

## Yue Da: As good as gold mines

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**Recommendation: Not Rated**

**China Mining**

Price	HK\$3.58	Yield (12/05A)	0.56%
12 mth range	HK\$0.51-3.67	ROE (12/05A)	4.6%
Market cap.	US\$92.4m	Net gearing (12/05A)	Cash
No. shares o/s	*201.23m	Net debt/sh. (12/05A)	NA
Daily t/o, 3 mth	US\$0.29m	BV/sh. (12/05A)	HK\$2.13
Free float %	30%	Consensus EPS	
Major shareholder	Jiangsu Yue Da Group – 70%	- 12/06F	HK\$0.203
Tickers	0629.HK/ 629 HK	- 12/07F	HK\$0.351

\*Before CB conversion

### Key points:

- Foray into the mining business of lead and zinc offers attractive returns going forward.
- Shortage of zinc bodes well for future selling price.
- Profit guarantee of RMB45m p.a. for the next two years will cap downside risk.
- Expected to improve mine efficiency and double production capacity.
- All four mines will be ramped up next year, boosting earnings by almost 100%.
- More attractive mining projects in the pipeline.
- Trading below 10x forward P/E on a fully diluted basis.
- Potential upside surprises from existing and new mining projects and higher selling prices.

**Background.** Listed in 2001, Yue Da Holdings is originally engaged in toll management and operation of two major road sections in Jiangsu and Hebei Province. In June 2006, the company entered into mining business of lead and zinc.

**Why mining business?** As many highways have been built in China, the company found it more difficult to find new toll road projects with reasonably high returns. IRR for its existing toll road project is around 13%. Furthermore, the existing toll roads are facing problems such as traffic diversion from other competing roads.

The prices of nonferrous metals, such as lead and zinc, have been rising over the past few years with expected continued strong demand going forward. Given that Yue Da's controlling shareholder has extensive experience and advantages in the mining and energy industries (i.e. coal mining), Yue Da has decided to expand its footing into the mining business. On 23 June 2006, Yue Da completed a Share Transfer Agreement with Feilong Holdings (China) to acquire the entire issued share capital of Yuelong (Baoshan), Yuelong (Puer) and Yuelong (Yaoan), which hold 52% of the registered capital of Feilong Nonferrous, Puer Feilong and Yaoan Feilong respectively. All of the mines are located in the Yunnan Province. Feilong will hold up to 21.5% of the enlarged capital upon exercising the CB while Jiangsu Yue Da Group's interest will be diluted to 54.6%.

**Win-win situation for both parties.** The acquisition consideration of RMB300m (or HK\$288.5m) was funded by a combination of convertible bonds (HK\$75m), promissory notes (HK\$75m) and cash (HK\$138m). The company had a net cash of RMB112m as at Dec 2005. The transaction enables original owner Feilong to (1) receive cash to fund its other smelting expansions, and (2) enjoy the potential upside from exercising the CB in the future (one year shares lock-up after exercising CB). On the other hand, Yue Da owns four mines with attractive returns. Yue Da signed the deal when the price of zinc concentrate was below RMB10k (cf. the current price of around RMB20k). Also, management said the purchase consideration was only based on the valuation of two of the four mines.

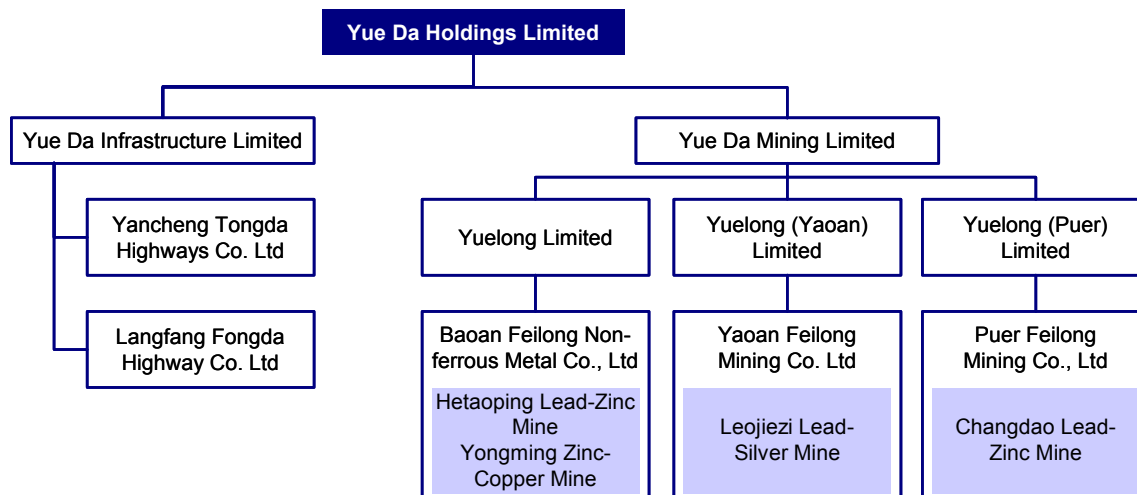
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**Chart 1: Business structure after acquisition**



