

Company visit

Hong Kong / Industrials

06 February 2013

Last price(31 Jan 13)	HK\$0.21
Upside/downside(%)	
HSI	23729.53
Mkt cap(HK\$m/US\$m)	1,444/186
52 week range (HK\$)	0.20 - 0.40
Avg trading volume daily (US\$m)	0.21
Foreign ownership(%)	N/A

Source: Bloomberg

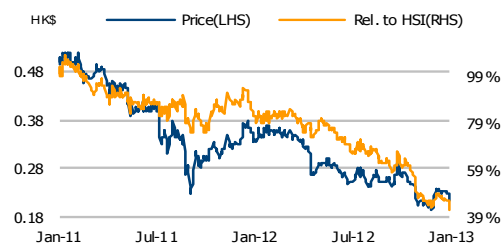
Financial statement

Fiscal year ending	2009A	2010A	2011A	2012A
Revenue (mn)	301	849	1,147	1,050
Net Profit*	373	1,104	1,462	-528
EPS*	0.07	0.17	0.22	-0.077
EPS growth (%)*	N.A.	142	29	N.A.
P/E (x)*	6.5	2.9	1.5	N.A.
Dividend Yield	0	0	0	0
P/B (x)	0.89	0.67	0.42	0.41
ROE (%)*	17.6	27.5	N.A.	N.A.
Net debt/equity (%)	-13.2	-32.1	-27.3	-16.5

* figures are calculated based on underlying net profit.

Source: Bloomberg

Performance



Performance	1M	3M	12M
Absolute (%)	6.5	(20.0)	(37.7)
Absolute(US\$, %)	6.4	(20.1)	(37.7)
Relative to HSI (%)	1.8	(29.7)	(54.0)

Source: Bloomberg

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APAC Resources Ltd (Not Rated, 1104 HK)

Dancing with the iron ore price

APAC, an investment holding company, targets private and listed natural resource companies that have the potential to tap into China's increasing commodities demand.

APAC's investment business is dedicated to the global resource sector and its competitive advantage is its management team's expertise in linking its investment knowledge with the practices of the resource sector. The company identifies low cost resource projects which have the potential to increase their cash flows while controlling risks.

APAC's business is divided into three segments (based on the nature of each business and its business cycle):

- 1) Primary strategic investments – APAC buys over a 20% interest at the production stage (this segment contributed 97% of net profit in FY12 and 59% in FY11);
- 2) Resource investments – APAC buys less than a 20% interest in companies it has identified as potential acquisition targets;
- 3) Commodity trading business – APAC trades coal and iron ore, with iron ore being dominated by two off-take agreements with Mount Gibson.

APAC has a diversified business portfolio, with its highest exposure currently in iron ore and trading.

Although we are bullish on the iron ore price for 2013 (we estimate it will range between US\$130 and US\$150/t: see [link](#)), we believe that APAC's stock price has not fully factored in such a range of iron ore prices for this year.

APAC's dedication to the resource sector is a double-edged sword, as: 1) its stock price could be negatively affected when the commodity cycle turns south; and 2) the output of its key iron ore asset, Mount Gibson, will start to shrink from 2014.

