

BUSINESS ANALYSIS REPORT

on

PUDA COAL **(NYSE AMEX:PUDA)**

Geoinvesting LLC

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Introduction

Puda Coal (NYSE AMEX:PUDA) grabbed our attention at the beginning of March 2011 during our continuing effort to potentially allocate funds to a very select number of ChinaHybrid companies attempting to survive in a challenging environment that has not been kind to Reverse Take Over firms (RTO) . We felt that solid analyst estimates combined with the strong pricing of its most recent public offering on December 8, 2010 substantiated a complete review of the company, which we had hoped would validate investor optimism. **To our surprise**, during our investigation of PUDA's SAIC filings we discovered:

- A corporate ownership structure that is **materially different** from the structure reported to the SEC in the Company's 2010 Form 10-K filed on March 16, 2011.
- Numerous material and undisclosed share ownership transfers since the Company listed its shares on the Nasdaq exchange in September 2009, that bring into question the claims of public shareholders on at least 50% of PUDA and its assets, earnings and cash flows.

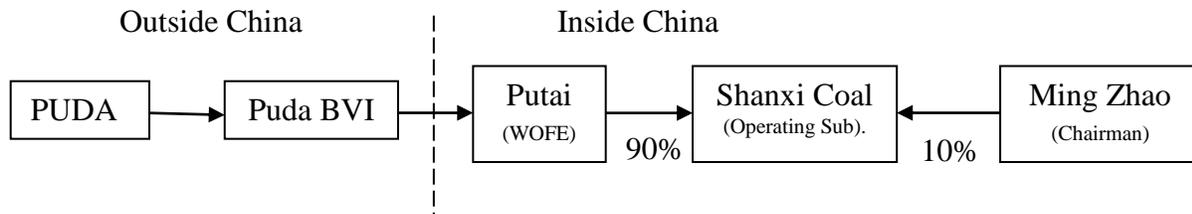
Investors should not take this issue lightly. Whether or not one wants to reference Warren Buffet, as many bullish ChinaHybrid advocates do or Graham & Dodd, we can all agree that a staple to equity investing is that proper valuation ultimately boils down to the **claims to future company cash flows**. This claim is dictated by an ownership in shares of a company that U.S. investors **rarely have to question** when purchasing domestic equities.

We are now finding that ownership structure **misrepresentations** have been a recurring theme in the stories of many questionable Chinese RTO firms companies we have investigated. Subaye (NASDAQ:SBAY) ([see report](#)), China Education (NYSE Amex:CEU) and China Redstone (OTCBB:CGPI) ([see report](#)) are just a few companies whose share prices have dropped accordingly.

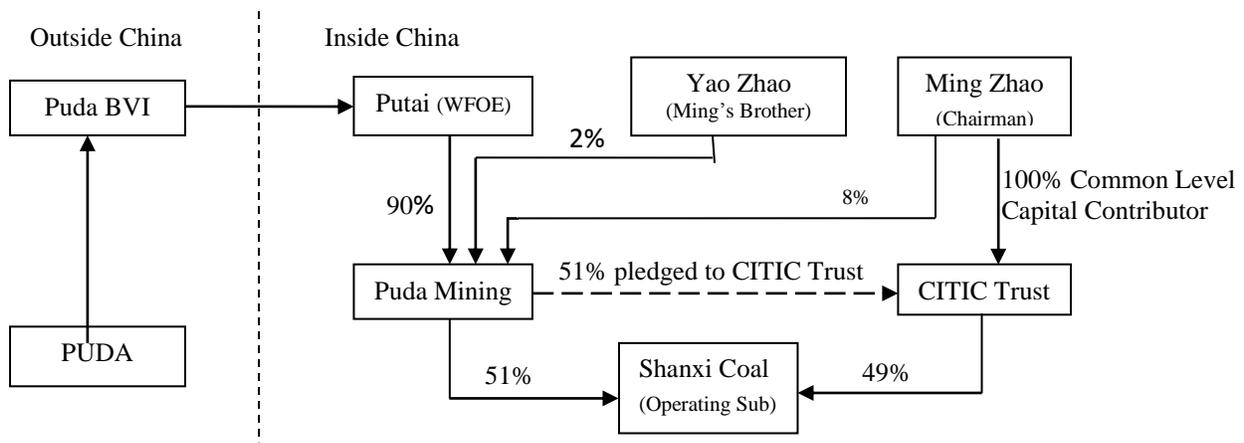
Now, we find that the PUDA's claims to past, current and future cash flows may have been compromised to a point where we believe the company's share price could be cut by at least 50% from current levels.

