24 January 2019

METALS & MINING

Q4 2018 Operational Update

Marketing Communication (Connected Research)

Central Asia Metals#

BBG Ticker: CAML LN *Price: 229p* *Mkt Cap: £409m* **BUY**

Year to December	Revenue (US$'000)	EBITDA (US$'000)	Net Income (US$'000)	EPS (US$)	DPS (GBp)	EV/Sales (x)	EV/EBITDA (x)	P/E (x)	Div Yield (%)
2016A	66,707	39,921	26,270	0.24	15.50	7.9	15.9	20.1	3.9%
2017A	102,517	66,393	36,369	0.29	16.50	5.1	9.5	14.5	4.4%
2018F	197,725	122,059	49,756	0.28	13.85	2.7	5.2	10.6	6.0%
2019F	196,144	119,427	57,955	0.33	15.34	2.7	5.3	9.1	6.7%

***SOURCE**: Company Data, VSA Capital Research.*

Q4 2018 Operations Update

2018 Production Ahead of Estimates

Central Asia Metals (CAML LN) beat our full year production estimates across copper, lead and zinc owing to continued strong operational performance. Copper production of 3.36kt in Q4 2018, up 8% YoY meant full year production of 14kt, in line with 2017 production, at the top end of full year guidance and 2% ahead of our forecast. Sasa zinc production of 5.8kt in Q4 2018 was up 8% YoY resulting in 2018 output of 22.53kt, up 4% YoY and ahead of our forecast by 1%. Lead production of 7.40kt was flat YoY meaning 29.39kt through 2018 although down 2% YoY was 2% ahead of our forecasts.

Guidance for 2019 Implies Continued Robust Output

CAML has provided 2019 guidance broadly in line with our existing forecasts. At Kounrad guidance of 12.5-13.5kt for 2019 is 0.5kt lower than 2018 and 2% lower than our prior estimate of 13.75kt. This is due to the higher contribution from the Western dumps in 2019 (c70%). At Sasa guidance for zinc and lead output is unchanged from 2018 at 22-24kt and 28-30kt respectively. We anticipate 2019 production of 28.6kt lead and 22.2kt of zinc.

Rising Free Cash Flow Generation

Despite a reduction in 2018 forecasts reflecting weaker commodity prices in H2 2018 we have reduced our revenue, EBITDA and net income estimates by 3%, 5% and 8% to US$198m, US$122m and US$50m respectively. Net income continues to reflect a one-off legacy tax charge meaning our 2018F dividend estimate is reduced to 13.85p/sh. However, lower capital spending and a continued low cost base imply a 33% increase in FCF to US$88m in 2019F.

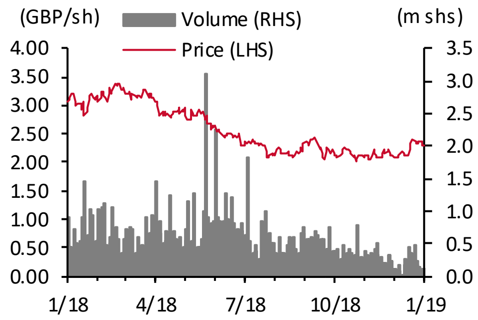
Recommendation and Target Price

Trading on a dividend yield of 6% highlights the ongoing value opportunity and we expect the shares to outperform as FCF generation continues to increase in 2019 and 2020. **We reiterate our Buy recommendation and target price of 309p which implies 33% upside and 40% on a total return basis.**

Company Description

Central Asia Metals is a London listed base metals mining company with primary operations in Kazakhstan and Macedonia

One Year Price Performance



Price % chg	1mn	3mn	12mn
	7.5%	6.8%	-25.6%
12mn high/low			339.5p/203p

***SOURCE**: FactSet, as of 23 January 2018 close.*

Market:	LSE AIM
Target price:	309p
Shares in issue	176m
Free float:	95%
Net Debt (Dec 2018F):	£81.8m
Enterprise value:	£491m
Major shareholders	
JO Hambro Capital Mgt	9.44%
Blackrock Inc	9.07%
Orion Resource Partners	8.68%

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Q4 Operational Update

Central Asia Metals (CAML LN)# announced strong Q4 2018 production with copper and zinc production of 3,363t and 5,769t up 4% and 8% respectively YoY while lead production was unchanged at 7,401t. CAML's full year production of 14,049 copper, 22,532t zinc and 29,388t lead comfortably achieved its guidance of 13-14kt copper, 22-24kt zinc and 28-30kt lead whilst being ahead of our estimates by 1-2%. We expect CAML to deliver again on guidance in 2019 maintaining its track record of operational consistency and reliability which we expect to drive continued robust earnings and strong cash flow generation. However, with lower capital spending requirements in 2019 we continue to expect an uplift in FCF generation of around US$88m versus US$66m in 2018 driving a higher dividend in 2019.

Production highlights

	Q4 2018	Q3 2018	Q4 2017	% Chg, YoY	% Chg, QoQ	2018	2017	% Chg, YoY
Copper, tonnes	3,363	3,938	3,234	4%	-15%	14,049	14,103	-0.4%
Zinc, tonnes	5,769	5,742	5,348*	8%	0%	22,532	21,585*	4%
Lead, tonnes	7,401	7,602	7,437*	0%	-3%	29,388	29,881*	-2%

Two months attributable to CAML **SOURCE: Company Data, VSA Capital Research.*

Kounrad

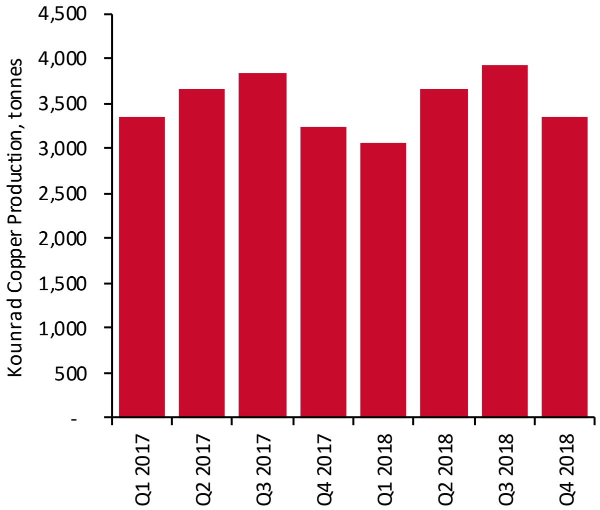
At Kounrad the expected seasonal impact meant that copper output in Q4 2018 was lower QoQ, however, CAML achieved a 4% increase YoY to 3,363t with a strong H2 2018 meaning that CAML hit the top end of its guidance range at 14,049.

Sales of 9,670t of copper through the first 9mo18 indicate that the inventory build up experienced in H1 2018 had not yet worked through given production of 10,869t, however, we continue to expect this to be resolved by the end of the year with copper sales to be broadly in line with production. This does, however, mean that CAML's realised copper price may be lower than the LME average price through the year of US$6,544/t which was in line with our forecast.

