

The second largest gold producer in China

China Resources

Zhaojin Mining Industry (1818 HK)

Not Rated

Company profile. Zhaojin Mining is an integrated gold production enterprise with exploration, mining, ore processing and smelting operations based in Zhaoyuan district of Shandong province in China. Its 130.5 tonnes of gold resources makes it the second largest gold producer in China in terms of reserves, just after Zijin Mining.

Production growth. The group reported a 2-year production CAGR of 57.3%, from 85.2 K OZs in 2003 to 210.8 K OZs in 2005. It intends to produce 225.3 K OZs and 253.2 K OZs of gold in 2006 and 2007, respectively. Potential disclosure of the production target for next year would enhance the group's earnings visibility.

Table 1: Offer stats

Price range	HK\$9.80-HK\$12.68
No. of shares offered	172.8m
Fund raised	HK\$1,693.4m-HK\$2,191.1m
Offer PE (FY12/06)	26x-33x
Total market cap (H+ Domestic shares)	US\$883.0m-US\$1,142.5m
IPO open	29 Nov
IPO close	29 Nov
Listing	8 Dec

Source: Company data

Table 2: Use of proceeds

	(HK\$m)
Production capacity expansion	500
Exploration	250
Acquisitions of operating mines	500
Implementation of COAL	150
Acquisitions of exploration projects	250
Repayment of debt	170

Source: Company data

Revenue model. In FY12/05, 93.1% of its revenue was derived from the sales of gold bullion, with the balance of the revenue generated from the sales of silver, sulphur and other by-products. Thus, it is vulnerable to the fluctuation in the spot gold price. Spot gold price hit US\$714.80/ounce on May 12, 2006 and retreated to US\$638.70/ounce on November 27, 2006. Between FY12/03 and FY12/05, the group's net profit increased at a 2-year CAGR of 87.4%, from RMB45.5m to RMB159.7m, against its a 2-year revenue CAGR of 50.3%.

Well-located mines. According to the statistics from China Gold Association, 10% of China's total remaining gold resources were found in the group's home base, the Zhaoyuan district of the Shandong province in 2005. The district has well-developed infrastructure system to accommodate the gold producing industry as well.

Reserve growth potential. Extensive area of the group's existing mines has not been explored. Besides, it has discovered new deposits in its mining area, such as Jintingling Gold Mine Deposit. Nevertheless, the reserve replacement ratio at its mines is projected to be less than 1x until 2007. Thus, the annual addition of reserves is not expected to completely replenish the annual depletion.

Table 3: Key financials

Year end Dec (RMBm)	2003A	2004A	2005A	1H05A	1H06A
Revenue	384.0	428.1	867.7	403.6	528.7
Gross profit	146.0	190.9	439.4	184.5	316.9
Pre-tax profit	74.7	100.0	240.0	92.0	223.4
Net profit	45.5	165.6	159.7	60.0	147.1
YoY % Change					
Revenue (%)	-	11.5	102.7	-	31.0
Gross profit (%)	-	30.7	130.2	-	71.8
Pre-tax profit (%)	-	33.9	139.9	-	142.7
Net profit (%)	-	264.2	(3.5)	-	145.1
Gross margin (%)	38.0	44.6	50.6	45.7	59.9
Pre-tax margin (%)	19.5	23.4	27.7	22.8	42.3
Net margin (%)	11.8	38.7	18.4	14.9	27.8

Source: Company data

Table 4: Mines profile

	2003A	2004A	2005A	2006F	2007F
Mill throughput (K tonnes)					
Jinchiling Mine	90.8	100.9	112.5	118.1	118.1
Hedong Mine	316.5	335.2	329.6	307.2	305.0
Xiadian Mine	237.1	301.5	339.4	342.9	373.8
Dayingezhuang Mine	731.3	843.6	955.4	955.6	991.9
Jintingling Mine	110.0	441.4	409.0	360.0	380.0
Head grade (g/AU)					
Jinchiling Mine	5.9	5.9	5.8	5.5	5.5
Hedong Mine	3.2	3.3	3.5	3.7	4.3
Xiadian Mine	3.7	3.8	3.8	3.8	3.9
Dayingezhuang Mine	2.6	2.6	2.5	2.7	2.7
Jintingling Mine	2.6	2.1	2.8	2.9	3.5
Mill recovery (%)					
Jinchiling Mine	96.1	96.0	96.2	96.0	96.0
Hedong Mine	94.2	94.8	95.8	95.5	95.5
Xiadian Mine	96.4	96.5	96.4	96.5	96.5
Dayingezhuang Mine	94.1	94.4	94.5	94.5	94.5
Jintingling Mine	94.6	93.2	94.0	95.0	95.0