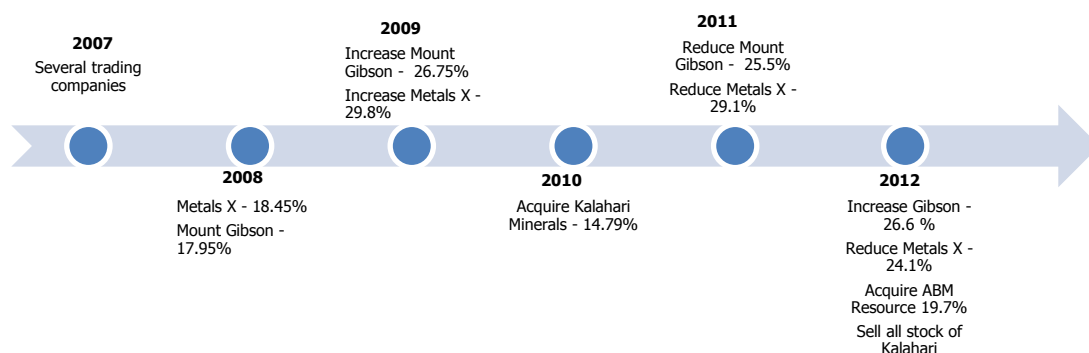
To guarantee its future performance, APAC will need to expand its primary strategic investments by acquiring low cost mining assets in order to generate stable cash flows. Thanks to its management expertise, we believe that APAC should be able to show investors its progress on this front very soon.

A strategic holding company in the mining industry

APAC's portfolio changes every year. Current investments include:

- A 26.6% interest in Mount Gibson (MGZ.AU) – an iron ore miner
- A 24.1% interest in Metals X (MLX.AU) – a tin miner and nickel and gold developer
- A 19.9% interest in ABM Resource (ASX.AU) – a gold explorer
- Investments in around 60 emerging natural resources companies globally

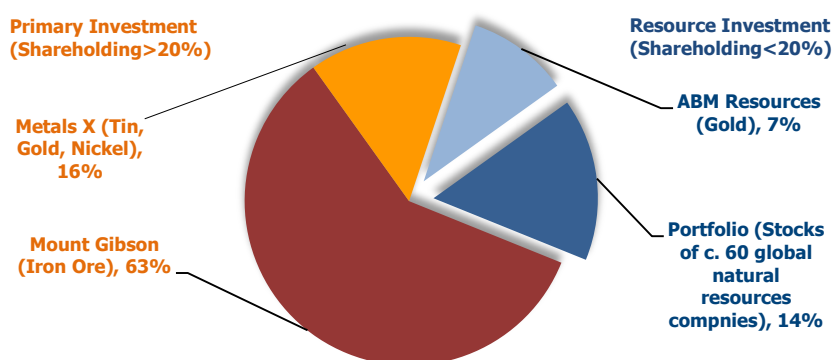
Figure 1 Key investment timeline



Source: Company data, Mirae Asset Research

APAC's current major investment is in Mount Gibson, which accounts for 63% of the company's assets. Mount Gibson's iron ore output is estimated to grow by 30% in FY13 and the company plans to expand in the near term through M&As by investing some of its A\$279m cash pile. In addition, another of APAC's investments, Metals X, has established a second mining area at Renison mine, which will increase its output volume. Overall, APAC's primary investments account for 79% of its total investments and its resource investments account for 21% (Figure 2).

Figure 2 APAC's investment portfolio breakdown by AUM



Source: Company data, Mirae Asset Research

Three business segments: primary strategic investments, resource investments and commodity trading

Primary investments – Mount Gibson and Metals X

- APAC invested in the resource companies at the production stage
- APAC is paid the attributable profits from the associate
- APAC's P&L is not affected by changes in the associates' market capitalizations, but by the associates' profit level
- APAC has signed take-off agreements to feed its commodity trading segment

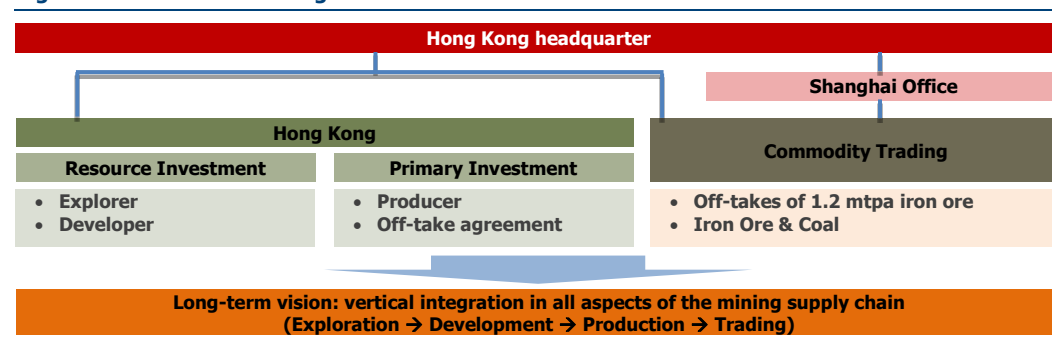
Resource investments – ABM Resources and portfolio of 60 stocks