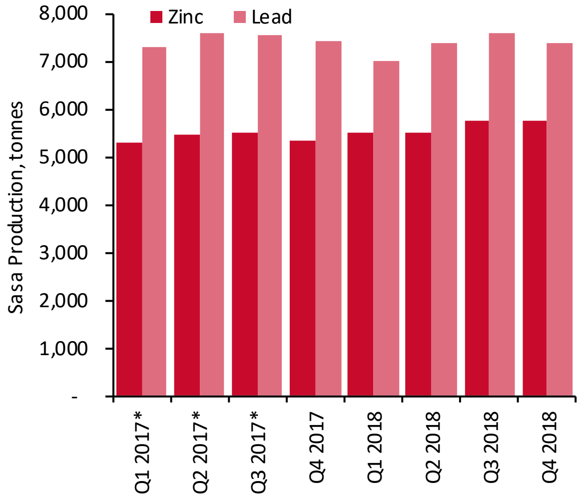
In 2018 approximately 65% of production was attributable to the Western dumps and this is set to rise to 70% in 2019 as part of a managed transition before the Eastern dumps are exhausted in 2022. Differing metallurgical characteristics of the Western dumps mean longer leach times and lower recoveries (35-42% versus 45-50%) albeit on a significantly larger volume of waste dumps. Our LoM forecast is a managed decline in production from c14kt to around 12kt by the end of the mine life in 2032 and the marginally lower guidance in 2019 which means a reduction in our forecast of just 0.35kt to 13.4kt is the start of that.

From a cost perspective Kounrad has a relatively low fixed cost base and the impact of longer leach times and lower recoveries has a relatively limited impact due to the inherent nature of the process. The additional distance from the Western dumps to the processing plant does increase pumping costs. This is, however, likely to be offset at least in part by the weaker USDKZT which depreciated 13% through 2018 and we forecast unit costs of US$0.58/lb in 2019 implying continuing strong unlevered FCF generation of US$48.8m at Kounrad. This is modestly higher than our prior estimate of US$0.57/lb owing to the lower output projection. We do highlight that although this appears to be a significant YoY increase in percentage terms, CAML remains one of the lowest cost producers in the world and this expected transition has only a relatively minor impact on forecast free cash flow generation.

Kounrad Quarterly Production



Sasa Quarterly Production



Not attributable to CAML **SOURCE: Company data, VSA Capital Research.*

Sasa

At Sasa zinc production in Q4 2018 of 5.77kt was up 8% YoY and unchanged QoQ resulting in full year production of 22.53kt, up 4% YoY and 1% ahead of our forecast. Ore mined and milled at 803kt was up 1.4% YoY and ahead of our estimate of 780kt (in line with mill capacity). This was the primary reason for zinc and lead output beating our estimates. Our forward estimates for ore milled are now at 790ktpa marginally above mill capacity, however, this has consistently been exceeded in recent years. Zinc grades were consistent throughout 2018 averaging 3.31% which was 0.13pp above 2017. This was, however, offset by a dip in recoveries earlier in the year as a replacement stirred media detritor (SMD) mill was commissioned meaning that recoveries of 84.6% were 0.9pp lower YoY. However, we expect 85% to be maintained now that the mill has been fully commissioned.

Sasa Operating Highlights

	Q4 2018	Q3 2018	% chg, QoQ	2018	2017	% Chg, YoY
Plant Feed	205,130	206,014	0%	804,749	793,332	1%
Lead grade, %	3.86	3.92		3.90	3.98	
Zinc grade, %	3.31	3.25		3.31	3.18	
Lead concentrate	10,151	10,455	-3%	40,317	40,757	-1%
Recovery, %	93.4	94.0		93.6	94.6	
Grade, %	72.9	72.7		72.9	73.3	
Contained Lead	7,401	7,602	-3%	29,388	29,881	-2%
Zinc Concentrate	11,846	11,658	2%	46,128	43,676	6%
Recovery, %	85.0	85.7		84.6	85.5	
Grade, %	48.7	49.3		48.9	49.4	
Contained zinc	5,769	5,742	0%	22,532	21,585	4%

Not attributable to CAML **SOURCE: Company Data, VSA Capital Research.*

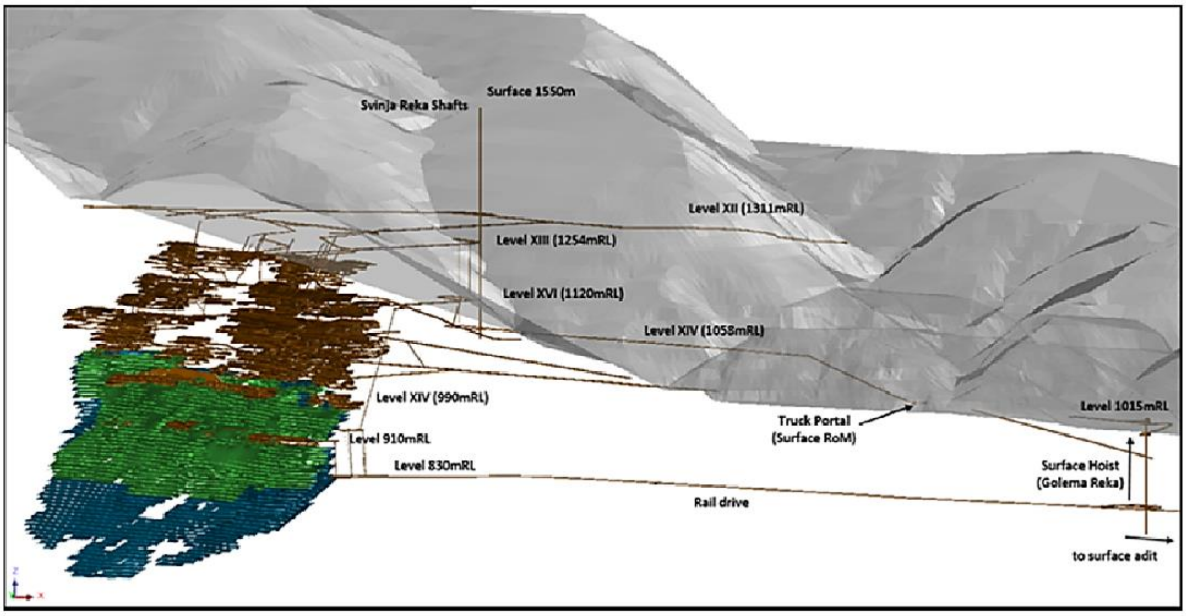
Lead production in Q4 2018 was 7.40kt, flat YoY although down 3% QoQ resulting in full year production of 29.39kt which was down 2% YoY although 2% ahead of our forecast. Lead grades declined by 0.8pp YoY while lead recovery was 1pp lower YoY which accounts for the modest decline in annual output. This does, however, remain well within the range of past performance and towards the top end of the guidance range.