Corporate Structure Discrepancies

Indeed, PUDA entered the U.S. capital market with the indirect ownership of PRC mining operations (Shanxi Coal) through a WOFE (Putai) which directly owns 90% of the shares of Shanxi Coal. In the most recent 10K (March 16, 2011), PUDA still claimed the same corporate structure without reflecting the substantial changes that we indentified. The corporate chart presented in the 2010 10K is as follows:



However, since September 3, 2009, the PUDA ownership structure has been modified numerous times to where U.S. investors, through the indirect ownership of the WOFE, currently only have claim to no more than 45.9% of Shanxi Coal's interests, or potentially less if the consolidation of operations is disallowed under U.S. GAAP accounting standards. The corporate structure of PUDA at the end of 2010 can be more accurately depicted as follows:



For the sake of time, we will attempt to keep this story as simple as possible so that investors can **quickly understand the very serious implications that are present.**

Key points

- The sudden changes in the corporate structure that began in September of 2009 **coincided with new PRC regulations** dictating the size that a company must be in order to consolidate/purchase smaller mines. A company with consolidated revenues under the minimum threshold could be forced to sell its interest to larger “qualified” consolidating firms.

Simply put: **eat or be eaten**. Possibly realizing that it could not raise enough funds from already generous investors in the U.S. capital market to grow its revenue base or take advantage of new industry dynamics, PUDA eventually found its pot of gold in a large investment trust located in the China (CITIC Trust Co., Ltd.). CITIC Trust agreed to invest around RMB 3 billion into Shanxi Coal in 2010.

But nothing comes for free. At the expense of gullible U.S. investors, **49%** of the shares of Shanxi Coal were transferred to the trust, while the remaining **51%** shares of Shanxi Coal were pledged to the trust. Shanxi coal is also required to pay annual interest and/or dividend on the RMB 3 billion CITIC Trust investment.

- U.S investors no longer have a 90% interest in PUDA’s PRC mining **operations**
- PUDA has not clearly disclosed the series of material ownership changes in its SEC filings.

Implications of Our Findings

- It appears that U.S. Shareholders now **only have claim to 45.9%** of Shanxi cash flows. (90% * 51%).
- GAAP accounting rules may dictate that profits from Shanxi Coal cannot be consolidated into PUDA (U.S.A), which could further jeopardize claims on cash flows.
- It looks like the best case scenario is that only 51% of Shanxi Coal’s cash flow may legally flow to U.S. investors if Ming Zhao’s and Yao Zhao’s pledged 10% shares of Puda Mining make their way back to Putai.
- Shareholder equity of PUDA may have been significantly overstated.
- Interest expense may be understated.
- Auditors may have to consider restating past financial statements.
- Investors, especially those who participated in the December 2010 money raise, may have merit to pursuing legal actions against the company for lack of disclosure.

Valuation

The math here is rather simple. If we assume that U.S. investors ...

- Have a right to 45.9% ($90\% * 51\% = 45.9\%$), of Shanxi Coal's cash flows (ownership is essentially cut in half).
- Still have faith in analyst estimates.
- Are still comfortable valuing PUDA shares at around 6 times the 2011 mean analyst EPS estimate of \$1.70.

...we calculate that PUDA shares should approach \$5.10 ($6 * 0.85$). If cash flows cannot be consolidated, the valuation scenario could be direr. In the event that Shanxi Coal cannot pay the required annual interest and/or dividends to CITIC Trust, the pledged 51% shares of Shanxi Coal owned by Puda Mining may be executed by CITIC Trust to satisfy this obligation.