- APAC invested in the resource companies at the exploration, development, and production stages
- APAC's P&L is determined by the stock price of the target companies
- Before APAC closes its exposure to target companies, the unrealized mark-to-market profit or loss is recorded in the income statement
- After identifying an undervalued company, APAC will increase its shareholding, potentially turning the target company into its associate (primary investment)

Iron ore and coal trading in China

- Based in Shanghai and currently trading iron ore and coal
- Dominated by two off-take agreements with Mount Gibson (iron ore); shipments are sold on the spot market to steel mills and traders in China
- Purchase agreements are based on Platts iron ore CFR China Index. There is a time lag between paying for cargoes based on the preceding one month average and selling on the spot price
- The profit level is more influenced by the speed and magnitude of the change in iron ore prices than by the absolute level of iron ore prices
- The top three customers contributed 88% of the segment's revenue in 2012

Figure 3 APAC's business segments



Source: Company data, Mirae Asset Research

Figure 4 Profit from the three segments

Profit mix 2011-12		
HK\$m	2011	2012
Primary strategic investments	866	240
Resource investments	180	-296
Commodity trading	138	5.6
Impairment loss/reversal	286	-411
Other effects (FX, disposal of partial interest in an associate, etc.)	-8	-66.6
Net profit	1,462	-528

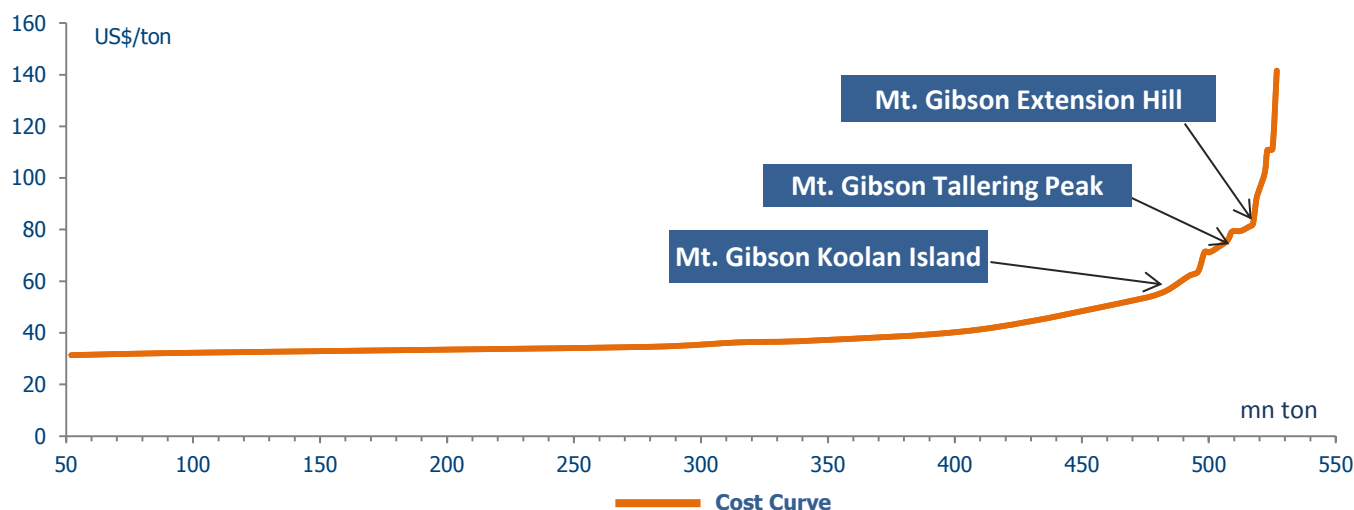
Source: Company Data, Mirae Asset Research

