

Classical Insights

Global Investment Analysis Based on the Classical Economic Model

Classical Insights Afternoon Bullet Points March 11, 2009

QUA CN -- US\$3.25

all data are in US\$

Sales and earnings

	2008	2009e	2010e	2011e
Sales (\$ mln)	487	416	603	737
Sales growth		-15%	45%	22%
EPS	0.61	(0.07)	0.98	1.73
Cash flow	0.95	0.32	1.39	2.15
FCF	(3.26)	(0.43)	0.68	1.49

Target price & valuation data

Our 12-mo target	\$12.07	(9x 2010 EPS + \$3.27/sh)	
Upside to target	271%		
Mkt cap (\$ mln)	\$270	Enterprise value	\$235
P/sales (2009e)	0.65	EV/sales (2009e)	0.56
P/E (2009e)	nmf	EV/EBITDA (2009e)	10.0
P/E (2010e)	3.3	EV/EBITDA (2010e)	1.6
P/E (2011e)	1.9	EV/EBITDA (2011e)	0.9

cash flow defined simply as EPS + depreciation. FCF defined as cash flow - capex.

We are resuming coverage of Quadra Mining with a US\$12.07/share price target (based on \$2.25/lb. copper in 2010). We're valuing Quadra at 9x expected 2010 earnings, plus \$0.74/share for net balance sheet cash and \$2.53/share for projects (chiefly Sierra Gorda). The 9x multiple may seem a tad high, but we expect QUA's valuation to be helped by rising copper prices going into 2011 (we're modeling for \$2.75/lb. copper in 2011).

Quadra has a cash-positive balance sheet, three good mines with moderate cash costs -- and huge exposure to upside in the copper price. At \$2.75/lb. copper, we have QUA earning \$1.73/share. Conceptually \$2.75/lb. copper is not a high hurdle with gold at \$900/oz.

The top risk is that QUA's earnings in 2009 are likely to be slightly negative -- even at \$1.75/lb. copper. (Cash flow should remain positive, though.) Moreover, in the near term, there is a clear risk that the copper price will suffer another down-leg.

Points:

1) Quadra is transitioning from a single-mine company to a three-mine company. The new Carlota mine starts producing this quarter. (There were 32 million lbs. of copper were on the Carlota leach pads as of January 1.) Last month, Quadra bought Centenario Copper, thereby gaining the Franke mine, which is similar in size to Carlota. Both of these mines cost \$250 million to build. (The replacement cost of Quadra's entire infrastructure is \$1 billion-plus, yet the EV of the entire company is now less than a quarter of that.)

Quadra's main mine (Robinson) is expected to produce 140 million copper lbs. and 105,000 gold ounces this year. That's down from 2008, due to variations in metallurgy at the mine. Still, company-wide copper production will rise this year thanks to the additions of Carlota and Franke:

Quadra Mining: Annual copper production

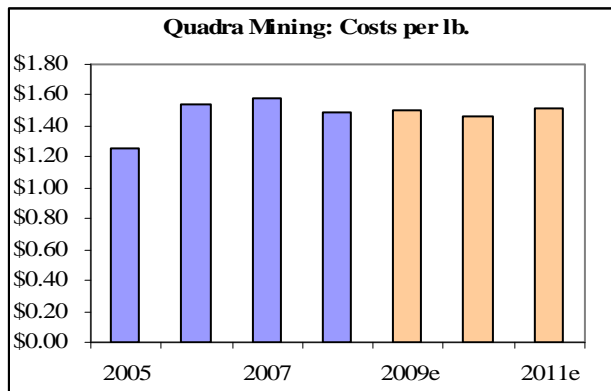
Mine	Country	Million pounds of copper/year							
		2004	2005	2006	2007	2008	2009e	2010e	2011e
Robinson	USA	32	126	118	134	147	140	138	138
Carlota	USA	0	0	0	0	0	45	65	65
Franke	Chile	0	0	0	0	0	45	65	65
	Total	32	126	118	134	147	230	268	268

Sources: Quadra Mining, Churchill Research

2) The value proposition for Quadra goes like this:

- By this summer, QUA will be producing 268 million lbs. annually at a cash cost of \$1.50/lb. Thus, every \$1/lb. increase in the copper price over \$1.50/lb. generates pre-tax, pre-SG&A cash flow of \$268 million;
- SG&A + stock-based comp should be about \$25 million/year. Depreciation will run \$25-30 million and the tax rate should be about 28%;
- There are 80 million shares outstanding;
- If you put all that together, Quadra's break-even copper price (for earnings) is about \$1.77/lb. Every dime increase in the copper price above \$1.77/lb. leads to about \$0.20/share in increased earnings.

3) Cash costs (on-site) at Robinson were \$1.49/lb. in 2008. We expect that figure to rise fractionally in 2009 as the new mines (Carlota and Franke) start up. Cash costs should then dip again by a few pennies in 2010 due to efficiency gains at Carlota and Franke. All costs should rise in 2011, so we're looking for \$1.51/lb. that year.



4) One of the knocks on Quadra has always been that the Robinson mine has a short mine life, but this really isn't true. Robinson has been running for 100 years, and while it currently has an official mine life of 10 years, management says it would be extendable well beyond that. Carlota has an 11-year mine life and the new Franke mine can run for a couple of decades at least.

5) This brings us to Sierra Gorda, which is now a world-class deposit at 19.5 billion copper equivalent pounds (NI 43-101 compliant). That's more than 12 times the size of the Robinson deposit. We are now valuing Sierra Gorda at \$0.01 per copper-equivalent pound in the ground (was \$0.025) for a total valuation of \$195 million.

