

IRC

Dropped 24% after warning, our 1H result preview.

IRC released 2Q operating result on 12th July 2012, which included a writedown. Share price has been pressured (on weak sentiment in both the commodity sector and overall Chinese economy) and further dropped on the day of the announcement. Despite this, we maintain our BUY rating with target price is lowered to HK\$1.37 (from HK\$1.55). We continue to see the counter as a good medium to long term investment given its de-risked profile and potential narrowing of valuation gap with peers as production ramps up.

Report highlights

- On track to meet target volume, achieved 52% of production volume in 1H
- Slight recovery on ASP; but do not anticipate a catalyst to drive price higher in short term
- Construction progress on track, overall investment thesis intact
- Revised TP down to HK\$1.37 (BUY) reflecting operating conditions and revised forecasts

On track to meet targeted volume, achieved 52% of overall ore production volume in 2012F. During the 2Q FY12/12A period, IRC produced 203.5k tonnes of iron ore concentrate and 28.7k tonnes of ilmenite. Combining with 1Q result, 53% of 820k targeted iron ore concentrates and 44% of 125k ilmenite concentrates production volume completed. Nevertheless, iron ore concentrates production volume and sales decreased on quarterly basis. Iron ore concentrate production volume dropped by 11% QoQ while the sales volume was down by 5% QoQ. Management explained that the decrease in both production and sales volume was due to surplus output in 1Q, and hence slowing down 2Q mining output to stick to their plan. We expect 3-4Q production volume will continue to be low at 210k tonnes iron ore concentrate per quarter. Table 1 indicated the 1 year trailing quarter volumes:

Table 1. Operating Result 3Q11A-2Q12A

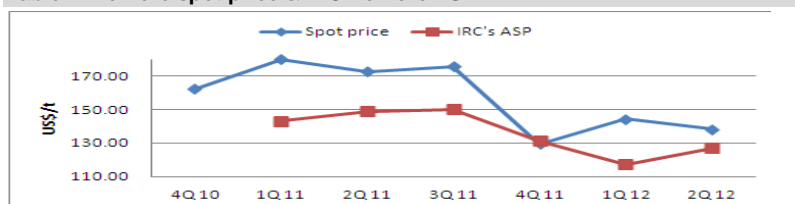
	3Q 11A	QoQ	4Q 11A	QoQ	1Q 12A	QoQ	2Q 12A	QoQ
Prod volume								
iron ore	217,147	27%	233,908	8%	228,829	-2%	203,481	-11%
ilmenite	17,948	22%	23,371	30%	26,751	14%	28,694	7%
Sales volume								
iron ore	210,293	5%	192,810	-8%	217,689	13%	206,332	-5%
ilmenite	22,035	166%	18,187	-17%	25,970	43%	26,996	4%

Source: SBI E2-Capital

ASP recovery, but do not anticipate a catalyst to drive price higher in short term.

IRC reported iron ore ASP was up by 9% QoQ to 2Q US\$127/t from 1Q US\$117/t. The rebound in price reflected the over-correction during the previous period. On market outlook, the ongoing uncertainty in Europe and recent slowing momentum of Chinese and US economies further put pressured on commodity prices. Expectations are for prices to range in the US\$120 and US\$140 in 2H FY12/12F. We revised down our 2H 12F ASP forecast from US\$130/t to US\$125/t. IRC selling price illustrated (Table 2) that there is around a quarter lag on spot price.

Table 2. Iron ore spot price & IRC iron ore ASP



Source: SBI E2-Capital

Ticker	1029 HK
Rating	BUY
Price (HK\$)	0.67
Target Price (HK\$)	1.37 (+108%)
12m Price Range (HK\$)	0.64-1.92
Market cap. (US\$m)	293.7
Daily t/o (US\$m)	0.2
Free float (%)	27.5

Financial summary

Year to Dec	11A	12F	13F	14F
Turnover (US\$m)	122.2	162.2	165.9	290.1
Net Profit (US\$m)	1.6	(6.7)	(26.8)	(1.3)
EPS (US\$)	0.0	-	-	0.0
P/E (x)	476.0	-	-	-
P/B (x) pre-CB	0.92	0.36	0.37	0.37
EV/EBITDA (x)	-	12.6	13.6	6.8
Yield (%)	-	-	-	-
ROE (%)	-	-	-	-
ROCE (%)	-	0%	-	3%
N. Gear. (%)	Cash	4%	26%	38%

