

JPM-pp1

Asia Pacific Equity Research

27 May 2015

Zijin Mining Group - H (2899 HK)

Neutral

Price: HK\$2.99

26 May 2015

Price Target: HK\$3.00

PT End Date: 31 Dec 2015

Expect A-share placement and overseas acquisitions to be earnings dilutive in near term

Zijin has proposed an A-share placement of up to RMB10b for acquisitions of a copper mine in Congo and a gold mine in Papua New Guinea. In addition, the company also announced a strategic partnership with Barrick Gold. While we view these events as positive, given potential for improved financial strength and increased mining reserves, we view the impact on FY15 earnings is dilutive. In the near term, we see improved sentiment from Southbound trading to continue to lend support to Zijin-H, given a significant A/H discount (c120%), but fundamentally, at 1.8x FY15E P/B, Zijin is fairly valued relative to its global peers (2.0x P/B). With gold prices range-bound in a strengthening dollar environment, we stay N rated.

- A-share placement for overseas acquisitions.** Zijin announced yesterday a proposal to raise RMB10Bn by issuing up to 2,421m A-shares at RMB4.13 or above, to no more than 10 strategic investors. The proceeds will be used for: 1) acquisitions of Ivanhoe's Komao copper mine (49.5% stakes) in Congo and Barrick Gold's Porgera gold mine (50% stakes) in Papua New Guinea, 2) development of its Kolwezi copper mine in Congo, 3) construction of Zijinshan gold and copper floatation plant, and 4) working capital. In addition, the company announced a strategic partnership with Barrick Gold (covered by John Bridges, see [note](#)). Both the A-share placement and the two acquisitions are subject to government approval.
- 11% earnings dilution.** We believe the two acquisitions will have minimal impact on Zijin's FY15 earnings, given that Komao lost USD53m and Porgera posted a small USD40m profit in 2014. Yet, the new share placement, if materialized, should see an 11% EPS dilution although net gearing (ND/E) should improve by c30ppt to c50% (from 84%) on our 2015 estimates.
- Acquisition of Komao copper mine.** Zijin has agreed to purchase 49.5% stakes of Komao copper mine from Ivanhoe for USD412m. This implies a transaction EV/resource of USD59/t. Komao is a greenfield discovery in Congo, with a copper resources (indicated) of 19.7Mt grading 2.67% copper. The mine is designed to produce 100kt of contained copper in phase 1 (first 5 years) and 300kt of blister copper in phase 2, with no timeline provided. In 2014, Komao posted a net loss of USD53m. Zijin sees good synergy as Komao is located 25km away from its Kolwezi copper mine. Kolwezi is a greenfield with designed copper output of 52ktpa and total resource of 1.5Mt grading 4% copper. Construction period is 2.5 years, with total capex of USD577m and project IRR of 17%, according to management.
- Acquisition of Porgera gold mine.** Zijin has also agreed to purchase a 50% stake in the Porgera gold mine from Barrick Gold for USD298m, implying a transaction EV/reserve of USD250/oz and PE of 14.8x 2014 earnings. Porgera is operational with 2014 gold output of 0.5moz and total gold reserve (proved + probable) of 3moz, grading 5.5g/t gold. According to WoodMac, Porgera is a high cost gold producer due to its remote location, difficult operating conditions (located in rugged mountainous terrain, Papua New Guinea). That said, Porgera posted a net profit of USD40m in 2014, with an all-in cash cost of USD996/oz.
- Retain Neutral.** We have an N rating on Zijin as we consider the stock fairly valued fundamentally at 1.8x FY15E PB (global peers' 2x). While we believe Zijin's "internationalization" strategy supports business growth, we estimate minimal near-term earnings impact with most of the new mines acquired at development stage and facing operating issues. We remain cautious about Zijin's 2017 output targets: gold of 67 tonnes (+97% from 2014 levels), copper of 330Kt (+138%) and zinc/lead of 360Kt (+236%).

Table 1: Use of A-share placement proceeds

Project name	Total investment (RMBm)	Amount funded by IPO proceeds
Construction of Congo Kolwezi copper mine	3,529	3,223
Acquisition of Congo Komoa copper mine (49.5% stakes)	2,517	2,517
Acquisition of Progera gold mines (50% stakes)	1,821	1,821
Construction of Zijinshan gold and copper floatation plant	444	444
Working capital	1,995	1,995
Total	10,307	10,000

Source: Company data, J.P. Morgan

Table 2: Komoa's financial highlight

USDm	2014	2013
Total assets	16	15
Total Liabilities	336	253
Net assets	(320)	(267)
Revenue	-	0
Net profits/(losses)	(53)	(81)

Source: Company data, J.P. Morgan

Table 3: Porgera's financial highlight

USDm	2014	2013
Total assets	1,147	1,582
Total Liabilities	1,304	1,781
Net assets	(156)	(200)
Revenue	644	657
Net profits/(losses)	40	(1,017)

