

山东黄金 [1787 HK]

中国金矿商龙头；资产负债表稳健；首次覆盖并予「买入」

山东黄金是金价上涨的主要受益者。国际金价近期呈上升趋势，但按美元计算，年初至今仍下跌6%。我们看好金价，预计到2019年将较目前水平上涨5%。而由于山东黄金有高经营杠杆，加上产量稳定增加，料将成为受益者。我们对2019-2020年的金价预测为每克人民币287元（约合1,295美元/盎司），比当前水平高出5%，意味着山东黄金每股盈利在2018-2020年的年均复合增长率应达到22%以上。我们首次覆盖山东黄金，并予买入评级，目标价为23.20港元，上升空间约30%。

投资亮点

看好金价走势：考虑到贸易战带来不确定性，加上全球黄金产量持平或下降，我们看好金价的中长期走势。基于2018年-19年金价为1,295美元/盎司的预测，我们估计山东黄金2019年净利润将较市场共识预测高约17%。

阿根廷合资企业提供长期增长潜力：山东黄金持有50%股权的Veladero矿山与阿根廷Barrick Gold合约占公司上半年总产量的24%左右。虽然Veladero矿山处于满产状态，但Barrick JV拥有在阿根廷El Indio地带进一步勘探的权利，开辟了与Barrick进一步合作和交易的可能性。

母公司提供中国黄金资源：公司控股股东山东黄金集团在山东省拥有40年的金矿开采和勘探经验。2017年3月，山东黄金集团在三山岛西岭矿区发现了一个1,000多米深的世界级矿体。资源含金量约为12,300.2千盎司，约为383吨，品位为4.5克/吨。山东黄金拥有向山东黄金集团收购相关资源的优先购买权。

强劲的资产负债表为并购提供条件：继山东黄金最近在香港上市后，公司目前净负债权益比率较低，约为53%，有助公司进行进一步并购。

H股估值吸引：我们的2019年每股盈利预测较市场对H股的共识预测高出18%。然而，我们的每股盈利预测较A股分析师估计的低3%。其中一个原因可能是A股分析师尚未对计入山东黄金近期发行H股带来的摊薄效应。根据我们的数据，山东黄金H股的2019年市盈率为19.2倍。我们认为山东黄金的H股估值吸引，而根据我们预测的2018-2020每股盈利复合年增长率22%计算，我们给予公司的目标2019市盈率为25倍，目标价为23.20港元。风险因素包括：(i) 国际金价下跌；(ii) Veladero矿的环保问题变得复杂；(iii) 山东黄金集团抵押公司股份；(iv) 持有主要勘探及采矿许可证的是山东黄金集团，而非山东黄金。

	2016	2017	2018E	2019E	2020E
收入(百万人民币)	50,199	51,041	52,182	52,736	53,583
增长(%)		1.7%	2.2%	1.1%	1.6%
净利润(百万人民币)	1,296	1,135	1,260	1,775	2,037
增长(%)		-12.5%	11.1%	40.8%	14.8%
每股盈利(人民币)	0.70	0.61	0.63	0.81	0.94
增长(%)		20%	4%	30%	15%
市盈率(倍)	22.4	25.5	25.0	19.2	16.7
市净率(倍)	1.9	1.8	1.5	1.5	1.4
每股派息(人民币)	0.10	0.12	0.13	0.16	0.19

来源：公司年报，中国银河国际证券研究部

備註：根據中國會計準則。山東黃金A股是使用中國會計準則，而山東黃金H股是使用IFRS，這或導致報告數據出現少許落差。

采矿行业

买入 (首次覆盖)

收盘价：17.82 港元 (2018年12月6日)

目标价：23.20 港元 (+30%)

股价表现



市值(H股)	63.60亿港元
市值(A股)	人民币524.45亿元
流通在外股数(H股)	3.56亿股
流通在外股数(A股)	18.57亿股
自由流通量(总数)	33%
52周高位(H股)	18.22港元
52周低位(H股)	13.00港元
三个月日均成交额(H):	350万美元*
三个月日均成交额(A):	7,800万美元
主要股东:	SDG Group (38%)

来源：公司、彭博

备注：*H股只计算10月上市至今

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SHANDONG GOLD [1787 HK]

Leading PRC Gold Producer with a Strong Balance Sheet

Shandong Gold is a major beneficiary of higher gold prices. International gold prices have recently been trending up but in USD terms, they are still down 6% YTD. We are constructive on gold prices and see them trending up 5% from current levels into 2019. Shandong Gold, with its high operating leverage and increasing production, will be a beneficiary. Our gold price projection of RMB287 per gram (~US\$1,295/oz) in 2019-2020, or 5% above current levels, means Shandong Gold should achieve a 22%+ EPS CAGR in 2018-20. We initiate our coverage on Shandong Gold with a BUY rating with a price target of HK\$23.20, or ~30% upside.