We expect robust operational performance to be maintained at Sasa with 2019 lead and zinc production of 28.96kt and 22.16kt respectively within the guidance ranges of 28-30kt and 22-24kt. Our zinc forecast on grade at 3.25% is in line with the previously announced mine plan.

CAML is, however, currently in the process of updating the current mine plan. Drilling to upgrade confidence and expand the existing resources at Sasa is ongoing. Although this is to be carried out through the course of 2019 an updated JORC compliant resource is due to be completed during Q1 2019. The Sasa resource covers two ore bodies; Svinja Reka (we assume mined to 2034) and Golema Reka (we assume mined from 2034 to 2038). The Golema Reka resource of 7.4mnt at 3.7% Pb and 1.5% Zn entirely in the inferred category and the current assumption is that approximately 50% is mined while at Svinja Reka 17% of the current resource is in the inferred category.

We therefore see multiple key positive outcomes from the updated mine plan. Greater confidence in forecast ore grades in the near term and the potential extension of the mine life beyond the current limit of 2038. Additionally, the extension of the resource at depth below Svenja Rika as highlighted by recent drilling results would likely delay the transition to Golema Reka where the resource is also being upgraded in confidence. We also note that the resource is open along strike which presents the opportunity for further resource expansion although drilling in the current programme is not planned to test the lateral extent of mineralisation.

Current Mine Plan at Sasa



***SOURCE:** Company data, VSA Capital Research. Brown (Probable Reserves), Green (Indicated Resources), Blue (Inferred Resources)*

The initial results released in the Q4 2018 update indicated potential upside to the existing mine plan. Our current forecasts include a drop off in zinc grades towards the end of the mine life between 2029 and 2034 from 3.1% to 2.8% Zn in 2029 and to 1.44% Zn in 2034 as mining transitions to Golema Reka for the remaining four years of the mine plan as per the CPR.

Drilling highlights from Svinja Reka include:

- 6m from 9m at 3.57% Pb and 5.49% Zn
- 9m from 10m at 9.11% Pb and 106% Zn
- 6m from 23m at 3.82% Pb and 4.21% Zn
- 28m from 68m at 7.46% Pb and 4.60% Zn
- 40m from 73m at 9.40% Pb and 2.56% Zn
- 28m from 80m at 6.81% Pb and 6.69% Zn
- 30m from 105m at 9.14% Pb and 5.14% Zn

Drilling highlights from Golema Reka include:

- 5m from 279m at 5.65% Pb and 2.98% Zn
- 10m from 371m 5.96% Pb and 1.10% Zn
- 3m from 363m at 5.67% Pb and 4.21% Zn

Following the exploration drilling programme carried out at CAML's Shuak project in Kazakhstan the company has now reviewed the data and determined that the project most likely no longer fits into CAML's growth plans. The licenses were acquired in 2016 whilst CAML was still a single asset producer, however, as a multi asset producer now its hurdle rates for projects have advanced. Previously announced results indicated promise, however, the latest announcement indicates that the project is not going to fulfil CAML's development criteria. This may well be an attractive asset for a smaller player although CAML will now focus its growth strategy on inorganics growth.

CAML Operational and Financial Highlights

	2016A	2017A	2018F	2019F	2020F
Copper Production, t	14,020	14,103	14,049	13,400	13,400
Lead Production, t	-	4,951	29,388	28,961	28,961
Zinc Production, t	-	3,625	22,532	22,160	21,824
C1 Cash Cost, Copper, USD/lb	0.43	0.52	0.54	0.58	0.59
C1 Cash Cost Zinc, USD/lb	-	0.44	0.44	0.52	0.55
Revenue, USD'000	66,707	102,517	197,725	196,144	197,514
EBITDA, USD'000	39,921	66,393	122,059	119,427	119,836
Operating Profit, USD'000	33,645	46,467	87,327	83,368	84,226
Net Income, USD'000	26,270	36,369	49,756	57,955	61,220
EPS, USD/sh.	0.24	0.29	0.28	0.33	0.35
P/E, x	20.1x	14.5x	10.6x	9.1x	8.6x
EV/EBITDA, x	15.9x	9.5x	5.2x	5.3x	5.3x
Net Debt/EBITDA, x	-1.0x	2.1x	0.9x	0.5x	0.0x
Capex, USD'000	(12,331)	(4,082)	(16,200)	(11,000)	(10,300)
Unlevered FCF	22,711	48,723	81,539	99,094	94,133
Unlevered FCF Yield, %	4%	9%	15%	19%	18%
Levered FCF	23,203	41,909	66,374	88,238	86,472
Levered FCF Yield, %	4%	8%	13%	17%	16%
Dividend Yield, %	4%	4%	6%	7%	7%
Dividend Per Share, GBP	15.50	16.50	13.85	15.34	15.79

***SOURCE:** Company Data, VSA Capital Research.*

Changes to Earnings Estimates

Having adjusted our commodity prices to reflect full year averages for 2018 this resulted in a 4% reduction in zinc and lead prices in our model. This was in part offset by CAML production ahead of our forecasts by 1-2%. Overall, this means a 3% reduction in revenue in 2018 which feeds through to a 5% reduction in EBITDA and 8% reduction in net income. Net income continues to reflect a US$5.9m legacy tax charge in relation to Sasa. This means that our dividend estimates for 2018 is reduced by 4.6% to 13.85p/sh. representing a 6% yield which remains amongst the strongest in the peer group.

Despite the reduction in our earnings estimates the near-term profile of rising free cash flow generation remains unchanged due to lower capex in 2019F (albeit adjusted up for a slight delay in the commissioning of the tailings storage facility) and we forecast an increase from US$66m in levered free cash flow, from which the dividend is paid, in 2018F to US$88m in 2019F. This highlights our investment case for CAML which despite a weaker near-term outlook for commodity prices is underpinned by CAML's low cost base which drives rosbut operating margins and strong free cash flow generation.

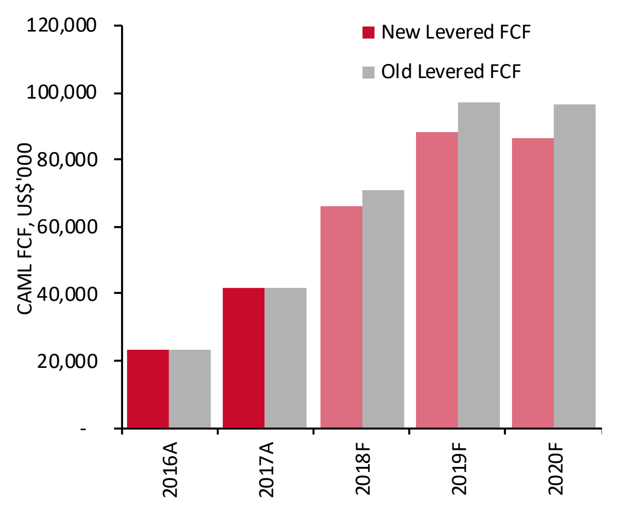
Earnings Changes Highlights

	Revenue			EBITDA			Net Income			Capex		
	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg	Old	New	% Chg
2018F	202,804	197,725	-3%	128,100	122,059	-5%	54,303	49,756	-8%	(16,200)	(16,200)	0%
2019F	212,911	196,144	-8%	136,244	119,427	-12%	75,921	57,955	-24%	(10,300)	(11,000)	7%
2020F	208,611	197,514	-5%	131,216	119,836	-9%	74,731	61,220	-18%	(10,300)	(10,300)	0%