Details of investment portfolio

1. Mount Gibson – 63% of assets; net profit of HK\$372m in 2012

- Fifth largest iron ore producer in Australia
- Production capacity of c.10mtpa 62% Fe
 - Koolan Island: capacity of 4mtpa; production of 3mtpa; C1 cash cost (FOB) of US\$60-65/t
 - Talling Peak: capacity of 3mtpa; production of 3mtpa; C1 cash cost (FOB) of US\$75-80/t
 - Extension Hill: capacity of 3mtpa; production of 3mtpa; C1 cash cost (FOB) of US\$80-85/t
- 100% of Mount Gibson's iron ore is delivered to China
- Contracted off-take agreement with APAC for 20% of production from Koolan Island and Talling

Figure 5 The cash cost of Mount Gibson is mid-to-high level, among Australian iron ore supply

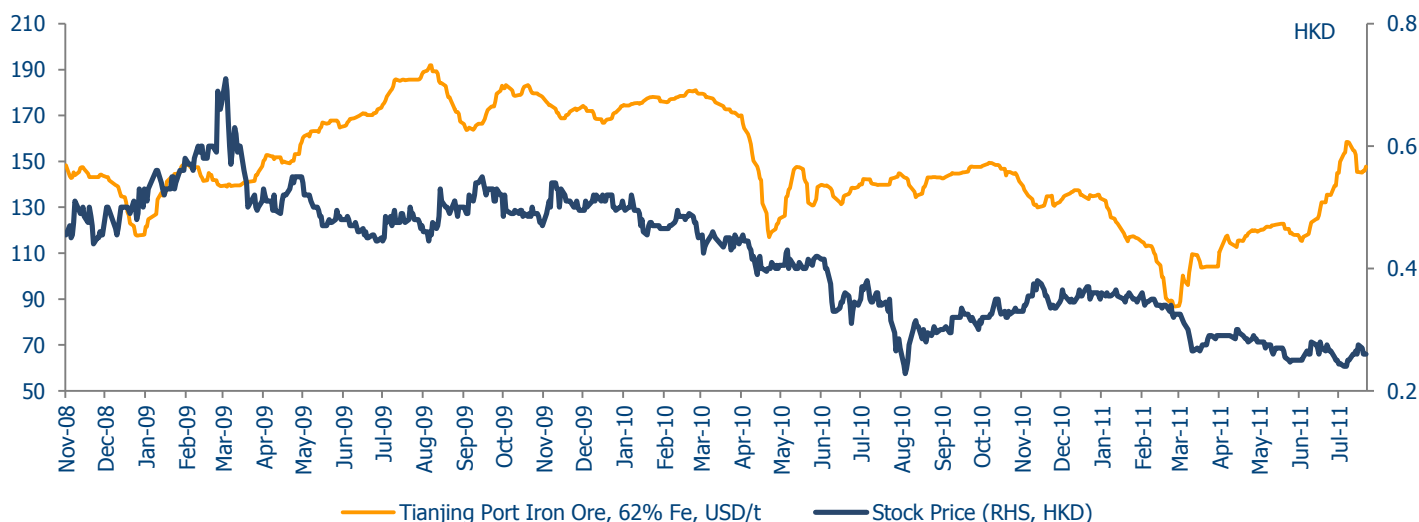


Source: CRU, Mirae Asset Research

Since 50% of APAC's investment is allocated to Mount Gibson, the profit of Mount Gibson substantially affects the profit level of APAC. In addition, iron ore prices have a direct impact on Mount Gibson's profitability; hence, it also has a major bearing on APAC's profit.