Quadra Mining: Sierra Gorda copper resources

Sierra Gorda	Copper reserves (tonnes)	Copper EQ Grade	contained Cu EQ (mln. pounds)	Assuming 77% Recovery rate
Indicated	1,129,184,000	0.52%	12,935	9,960
Inferred	673,567,000	0.44%	6,529	5,027
totals	1,802,751,000	0.49%	19,464	14,988
Value at \$0.01/lb. Cu equivalent			\$195	

Sources: QUA, Churchill Research estimates

The official grade at Sierra Gorda is definitely on the low side at 0.49%, but that shouldn't present a problem for two reasons:

- A substantial portion of the deposit is higher grade: There are more than 2.6 billion copper-equivalent pounds in the deposit with an average copper-equivalent grade of

1.02%. So, Quadra could build a 260 million lbs/year operation (twice the size of Robinson) and run it for 10 years before ever having to deal with grades below 1.00%.

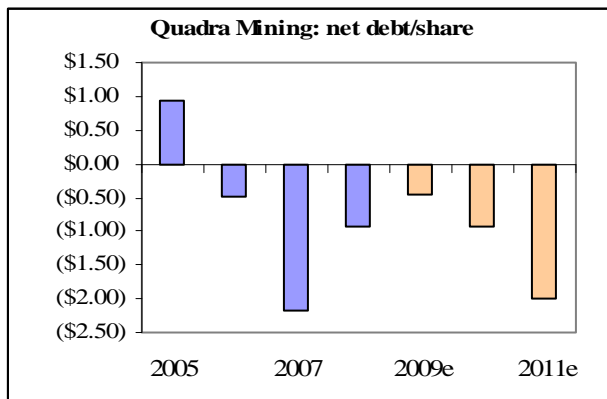
- Quadra is experienced at working with low-grade ore. The Robinson mine features copper grades in the 0.6% range.

To put the Sierra Gorda deposit in perspective, it's now bigger than the main deposits of all the other publicly-traded Andean copper juniors (Chariot, Candente, Inca Pacific, etc.) and it is also a bit larger than Baja Mining's huge Boleo deposit in Mexico and Equinox's Lumwana deposit in Zambia. The attractiveness of Sierra Gorda alone makes Quadra an acquisition target. Management says it has been discussing JV deals with 10 major firms (mostly Asian) to develop Sierra Gorda.

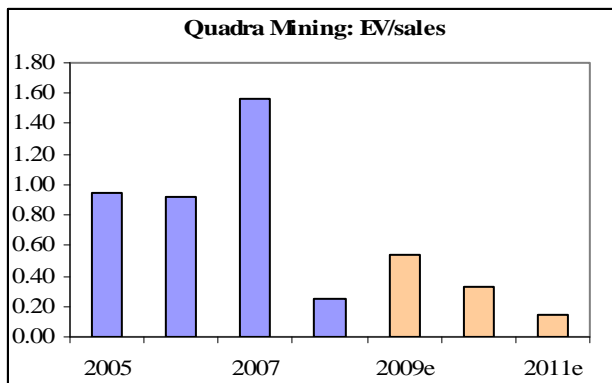
6) We are reducing the value we assign to the Malmbjerg moly deposit in Greenland to \$15 million (was \$48 million). QUA management recently did a radical write-down of the project's carrying value. Malmbjerg is permitted and has had a full feasibility study done – but building the mine only makes sense at a \$15/lb. moly price (and moly is currently about \$9/lb.).

7) We're modeling for capex of \$60 million/year through 2011, for continuing development at Robinson, completion of Franke and Carlota and further work on Sierra Gorda.

8) Quadra had net cash of about \$62 million as of December 31. As the chart below shows, net cash fell significantly in 2008, due to the cost of completing the Carlota mine – and due to the cost of a huge negative “true-up” in Q4 (as a result of a reversal of Q3 provisional pricing). We expect QUA to run slightly free-cash-flow negative this year (at \$1.75/lb. copper) but then start to pile up cash in 2010:



9) The EV/sales chart for Quadra looks quite amazing. It had gotten up to 2x during 2008, but now is around 0.5x – and it will fall still further if the copper price rebounds, as we expect:



Valuation: We're valuing Quadra at 9x expected 2010 earnings, plus \$0.74/share for net balance sheet cash, \$2.35/share for the Sierra Gorda project and \$0.18/share for Malmbjerg.

Top risks are: a) a plunge in the copper price, b) geologic difficulties at Robinson, c) trouble in completing and/or starting up the Franke and Carlota mines, and d) a surprise acquisition bid by QUA management. (Management wants to get up to *five* mines, from three now. It has some cash, so another acquisition could occur at any time.)

The Classical Insights portfolio holds Quadra Mining.

Mike Churchill

Bullets are archived at www.churchillresearch.com . Please call or email for a username and password.

Churchill Research, Inc.
105 N. Virginia Avenue, Suite 200
Falls Church, VA
22046
(703) 243-2670
(703) 340-4726
mike@churchillresearch.com
www.churchillresearch.com

This material is based on information from sources believed to be reliable but its accuracy or completeness is not guaranteed. This report is published solely for informational purposes and is not to be construed as a solicitation or offer to buy or sell any securities. Opinions expressed herein are subject to change without notice. This report may not be reproduced or distributed without the permission of Churchill Research Inc.

The Classical Insights portfolio is Mike Churchill's own brokerage account, held at UBS. The Classical Insights Fund LP is a long/short hedge fund. The Classical Insights Fund LP and employees of Churchill Research Inc. can and do hold positions and trade securities mentioned in this report. We try to inform clients of trades in new positions in the Classical Insights portfolio prior to those being made. Subsequent trades are sometimes done without notice. The Classical Insights Fund will hold positions different from the Classical Insights portfolio.