

Handsome earnings growth expected

China Resources

Yue Da Mining Holdings (629 HK, HK\$5.05)

Not Rated

From toll roads to mining. Yue Da, pure toll road operator, has transformed itself into a non-ferrous metal producer since the acquisition of mining assets in Yunnan province between 2006 and 2007 and the disposal of Yancheng Tongda (for HK\$65.0m), an operator of the Xin Fu section of National Highway 204, which links Yantai in Shandong and Shanghai. The group has boosted its profitability and shareholder value by shifting away from toll road operations, with their limited growth potential (few new investment opportunities given China's well-developed road network), government-regulated tariffs and investment return schemes, and the development blueprint of the national highway network. Another factor behind the move was the group's inability to compete with established toll road operators in terms of scale and toll collection rights. In contrast, the mining business offers better growth prospects as the prices of non-ferrous metals are determined by the market, not other producers. China's rapid economic is fuelling demand for non-ferrous metals, enlarging the group's market.

Re-rating. Yue Da's new business alignment has been well received by the market, with the share price surging more than eleven-fold since Jan 2005 (when the mining acquisition was announced) and historical P/E multiples expanding from 5.9x for FY12/05A to 72.7x for FY12/06A. We expect the re-rating to continue, given the strong growth momentum of its mining division, expansion in its mineral resource base and attractive forward valuation.

Proven track record in mining. The group completed the acquisition of 52.0% in the Yuelong mining project (four non-ferrous metal mines) in Yunnan province in June 2006. The mining division generated an operating profit of HK\$47.0m after only six months of operation, while the toll road operation reported an operating loss. The mining division was the sole earnings contributor to the group in FY12/06A. In 1H FY12/07F, the mining division reported an operating profit of HK\$45.2m, representing 83.8% of the group's gross operating profit before head office expenses and exceptional items. We expect the growth momentum of the mining business to remain strong, driven by the elimination of minority interests in four mines in Yunnan and an increase in the company's daily ore extraction and processing capacity.

Elimination of minority interests. In June 2007, the group acquired an additional 48.0% in Feilong Nonferrous Metal Mine, Puer Feilong (lead and zinc mine) and Yaoan Feilong (lead and silver mine). After the completion of the acquisition, it owns 91.5% of Baoshan Feilong Hetaoping (lead and zinc mine) and Baoshan Feilong Yongming (zinc mine), as well as 100.0% in Yaoan Feilong and Puer Feilong. The four mines in Yunnan became the group's wholly-owned subsidiaries at the beginning of 2H FY12/07F.

Processing expansion. In 1H FY12/07F, Baoshan Feilong Nonferrous Metal Mine (operating the Hetaoping and Yongming mines) and Yaoan Feilong Mining (operating Laojiezi Yaoan mine) expanded the production capacity of their processing plants. Yaoan Feilong's additional processing plant (daily capacity of 600 tons) came on stream in Mar 2007 and Baoshan Feilong's upgraded processing plant (daily capacity of 500 tons) was launched in Apr 2007. We estimate that the processing capacity of the group's mines in Yunnan will expand 86.4% YoY to 3,850t.p.a of ore by end-FY12/08F and boost its metal production volume.

Full launch of Tengchong Mine in FY12/08F. The group acquired the entire stake in the Tengchong mining project in Tengchong county, Yunnan, for RMB250.0m in Dec 2006. The project has rich iron and zinc resources but its production was hampered by the company's limited processing capacity between Jan and May 2007. Ore transport was also negatively affected by road-use disputes with local villagers. The situation was further aggravated after the government suspended all local mining activities due to accidents for more than a month in 2H 2007. All these issues have now been resolved. The company also acquired a processing plant, Ruilong, at

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the mine in May 2007 and upgraded its production facilities expanding capacity. Thus, we expect Tengchong to reach its full scale operations in FY12/08F.