Mount Gibson's net profit after tax decreased by 28% from A\$239.5m in FY11 to A\$172.5m in FY12 due to the weaker realized iron ore price.

Figure 6 Correlation between APAC's stock price and the iron ore price (2008-11)

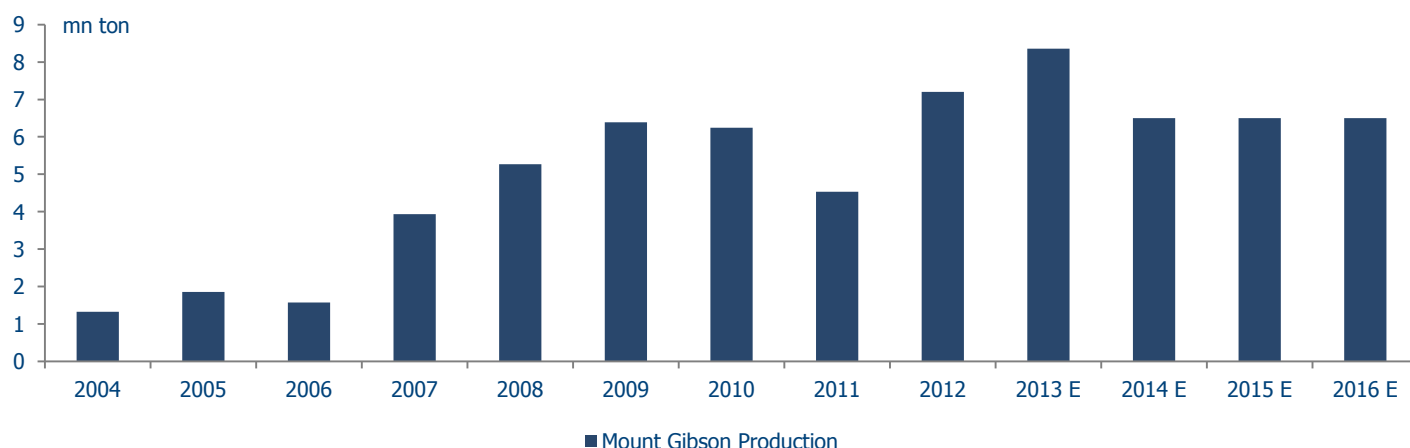


Source: Bloomberg, Mirae Asset Research

Although we are bullish on the iron ore price for 2013 (we estimate it will range between US\$130 and US\$150/t), we believe that APAC's stock price has not fully factored in such a range of iron ore prices for this year.

In addition to our positive view on the iron ore price, we expect Mount Gibson's FY13 iron ore production will increase 30% to 9m tons from 6.9m tons in FY12, as Extension Hill, one of Mount Gibson's mines, is expected to ramp-up to full capacity in FY13 (Figure 7). Furthermore, improved transportation infrastructure has removed the constraints on carrying capacity, which will boost sales. In FY12, sales of 5.2m tons were much less than the output of 6.9m tons. However, sales volume has improved substantially in the latest quarter after the successful commissioning and ramp-up of its rail/port facilities.

Figure 7 Mount Gibson's iron ore production forecast



Source: Company data, Mirae Asset Research

Mount Gibson’s consensus earnings have factored in the volume growth for FY13 (Figure 8).

Figure 8 Mount Gibson’s financial performance

A\$m	2010A	2011A	2012A	2013E
Revenue	536	672	649	902
Net profit after tax	132	240	173	225
Net assets	927	1,167	1,277	1,473
EPS (AU cents)	12	22	16	20.5

Source: Mount Gibson, Bloomberg Consensus, on 31 January 2013

Since no more investment is required from APAC, the risks for APAC are now limited. Therefore, Mount Gibson is now a cash cow for APAC.

