

**BEA securities**

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HONG KONG RESEARCH**21st March 2006**

Analyst: Kelvin Li

Main Board H-share Listing - Research

湖南有色金屬股份有限公司

Hunan Nonferrous Metals Corporation Limited [Stock Code: 2626]**Joint Global Coordinators, Joint Bookrunners,** : BOC International
Joint Sponsors and Joint Lead Managers

Morgan Stanley

Sector : Materials**Business** : Integrated nonferrous metals production

Total share offer: <u>1,075,582,000</u> H shares (33.0% of the enlarged share capital) Public Offer: 107,558,000 H shares (10%) Placing: 968,024,000 H shares (90%) Greenshoe: 161,336,000 H shares	<u>Business of Hunan Nonferrous Metals (HNMC)</u> HNMC is the largest integrated producer of nonferrous metals, excluding aluminium, in China in terms of production volume. Major products of the Group include tungsten, zinc, antimony, and lead, and compounds, alloys and other products derived from these metals. HNMC possessed a vertically integrated production chain, which includes upstream exploration, mining and ore processing, midstream smelting, downstream refining and value-added operations. HNMC's business can be categorized into three segments, namely nonferrous metal mining, nonferrous metal smelting and production of cemented carbides, and tungsten, molybdenum, tantalum, niobium, and their compounds. HNMC's productions facilities are situated in five operating centres in Hunan province. There are three principal mines, namely Shizhuyuan Mine, Hsikwangshan Mine and Huangshaping Mine. The Group's smelting and refining plants are primarily located at Zhuying, Zhuye and Hsikwangshan, while downstream production facilities are at Zhuying and Zhuye.
Price: HK\$1.20 - HK\$1.65 per H share Market Cap.: HK\$1,291 million – HK\$1,775 million FY2005E P/E: 9.8x-13.5x (pro-forma fully diluted) Adjusted NTA per share: HK\$0.74-HK\$0.88 Staffing: 21,242 (as of 13 th March 2006)	
HK Public Offer period: 21 st March 2006 – 24 th March 2006 noon Receiving bank: Bank of China (HK) Share registrar: Computershare Hong Kong Investor Services Limited Listing date: 31 st March 2006	

Major Shareholders after Listing (Assuming the over-allotment option is not exercised)

Hunan Nonferrous Metals Holding Group Co. Ltd. (*)	60.96%
The National Council for Social Security Fund (NSSF)	3.30%
Shenzhen Bangxin	1.75%
Zijin	0.92%
Hunan Valin	0.04%
Powerise	0.03%
	<u>67.00%</u>

Remark: (*) owned by the State-owned Assets Supervision and Administration Commission of Hunan Province (Hunan SASAC).

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,175.7 million – HK\$1,638.4 million.

(Assuming issue price between HK\$1.20-1.65 each and the over-allotment option not exercised.)

	HK\$ million
For (i) acquisition of mines and mining rights in relation to mines with identified mineral resources, and (ii) exploration and development of mineral resources, of which a significant portion is intended to be used in relation to the acquisition of mines and mining rights	564.3 - 786.4
Capital expenditures for (i) the “High Performance Cemented Carbides Tools Engineering” project at Zhuying and (ii) the “ITO and High Purity Metal Products Series” project at Zhuye	423.2 - 589.8
For potential acquisitions and strategic investments consistent with our business strategies	105.8 - 147.5
For working capital and other general corporate purposes	Remaining balance

Financial Highlights

	Year ended 31 st December			9 months ended 30 th September
	2002	2003	2004	2005
	RMB million	RMB million	RMB million	RMB million
Turnover	4,667	5,822	7,309	6,420
Gross profit	649	804	1,138	1,179
Operating profit	233	289	864	719
Attributable profit to equity holders	55	169	555	394
Basic EPS	RMB0.0265	RMB0.0810	RMB0.2655	RMB0.1877
	RMB million	RMB million	RMB million	RMB million
Owners' Equity	1,141	1,313	1,422	1,909

Strengths/Opportunities

- ✓ Nonferrous metals are used in various kind of industrial production ranging from blade and steel to medical equipment, car parts and weapons. Leveraging on its integrated production chain and leading market position for selected metals (top producer of cemented carbides, zinc and antimony in the PRC), HNC are well positioned to grasp business opportunities in the fast-growing Mainland nonferrous metal industry.
- ✓ China is world's leading non-ferrous metals producer in terms of output and reserve. Given its strategic value in national defence and great importance in industrial modernization, we expect the sector would continue to gain support from the government and grow favourably in coming years.

Weaknesses/Threats

- × Raw materials from HNMC's own mines have not been sufficient to fulfil production needs and it had to purchase from external suppliers. As there is no hedging on external raw material procurement, the Group could face risks that it may not be able to fully transfer the rise in raw material cost to their end clients. In order to lower reliance on external procurement, the Company plans to use nearly half of the net IPO proceeds to acquire mines and mining rights and spend about RMB120 million over the next four years for further exploration of the acquired mines.
- × As of 30/09/2005, HNMC's net debt-to-equity ratio stood high at 200%. However, the Company revealed that it would continue to incur debt for funding daily operations and future expansion, and its debt ratios are expected to stay at high levels.

Recommendation: Trading Buy

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