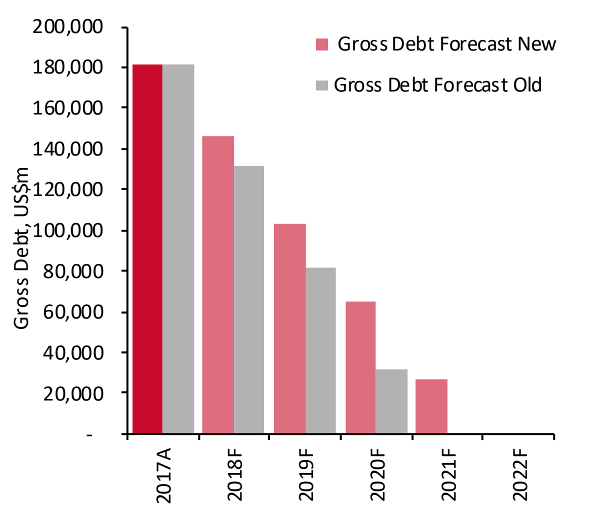
SOURCE: *Company Data, VSA Capital Research.*

Continued depreciation of the USDKZT along with copper production ahead of our forecasts has meant that our Kounrad unit cost estimate for 2018 is reduced to US$0.54/lb from US$0.55/lb, however, the reduction in forecast production from 2019 onwards of 2% to 13.75kt means an increase from US$0.57/lb to US$0.58/lb despite the benefit of currency depreciation. In 2018 our unit costs at Sasa remain unchanged at US$0.44/lb zinc equivalent, however, in 2019 we expect the impact from higher treatment charges for zinc concentrate to impact earnings. There was a sharp rise in global zinc treatment charges of around 30-40% reported in Q4 2018 owing to zinc smelter bottlenecks. Consequently, we expect CAML to be impacted resulting in an increase in unit costs versus our prior estimates by 2% in 2019F and 10% in 2020F. That said these bottlenecks mean that the refined metal market is likely to remain in deficit providing support for zinc metal prices.

Changes to Levered FCF Outlook



Changes to Debt Repayment Profile



SOURCE: *Company data, VSA Capital Research.*

We also note the changes to CAML's corporate debt facility as announced in early January 2019. When Sasa was acquired in November 2017 it inherited US$67m in debt funding held by Sasa and its subsidiaries as well as the additional debt financing of US$120m that CAML raised to finance the acquisition. CAML has now opted to enlarge its debt facility with its oftake partner **Traxys** in order to fully repay the Sasa loans and consolidate all outstanding debt at the corporate level.

The new terms of the corporate facility are interest of 4.75% plus 1 month US LIBOR to repaid monthly on a straight line basis within four years and there are now no cash sweeps in relation to free cash flow generation. This implies that CAML will by debt free by 2022F implying a less aggressive repayment profile compared to previous guidance. During 2018 CAML repaid US$36m with a year end cash position of US$39m. This new repayment profile frees up around US$15-30mpa giving CAML greater flexibility and although it does not directly impact the available cash from which dividends can be paid it will most likely provide the board with greater leeway when determining the annual payout ratio.

Valuation Update

Commodity Price and Macro Assumptions

Our commodity price assumptions are adjusted to actuals for 2018 meaning a 4.5% reduction in our lead price and a 3.7% reduction in our zinc price estimate while copper is broadly unchanged. Given the pullback in commodity prices the lower starting point to 2019 has also meant that we have adjusted our commodity price forecast profiles, however, we continue to have a constructive outlook on prices for base metals with deficits likely to persist in the near term in zinc and copper in particular.

Changes to Commodity Price Forecasts

		2018A	2019F	2020F	2021F	2022F	LT
Copper	Old	6,550	7,000	7,250	7,000	6,750	6,500
	New	**6,544**	**7,000**	**7,250**	**7,000**	**6,750**	**6,500**
Lead	Old	2350	2,250	2,150	2,100	2,100	2,100
	New	**2,248**	**2,250**	**2,150**	**2,100**	**2,100**	**2,100**
Zinc	Old	3,000	3,250	3,000	2,750	2,500	2,500
	New	**2,892**	**3,000**	**3,100**	**2,950**	**2,750**	**2,500**

SOURCE: *Company data, VSA Capital Research.*

Changes to Macro Assumptions

		2018A	2019F	2020F	2021F	2022F	LT
USDEUR	Old	330	330	300	300	275	250
	New	**345**	**350**	**330**	**315**	**300**	**300**
USDKZT	Old	1.20	1.25	1.27	1.27	1.28	1.29
	New	**1.18**	**1.23**	**1.25**	**1.27**	**1.27**	**1.27**

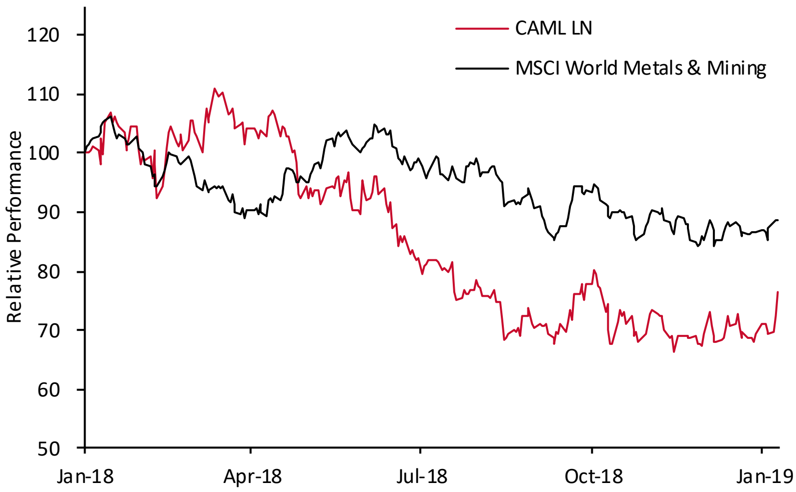
SOURCE: *Company data, VSA Capital Research.*

We also note the decline in the USDKZT which has weakened this year to near all-time lows on the back of a pullback in commodity prices. The full year average of USDKZT 345 was 3% lower than our estimate of 335 although ended the year at 385 and we have adjusted our estimates going forward to reflect this which is likely to benefit CAML's unit costs at Kounrad. At Sasa a stronger Euro during 2018 has had the opposite impact and although IMF projections continue to suggest a stronger EURUSD manufacturing weakness in Germany, political instability in France and ongoing financial instability in Italy could result in currency weakness benefitting unit costs at Sasa; however, our base case is for continu ed stable growth in the Eurozone suggesting support for the currency.