Investment Highlights

Positive on the gold outlook: In light of trade war uncertainties, and flat-to-declining global gold production, we are constructive on the medium- to long-term outlook on gold prices. Using our house view of RMB287 per gram (~US\$1,295 per oz) in 2018-19, we estimate Shandong Gold's 2019 net profit will be ~17% higher than consensus.

Argentina JV to provide long-term growth potential: Shandong Gold's 50%-owned Veladero mine with Barrick Gold in Argentina accounted for ~24% of the Company's total 1H18 production. While the Veladero mine is operating at full capacity, the Barrick JV includes further exploration rights in Argentina's El Indio belt, opening up the possibility of further cooperation and deal flow with Barrick.

PRC gold resources available from parent: The Company's controlling shareholder, SDG Group, has 40 years of gold mining and exploration experience in Shandong Province. In March 2017, SDG Group Co. discovered a world-class ore body more than 1,000 meters underground in the Sanshandao Xiling mine area. The resource gold content is approximately 12,300.2 koz, or ~383 tons, with a grade of 4.5 grams/ton. Shandong Gold has first right of refusal on acquiring gold mines from SDG.

Strong balance sheet offers room for M&A: Following the Company's recent IPO in Hong Kong, Shandong Gold currently has a conservative net debt to equity ratio of ~53%, offering potential for further M&A.

H shares attractively priced: Our 2019 EPS estimates are at 18% above H Share consensus. Our EPS estimates are 3% below A Share analyst estimates, however. One reason could be that A Share analysts have not yet accounted for dilution from Shandong Gold's recent H Share issuance. By our numbers, Shandong Gold H Shares trade at 19.2x 2019 PER. We think Shandong Gold's H Shares are attractively priced, and we value the Company at 25x 2019 PER, based on our forecast 2018-2020 EPS CAGR of 22%, for a target price of HK\$23.20. Risk factors include: (i.) a decline in international gold prices; (ii.) environmental complications at the Veladero mine; (iii.) SDG Group's pledged shares in the Company; and (iv.) key exploration and mining permits held by SDG Group rather than with Shandong Gold.

	2016	2017	2018E	2019E	2020E
Revenue (RMB Mn)	50,199	51,041	52,182	52,736	53,583
Growth (%)		1.7%	2.2%	1.1%	1.6%
Net Profit (RMB Mn)	1,296	1,135	1,260	1,775	2,037
Growth (%)		-12.5%	11.1%	40.8%	14.8%
EPS (RMB)	0.70	0.61	0.63	0.81	0.94
Growth (%)		0%	20%	4%	30%
PER (x)	22.4	25.5	25.0	19.2	16.7
PBR (x)	1.9	1.8	1.5	1.5	1.4
DPS (RMB)	0.10	0.12	0.13	0.16	0.19

Source: Company Annual Report, CGIS Research

Note: Figures based on PRC GAAP. PRC GAAP is used for Shandong's A Shares, while IFRS is used for the Company's H Shares, which results in small differences in reporting.

Mining Sector

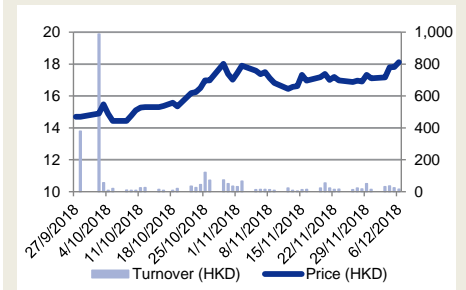
BUY

 (Initiation)

Close: HK\$17.82 (Dec 6, 2018)

Target Price: HK\$23.20 (+30%)

Price Performance



Market Cap (H Share)	HK\$ 6,360m
Market Cap (A Share)	RMB 52,445m
Shares Out. (H Share)	356m
Shares Out. (A Share)	1,857m
Free Float (Total)	33%
52W High (H Share)	HK\$ 18.22
52W Low (H Share)	HK\$ 13.00
3M Avg. Daily T/O (H):	US\$3.5m*
3M Avg. Daily T/O (A):	US\$78m
Major Shareholders:	SDG Group (38%)

Sources: Company, Bloomberg

Note: * October – Present only on H Share Listing

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CONSTRUCTIVE ON GOLD PRICES

There is considerable debate on whether there will be a sustainable rally in gold prices. International spot gold prices have rebounded 5.4% from the 2018 low of US\$1,174 per oz, but are still down ~6% YTD. In USD, the price is still ~35% below the record high of US\$1,900 per oz reached in Sept. 2011. We have a positive outlook on gold due to the ongoing trade war dispute and uncertainty as the 10-year bull market in U.S. equities begins to subside. We believe future gold prices will be decided by a confluence of factors as follows:

MAJOR POSITIVE FACTORS

1. **Buying from emerging market central banks:** Central banks in Asia and Eastern Europe increased their purchases of gold in 2018 for the first time in five years to 450 metric tons, up from 375 tons in 2017. The last time central banks added significantly to their reserves was in 2013, when banks increased their reserves by 646 tons, the most significant increase in several decades.
2. **2019 global gold production is expected to remain flat or decline:** Although gold mining capex in the industry has increased significantly since 2013, gold production volume from mines has stayed constant over the past several years. Global gold production is expected to decline in 2019.
3. **Gold as a hedge:** Investors may turn to gold as a hedge against a decline in the U.S. bull market, which has continued for nearly 10 years. In emerging markets, gold has outperformed EM currencies (including the RMB) and other commodities YTD.
4. **Gold lags behind other commodities on a five-year basis:** While gold is perceived as a store of value, in the past five years it has underperformed relative to other commodities.
5. **Potential USD peaking:** While the USD has appreciated YTD, a weakening stock market and weaker employment data could induce the Fed to slow or stall rate hikes. While the Federal Reserve operates independently from the White House, US President Trump has vocally expressed his desire for a weaker USD and slower rate increases.

NEGATIVE FACTORS

1. **High interest rates:** Higher interest rates make gold less attractive to hold in a high-yield environment.
2. **Cost of production coming down:** In recent years major gold producers have tightened their cost structure and are currently producing at lower cash costs.
3. **Global liquidity contraction:** In the event of an extreme financial panic, as in 2008, gold may actually decline in value as investors and banks sell gold for liquidity.

INTERNATIONAL VS. CHINA SPOT PRICES

China gold miners will be beneficiaries of the recent pickup in gold prices. The ASPs for China gold producers are largely based on the gold price in Shanghai, which tracks the international price quite closely (Figure 1).

The exact conversion rate between the international and China spot gold prices can fluctuate due to volatility in exchange rates, but the China gold price generally tracks the international gold price within a reasonably narrow range. The Shanghai spot price on Dec. 6 was ~RMB275/g, which is trading at less than a 1% premium to the international close of US\$1237/oz. Shanghai gold spot prices are flat YTD in RMB terms, and down ~5.5% in USD terms.

Figure 1: International Spot (USD/Oz) vs. Shanghai Spot Gold Price (translated to USD/Oz)



Source: Bloomberg, CGIS Research

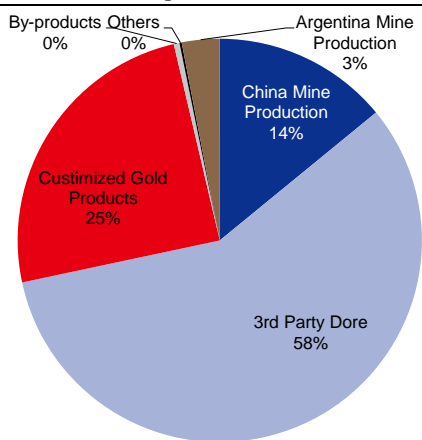
GOLD MINING: SHANDONG GOLD'S EARNINGS DRIVER

Shandong Gold, based in Jinan, Shandong province, is the largest listed PRC gold producer among China and HK listed companies by mine output. Shandong Gold mines ~29 tpa in China (~35.5 tpa including Argentina), accounting for ~7% of China's total gold production. Other key players include Zijin Mining (~14 tons PRC production, 37 tons including foreign mines), Zhaojin Gold (~20.4 tons) and Zhongjin Gold (~25 tons).

Mined gold accounts for ~17% of Shandong Gold's revenue, but substantially all of the Company's profits. The Company's refining segment, which includes 3rd party dore (a semi-refined gold product) and customized gold products, is done on a cost plus basis with thin margins.

