

## IRC

### Rocky Mountain Way

#### to summarize...

- IRC released its 3Q operating result, achieving 83% and 62% of iron ore concentrate and ilmenite concentrate annual production target.
- Iron ore concentrate production reached 261.2k tons, in line with our expectation, while ASP was down to US\$110/t.
- Ilmenite concentrate production reached 33.3k tons. With the completion of ilmenite production line grade, production capacity further increased by 150%.
- Price HK\$110/t suggested segmental operating loss in mining operation and development in 3Q; while
- No major catalyst on iron ore spot price. 3Q spot price shows high possibility of operating loss in 4Q result.
- Maintain Hold rating with Target Price HK\$1.12.

**What news.** IRC released 3Q operating result on 18<sup>th</sup> Oct 2012. Kuranakh continues to operate at full level. Accumulative production volume to 3Q for iron ore concentrate and ilmenite concentrate reached 684.1kt and 77.3kt, representing 83% and 62% of year target respectively. ASP of IRC iron concentrates dropped by 13%/27% QoQ/ YoY reflecting the weakening demand, while the 3Q index spot price first time dropped below the US\$100/t mark since 2009. The sluggish spot price might adversely affect IRC's 4Q performance resulting an operating loss and greater net loss for the 12F end result. We maintain HOLD rating on IRC at Target price HK\$1.12.

**3Q operation update and review.** IRC's iron ore production capacity in Kuranakh has already reached full capacity by the end of 11A, hence, there is no major surprise in production volume as ramped production scale. Iron ore concentrate production volume increased by 28%/ 20% QoQ/ YoY to k tons. If we assume similar output in 4Q, annual iron ore concentrate would be 954.7kt, denoted 106% of annual target. In terms of ilmenite, the recent announcement stated IRC has completed the installation of new separator in ilmenite production line, effectively; enhanced annual capacity of ilmenite concentrate by 150% to 160k. Year to 3Q, IRC produced 77.3kt of ilmenite concentrate, completed 62% of annual target. Assume the upgraded will add 1.0x of 4Q production volume, annual production volume of ilmenite concentrate for IRC would be 125.9kt, exceeding target volume by 0.7%.

**In terms of ASP,** the 3Q average selling price for iron ore concentrate was US\$110/t, dropped by 27% YoY/ 13% QoQ and 8% discount of our estimate. The low ASP reflected the shrinking commodities demand since the beginning of 2012. While the IRC's iron ore concentrate 3Q ASP was yet to fully reflect the steep drop in stop price during the period, which will reflect in 4Q result. We expect the 4Q iron ore concentrate ASP might reach as low as US\$90/t. For ilmenite concentrate, ASP remained strong in 3Q at US\$284/t, increased by 1% YoY/ 34% QoQ and roughly the same as our estimate. Table 1 shows the details breakdown of 3Q operating result:

**Table 1. Operating Result 2Q11A-3Q12A**

	4Q 11A	QoQ	1Q 12A	QoQ	2Q 12A	QoQ	3Q 12A	QoQ
<b>Prod volume</b>								
iron ore	233,908	8%	228,829	-2%	203,481	-11%	261,204	28%
ilmenite	23,371	30%	26,751	14%	28,694	7%	33,267	16%
<b>Sales volume</b>								
iron ore	192,810	-8%	217,689	13%	206,332	-5%	260,033	26%
ilmenite	18,187	-17%	25,970	43%	26,996	4%	24,312	-10%
<b>ASP</b>								
iron ore (US\$/t)	131	-13%	117	-11%	127	9%	110	13%

Source: SBI E2-Capital

Ticker	1029 HK
<b>Rating</b>	<b>HOLD</b>
Price (HK\$)	0.73
Target Price (HK\$)	1.12
12m Price Range (HK\$)	0.5-1.59
Market cap. (US\$m)	327.0
Daily t/o (US\$m)	0.2
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 (%)	19.8	(6.2)	(45)
Actual price changes (%)	24.6	4.4	(34.9)



Source: Bloomberg

Isaac Lau  
(852) 2533 3723  
IsaacLau@sbie2capital.com

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If we further look into 1H result, the other operating cash cost + finance cost was round US\$10/t and mining cash cost of roughly US\$97/t, while the central administrative expenses were roughly US\$31/t. Hence, IRC's 3Q segmental operating result will be marginal, and might result in segmental loss at ASP US\$110, and group 3Q net loss would be unavoidable assuming no major accounting profit.

