

## APAC Resources

### Resource Investment and Commodity Business

to summarize...

- APAC is an investment holding company, specialising in resources investment to meet China demands
- APAC defines its business into three business segment by stage of business cycle and business nature: 1) primary strategic investment, 2) resources investment and 3) commodity trading business.
- Its key asset holdings are: Mount Gibson (iron ore producer), Metals X (tin and nickel oriented miner) and Kalahari (uranium exploration project).
- APAC's strategy is to add mining operation to complement its business line.

**Specialist in mineral resources with China angle.** APAC focuses its investment on mineral resource companies with China angle since entering into this new business via an acquisition in 2007. The core business is to invest into metals and mining listed companies worldwide via their HK office as well as commodity trading business via their Shanghai office. Major investment includes 25.7% interest in Mount Gibson (MGX.AU), 29.7% interest in Metals X (MLX.AU), 14.5% interest in Kalahari Minerals (KAH.LA) and together with another 40-50 companies, represents 64%, 13%, 16% and 7% of APAC's effective total investment respectively. That said, three major assets together represent over 90% of total investment.

**Three business segments business: primary strategic investment, resource investment and commodity trading.** Primary strategic investment section is investments at production stage. Under this classification, their attributable profits booked as share of profit from associates, hence, changes in market capitalizations of the 2 investments would not impact on P&L. MGX and MLX are currently classified in this category. Resource investment section represents investments at early stage of development. APAC records profit or loss with changes in market capitalization of the 40-50 companies in this group, investments involving gold, copper, uranium, oil and gas, etc. For instance, uranium project - KAH. Commodity Trading arm trades mineral resources in China focusing on iron ore and coal. Trading arm is currently relied on iron ore supply from MGX that is secured by previous off-take agreement.

**Table 1. Profit mix during 1H 2010 and 2011**

HK\$m	1H 2010	1H 2011
Primary Strategic Investments	172.4	333.4
Resource Investment	(106.3)	(199.6)
Commodity trading	75.8	12.2
Other effect	1.5	211.6
Net profit	143.4	357.6

Source: SBI E2-Capital

Table1 summarizes the financial performance in three segments. Total net profit for 1H FY12/11A was up 1.5x YoY to HK\$357.6m, of which Primary Strategic Investment contributed HK\$333.4m, Resource Investment contributed (HK\$199.6m), and Commodity Trading contributed HK\$12.2m. The other effect is largely attributed by reversal of impairment loss in associates. Reversal of impairment loss occurs when recoverable amount of associates is higher than carrying amount, as a result, the previously recognized impairment loss is reversed through profit.

**Key performance indicator - MGX.** Mount Gibson is the fifth largest iron ore producer in Australia contributing 64% of APAC's investment, has annual turnover of over A\$600m. Maiden dividend was paid at A\$0.04/share paid in Sep 2011

Please refer to important disclosures at the end of this report

Ticker	1104 HK
Rating	Not Rated
Price (HK\$)	0.32
Target Price (HK\$)	n.a
12m Price Range (HK\$)	0.22-0.58
Market cap. (US\$m)	281.4
Daily t/o (US\$m)	0.2
Free float (%)	48.6

#### Financial summary

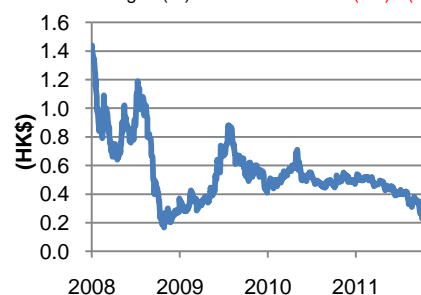
Year to Dec	08A	09A	10A
Turnover (HK\$m)	298.6	301.4	848.7
Net Profit (HK\$m)	(1,252.3)	372.6	1,104.5
EPS (HK\$)	-	0.07	0.17
P/E (x)	-	4.6	1.9
P/B (x) pre-CB	1.2	0.6	0.4
EV/EBITDA (x)	-	-	32.4
Yield (%)	-	-	-
ROE (%)	-	17	27
ROCE (%)	-	18	28
N. Gear. (%)	cash	cash	cash

Source: SBI E2-Capital

	11F	12F	13F
Consensus EPS (HK\$)	-	-	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	8.7	1.2	(11.5)
Actual Price Changes (%)	16.4	(3.0)	(28.1)