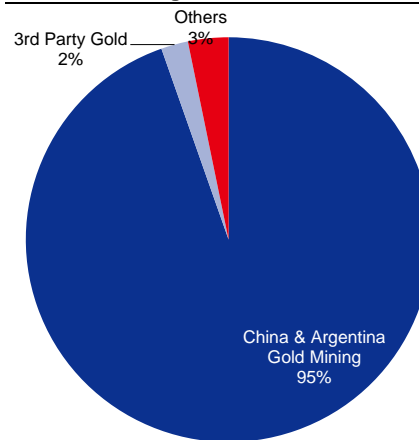
Figure 2: Shandong Gold's Mining & Smelting Operations

2017 Gold Mining as a % of Revenue



Source: Company Reports, CGIS Research

2017 Gold Mining as a % of Gross Profit



Source: Company Reports, CGIS Research

Shandong Gold's PRC Mines

Shandong operates 12 PRC mines, 9 of which are in Shandong province. The Company also purchased a 50% stake in Barrick's Veladero mine in Argentina in 1H18. Reserves attributable to Shandong Gold are 10,651 koz (equivalent to approximately 331.3 tons). Since its inception, the Company has operated primarily in Shandong province, the largest gold producing province in China in terms of 2017 gold mine production volume, and gradually expanded into the Inner Mongolia autonomous region, Gansu province and Fujian province.

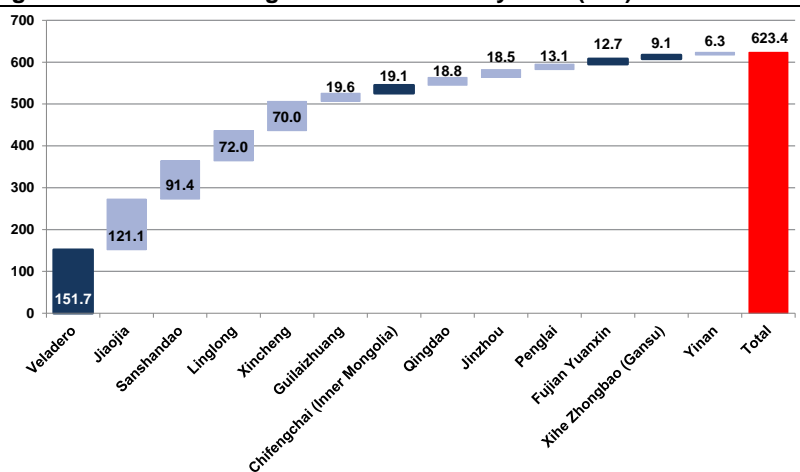
Figure 3: 1H18 Shandong Gold's Mine Production and Reserves

	Ownership	Gold Production (Equity Basis)	Gold Reserves (100% basis)	Gold Reserves (Equity Basis)	Life of Mine
	(%)	(koz)	(koz)	(koz)	(year)
Sanshandao	100%	91	2,290	2,290	13
Jiaojia	100%	121	950	950	4
Xincheng	100%	70	2,630	2,630	11
Linglong	100%	72	550	550	4
Guilaizhuang	71%	20	80	60	2
Jinzhou	60%*	13	90	50	5
Qingdao	100%	19	670	670	9
Penglai	100%	19	210	210	5
Yinan	100%	6	10	10	0
Shandong Province		431	7,480	7,420	
Chifengchai	74%	19	150	110	3
Fujian Yuanxin	90%	13	100	90	4
Xihe Zhongbao	70%	9	450	310	20+
Other Provinces		41	700	510	
China Subtotal		472	8,200	7,950	
Veladero Mine	50%	152	5,401	2,701	7
Total		623	13,601	10,651	

Source: Company Reports, CGIS Research

Note: * Mining rights owned by Jinzhou Group and its 100% and 90% owned subsidiaries (Fuling Mining and Qianling Mining). Shandong Gold holds 60.43% interest in Jinzhou Group, so effectively holds 60.43% and 54.39% of Fuling Mining and Qianling Mining

Shandong Gold's four flagship China Mines were among the 10 largest gold mines in the PRC in terms of 2017 gold mine production volume, with the Company's Jiaojia Gold Mine, Sanshandao Gold Mine, Xincheng Gold Mine and Linglong Gold Mine ranking first, second, fifth and sixth, respectively, among gold mines in China with production of 233.8 koz, 209.1 koz, 139.7 koz and 130.6 koz, respectively. The life of the Company's China mines ranges from 4 to 13 years, but Shandong Gold's flagship mines have strong potential to increase reserves though increased exploration. The Company's China mines enjoy a low cash cost structure of ~US\$682 per oz., or ~RMB150 per gram.

Figure 4: 1H18 Shandong Gold Production by Mine (koz)


Source: Company Reports, CGIS Research

Veladero: Shandong Gold's Argentina JV

Outside of China, Shandong Gold operates the Veladero mine in San Juan, Argentina as a 50/50 JV with Barrick

Gold. The Company purchased its 50% stake for ~US\$990m on June 30, 2017 and consolidates its 50% proportion of revenues and costs. The Veladero mine is the largest producing gold mine in Argentina and in South America, producing 641 koz in 2017. Veladero is currently the largest foreign gold mine owned by any PRC company. Veladero's cash costs are slightly higher than the Company's PRC mines, with costs of ~US\$836 per oz, or ~RMB180 per gram. The mine is currently Barrick's highest cost mine. Veladero currently has a mine life of ~7 years, but Shandong Gold management believes there is further potential for new discoveries at the mine, and plans to increase exploration activity.