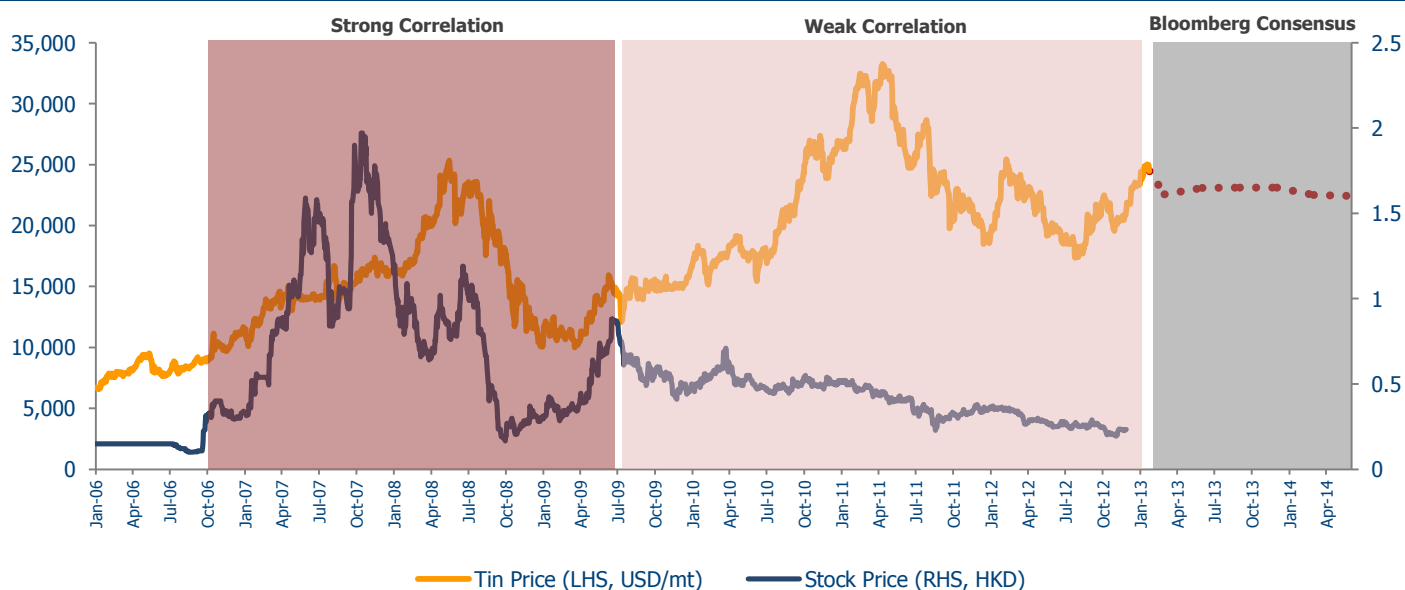
2. Metals X – 16% of assets; net loss of HK\$79m in 2012

- Largest tin producer in Australia, contributing 2.5% of global primary tin supply
 - Production target of 7-8kt pa tin in concentrate
 - Resources of 261kt tin
- A rapidly advancing gold developer
 - Production target of 120-180koz per annum
 - Resources of 6.16moz gold equivalent in Central Murchison & Rover
- Wingellina Nickel project
 - Production target of 40ktpa nickel and 3ktpa cobalt
 - Resources of 183mt nickel ore (c.2mt nickel)

As 16% of APAC’s portfolio was allocated to Metals X in FY12, attributable profits from Metals X will affect APAC’s profit levels. However, the impact has been less significant in recent years.