Source: SBI E2-Capital

	12F	13F	14F
Consensus EPS (US\$)	(0.0)	0.02	0.02
Previous earnings (US\$m)	-	-	-
Previous EPS (US\$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(21.4)	(34.1)	(56.9)
Actual price changes (%)	(21.2)	(39.1)	(63.4)



Source: Bloomberg

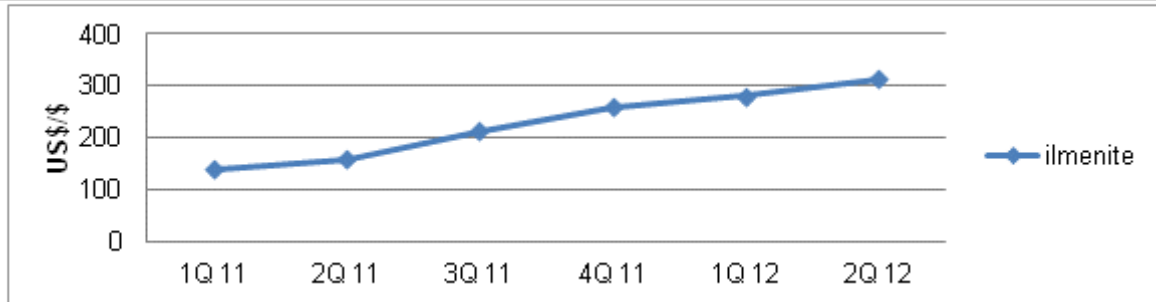
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For ilmenite, ilmenite selling price continues to outperform. Ilmenite ASP was up by 5% QoQ to 2Q US\$293/t from 1Q US\$280/t or increased by 92% YoY from 1H 11A US\$153/t. New ilmenite separators will be installed on track with plan in the 2H FY12/12F, increasing ilmenite capacity to 160k tonnes per annum in 2013F from 125k tonnes in 2012F.

Table 3. Ilmenite 1Q 11A – 2Q 12A ASP US\$/t



Source: IRC

Potential changes in sales contribution mix? Lower iron ore concentrates ASP and higher ilmenite concentrate effectively leveraged up the sales contributed from ilmenite concentrate. Assume the new ilmenite separators come online as planned in 2H FY12/12F, annual ilmenite production capacity will increase to 160k tonnes. If iron ore and ilmenite selling price remain at current high level, % revenue from ilmenite of total mining turnover can reach as high as 30% in 2013F and then fall substantially as K&S commenced production in subsequent years. (P.S. assuming revenue recognition for ilmenite is at full price instead of net of mining cost.)

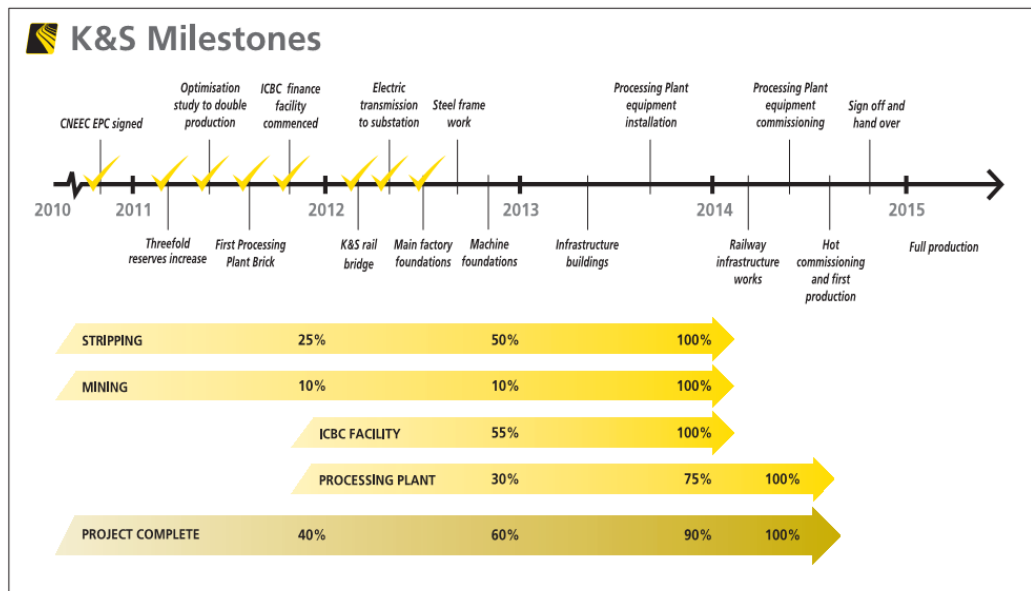
Table 4. Revised forecast breakdown for 1H FY12/12F (US\$)