Long Term Opportunity – Pascua Lama and Other Production in Argentina

Barrick and Shandong are likely to increase cooperation in Argentina. As part of the JV agreement, Barrick and Shandong Gold have formed a working group to explore the joint development of the Pascua Lama deposit. The Pascua Lama project is an open pit operation holding gold, silver, and copper. Pascua Lama, which straddles the Chile-Argentina border, has been closed since 2013, when a Chilean court ordered Barrick to halt construction over environmental concerns. In Jan. 2018, Chile's environmental authority ordered a definitive closure of the Pascua Lama project, but did not revoke the mine's environmental permit, leaving room for future negotiation. Barrick subsequently took a ~US\$429m write down on the mine.

While Chile's environmental authority continues to impose obstacles to the mine's development, Argentina, where one fifth of the deposit is located, supports the project. The scale of Pascua Lama is potentially larger than Veladero. If the mine goes into production, Pascua Lama would generate 800-850k ounces of gold per year, in addition to 35 million ounces of silver, with a 35-year mine life.

Beyond Pascua Lama, Barrick and Shandong Gold will explore further investment opportunities in the El Indio Gold Belt on the border of Argentina and Chile.

STRONG BALANCE SHEET ALLOWS FOR M&A

Following the Company's recent IPO in Hong Kong, which raised HK\$4.8bn (~RMB4.2bn), Shandong Gold currently has a net debt to equity ratio of ~53%, including gold leasing. This might allow more M&A activity in the future, including acquiring projects from Shandong's parent, SDG Group, which owns 38% of the Company.

Figure 5: Shandong Gold's Mine Production and Reserves

Company	Debt to Equity*
Shandong Gold	53%
Zijin Mining	80%
Zhongjin Mining	98%
Zhaojin Mining	111%

Source: Company Annual Reports, CGIS Research

Note: * Gold leasing and preferred equity calculated as debt

GROWTH OPPORTUNITIES VIA PARENT

Shandong Gold has a track record of acquiring gold assets from its parent company, SDG Group. SDG Group is a large SOE, controlled by Shandong SASAC, with over 40 years of operating experience in gold mining. SDG currently holds gold resources of 1699.5 tons vs. the Company's ~831 tons (PRC only). SDG group has historically provided Shandong Gold with M&A opportunities, which has contributed to the Company's production growth.

Since Shandong Gold's IPO in 2003, the Company has completed 17 acquisitions, growing from 2.8 tons of production to over 35 tons per annum today. Many of these acquisitions came from SDG Group. SDG Group typically injects mining and exploration assets into Shandong Gold once applications for boundary and capacity expansion are completed.

SDG group holds a number of gold resources that are at the early development stage. In March 2017, SDG Group discovered a significant orebody more than 1,000 meters underground in the Sanshandao Xiling mine area, with resource gold content of 12.3m oz, or ~383 tons. Shandong Gold holds first right of refusal to acquire this resource from SDG.

VALUATION

We have a target price of HK\$23.20, based on a 25x multiple of Zhaojin's 2019 PER. This valuation is supported by Shandong Gold's growing mine production, high sensitivity to gold prices, and low cash production costs. We think this valuation is reasonable in light of Zhaojin's 2018-20 EPS growth of ~22% through 2020. Furthermore, in a scenario where gold prices increase 10% from today's current levels, Shandong Gold's 2019 PER would fall to 15.8x.