Source: Company data

**Table 1: Terms of acquisition**

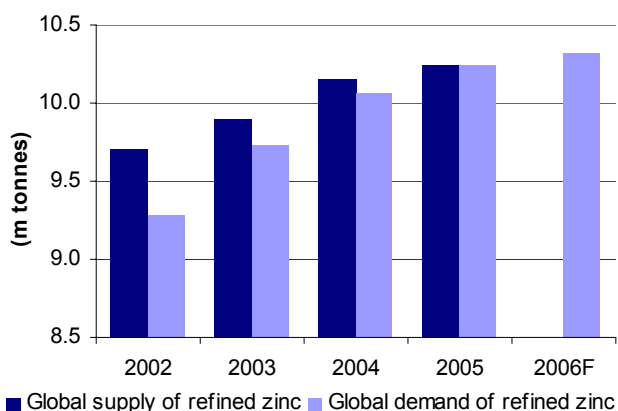
Type	HK\$m	Remarks
Convertible Bonds	75	Conversion: HK\$40m by June 07, HK\$20m by June 08 and HK\$15m in June 09 Interest rate of 3.5% at a conversion price of HK\$1.2~1.8 per share
Promissory Notes	75	Repayment: HK\$10m by June 07, HK\$30m by June 08 and HK\$35m by June 09 Interest rate of 3.5%
Cash	138	
<b>Aggregate consideration</b>	<b>288</b>	

Source: Company data

**Unique characteristics of zinc.** The most widely used nonferrous metals in the world are copper, aluminum, zinc, lead, nickel, magnesium, tin, titanium, mercury and antimony. With a soaring copper price, zinc has become a substitute for copper, resulting in new demand. Zinc ingots are mainly used in galvanizing steel making and die casting alloys. Note that the recoverability of zinc is the lowest among nonferrous metals.

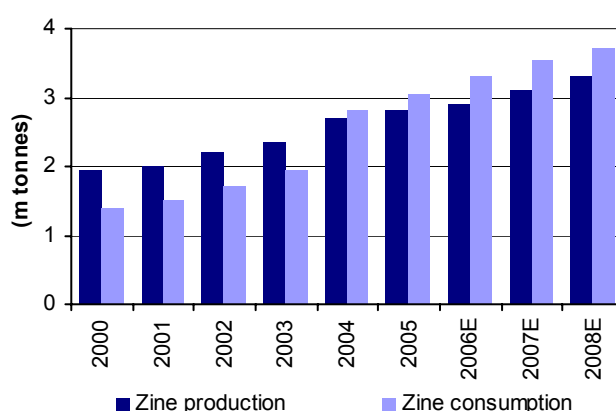
**Zinc: demand > supply.** According to the report of CRU, there was a global shortage of 310k tons of zinc in 2005. The shortage is particularly pronounced in China, given the robust demand was driven by the significant capacity expansion of galvanized steel industry in PRC. China is the world's largest zinc producer, but its production is still not enough to cope its domestic demand. The total zinc production in China reached 2.8m tons (up 1.3% YoY) in 2005, while consumption rose 7.2% YoY to 3m tons. Expansion in smelter capacity has also spurred the demand for more upstream zinc concentrates from domestic sources and imports. Some industry specialists suggested that the domestic zinc proven reserves are only adequate to last for 7~8 years. We currently assume zinc price to trend up further in 2007 (due to continued shortage), despite the fact that the price of zinc has risen over 100% in 2006. In general, the price of zinc in China moves in tandem with the London Metal Exchange (LME).