	2Q 11A	3Q 11A	4Q 11A	1Q 12A	2Q12A	2H 12F	13F	14F	15F
Turnover %									
Iron Ore	96%	87%	84%	78%	76%	74%	70%	84%	91%
Ilmenite	4%	13%	16%	22%	24%	26%	30%	16%	9%

Source: SBI E2-Capital

K&S construction progress on track. Infrastructure progress was ahead of expectation. Pursuant to the announcement, there is no further delay to the schedule, while it was said that the cooperative working relationship between IRC and CNEEC is strengthened. The K&S project is mostly funded via ICBC bank facilities. Since the first drawdown in Dec 2011, IRC has been withdrawing between US\$10m-US\$15m per month to finance the construction. Our forecast completion timing for K&S project remains 1H FY12/14F.

Table 5. K&S Project Timeline



Source: IRC

1H FY12/12F result preview. We adjusted our 1H FY12/12F forecast in accordance to the 1Q and 2Q update. The expected turnover was revised down by 5% to US\$73.7m to reflect the lower than expected iron ore price. Net loss has increased to US\$13.1m (from US\$2.5m) taking into consideration the lower turnover and our estimated US\$6.06m writedown. The calculated iron ore ASP for 1H FY12/12F was US\$122/t, 2% lower than our expectation, the effect of which was partly offset by higher than expected ilmentie ASP. The calculated 1H ASP for ilmenite was US\$297/t, 19% higher than expectation. On the other hand, IRC expected to record a one-off non cash impairment of assets in the titanium project in China. The titanium project was established via JV arrangement with a Chinese partner, for the construction and operation of a titanium sponge production plant in Jiamusi City in Heilongjiang province in 2008. IRC owned 65% of interest in the JV. In 2010 (year of listing), IRC further acquired remaining 35% of the JV company, and recorded a provisional goodwill of US\$6.06m as shown in the historical balance sheet. Pursuant to the announcement, as a result of uncertainty regarding the project's future, management decided to slow down future expansion of that project, as a result, auditors advised to prudently write off the related portion of goodwill.

Table 6. Revised forecast breakdown for 1H FY12/12F (US\$)

Forecast	1H 12F (Revised Forecast)	1H 12F (Forecast)	% change	1H 11A	% change
Turnover					
Mining	67,395,125	74,786,857	-10%	53,871,000	25%
Engineering	6,296,714	6,296,714	0%		
	73,691,839	81,083,572	-9%	60,432,000	22%
Operating Expenses					
Total Operating Expenses	(77,279,495)	(77,101,813)	0%	(66,837,000)	16%
Operating Loss					
	(3,587,655)	3,981,758	-190%	(6,405,000)	-44%
Other gains and losses	(9,560,000)	(3,500,000)	173%	10,335,000	-193%
Profit before tax	(13,147,655)	(2,548,242)	416%	3,930,000	-435%

Source: SBI E2-Capital

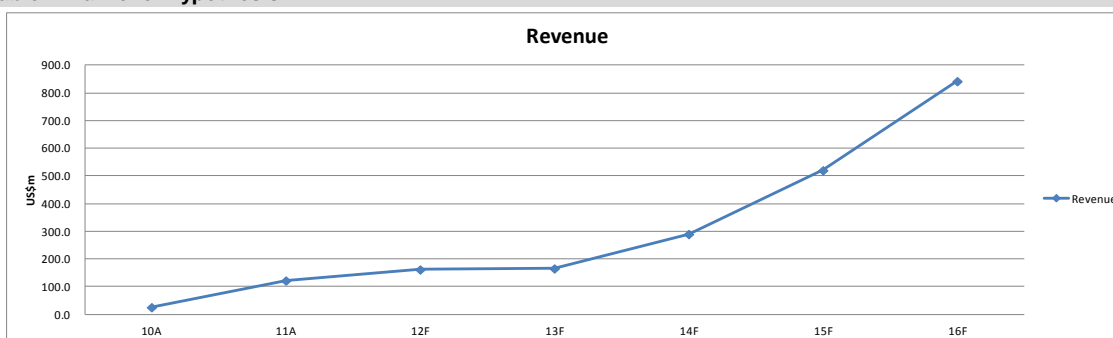
P.S: Other gains and losses:

- 1) For revised forecast and previous forecast, net increase in other losses of US\$6.06m represents write-off of goodwill provision.
- 2) For 1H FY12/11A, the US\$10.3m other gains and losses consisted of 1) US\$6.8m net foreign exchange gain, 2) US\$2m reversal of provision for listing expenses 3) the remainder US\$1.5m was other finance and accounting income.