Valuation Update

Our valuation of **Central Asia Metals (CAML LN)** is based on a 50/50 blend of NAV and a peer based 12-month EV/EBITDA multiple. Since the Q3 update CAML has traded in a relatively narrow range while the peer group EV/EBITDA multiple has continued to weaken, consequently CAML is now trading at a premium of 5% to its peer group which given the strong FCF outlook and robust earnings and dividend forecast which continues to be amongst the strongest in the peer group we believe that this is justified. Previously we have conservatively used a target multiple in line with the peer group given the discount on which CAML traded. We fully expect CAML to trade on a premium rating in the future, however, our current valuation already demonstrates clear upside potential and we have opted conservatively to maintain a target multiple in line with the fair sector multiple of 4.9x given that the premium rating has only recent been achieved.

CAML versus MSCI Metals & Mining and Aim Basic Resources



SOURCE: *Bloomberg, VSA Capital Research.*

Our sum of the parts target price for CAML is unchanged at 309p/sh. which implies 34% upside potential and 40% on a total return basis.

Central Asia Metals NAV Valuation

Division	Division NAV (US$'000)	Share, %	Attributable NAV, USD'000	P/NAV	Fair Equity Value (US$m)	Fair Equity Value (£m)
Kounrad	340,033	100%	340,033	1.0	340,033	260,125
Sasa	472,962	100%	472,962	1.0	472,962	361,816
Consolidated Net Debt					106,878	81,761
Total Equity Value					**706,117**	**540,180**

SOURCE: *Company data, VSA Capital Research.*

Valuation Summary

	USD'000	£'000
2018F EBITDA, VSA Capital	122,059	93,741
Sector 12-mo forward EV/EBITDA	4.9x	4.9x
Target 12-mo forward EV/EBITDA	4.9x	4.9x
Fair EV	603,325	463,354
Net Debt	106,878	82,082
Total Fair Equity Value	**710,203**	**545,436**
No. of Shares, m		176
Per Share Fair Value	310	310
NAV fair target price	308	308
Blended 12-mo Target Price, /sh.	**309**	**309**
Current Price, /sh.	229	229
Upside, %	34%	34%

SOURCE: *Company data, VSA Capital Research.*

Risks

- **Commodity Prices**. The company is primarily exposed to base metal price (copper, zinc and lead) and unexpected changes to commodity prices are likely to affect our valuation.
- **Political Risk.** Changes to the political regime and mining code in Kazakhstan and/or Macedonia would potentially alter the risk profile.
- **Macro Risk.** Unexpected moves in the KZT or EUR and higher than expected inflationary pressure might significantly impact the company's earnings.
- **Operational Risk.** The potential for delays and operating issues are an inherent industry risk.

Peer Group Comparison

						EV/EBITDA, x			P/E, x			Dividend Yield, %		
	Ticker	Location	Commodity	Market Cap (USDm)	Enterprise Value (USDm)	2017	2018F	2019F	2017	2018F	2019F	2017	2018F	2019F
DM														
Atalaya Mining	ATYM LN	Spain	Cu	423	366	6.29	5.85	4.78	17.09	10.78	9.12	-	-	-
Boliden AB	BOL SS	Sweden	Cu, Pb, Zn, Ag, Ni, Au	6,527	7,084	4.40	4.63	5.09	8.02	8.65	10.23	4.3%	6.6%	5.8%
Titan Mining	TI CN	USA	Zn	121	109	1.43	1.40	11.42	n/a	neg	89.53	-	0.1%	-
EM														
Antofagasta	ANTO LN	Chile	Cu	10,318	11,050	4.39	5.00	4.46	13.35	19.12	15.53	2.7%	2.2%	2.9%
Griffin Mining	GFM LN	China	Zn, Au	232	232	3.56	3.74	4.35	5.87	n/a	n/a	-	0.0%	5.2%
Hudbay Minerals	HBM CN	USA/ Peru	Cu, Zn, Au, Ag	1,439	2,068	3.34	3.44	3.97	10.03	15.55	35.26	0.4%	0.4%	0.4%
Kaz Minerals	KAZ LN	Kazakhstan	Cu, Au	3,173	5,413	5.13	4.38	4.65	6.79	6.61	6.28	-	1.8%	1.8%
KGHM	KGH PW	Poland / Chile	Cu, Au, Ag, Mo	4,825	6,960	4.12	5.13	4.73	6.80	10.53	7.97	1.2%	2.9%	2.2%
Lundin Mining	LUN CN	Global	Cu, Au, Ag, Co, Zn, Pb	3,072	1,942	1.81	2.99	2.97	8.02	14.46	14.91	2.9%	2.2%	2.1%
Nevsun Resources	NSU CN	Eritrea, Macedonia, Serbia	Cu, Zn, Au, Ag	1,353	1,213	15.86	15.56	16.38	neg	neg	nm	0.9%	0.1%	0.0%
Trevali	TV CN	Global	Zn, Pb, Ag	202	234	1.69	1.55	1.52	5.77	3.81	4.12	6.0%	5.7%	5.7%
Weighted Average						**4.61**	**4.94**	**4.97**	**9.27**	**11.95**	**12.36**			
Central Asia Metals	CAML LN	Kazakhstan, Macedonia		527	671	9.54	5.19	5.31	14.49	10.59	9.09	4.4%	6.0%	6.7%
					Discount/ Premium, %	**107%**	**5%**	**7%**	**56%**	**-11%**	**-26%**			

SOURCE: *Company Data, Bloomberg, VSA Capital Research*

Commodity Markets Update

Base metals prices remained range bound through H2 2018 following the sharp correction in Q2 2018 with a trade deal yet to materialise. However, we continue to believe that the correction has been excessive with data for the first nine months of 2018 demonstrating that copper, lead and zinc were all in deficit. Chinese economic date remains constructive as the rebalancing continues; personal savings remain high; household consumption rose 8% YoY in Q4 2018 driving strong consumption growth which accounted for 76% of GDP growth in 2018 supporting continued strong corporate earnings. Industrial production recovered in December to 5.7% while fixed asset investment was up 7.2% YoY in the last quarter. Furthermore, additional stimulus is expected to support to steady growth.

Although a formal deal has yet to materialise the change in tone since the talks in Argentina between Xi and Trump is noticeable and has supported equity markets globally while Chinese resumption of soybean purchases from the US demonstrates good faith. The risk now is that although both sides appear to want a deal but there is a question as to whether it can be practically achieved. Xi will not want to give any appearance of Chinese domestic policy being dictated by the US whilst Trump's focus on the bilateral trade deficit without consideration of the wider benefits of for example Chinese students and researchers to the US economy.