**Chart 2: Global supply and demand of zinc**



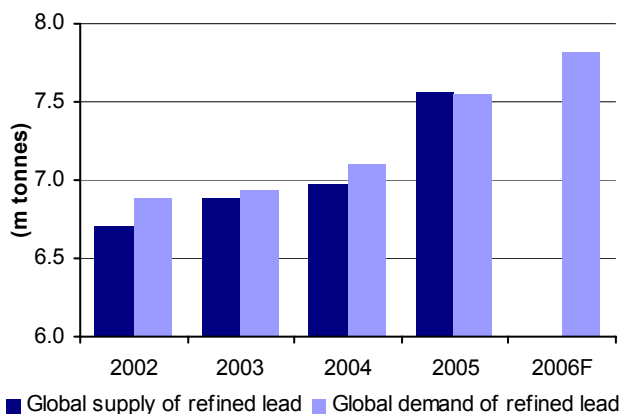
Source: Company data

**Chart 3: PRC supply and demand of zinc**

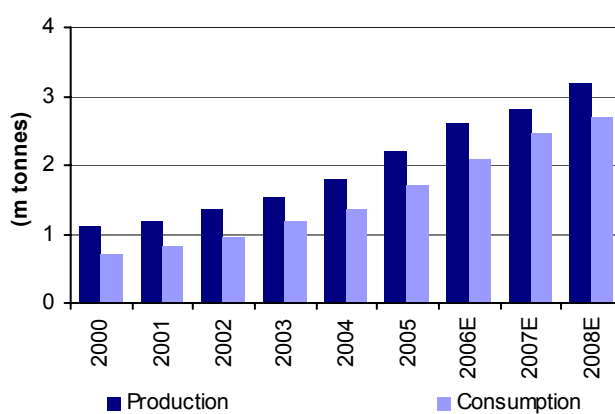


Source: The Yearbook of Nonferrous Metals Industry of China

**Demand for lead remains strong.** Lead ingots are mainly used in batteries and pigment. Demand for refined lead increases in China on the back of rising demand from China's automobile and telecom industries. China was the world's largest refined lead producer in 2003, with an output of around 2.2m tons (up 17% YoY). Lead consumption in China increased 28% YoY to 1.7m tons in 2005. Given the higher recoverability of lead, lead market has not seen a shortage situation as in the case of zinc. We expect the price of lead to stay high in 2007, and starts to trend down slightly in 2008.

**Chart 4: Global supply and demand of lead**

Source: Company data

**Chart 5: PRC supply and demand of lead**

Source: The Yearbook of Nonferrous Metals Industry of China

**Chart 6: Price trend of zinc**

Source: Bloomberg

**Chart 7: Price trend of lead**

Source: Bloomberg

### Upside potentials from the mining business

- **More mines will be operational in 2007.** Feilong Nonferrous, Puer Feilong and Yaoan Feilong are JV companies which hold the mining and exploitation rights of four zinc and lead mining sites, including (1) Hetaoping Mine of Feilong Nonferrous, (2) Yongming Mine of Feilong Nonferrous, (3) Yaoan Mine of Yaoan Feilong, and (4) Changdong Mine of Puer Feilong. Currently, only the Hetaoping mine is in operation while the other three mines are still in underground exploration or at the late development stage. In 2005, Hetaoping Mine produced 1,500 metal tons of refined lead ores and 8,200 metal tons of refined zinc ores. Hetaoping mine posted a net profit of RMB18.5m in 2005, following a turnaround in 2004. Yue Da expects the other three mines will commence production in 2007 and revenue contribution will increase significantly from 2007 onwards.
- **Expanding production capacity and efficiency.** Yue Da also plans to increase the production of its mines in 2007. For instance, the production of zinc and lead ores in Hetaoping mine will increase to 1,300 tons per day from the current production of 800 tons per day, while the production of lead ore in Laojiezi mine will increase from the current 600 tons per day to 1,200 tons per day. Meanwhile, a mining consultant firm (SRK in Australia) states that all these mines adopt a hand held mining method, which has relatively low efficiency. Management intends to improve the efficiency going forward.
- **Profits guarantee arrangement.** Under the deal arrangement, the ore concentrates produced by the four mines will be supplied to Feilong on a priority basis at market price. Interestingly, Feilong will guarantee an annual profit of RMB45m over the next 2 years starting from July 2006. However, given the current high price level

of zinc and lead, management is confident to generate profit more than the guaranteed level. In addition, Yue Da will also have the right to increase its stake to 100% for all four mines at the original price in the future.

