FY12/12F
Revenue	57.6	55.5	113.1
- Mining	51.7	49.6	101.3
- Engineering	5.9	5.9	11.8
Impairment charges	(6.1)	-	(6.0)
Operating expenses	(65.1)	(67.6)	(132.6)
Other	0.1	(2.6)	(2.5)
Profit/(loss) for the year/period	(13.5)	(19.1)	(32.5)
Key Assumption (US$/t)			
Iron ASP	122	110	116
ilmenite ASP	297	220	255
Mining cash cost/t (adjusted for ilmenite contribution)	110.0	102	106
Cash margin	10%	7%	9%

Source: SBI E2-Capital

Market and 1Q 2013 outlook. Iron ore spot price fluctuated during year 2012. The first three quarters showed an overall downtrend which was largely due to 1) EU debt crisis and 2) slowdown in domestic demand. In Sep, spot price hit the lowest at US$87/t, the first time since 2009. Chinese steel mills subsequently took advantage of price fail and low-cost inventory iron ore led to strong rebound in price to US$120/t. The spot price continued to rise and exceeded US$150/t recently. The rally in price was largely reflecting shortage in domestic supply as a result of the harshest winter in China in near three decades coupled with steel mills revival. Such shortage due to closure is said to be equivalent to 15% supply in China, especially those located in the northern region remains shut, which was since the sluggish price during 1H 2012. As the acceleration in fixed asset investment under the 12th five year plan, iron ore price will remain at reasonable level. However, we suspect if the recent rally in price would be sustainable and we maintain our mid-term forecast of average price in the range between US$130m ~ US$140m. Despite the rally in current price trend, the 4Q average spot increased by 8% QoQ to US$120.6/t. Hence, it is yet to form a substantial improvement to IRC's 1Q 13F forward result. Yet, incremental interest expense as a result of ICBC loan drawdown and increase in operation expense will pressure on earning. Illustration 1 shows the current spot price trend..

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



Source: SBI E2-Capital

Our view and valuation. We like IRC as an early stage value investment with upside potential to become large scale miner (as commencement of the K&S project by late 2014).IRC has actual output exceeded the target; however, earning performance was adversely affected by the downtrend in commodity price during 2012. The current rally in spot price may be yet to form a turnaround to 1Q 13F operating result. Hence, we see the current share price might be a good opportunity to realize a good short-term profit before rerating potential in the future.