**impairment/ accounting gain or loss changes has no impact on cash flow, and hence no impact of DFCF model valuation

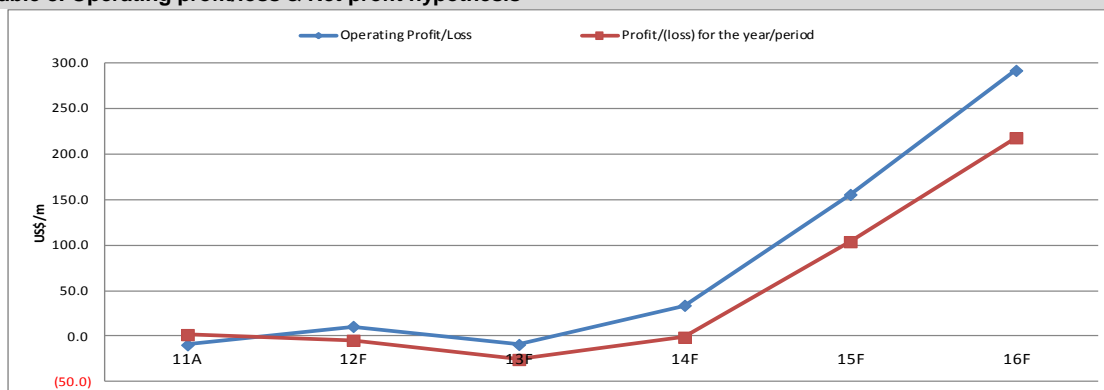
Financial model adjustment. We also revised down the 2H and long-term Kuranakh iron ASP from US\$130/t to US\$125/t to reflect the overall uncertainty of future price outlook, while our forecast for K&S and Garinskoye products ASP adjusted from US\$143/t to US\$137/t. (Higher price than Kuranakh iron ore concentrate was due to the quality and impurity of ore concentrate.) We remain our prudent forecast on long-term ilmenite price at US\$250/t, while there are no other major changes in the financial model. Tables 7 and 8 illustrated our hypothesis on business performance in 5 years:

Table 7. Turnover hypothesis



Source: IRC

Table 8. Operating profit/loss & Net profit hypothesis



Source: IRC

24 July 2012

Our view and valuation. We maintain our view on IRC as a good pick for mid-long term investment. We lowered target price from HK\$1.55 to HK\$1.37, to reflect 4% downward adjustment on Kuranakh, K&S and Garinskoye iron ore products selling price as a result of more prudent estimation of future iron ore price and 1% increase in risk premium due to long-term uncertainty of market outlook.

We believe the current price HK\$0.66 entry level is attractive. We think IRC is a developing growing miner, largely de-risked as it has entered early production stage and its expansion plans fully funded. Its current development stage explains the valuation gap between comparables such as China VTM (893 HK, HK\$1.13) and Hanking (3788 HK, HK\$2.45) (See Table 9). As overall production volume and operation scale ramps up over time, we expect an overall re-rating in this counter and the valuation gap to narrow. The current price implies marketcap per ton of total reserves and resources of HK\$1.56.

Table 9. EBITDA, Mktcap to resources and reserves ratios

	IRC 1029 HK	China VTM 893 HK	Hanking 3788 HK
EBITDA 11A (HK\$m)	111	1,050	1,150
Curr Mkt Cap (HK\$m)	2,360	2,410	4,560
Res & Res 11A (mt)	1,514	397	368
EBITDA 11A/ R&R	0.07	2.64	3.13
Cur MktCap/R&R	1.56	6.07	12.39

Source: Bloomberg, SBI E2-Capital

Table 10. 1 year trailing daily PB band



Source: Bloomberg

Table 11. Peers comparison table

Name	Ticker	Price	Mkt Cap (HK\$m)	Hist. P/E	Curr P/E	Hist. P/B	Cur P/B
IRC LTD	1029 HK	0.67	2,291.0	454.9	296.5	0.6	0.4
Average			2,328.7	332.2	59.0	2.1	1.7
CHINA VANADIUM TITANO - MAGN	893 HK	1.13	2,344.8	4.3	3.3	0.8	0.6
NEWTON RESOURCES LTD	1231 HK	0.40	1,600.0	1,311.3	219.2	2.8	1.2
CHINA HANKING HOLDINGS LTD	3788 HK	2.45	4,483.5	7.9	8.1	3.3	3.3
CHINA ZHONGSHENG RESOURCES	2623 HK	1.23	886.7	5.5	5.5	1.6	1.6

Source: Bloomberg

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