Source: Bloomberg

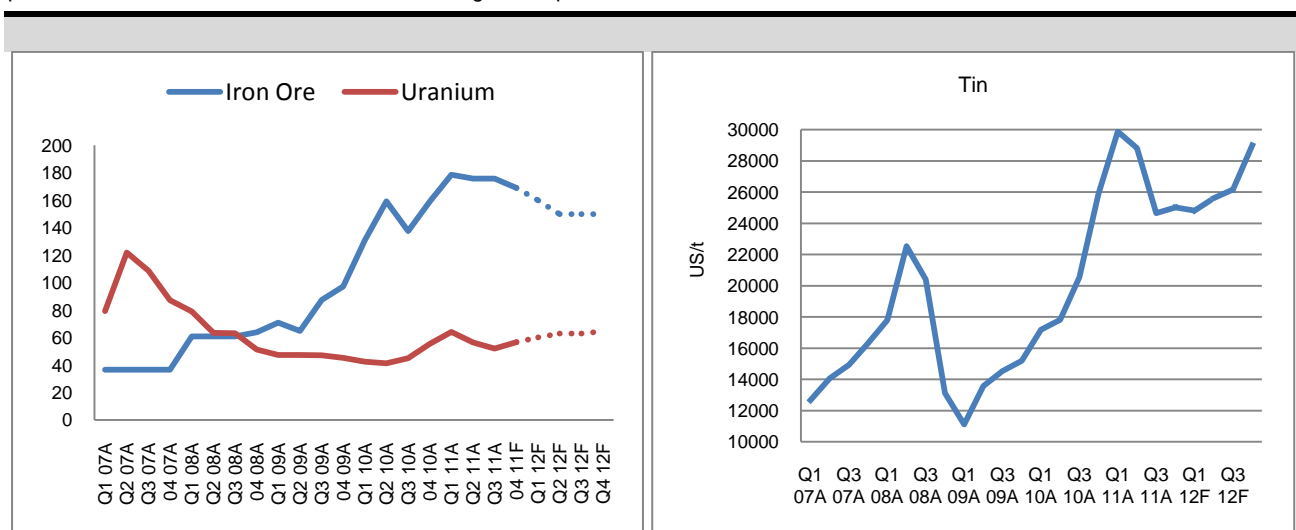
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contributing HK\$90m APAC's dividend income. Production and sales volume of iron ore was adversely affected by the weather-related issue in 1H FY12/10 and 1H FY12/11, decreased 36% and 32% respectively. Iron ore price remained strong during the 1H 2011 at ASP US\$177/t, due to higher than expected Chinese steel production while supply restricted due to export bans in India and delays in major mine expansions. We expect higher production ramped up to pre-disaster level and the commissioning of new Extension Hill mine will boost iron ore concentrate production as compared with 1H 2011. In the short run, iron ore might be fluctuated due to tightening policy in China and uncertainty arise from the EU sovereign debt crisis.

**Price driven growth prospective – MLX.** Metals X, which is the largest tin producer in Australia, engaged in tin and nickel mining business, recorded a maiden profit in 2010. During the 1H 2011, tin production was down 25% due to delay in production process, however, EBITDA increased to A\$31m as a result of increase in tin prices. We expect tin price will stay high due to Indonesian export restriction as well as demand growth from electronics sector. Indonesia is the world largest tin products exporter, has recently banned tin export in Oct 2011. The latest update denotes restriction of tin export might be released if the selling price increases to approximately US\$25,000/t. Given current trading price of US\$20,000/t represents a potential 25% upside in price.

**Investment at early stage – KAH.** Companies under Resource Investment category are mostly investments under exploration. Kalahari, which dominates 75% of investment under this group, is an ASX-listed company which holds the world fourth largest uranium deposit. During 1H of 2011, company value was adversely affected by Fukushima earthquake as well as turbulence in global market. Consequently, resource investment segment loss was widening 87% YoY to HK\$199.6m. There is however an upside that a possible cash bid offer by China Guangdong Nuclear Power Corporation (CGNPC). The Charts below illustrate the quarter average historical prices and estimated prices of tin, iron ore and uranium from Bloomberg for the period Q1 FY12/07A to Q4 FY12/12F.



Source: Bloomberg consensus

**Commodity trading arm - cash inflow.** APAC business model is to invest in resource companies at early stage, in line to enjoy return and to secure off-take once they matured. APAC invests directly into mining companies to secure off take for its commodity trading business. Trading arm plays a crucial role in the business as a regular revenue source. The current annual shipping recourse is 0.7mtpa and expected to increase by 70% YoY to 1.2mtpa in 2012.

**Expertise in mining business.** APAC Resources is supported by strong management team with experience in mining industry. Andrew Ferguson - CEO and John Ellis – Investment Manager, share over 20 years experience in natural resource investment.

According to the third party forecast below, the attributable net profit of sum of the 2 investments could go up by 93% YoY to HK\$10,73.1m for FY 06/12E..

**Table 2. Consensus on organic growth of APAC primary investments**

AU\$m	FY 06/10 A	FY 06/11A	FY 06/12E
Mount Gibson (MGX AU)			
Net profit	132	240	469
25.7% net profit	33.9	61.7	120.5
	FY 06/10 A	FY 06/11E	FY 06/12E
Metals X (MLX AU)			
Net profit	12	24	42
29.6% net profit	3.6	7.1	12.4
Primary investment profit AU\$m	37.5	68.8	132.9
Primary investment profit in HK\$m	302.8	555.5	1,073.1

Source: RBC Capital Markets, Southern Cross

Table 3. NAV

Month	11/10	12/10	01/11	02/11	03/11	04/11	05/11	06/11	07/11	08/11	09/11
NAV per share	0.91	1.09	1.05	1.06	1.03	1.04	0.98	0.97	0.97	0.9	0.72
APAC share price	0.48	0.49	0.5	0.5	0.46	0.45	0.45	0.4	0.42	0.37	0.27
Discount (%)	47	55	52	53	55	57	54	59	57	59	63

Source: SBI E2-Capital

The table above illustrates the NAV/share and APAC's share price for the past twelve months, which the widening discount rate for APAC share price over NAV/share might signal market over react the effect on APAC's value during the current economic downturn.

**Outlook.** APAC is a mining related investment company, and therefore financial performance largely depends on its investments, ie, MGX MLX and KAH. MGX is in its mature stage as a cash cow to APAC by rewarding cash dividend. We would expect more M&A activities from MGX given the considerable cash in hand and the enrollment of Mr. Hill (Chairman). For MLX, tin price is likely to remain strong in near strong due to banning exportation of tin products in Indonesia (the world largest Tin product exporter.). The price inflation in tin price might drive MLX turnover growth as well as high profit margin and hence benefit APAC's financial result.

**Valuation.** APAC is currently trading at 0.4x Price to NAV.

**Risks.** Cautiousness should be paid to the followings: 1) fund-of-fund like structure of certain investments, such as on Metals X and Kalahari, may pressure on company cash flow; 2) the company may need extra funding to fuel future growth through additional investments; 3) Investment horizon could be long with uncertain exit strategy; 4) Management control over investments cannot be guaranteed.

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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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