Resource expansion via acquisitions. We estimate the company's resources at 281,756.0 tons of lead, 645,913.0 tons of zinc, 8.8m tons of iron and 126.0 tons of silver. The company is in the process of acquiring three mines: 1) 100% in Daqian Mine in Shaanxi for HK\$120.0m - the mine has 106,642.0 tons of zinc and 47,744.0 tons of lead resources and in the Jan 2005- Aug 2007 period produced 1,076 tons of zinc ore and 16 tons of lead ore; 2) 71.0% in Hong Ling Mine in Inner Mongolia for HK\$895.4m - the mine has 514,500.0 tons of zinc resources and 17,364.0 tons of lead resources, and according to its profit sharing scheme, the group can get 92.0% of the profit generated by the mine before 2010, 87.0% in 2010-2017 and 71.0% from 2018. Between Jan 2005 and Sep 2007, the mine produced 19,213.0 tons of zinc ore; 3) 90.1% in Weng Qi Mine in Inner Mongolia for HK\$299.0m - the mine has 165,149.0 tons of zinc and 73,479.0 tons of lead resources. Between Jan 2005 and Sep 2007, it produced 8,930.0 tons of zinc ore and 1,092.0 tons of lead ore. The three deals should be finalized by end-1Q 2008 and boost the group's total lead and zinc resources by 70.1% and 112.6%, respectively, to 479,241.0 tons and close to 1.4m tons.

Table 1: The group's metal reserves

Mine	Lead (metal tons)	Zinc (metal tons)	Iron (metal tons)	Silver (metal tons)
Tengchong	na	220,000.0	8,845,700.0	na
Hetaoping	177,772.0	425,913.0	na	na
Yaoan	103,984.0		na	126.0
Daqian	106,642.0	47,744.0	na	na
Hong Ling	17,364.0	514,500.0	na	na
Weng Qi	73,479.0	165,149.0	na	na
Total	479,241.0	1,373,306.0	8,845,700.0	126.0

Source: Company data

Enhancing shareholder value. To calculate the gross value of the group's metal reserves, we base our ASP assumptions on the average Shanghai Changjiang spot price for Dec 2007 of RMB20,750.0/ton for zinc, RMB19,600.0/ton for lead and RMB3,625.0/gram for silver. Our iron ore ASP is RMB550.0/ton. The gross cash value (without deducting mining and processing costs and debt) of the group's zinc and lead reserves in Yunnan is thus estimated at RMB18,925.1m. The total acquisition costs of the five mines in Yunnan was RMB781.7m. Assuming the mining cost of lead and zinc metal at RMB3,225.2/ton and processing cost of metal at RMB3,541.2/ton, the net cash value of the group's metal reserves comes to RMB11,866.4m. After the acquisition of the three mines, using the same ASP assumptions, the gross cash value of the group's zinc and lead reserves comes to RMB37,889.2m. After deducting mining and processing costs and projected acquisition costs (RMB1,218.4m), the net cash value of the group's reserves is RMB29,469.2m, which means that the three new mines will boost the value of the group's metal resources by 148.3%.

2H results could surprise on the upside. The group reported a net loss of HK\$51.6m in 1H FY12/07F due to one-off items such as the HK\$71.5m fair value loss on embedded derivatives of convertible bonds and deferred taxation costs arising from a tax rate change in Mar 2007. In Jun 2006, the group issued a 3.5% CB at a nominal value of HK\$75.0m as the consideration of the acquisition of 52.0% in mining projects in Yunnan. In Jun 2007, 33.3m shares were converted at HK\$1.20 each. The group redeemed the rest of the CB at the total consideration of HK\$69.3m in Jun 2007. Thus, there will be no fair value loss on embedded derivatives of CB anymore, unless the group issues another CB. The group's mining division reported an operating profit of HK\$45.2m against a turnover of HK\$108.6m. We expect results to improve significantly in 2H FY12/07F due higher contributions from its mining division, production ramp up in mines and the resumption of normal operations at Tengchong Mine in 4Q 2007. In addition, the group acquired minority interests in four mines in Yunnan and since all the mines are wholly-owned, the group can consolidate all their earnings into its own accounts. We estimate the group's mining net earnings at HK\$172.8m in FY12/07F and consolidated net earnings at HK\$74.7m, representing an annual growth rate of 623.2%.

Net profit to surge 439.2% in FY12/08F. Growth drivers beyond FY12/07F include higher metal production and contributions from Daqian Mine, Hong Ling Mine and Weng Qi Mine. Again, we expect the deals to be completed by end-1Q FY12/08F and the mines to provide at least 240 days worth of production contribution to the group. Thanks to its capacity increase, we expect the group production volume of zinc concentrate to rise 229.5%, lead concentrate 156.6%, iron ore 62.5% and silver ore 14.3%. We adopt the one-year average Shanghai Changjiang zinc, lead and silver's spot price for 2007 as the ASP assumption for FY12/07F and

FY12/08F. We project the group's net profit to leap 439.2% YoY to HK\$402.9m in FY12/08F.