**Table 2: Details of the acquired mines**

Location (Yunnan Province)	Hetaoping Lead-Zinc Mine	Copper mine of Yongming Plant	Laojiezi Lead Mine, Yaoan	Changdong Copper- Zinc Mine, Puer
Mine Area (square mile)	5.0095	0.6602	0.9948	1.3533
Current reserve/amount of resource (ton)	Pb (177,772) Zn (425,913)	N/A	Pb (103,984) Ag (126)	N/A
Average grade (%)	Pb (2.04) Zn (6.24)	Similar to Hetaoping	Pb (4.26) Ag (49.29 g/t)	Higher than Hetaoping
Growth potential in future reserve	Very high	Relatively high	Low	Relatively high
Safe and environmental evaluation	Passed	Passed	Passed	Passed

Source: Company data

- **More attractive projects in the pipeline.** In July 2006, the company announced that it was considering investing in the right of another zinc and iron mine in China. Due diligence suggests that the mine has a reserve of around 10~12m tones of mineral bodies (or ores) with a weighted average grade of around 45% as to iron and a weighted average grade of about 2% as to zinc. In short, we expect the payback period of the project would be less than 3 years.

**Toll roads will be gradually phased out.** Yue Da owns the operation right of National Highway 204 (namely Xin Fu Section in Jiangsu Province), which has a remaining concession period of 12 years. The company also manages the National Highway 106 (i.e. Wen An Section in Hebei Province), which has a remaining concession period of 17 years. In 2005, these toll roads reported annual revenue of RMB102m and net profit of c.RMB20m. The company has not ruled out the possibility of disposing of these projects to fund the mining business in the future.

**Valuation and estimates.** We estimate a net profit of RMB52m and RMB102m in 2006F and 2007F respectively. The stock currently trades at 17.6x FY12/06F P/E and 9x FY12/07F P/E on a fully diluted basis. Peers are trading in the range of 5~22x forward P/E. Although the share price has surged, we believe the current valuation has not fully reflected the upside potential from both the existing and upcoming new mines.

**Table 3: Earnings assumptions**

Zinc and lead mines (52%-owned)	2004A	2005A	2006F*	2007F
<b>Daily ore production (tons per day)</b>				
Hetaoping Lead-Zinc Mine		600	800	1,300
Copper mine of Yongming Plant				200
Laojiezi Lead Mine, Yaoan				1,200
Changdong Copper-Zinc Mine, Puer				200
<b>Annual output (tons)</b>				
Zinc ore concentrate	5,733	8,163	4,792	11,000
Lead ore concentrate	1,135	1,468	1,371	4,000
Copper ore concentrate				336
Silver ore concentrate (gram)				99,369
<b>Selling price per tons (RMB) (excluding tax)</b>				
Zinc ore concentrate	4,300	8,196	17,699	18,584
Lead ore concentrate	1,500	4,292	6,195	6,195
Copper ore concentrate				44,248
Silver ore concentrate (per gram)				1.7
Revenue contributions from mining (RMBm)	26.8	73.2	93.3	244.2
Operating cost (RMB/ ton)	4,857	4,500	4,500	4,500
Net profit (RMBm)	(0.8)	17.3	65.6	162
<b>Yue Da (Year to Dec)</b>				
Attributable profit from mining (RMBm)	N/A	N/A	34.1	84.1
Attributable profit from toll road business (RMBm)	13.8	19.5	18.0	18.0
<b>Net profit (RMBm)</b>	<b>13.8</b>	<b>19.5</b>	<b>52.1</b>	<b>102.1</b>
EPS (RMB)	0.055	0.078	0.21	0.41

Source: Company data and SBI E2-Capital \* Yue Da acquired 52% of the mines in June 2006