Figure 6: Gold Miners' Valuation Comparison Table***

Name	Ticker	Mkt. Cap (USD Mn)*	Price (Lc)	52 Wk High	52 Wk Low	PER (x)			P/B (x)			EV/EBITDA (x)			ROE (%)	Yield (%)
						2018E	2019E	2020E	2017	2018E	2019E	2018E	2019E	2020E	2018E	2018E
A-share																
Shandong Gold**	600547 CH	7,649	28.24	34.20	21.04	45.1	34.7	30.2	2.6	2.7	2.5	13.4	11.8	10.8	5.9	0.6
Zijin Mining	601899 CH	8,575	3.40	5.55	3.21	16.8	14.4	11.3	2.2	1.9	1.7	9.0	8.2	7.6	11.8	5.3
Zhongjin Gold	600489 CH	4,021	7.47	10.38	6.36	73.2	62.3	58.8	1.9	1.9	1.9	13.7	13.2	12.9	2.2	0.5
MEDIAN						45.1	34.7	30.2	2.2	1.9	1.9	13.4	11.8	10.8	5.9	0.6
H-share																
Shandong Gold**	1787 HK	814	17.82	18.36	13.00	25.1	19.3	16.8	1.5	1.5	1.4	13.4	11.8	10.8	5.9	1.0
Zhaojin Mining**	1818 HK	997	7.42	7.62	5.51	29.9	21.8	15.5	1.9	1.8	1.7	17.0	13.8	11.4	5.0	1.0
Zijin Mining	2899 HK	2,130	2.9	4.37	2.49	13.3	12.5	11.7	1.7	1.5	1.4	9.0	8.4	8.0	12.1	3.4
MEDIAN						21.6	17.2	13.6	1.8	1.7	1.5	13.0	11.1	9.7	8.5	2.2
International																
Barrick Gold	ABX US	15,330	13.13	15.52	9.53	31.8	28.3	25.2	1.6	1.7	1.7	7.1	6.1	6.1	6.5	1.0
Newmont Mining	NEM US	17,999	33.79	42.04	29.06	27.9	24.8	22.1	1.7	1.7	1.6	8.8	7.7	7.6	5.3	1.6
Anglogold Ashanti	AU US	4,348	10.50	12.00	7.08	22.6	12.7	10.5	1.6	0.9	0.8	5.0	4.0	3.8	7.1	0.7
Kinross Gold	KGC US	3,501	2.80	4.78	2.38	31.1	30.4	23.5	0.8	0.8	0.7	4.6	4.5	4.3	2.9	0.0
Newcrest Mining	NCM AU	11,479	20.62	23.69	18.57	56.4	22.8	17.3	1.5	1.5	1.5	8.5	8.1	7.1	2.7	0.9
MEDIAN						31.1	24.8	22.1	1.6	1.5	1.5	7.1	6.1	6.1	5.3	0.9

Source: Bloomberg, CGIS Research

Note: * Mkt Cap based on local listing; ** Zhaojin and Shandong Gold figures based on CGIS forecast; *** Projections based on PRC GAAP reporting, which is used for the Company's A Shares.

ZHAOJIN'S SENSITIVITY TO GOLD PRICES

Amongst the listed Chinese gold miners, Zhaojin, Shandong Gold, and Zhongjin Gold are the most leveraged to higher gold prices. To analyse the impact of a more sustained rally in gold prices, we examined the earnings impact higher gold prices would have on gold producers.

Figure 7: Sensitivity to Gold Price Change by Gold Mining Company***

Change in Gold Price (%)	2019 Earnings Impact (%)			
	Shandong Gold*	Zhaojin Mining*	Zijin Mining**	Zhongjin Gold**
10%	54%	46%	14%	78%
5%	27%	23%	7%	39%
0%	0%	0%	0%	0%
-5%	-27%	-23%	-7%	-39%
-10%	-54%	-46%	-14%	-78%

Source: Company Filings, CGIS Research

Note: * Shandong Gold and Zhaojin Mining estimates based on CGIS forecast; ** Zijin Mining and Zhongjin Gold figures based on consensus earnings and 2017 gold prices/production levels; *** Estimates exclude hedging effects

As our numbers in Figure 7 show, every 5% increase gold prices would result in an earnings increase of 27% and 23% for Shandong and Zhaojin Gold, respectively. Zhongjin Gold is more sensitive to changes in gold prices, but its 60x PER multiple makes it less interesting. Zijin Mining is a diversified miner with less exposure to gold.

RISK FACTORS

Decline in International Gold Prices

Shandong Gold's earnings are sensitive to changes in gold prices, so a decline in international gold prices would have a negative impact on earnings. Our model has incorporated a 5% increase in the average gold price in 2019 and 2020 from the current level of RMB273 per gram. If this fails to materialise, our expectations for 2019 and 2020E net profit may prove overly optimistic.

Environmental Concerns: Cyanide Spills

Prior to Shandong Gold's investment in Veladero, Barrick experienced three cyanide spills in the course of approximately 3 months. In the first incident, which occurred in Sept. 2015, more than 1 million litres of cyanide-contaminated liquid spilled into a nearby river. Authorities suspended operations for 8 days, and Barrick paid a US\$10m fine. The second (and smaller) spill occurred in 2016 due to large block of ice rolling down a valley, which struck a pipe carrying cyanide solution (Veladero is 4,000-4,500 meters above sea level). Production was suspended for 3 weeks. The third spill occurred in 2017, when a coupling on a pipe failed, and gold and cyanide solution spilled at Veladero's leach pad facility. The spill was reportedly contained within the facility, but the government restricted the addition of cyanide, demanding Barrick improve the existing leach infrastructure to prevent future accidents. The restrictions were lifted in 2017.