VSA Commodity Price Forecasts, USD/t

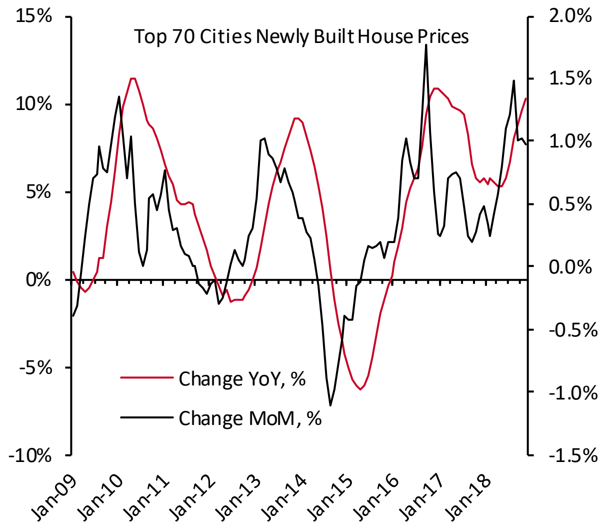
		2016A	2017A	2018A	2019F	2020F	2021F	2022F	LT
Copper Price	USD/t	5,800	6,200	6,544	7,000	7,250	7,000	6,750	6,500
Lead Price	USD/t	2,175	2,325	2,248	2,250	2,150	2,100	2,100	2,100
Zinc Price	USD/t	2,600	2,890	2,892	3,000	3,100	2,950	2,750	2,500

SOURCE: *Bloomberg, VSA Capital Research.*

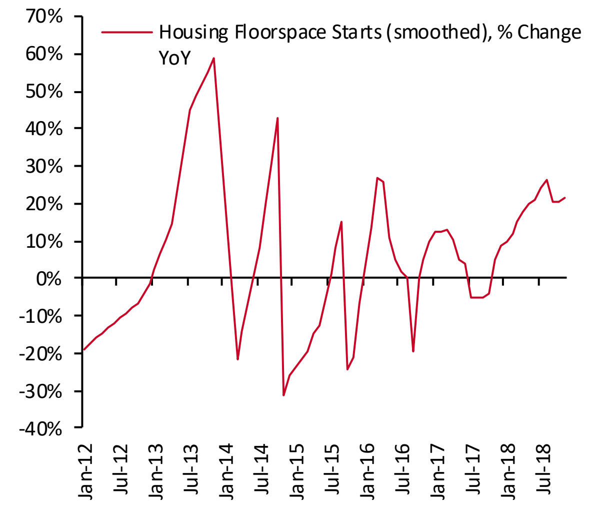
China Indicators Show Rebalancing Underway

The focus of the Chinese government is on successfully managing a rebalancing of the economy to a consumption led economy with a strong contribution from high value add manufacturing rather than an investment led model. Consumption remains strong underpinned by rising incomes which is now driving growth outside of China's mega cities such as Beijing and Shanghai while a crackdown on shadow banking suggests that steps are being taken to prevent the debt burden weighing on future growth. We see the managed slowdown and rebalancing as preferable to supporting high growth rates for near term gain at the expense of future growth.

China House Prices Growth Rebounds



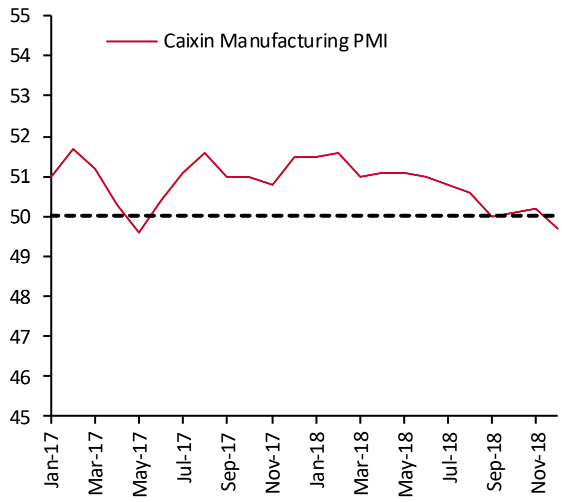
Housing Starts Rising Strongly



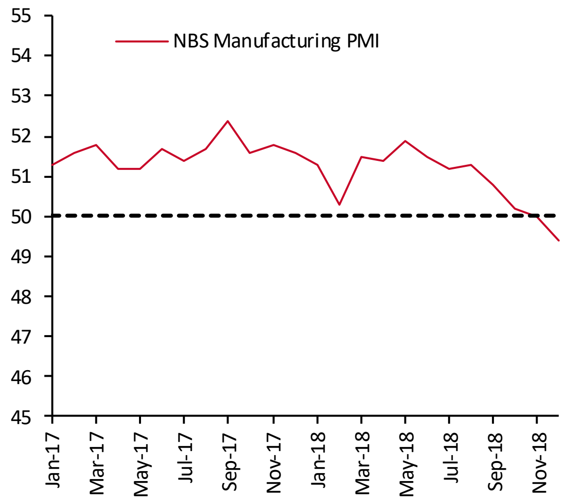
SOURCE: *Bloomberg, VSA Capital Research.*

Following an acceleration in house price growth in the middle of 2018 to 6.6% YoY and 1.2% MoM in July; price growth has moderated on a monthly basis to around 1% but remains positive. More importantly for forward commodities demand we highlight that housing starts continue to grow strongly at 22% YoY in November.

China Unofficial Manufacturing PMI



China Official Manufacturing PMI

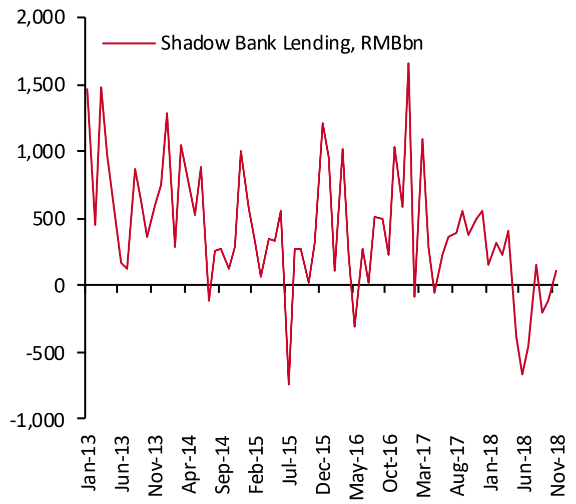


SOURCE: *Bloomberg, VSA Capital Research*.