Investors will most likely want to know if PUDA can remedy the current ownership structure. The answer lies in the probability of CITIC Trust's share stake finding its way back to U.S. investors. At first glance, the chances do not look promising; especially in the near term as the trust agreement covers a time frame from 3 to 10 years. We also do not know the terms and monetary cost(s) related to the reversal/unwinding of CITIC Trust's ownership.

Moreover, if there is a buyout provision to unwind the CITIC Trust agreement with CITIC, a bigger question may be - will U.S. investors unknowingly be asked to foot the bill, potentially masked by a claim that PUDA desires to raise money to "purchase" more mines? Lastly, how can we properly value companies that we may not be able to trust?

Exhibit

In the PUDA corporate structure, there are two important companies, one is Shanxi Coal, the operating entity of PUDA and the other one is Puda Mining, which joined the corporate structure recently. These two companies both have complex corporate history. We list its important corporate structure change as follows:

1. Ownership Interest Transactions History – Shanxi Coal

- June 7, 1995, as stated in the SEC document, Shanxi Coal was established with the name Shanxi Huazhiying Resource Trade Co., Ltd..
- Jan 24, 2006, Shanxi Coal changed to its current name.
- Nov. 28, 2006, Putai became 51% shareholder of Shanxi Coal. Ownership: Putai, 51%; Ming Zhao, 39.2% and Yao Zhao, 9.8%.
- Sep. 13, 2007, the ownership of Shanxi Coal changed to Putai, 90%; Ming Zhao, 8% and Yao Zhao, 2%.
- September 3, 2009, Putai transferred its 90% ownership of Shanxi Coal to Ming Zhao. Yao Zhao transferred his ownership of 1% of Shanxi Coal to Ming Zhao and the other 1% to Wei Zhang.
- March 25, 2010, Shanxi Longxin Coal Co., Ltd. (“Longxin”), paid RMB 200 million (approximately \$29.3 million) for 66.6% equity interest in Shanxi Coal. Ownership: Longxin, 66.6%; Ming Zhao, 33.1%; Wei Zhang, .3%.
- April 14, 2010, Longxin invested additional RMB 200 million (\$29.3 million) in Shanxi Coal in exchange for 13.4% additional equity. Ownership: Longxin, 80%; Ming Zhao, 19.8%; Wei Zhang, .2%.
- April 26, 2010, Shanxi Longxin Coal Co., Ltd. withdrew from Shanxi Coal. Ownership: Ming Zhao, 99%; Wei Zhang, 1%.
- July 22, 2010, Ming Zhao transferred 49% shares of Shanxi Coal to CITIC Trust Co., Ltd. “CITIC Trust”. Ownership: Ming Zhao, 50%; CITIC Trust, 49%; Wei Zhang, 1%.

Jan. 26, 2011, Puda Mining claimed that Ming Zhao and Wei Zhang planned to transfer and/or transferred 15% of Shanxi Coal shares to Puda Mining. Puda Mining has already pledged the 51% share to CITIC Trust for guarantee the investment of CITIC Trust. (As this is a most recent transaction, the SAIC files do not include the share transfer agreement between Puda Mining and Ming Zhao and Wei Zhang yet.)

2. Ownership Interest Transactions History – Shanxi Puda Mining Co., Ltd.

- Aug 7 2002, Puda Mining, formerly known as Shanxi Ganglian Stainless Steel Co., Ltd., was established.
- Sep. 12, 2006, Shanxi Coal became the sole shareholder of Puda Mining, known at the time as Shanxi Dongyang Mining Co., Ltd.
- April 8, 2010, Shanxi Coal transferred its 100% interest in Puda Mining to: Putai, 90%; Ming Zhao, 8%; Yao Zhao, 2%.
- Dec. 6, 2010, Puda Mining changed to its current name, Shanxi Puda Mining Co., Ltd.
- In Jan, 2011, Putai injected RMB 477,50 million to Puda Mining and the total paid-in capital of Puda Mining increased to RMB 500 million. (As this is a most recent transaction, we still not have full set documents but one Capital Verification Report from the SAIC files.)

Disclosure: Short PUDA stock and long PUDA puts.

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