Pledged Shares

In 2017, SDG Group pledged 260m shares in Shandong Gold (or 14% of Shandong's total share base) as security for borrowing. In the event of a steep sell-off in Shandong Gold, SDG Group could be forced to sell down or increase its pledge of existing shares in the Company, which could pressure Shandong Gold's share price.

Key Mining and Exploration Permits Held with Parent

Shandong Gold historically has relied on its parent, SDG, for access to mining deals, as well as mining licenses and exploration permits. Currently, all of the Company's mining licenses are with the parent company, although transfer of the exploration and mining permits from SDG Group to Shandong Gold is generally expected to commence by the end of 2020. However, due to insignificant resources detected in certain gold mines, the decision on whether to transfer the corresponding permits attached to such gold mines is expected to be made by the end of 2023, based on the then exploration results.

FINANCIAL MODEL

P&L Observations

- 1.) We expect gold production and the cost structure to remain relatively stable through 2019. In 2020, we assume production levels will increase by 95k ounces. Our forecast assumes gold pricing of ~RMB287/gram (or ~US\$1,295) in 2019-2020, a ~5% increase from today's levels.
- 2.) In 9M18 the company achieved RMB770m in net profit, or 61% of our full-year estimate. We anticipate a strong Q4 2018 on the back of stronger gold pricing since September, as well a reduction in fair value losses, which hurt Q3 2018 profit.
- 3.) We have not built in any M&A into our assumptions through 2020.
- 4.) We currently anticipate stable production through 2020, but should the Company pursue M&A activity to grow production, our forecasts could prove overly conservative.
- 5.) In 2016-17, finance expenses comprised roughly one third of PBT. Therefore, debt and interest rate movements can impact Shandong Gold's earnings.
- 6.) The figures below are based on PRC GAAP. PRC GAAP is used for Shandong's A Shares, while IFRS is used the Company's H Shares. There are minor differences between the two reporting standards.

Figure 8: Simplified Consolidated Statement of Profit and Loss

Dec. Year End (RMB Mn)	2016	2017	2018E	2019E	2020E
Sales Revenue	50,199	51,041	52,182	52,736	53,583
COGS	(45,799)	(46,412)	(47,255)	(47,275)	(47,748)
Gross profit	4,400	4,629	4,927	5,461	5,835
Taxes & Surcharge	(181)	(241)	(265)	(267)	(272)
Selling and distribution costs	(34)	(31)	(28)	(28)	(29)
General and administrative expenses	(2,205)	(2,201)	(1,989)	(2,007)	(2,016)
Total EBIT	1,979	2,156	2,646	3,159	3,519
Depreciation & Amortization	1,573	2,257	2,627	2,816	3,026
EBITDA	3,553	4,413	5,272	5,975	6,546
Finance expense	(325)	(500)	(695)	(668)	(660)
Other income	48	(8)	(71)	0	0
Other expense	(7)	(23)	6	-	-
Pre-Tax Profit	1,695	1,626	1,885	2,491	2,859
Tax Expense	(383)	(435)	(550)	(623)	(715)
Net Profit After Tax	1,312	1,191	1,335	1,868	2,144
Minority Interest	16	56	75	93	107
Earnings to Equity Owners	1,296	1,135	1,260	1,775	2,037
EPS	0.70	0.61	0.63	0.81	0.94
DPS	0.10	0.12	0.13	0.16	0.19
% YoY growth					
Revenue	na	1.7%	2.2%	1.1%	1.6%
Gross profit	na	5.2%	6.4%	10.8%	6.9%
EBIT	na	8.9%	22.7%	19.4%	11.4%
Net profit to common	na	-12.5%	11.1%	40.8%	14.8%
Margins and ratios					
Gross profit margin	8.8%	9.1%	9.4%	10.4%	10.9%
EBITDA Margin	7.1%	8.6%	10.1%	11.3%	12.2%
EBIT Margin	3.9%	4.2%	5.1%	6.0%	6.6%
Net Profit Margin	2.6%	2.2%	2.4%	3.4%	3.8%

Source: Company Annual Report, CGIS Research

Balance Sheet Observations

- 1.) Relative to its domestic gold mining peers, Shandong Gold has a strong balance sheet, with net debt to equity at 53% following its latest H-Share issuance in Hong Kong, which raised HK\$4.8bn (~RMB4.2bn). Prior to the Company's fund raising, its net debt to equity ratio was ~80%.
- 2.) We have not factored in any further M&A into our assumptions through 2020.
- 3.) Gross debt is ~RMB18bn. Over the past 12 months, Shandong Gold has reduced some of its traditional loan borrowings and increased its exposure to gold financing, which has slightly lower interest costs. We expect Shandong Gold to maintain or increase its current debt level should the Company begin pursuing any M&A activity.
- 4.) The figures below are based on PRC GAAP. PRC GAAP is used for Shandong's A Shares, while IFRS is used for the Company's H Shares. There are minor differences between the two reporting standards.