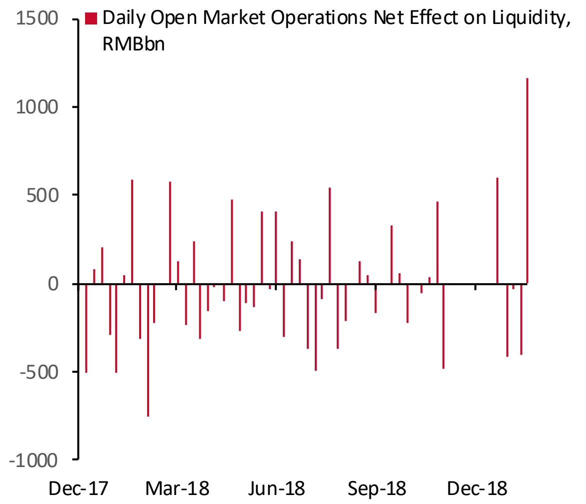
Industrial production growth of 5.7% YoY in December rebounded from 5.4% in November allaying concerns of an industrial slowdown in China. We believe that in November reading will have influenced PMI data and the latest data, PBoC injection of liquidity in January along with a possible cut in the reserve requirement ratio should provide additional support. Recent volatility in equity markets has been focused on weak auto sales. These have been weak throughout 2017 but driven by two factors which are not necessarily indicative of weaker industrial growth. The first is EVs where sales in 2018 were up 86% YoY, although currently only a small portion of the overall market this represents the start of a longer-term transition. Secondly, the market for used cars is new but rapidly gaining traction with sales doubling to 12m in three years by 2017 to around half of new car sales. We do note though that premium model new sales have stayed firm. We also highlight that whilst **Apple's (AAPL US)** results demonstrate weaker sales in China it is worth noting that the latest products retail at more than the average monthly Chinese wage.

Shadow banking activity contracted between May-August last year and was more significant than those contractions in 2015 and 2016. We are encouraged that the Government are focused on derisking the economy and believe that the PBoC liquidity injection last week of RMB 560bn (US$83bn) will help to replace that taken out via lower shadow banking activity. Although this is not a direct intervention into the real economy, it is a source of lower risk financing which does not carry the same risk as the more opaque and less well regulated shadow banking sector. We see these latest measures as a method of bringing credit more directly into the government's control allowing that process to be managed directly.

China Shadow Bank Lending Contraction



PBoC Record Liquidity Injections

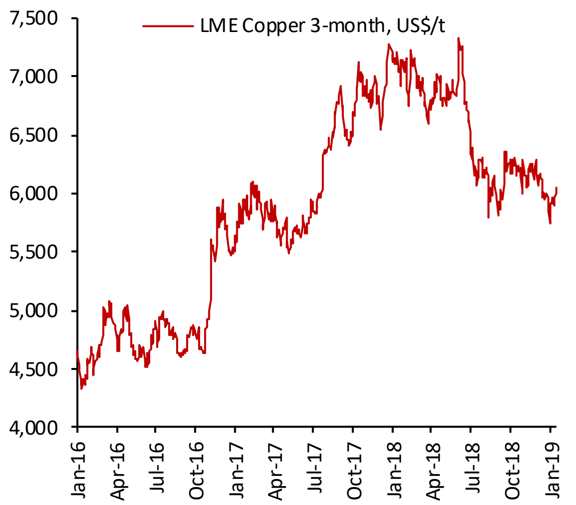


SOURCE: *Bloomberg, VSA Capital Research.*

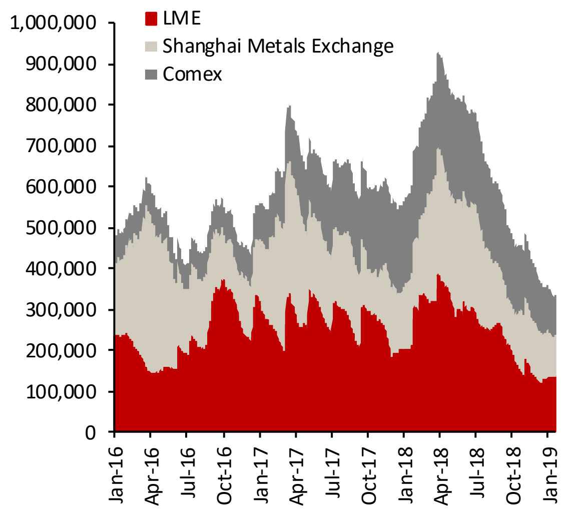
Copper Update

Copper prices were down 17% through 2018 having sharply corrected during Q2 2018 on the back of trade war fears between the US and China. With no firm commitments agreed base metal prices have remained range bound in recent months and copper prices have failed to break out above the US$6,000/t resistance level. This sharp correction is not borne out in the fundamentals, in our view, with robust demand expected to continue. Chinese imports in 2018 were up 13% YoY to 5.3mnt although we do note that imports in the final two months of the year were weaker down 2% and 5% YoY respectively. The medium to long term outlook remains positive, in our view, with supply growth affected by falling grades, rising costs and resource nationalism and demand set to remain robust.

Copper Price, US$/t



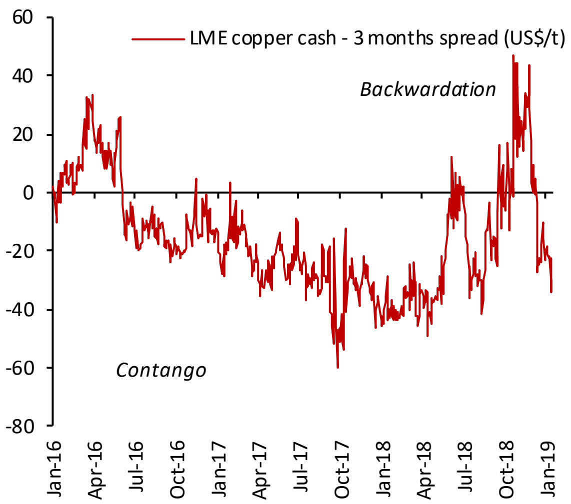
Copper Inventories



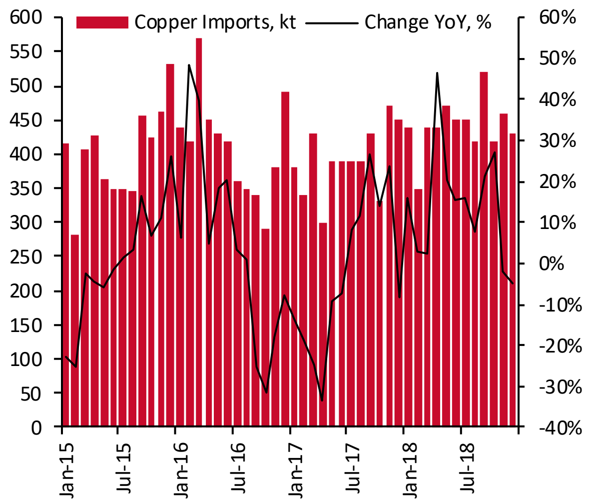
SOURCE: *Bloomberg, VSA Capital Research.*

Data from the ICSG showed a widening deficit in the refined copper market of 595kt over 9mo18. Consequently, with robust demand over the same period inventories have continued to be rapidly drawn down and are now down 61% from April 2018 highs to multi year lows of 332kt and the drawdown shows little sign of halting. With inventories at such low level, the market in deficit and with ongoing robust demand we believe this provides a backdrop for higher prices.