Source: Company data, J.P. Morgan

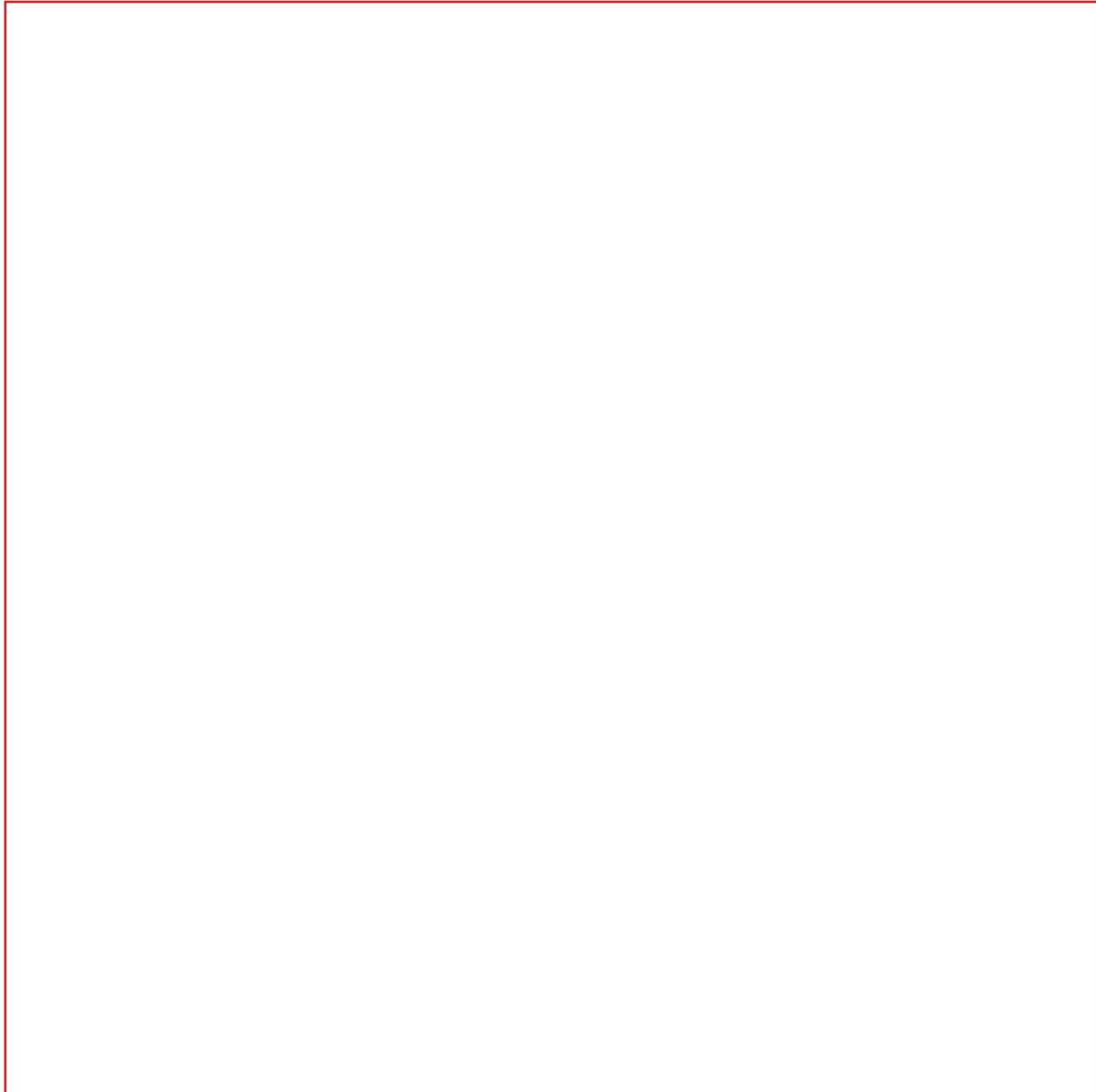
Figure 2: Komoa's location map





Source: Wood Mackenzie, J.P. Morgan

Figure 1: **Porgera's location map**



Source: Wood Mackenzie, J.P. Morgan

Investment Thesis

Zijin is China's second-largest gold and copper miner. Within our gold coverage, the company is most vulnerable to the copper price

shock, with gold and copper (from its mines and byproduct credits) accounting for 55% and 30% of its revenue. While we believe the company's effort over recent years to replenish gold assets and reduce costs will help Zijin to better weather the commodity storm, Zijin will be negatively affected should copper prices remain at current levels. Near term, we see improved sentiment from Southbound trading to continue to lend support to Zijin-H, given a significant A/H discount (c120%), but fundamentally, at 1.8x FY15E P/B, Zijin is fairly valued relative to its global peers (2.0x P/B). Stay N rated.

Valuation

Our Dec-15 price target for Zijin-H of HK\$3.0 equates to a 1.8x P/BV, based on our FY15 estimates. This is based on a blended average of P/BV-ROE valuation, EV/EBITDA multiple, P/E multiple, DCF-based NPV and EV/reserve method.

Risks to Rating and Price Target

- **Upside risk:** Stronger-than-expected gold prices, better-than-expected cost performance, faster-than-expected production growth, ongoing share buybacks, higher dividend distribution and M&As.
- **Downside risk:** Weaker-than-expected gold prices, higher-than-expected cost pressure, slower-than-expected production growth, worse-than-expected working capital control, higher-than-expected capex requirement.

Asia Metals and Mining

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10-Mar-07	OW	4.12	6.04

11-Jul-07	OW	5.18	7.40
10-Sep-07	OW	8.84	10.80
29-Oct-07	OW	13.04	16.00
30-Jul-08	OW	6.32	9.20
19-Sep-08	N	4.04	5.80
25-Oct-08	N	1.59	3.83
22-Mar-11	N	6.07	--
03-Aug-14	OW	2.01	2.45
15-Jan-15	N	2.47	2.45
23-Jan-15	N	2.62	2.20
07-May-15	N	2.99	3.00

<http://gfd-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=503924&shareClassServerId=4&chartDesignation=1&actionType=C>

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