Source: Company data

Table 5: Sales and cost analysis

Year to Dec	2003A	2004A	2005A	1H05A	1H06A
Gold sales volume (K OZs)	111.9	108.4	221.6	106.2	108.5
ASP (RMB per ounce)	2,951.9	3,327.2	3,647.8	3,540.3	4,690.0
Operating cash cost (RMB/gram)	52.5	51.6	50.4	N.A.	N.A.

Source: Company data

Tax issues. The group is subject to pay a number of taxes, including corporate tax, resources tax, business tax, valuated-added tax, city maintenance and construction tax, education surcharges and property tax. The PRC government increased the resources tax rate for the group's mines from RMB4.00/tonne of gold ore to RMB5.00/tonne, effective from May 1, 2006.

Strategic investors. Standard Bank, Star Valley Group and Hong Kong Tobacco, Green Jacket and Global Investment will take up 30.3m shares, or 17.6% of the shares offered, collectively. The strategic investors are subject to a 6-month lock-up period.

Expiry of the exploration and mining permits. The group's mining permits covering 5.3%, 1.9% and 50.3% of its mining area would expire upon 2007, 2008 and 2009, respectively. Besides, exploration permits covering 3%, 20% and 77% of its permitted exploration area will expire upon this year, 2007 and 2008, respectively. However, explorations and mining permits can be renewed within a prescribed period prior to their expiration, upon compliance with the prescribed extension procedure. Each renewal of exploration permit shall not exceed two years. If a holder of an exploration and mining permit fails to renew its permit, such exploration and mining permit shall be automatically void upon expiration. The validity period of the initial term of mining permit for a big-scale mine, medium-scale mine and small-scale mine shall be 30 years, 20 years and 10 years, respectively. Besides, the maximum validity period of the initial term of exploration permit is 3 years. Holder of the mining permit is subject to pay an annual mining right usage fee of RMB1,000/sq.km of mining area. Beside, holder of the exploration permit is subject to pay an annual exploration right usage fee, calculated as RMB100/sq.km of exploration area for the first three year of exploration. From the fourth year of exploration onwards, the rate will be increased by RMB100/sq. km of exploration area annually. Nevertheless, the annual maximum rate shall not exceed RMB500/sq.km of exploration area.

Table 6: Expiry date of mining permits

Expiry date	Mining area covered (sq.km)	Proportion of mining area (%)
2007	1.6	5.3
2008	0.6	1.9
2009	15.1	50.3
2010	3.0	9.9
2014	9.8	32.6

Source: Company data

Earnings forecast and valuation. FY12/06 net profit is projected to be no less than HK\$270.3m, representing an annualized growth rate of 70.7%. The issue price range of HK\$2.60-HK\$3.30 represents a 26x-33x proforma FY12/06 P/E, comparing to the sector average P/E of 22x and 21.4x for FY07 and FY08, respectively.

Table 7: Peer group comparisons

Company	Mkt cap (US\$m)	Est Cur-Yr P/E (x)	Est Next Yr P/E (x)
Newmont Mining	20,508	22.8	20.1
Newcrest Mining	6,520	18.0	25.0
AngloGold Ashanti	12,974	15.3	15.0
Gold Fields	8,951	14.2	12.9
Goldcorp	19,854	28.5	27.9
Kinross Gold	4,273	18.3	18.7
Meridian Gold	2,982	36.9	35.3
Lingbao Gold (H shares)	322	17.9	16.0
Zijin Mining Group (H shares)	2,238	26.6	23.9
W.A.		22.0	21.4

Source: I.B.E.S.