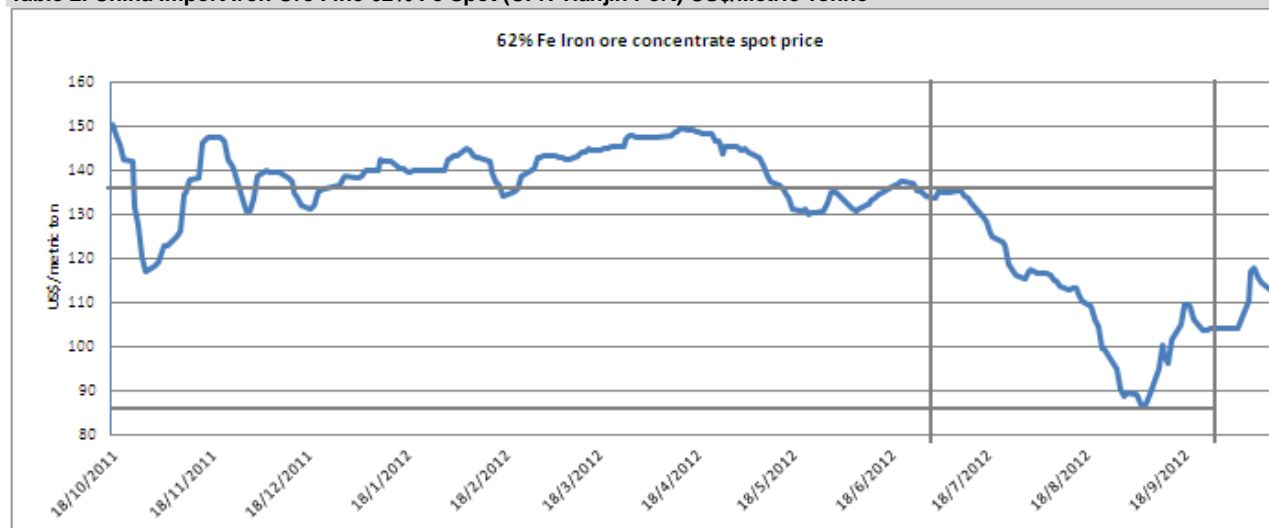
**Financial Model:** We assumed the average iron ore concentrate ASP of US\$110/t and the average ilmenite ASP of US\$220/t in 2H 12 from our previous update. Since, difference between iron ore and ilmenite price to the result is likely to offset each other; hence we are yet to fully revise our full year forecast. We will perform details review upon 4Q result. Table 3 shows our previous assumption for FY12/12F:

**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 outlook and fourth quarter outlook.** As mentioned, iron ore price recorded steepest drop in July in four years and hit the lowest at US\$87/t in Sep, which was the first time since 2009 that iron ore price had dropped below US\$100/t mark. Pursuant to Tianjin port 62% Fe spot price, the recent spot price has recovered to US\$105-US\$115/t level. The rebound in spot price was largely due to buyer took advantage of falling price, iron ore imports reached 20 months high in Sep. Going forward, the short-term price outlook is still negative given the steel production has been failing for the last three consecutive months while major steels mills continued recording loss in 3Q. For a longer term, we expect to see a turnaround in iron demand in second half of 13F, because the recent news update has indicated that China government has been launching economic stimulus with commencement of national construction projects in near term to boost the economy and the fixed asset investment, (i.e. rebound demand for iron ore). For IRC, we expect 4Q result could be worse than 3Q, which is largely due to further decrease in expected ASP of iron ore concentrate. During the 3Q period, the average spot price of iron ore 62% Fe further decreased by 20% QoQ to US\$112.1/t from US\$139.4/t in 2Q. Given that IRC prices new orders at discount to previous quarter price, we expect the 4Q ASP can reach as low as US\$90/t, i.e. less than its mining cash cost. Table 2 shows the iron ore spot price:

**Table 2. China Import Iron Ore Fine 62% Fe Spot (CFR Tianjin Port) US\$/Metric Tonne**

Source: SBI E2-Capital

**Our view and valuation.** Despite the exceeding production volume in 3Q result, the lower in ASP has larger impact on dollar revenue. The calculated revenue from mining in 3Q is roughly US\$28.6m, dropped by 9% YoY. Yet, 3Q iron ore concentrate ASP of US\$110/t and 4Q expected ASP of US\$90/t would lead to segmental operating loss and greater net loss in 2H. Adding up 1H net loss, 2012 annual net loss would be unavoidable, hence, we anticipate IRC will announce full year profit warning at 4Q operating update. More comprehensive 2H forecast will be provided after 4Q announcement. We maintain Hold rating for IRC at target price HK\$1.12.

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**STRONG BUY** : absolute upside of >50% over the next three months

**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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