Very attractive. Hong Kong-listed metal mining plays are trading at an average one-year forward P/E of 18.0x and two-year forward P/E of 15.0x. Selected metal mining companies listed in Hong Kong, China, Canada and Australia are trading at average one-year forward P/E of 18.3x and two-year forward P/E of 14.6x. Trading at a P/E of 3.8x for FY12/08F, the group's valuation is very attractive. The group is trading at a 87.1% discount to its intrinsic value calculated as the estimated net cash value of its metal resources at its mining assets in Yunnan.

Table 2: Peer group comparison

Company name	Ticker	Year	Currency	Price	Market Cap (US\$m)	P/E (x)	
		End				1-yr forward	2-yr forward
Jiangxi Copper	358 HK	Dec	HKD	20.5	18,745.3	12.5	12.3
Hunan Non-Ferrous Metal	2626 HK	Dec	HKD	3.85	1,820.6	19.2	14.7
China Molybdenum	3993 HK	Dec	HKD	9.75	6,088.0	18.2	13.4
Zijin Mining Group	2899 HK	Dec	HKD	8.8	12,749.5	41.9	31.1
Lingbao Gold	3330 HK	Dec	HKD	4.14	410.2	16.0	9.5
Aluminum Corp of China	2600 HK	Dec	HKD	10.02	45,100.7	10.0	10.0
Zhaojin Mining Industry	1818 HK	Dec	HKD	29.7	2,771.4	48.3	30.9
Huludao Zinc Industry	000751 CH	Dec	CNY	16.43	2,520.0	27.6	14.8
Yunnan Chihong Zinc & Germanium	600497 CH	Dec	CNY	77.92	4,198.6	22.8	19.6
Energy Resources of Australia	ERA AU	Dec	AUD	17.45	2,851.4	65.8	29.9
Minara Resources	MRE AU	Dec	AUD	4.54	1,808.9	7.2	7.3
Mincor Resources NL	MCR AU	Jun	AUD	2.75	466.0	5.1	4.0
Independence Group NL	IGO AU	Jun	AUD	6.46	640.0	12.4	14.2
Iluka Resources	ILU AU	Dec	AUD	4.12	855.0	22.2	32.4
Consolidated Minerals	CSM AU	Jun	AUD	4.94	1,118.9	9.7	10.3
CBH Resources	CBH AU	Jun	AUD	0.35	252.6	5.1	4.5
Lundin Mining Corp	LUN CN	Dec	CAD	7.22	2,733.8	5.4	5.3
Cameco Corp	CCO CN	Dec	CAD	32.7	10,866.5	18.2	12.1
<i>Average</i>						<i>18.3</i>	<i>14.6</i>

Source: Bloomberg

Risks. 1) Lower-than-estimated metal content in ore; 2) overly optimistic ASP assumptions - if the US economic slowdown reduces demand for and consumption of non-ferrous metals; 3) acquisition completion hiccups; 4) lower-than-expected ore extraction and processing volume; 5) additional capital needs for the acquisition of the three new mines (debt or equity financing, or both), which will lift the group's net gearing ratio and dilute EPS; 6) possible government policy changes to tackle safety and environmental issues.

Fund raising in the past 12 months. In Jun 2006, the group issued a 3.5% CB at a nominal value of HK\$75.0m. In Jun 2007, 33.3m shares were converted at HK\$1.20 each. The group redeemed the rest of the CB for HK\$69.3m in Jun 2007. In Dec 2007, it raised HK\$128.1m by placing 20.0m shares at HK\$6.63 each.