Figure 9: Simplified Consolidated Statement of Financial Position

Dec. Year End (RMB Mn)	2016	2017	2018E	2019E	2020E
Cash & Equivalents	1,304	3,073	8,464	9,089	10,130
Trade and other receivables	187	447	575	578	583
Inventories	1,370	3,102	3,144	3,147	3,183
Prepayments	116	175	209	209	209
Others	77	112	116	116	116
Total current assets	3,053	6,909	12,508	13,139	14,222
Long-term equity investment	371	399	1,029	1,029	1,029
PPE, net	13,342	21,046	21,706	21,999	22,131
Intangible assets	8,945	9,819	9,927	10,529	11,084
Investment Properties	234	227	227	227	227
Goodwill	1,702	2,708	2,721	2,721	2,721
Deferred Tax Assets	144	123	136	136	136
Other non-current assets	565	885	921	909	897
Total non-current assets	25,304	35,207	36,666	37,550	38,224
Total assets	28,357	42,116	49,174	50,689	52,445
Trade, notes and other payables	2,818	3,654	3,650	3,651	3,671
Bank and other borrowings	530	789	2,636	2,636	2,636
Gold Leasing	3,170	5,751	7,960	7,960	7,960
Tax payable	121	313	246	246	246
Deposits from customers	171	127	88	88	88
Corporate bond	22	39	42	42	42
Others	408	0	0	0	0
Total current liabilities	7,240	10,674	14,622	14,623	14,643
Bank & other borrowings	88	6,858	7,362	7,362	7,362
Corporate bonds	3,290	3,294	686	686	686
Deferred tax liabilities	1,328	3,463	3,446	3,446	3,446
Other long term liabilities	65	659	652	652	652
Total non-current liabilities	4,772	14,273	12,146	12,146	12,146
Total liabilities	12,012	24,947	26,768	26,769	26,789
Shareholders Fund	15,519	16,324	21,498	22,918	24,547
Minority Interest	826	845	908	1,002	1,109
Total S/H Equity	16,345	17,169	22,406	23,919	25,656
Total Liab & S/H Fund	28,357	42,116	49,174	50,689	52,445

Source: Company Annual Report, CGIS Research

Cash Flow Observations

- 1.) Shandong Gold books financing expenses in financing cash flow. Finance costs ranged from RMB432-488m in 2016-17 on Shandong Gold's P&L. Our FCF calculations have been adjusted to include finance costs.
- 2.) Under our current assumptions of a 5% increase in the gold price in 2019-2020, we expect the Company to continue growing its cash balance by RMB600m to RMB1bn per year. In the event that gold prices do not move favourably from today's levels, cash earnings would be reduced by roughly RMB300m per year in 2019-20.
- 3.) The figures below are based on PRC GAAP. PRC GAAP is used for Shandong's A Shares, while IFRS is used for the Company's H Shares. There are minor differences between the two reporting standards.

Figure 10: Simplified Consolidated Statement of Cash Flows

Dec. Year End (RMB Mn)	2016	2017	2018E	2019E	2020E
Net Profit	1,309	1,193	1,337	1,868	2,144
Depreciation & Amortization	1,573	2,257	2,627	2,816	3,026
Finance Expense	332	488	698	668	660
Change in Working Cap	(410)	(202)	(190)	(4)	(22)
Other Non Cash Adjustments	(80)	(38)	35	0	(0)
Operating Cashflow	2,724	3,699	4,506	5,348	5,809
Capex	(1,963)	(3,797)	(2,853)	(2,500)	(2,500)
Others	280	(6,611)	(1,419)	(1,200)	(1,200)
Cash from Investing	(1,683)	(10,408)	(4,272)	(3,700)	(3,700)
Borrowings	1,700	11,645	6,564	6,000	6,000
Equity Issue	-	-	4,239	-	-
Dividend	(186)	(223)	(252)	(355)	(407)
Finance expense	(331)	(294)	(749)	(668)	(660)
Debt repayment	(1,650)	(4,500)	(4,924)	(6,000)	(6,000)
Short term debt repayment	0	0	(2,000)	0	0
Others	83	1,483	2,817	(0)	0
Cash from Financing	(384)	8,112	5,695	(1,023)	(1,068)
Change in Cash	657	1,403	5,929	625	1,041
FCF*	710	(7,003)	(515)	980	1,448

Source: Company Annual Report, CGIS Research

Note: * FCF equivalent to CFO + CFI - Finance expense

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