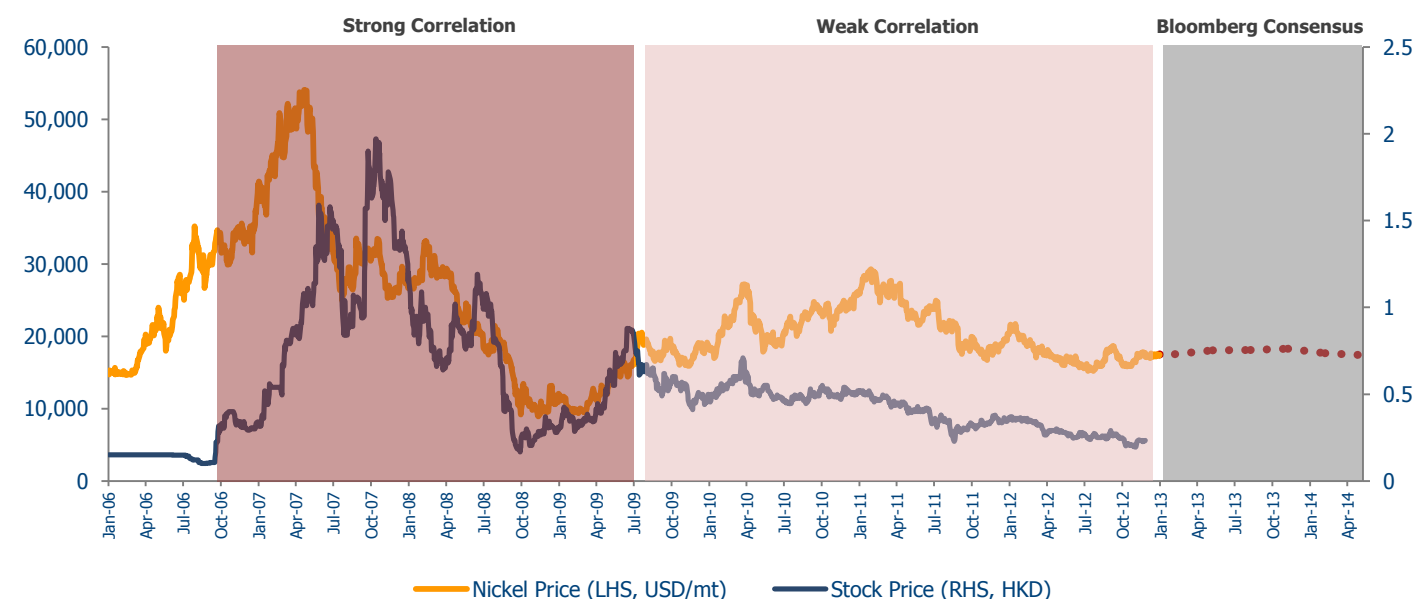
- In the first three years, when APAC had its highest concentration of investment in Metals X, the correlation between the stock price and the price of tin and nickel was strong (Figures 9 and 10).
- In the second half of FY09, APAC overweighted its shareholding in Mount Gibson, increasing its exposure to the iron ore price.
- Consequently, the stock price dropped by around 50% in 2011 due to the sluggish iron ore price, while the price for tin and nickel increased by 26% and 19% respectively.

Figure 9 Tin price versus APAC’s stock price



Source: Bloomberg Consensus, Mirae Asset Research

Figure 10 Nickel price versus APAC's stock price



Source: Bloomberg Consensus, Mirae Asset Research

Tin and nickel prices are estimated to be flat in 2013, based on Bloomberg consensus. Although Metals X's profitability should improve, the company will barely breakeven, in our view.

Figure 11 Metals X financial performance

A\$m	2010A	2011A	2012A	2013E
Revenue	97	73	53	70
Net profit after tax	13	63	(44)	4
Net assets	202	264	213	263
EPS (AU cents)	0.92	4.57	N/A	0

Source: Metals X, Bloomberg Consensus, Canaccord Research Estimates on 31 January 2013

3. ABM Resources – 7% of assets

- An emerging gold explorer in Australia
- Potential early production at Old Pirate
 - 724koz at 10.1gpt JORC resource
 - 97% gold recovery via simple gravity processing
- Buccaneer Project
 - 1.2moz at 2.2gpt JORC resource

APAC has invested in ABM Resources as a long-term strategy, as it could become a valuable resource company. Therefore, although unrealized mark-to-market losses will impact APAC's P&L, the final return will depend on the long-term prospects of the company.