Table 3: Assumptions on mining division

	2006A	1H07A	2007E	2008F	2009F	2010F
Annual production volume (tpa)						
Zinc ore concentrates	4,131.0	3,822.0	9,329.8	30,741.5	37,491.3	62,269.5
Lead ore concentrates	1,495.0	1,437.0	6,163.7	15,813.3	17,468.1	27,009.7
Silver (Kilograms)	915.0	951.0	8,539.5	9,759.4	9,759.4	14,313.8
Iron ore concentrates	na	52,290.0	68,112.0	110,682.0	119,196.0	127,710.0
ASP assumption (RMB/ton)						
Zinc ore concentrates	20,540.0	20,348.0	21,207.0	21,207.0	21,207.0	21,207.0
Lead ore concentrates	10,628.0	14,398.0	14,803.5	14,803.5	14,803.5	14,803.5
Silver (RMB/grams)	na	na	2.2	2.3	2.3	0.1
Iron ore concentrates	na	532.0	550.0	534.0	534.0	534.0

Source: Company data & SBI E2-Capital

Table 4: Mining division P&L

(HK\$m)	2007	2008	2009	2010
Gross revenue	370.1	946.6	1,060.1	1,665.4
VAT	(48.1)	(123.1)	(137.8)	(216.5)
Net revenue	322.0	823.5	922.3	1,448.9
Mining costs	(50.0)	(81.0)	(92.6)	(149.0)
Processing cost	(43.0)	(80.7)	(94.4)	(159.0)
Resources tax	(1.0)	(9.3)	(12.4)	(27.9)
Depreciation	(7.7)	(9.7)	(13.0)	(13.4)
Amortization	(22.0)	(75.9)	(75.9)	(75.9)
Transportation expenses	(11.9)	(19.3)	(20.8)	(22.3)
Cost of sales	(135.4)	(275.9)	(309.1)	(447.5)
Gross profit	186.5	547.6	613.1	1,001.4
SG&A	(11.2)	(24.1)	(26.6)	(45.8)
Interests expenses	0.0	0.0	0.0	0.0
Operating profit	175.4	523.5	586.5	955.6
Taxation	0.0	(61.0)	(87.4)	(181.2)
Minority interests	(2.5)	(11.0)	(31.0)	(62.5)
Net profit	172.8	451.5	468.1	711.9

Source: Company data & SBI E2-Capital

Table 5: P&L

Year to Dec (HK\$m)	05A	06A	07F	08F	09F	10F
Turnover	102.4	184.6	377.3	881.6	980.4	1,507.0
% chg		80.3	104.3	133.7	11.2	53.7
Gross profit	51.9	98.6	217.6	580.2	645.7	1,034.0
EBITDA	61.9	180.0	241.5	648.0	714.3	1,083.7
Depre./amort.	(27.2)	(42.5)	(45.6)	(102.5)	(105.7)	(106.1)
EBIT	34.8	137.5	195.8	545.6	608.5	977.6
Net int. income/(exp.)	(2.9)	(6.5)	1.4	(57.1)	(31.8)	(13.8)
Exceptionals	-	(90.9)	(53.6)	-	-	-
Associates	-	-	-	-	-	-
Jointly-controlled entit.	-	-	-	-	-	-
Pre-tax profit	31.9	40.1	143.6	488.5	576.7	963.8
Tax	(6.2)	(4.9)	(58.9)	(66.5)	(92.9)	(186.7)
Minority interests	(6.2)	(25.0)	(10.1)	(19.1)	(39.1)	(70.6)
Net profit	19.5	10.3	74.7	402.9	444.7	706.5
% chg		(46.9)	623.2	439.2	10.4	58.9
Dividends	4.2	-	-	-	-	-
Retained earnings	23.7	10.3	74.7	402.9	444.7	706.5
EPS (HK\$) - Basic	0.097	0.049	0.297	1.329	1.469	2.334
EPS (HK\$) - F.D.	0.096	0.047	0.247	1.331	1.469	2.334
DPS (HK\$)	0.021	-	-	-	-	-
No. sh.s o/s (m) - W.A.	200.0	210.0	251.6	303.1	302.7	302.7
No. sh.s o/s (m) - Y.E.	200.0	249.8	303.1	302.7	302.7	302.7
No. sh.s o/s (m) - F.D.	202.3	220.8	303.1	302.7	302.7	302.7
Margins (%)						
Gross	50.7	53.4	57.7	65.8	65.9	68.6
EBITDA	60.5	97.5	64.0	73.5	72.9	71.9
EBIT	34.0	74.5	51.9	61.9	62.1	64.9
Pre-tax	31.2	21.7	38.1	55.4	58.8	64.0
Net	19.0	5.6	19.8	45.7	45.4	46.9

Source: Company data & SBI E2-Capital