P & L (RMBm)	03A	04A	05A	Cash Flow (RMBm)	04A	05A
<b>Year to Dec</b>				<b>Year to Dec</b>		
<b>Turnover</b>	<b>70.9</b>	<b>93.2</b>	<b>102.4</b>	EBIT	25.1	34.7
% chg	-	31.3	9.9	Depre./amort.	27.6	27.2
Gross profit	33.1	41.8	51.9	Net int. paid	2.2	2.8
				Tax paid	4.8	6.2
EBITDA	46.7	52.7	61.9	Dividends received	-	-
Depre./amort.	(27.1)	(27.6)	(27.2)	<b>Gross cashflow</b>	<b>59.7</b>	<b>70.9</b>
EBIT	19.6	25.1	34.7	Chgs. in working cap.	2.6	(0.5)
Net int. income/(exp.)	(2.7)	(2.2)	(2.8)	<b>Operating cashflow</b>	<b>57.1</b>	<b>70.4</b>
Exceptionals	-	-	-	Capex	(5.6)	(7.2)
Associates	-	-	-	<b>Free cashflow</b>	<b>51.5</b>	<b>63.2</b>
Jointly-controlled entit.	-	-	-	Dividends paid	(4.2)	(4.2)
<b>Pre-tax profit</b>	<b>16.9</b>	<b>22.9</b>	<b>31.9</b>	Net distribution to MI	-	-
Tax	(3.2)	(4.8)	(6.2)	Investments	-	-
Minority interests	(2.1)	(4.3)	(6.2)	Disposals	-	-
<b>Net profit</b>	<b>11.6</b>	<b>13.8</b>	<b>19.5</b>	New shares	-	-
% chg	-	18.9	41.3	Others	(5.7)	(2.1)
Dividends	(4.2)	(4.2)	(4.2)	<b>Net cashflow</b>	<b>41.6</b>	<b>56.9</b>
Retained earnings	7.4	9.6	15.3	Net (debt)/cash - Beg.	11.0	52.6
EPS (RMB) - Basic	0.058	0.069	0.097	Net (debt)/cash - End.	52.6	109.5
EPS (RMB) - F.D.	0.058	0.068	0.096			
DPS (HK\$)	0.020	0.020	0.020	<b>Interim Results (RMBm)</b>	<b>05A</b>	<b>06A</b>
No. sh.s o/s (m) - W.A.	200.0	200.0	200.0	<b>Six months to June</b>		
No. sh.s o/s (m) - Y.E.	200.0	200.0	200.0	<b>Turnover</b>	<b>47.9</b>	<b>54.9</b>
No. sh.s o/s (m) - F.D.	201.9	201.9	202.3	% chg	4.7	14.8
				Profit from operations	18.1	21.1
<b>Margins (%)</b>				Interest expenses	(2.1)	(2.6)
Gross	46.6	44.8	50.7	Associates	-	-
EBITDA	65.9	56.5	60.4	Jointly-controlled entit.	-	-
EBIT	27.6	26.9	33.9	<b>Pre-tax profit</b>	<b>16.0</b>	<b>18.5</b>
Pre-tax	23.8	24.6	31.1	Tax	(2.8)	(3.7)
Net	16.4	14.8	19.0	Minority interests	(2.9)	(5.4)
				<b>Net profit</b>	<b>10.3</b>	<b>9.4</b>
<b>Balance Sheet (RMBm)</b>	<b>04A</b>	<b>05A</b>		% chg	8.7	(8.2)
<b>Year to Dec</b>				EPS (HK\$) - Basic	0.051	0.047
Fixed assets	366.6	339.9		DPS (HK\$)	0.020	-
Intangible assets	366.1	339.4				
Other LT assets	0.5	0.5		<b>Shareholding Structure</b>		
Cash	130.8	151.3			<b>Shares o/s (m)</b>	<b>%</b>
Accounts receivable	-	-		Jiangsu Yue Da Group	140.9	70.0
Other receivables	0.8	2.4		Public	60.4	30.0
Inventories	-	-		<b>Total</b>	<b>201.3</b>	<b>100.0</b>
Due from related co.s	-	-				
Other current assets	-	-		<b>Background</b>		
<b>Total assets</b>	<b>498.2</b>	<b>493.6</b>		Listed in 2001, Yue Da Holdings is originally engaged in toll management and operation of two major road sections in Jiangsu and Hebei Province. In June 2006, the company entered into mining business of lead and zinc.		
Accounts payable	(8.1)	(9.4)				
Other payable	(3.2)	(0.7)				
Tax payable	(1.9)	(2.9)				
Due to related co.s	(1.8)	(2.0)				
ST debts	(22.6)	(6.7)				
Other current liab.	-	-				
LT debts	(55.6)	(35.1)				
Other LT liabilities	(9.7)	(9.9)				
<b>Total liabilities</b>	<b>(102.8)</b>	<b>(66.9)</b>		<b>Key Ratios</b>	<b>04A</b>	<b>05A</b>
Share capital	21.0	21.0		Net gearing (%)	Cash	Cash
Reserves	280.4	304.5		Net ROE (%)	3.5	4.6
<b>Shareholders' funds</b>	<b>301.4</b>	<b>325.5</b>		EBIT ROCE (%)	6.7	9.4
Minority interest	94.1	101.2		Dividend payout (%)	30.4	21.5
<b>Total</b>	<b>395.4</b>	<b>426.7</b>		Effective tax rate (%)	20.9	19.5
Capital employed	379.6	367.3		Net interest coverage (x)	6.3	6.9
Net (debt)/cash	52.6	109.5		A/R turnover (days)	NA	NA
				A/P turnover (days)	57.6	63.3
				Stock turnover (days)	NA	NA