ABM Resources' stock price has moved at a comparatively low range since APAC's investment (Figure 12).

Figure 12 ABM Resources stock price

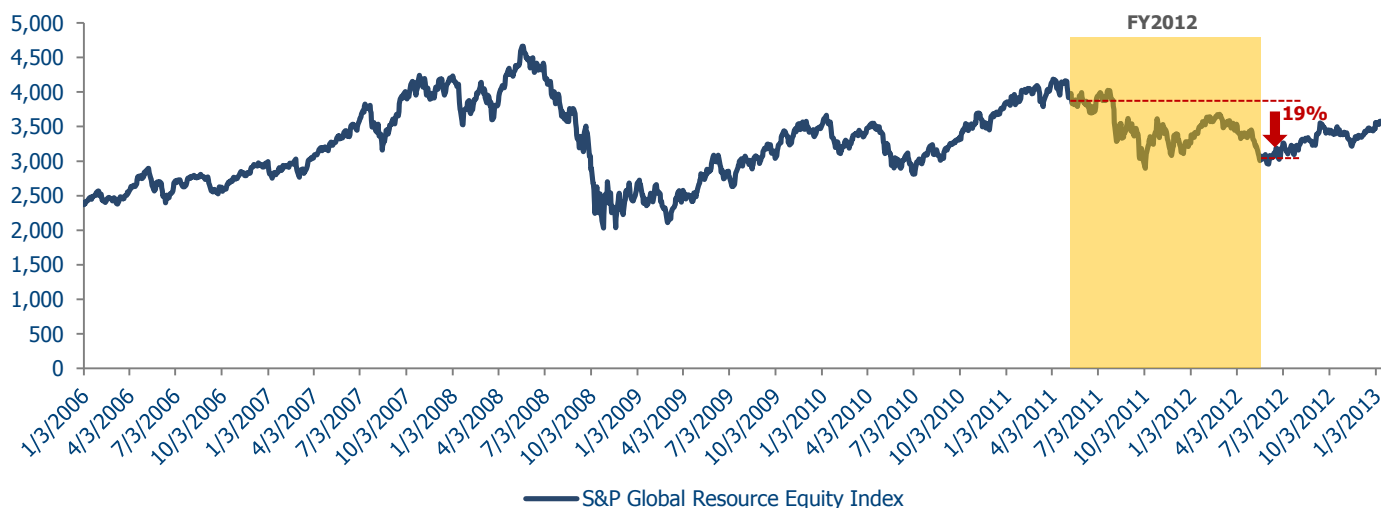


Source: Bloomberg, Mirae Asset Research

4. Natural resources companies' portfolio – 14% of assets

Some 14% of APAC's investments are allocated in numerous emerging resource companies around the world. This investment suffered a big loss in FY12, as the S&P Global Resource Equity Index dropped 19% (Figure 13).

Figure 13 Global resource equity was sluggish FY12



Source: Bloomberg, Mirae Asset Research

5. Commodity trading business

APAC trades iron ore and coal into China, and while doing so takes inventory risks. There is a time lag between paying for cargoes based on the preceding one month average and selling on the spot price. The profit level is more influenced by the speed and magnitude of changes in the iron ore price than it is by the absolute level of the iron ore price.

Recommendations

By stock (12 months)

Buy: A target price + 10% or more above the current price,
Hold: Target price within - 10% to +10% of the current price
Reduce: A target price of -10% or less below the current price

By industry

Overweight: over +10% of the current industry index
Neutral: -10% to +10% of the current industry index
Underweight: -10% or less than the current industry index

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