Trending Towards Backwardation



China Copper Imports, mnt



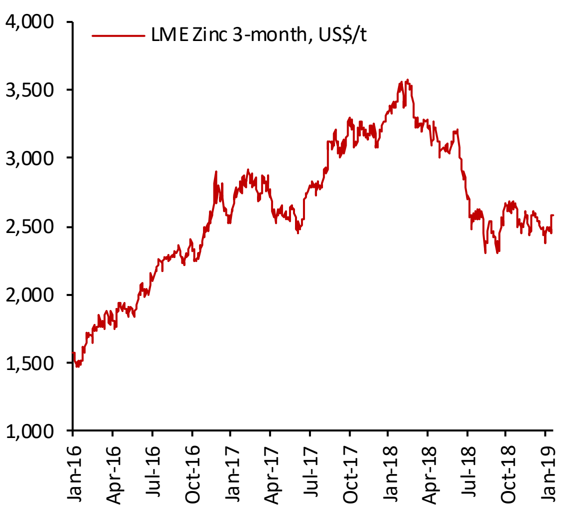
SOURCE: *Bloomberg, VSA Capital Research.*

Zinc Update

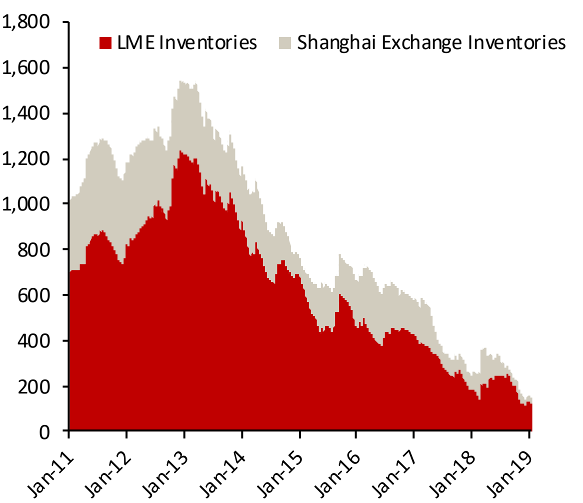
In 2018 zinc prices ended the year down 26% despite data showing that the market was in deficit of 301kt for the first nine months of 2018. Refined metal usage was broadly flat YoY over the same period. This was significantly wider than the initial seven months of the year where the deficit was around 33kt. The market was kept in deficit as mine closures in China, India and Australia offset a rise in European output. Inventories continued to be drawn down, falling by 40% through 2018. However, mined supply is set to bounce back in 2019 with **Glencore (GLEN LN)** and **Vedanta** amongst others bringing major projects online towards the end of 2018 which will have a more substantial impact in 2019. Demand is, however, expected to be strong, up 3% YoY, the strongest pick up in growth since 2015 on the back of stable Chinese demand and a recovery in US demand.

This means that overall we continue to expect markets to remain tight but with the deficit narrowing compared to that of 2018. Bottlenecks at smelters are now delaying mine output entering into the refined metal market and this means that treatment charges have jumped sharply by 30-40% in Q4 2018. The lag between higher treatment charges and incentive prices for additional smelter capacity means that metal prices are likely to be supported in the near term as refined metal output remains constrained.

Zinc Price, LME US$/t



Zinc Inventories, kt

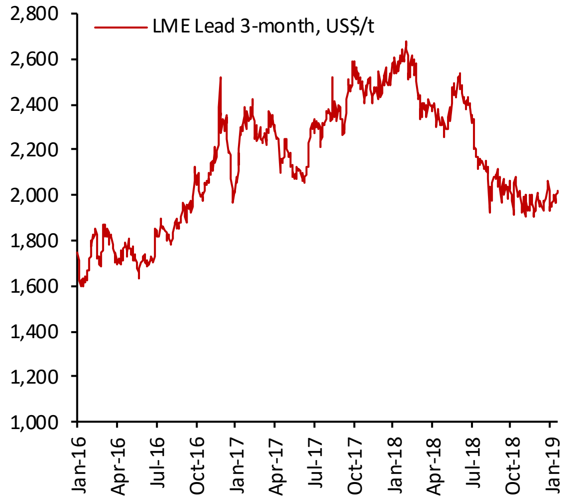


SOURCE: *Bloomberg, VSA Capital Research.*

Lead Update

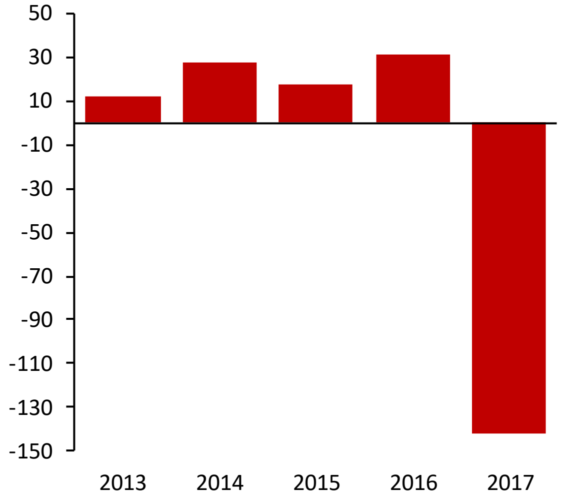
Lead prices have retraced along with other base metals, down 19% through 2018, hovering at the US$2,000/t support level. Trade tariffs again were the primary driver of the correction despite the ILZSG recording a narrow deficit during the first nine months of the year of around 94kt. Global demand in the first nine months of the year was flat YoY, however, output in terms of refined metal and mine output is expected to be down 0.4% and up 0.4% hence a finely balanced market.

Lead Price, LME US$/t



SOURCE: *Bloomberg, VSA Capital Research.*

Lead Market Balance, kt



SOURCE: *ILZSG, VSA Capital Research*

An ongoing Chinese environmental crackdown is likely to result in mine closures across China, particularly smaller scale operations over the short to medium term although this is likely to be offset by rising output from the zinc projects mentioned previously such as GLEN's Lady Loretta and their lead by-product contribution. We therefore anticipate that prices are likely to remain rangebound. We do note, however, that on the demand side over the longer term EV's continue to require a traditional lead acid battery due to the stability of the charge which is suitable for starting motors compared to that of lithium ion batteries.

Appendix 1: Financial Statements

Profit and Loss (US$'000), December Year End

	2016A	2017A	2018F	2019F	2020F
Revenue	**66,707**	**102,517**	**197,725**	**196,144**	**197,514**
Cost of sales	(18,388)	(31,363)	(84,710)	(91,200)	(91,561)
Gross Profit	**48,319**	**71,154**	**113,016**	**104,944**	**105,952**
Distribution and selling costs	(215)	(394)	-	-	-
Administrative Expenses	(13,266)	(15,294)	(22,738)	(21,576)	(21,726)
Other (expense)/income	192	(12,348)	-	-	-
Foreign exchange gain / (loss)	(1,385)	3,349	(2,950)	-	-
EBIT	**33,645**	**46,467**	**87,327**	**83,368**	**84,226**
Net finance costs	(91)	3,278	(11,915)	(10,579)	(7,499)
Profit before taxation	33,554	49,745	75,412	72,789	76,727
Mining and income tax	(6,661)	(13,468)	(25,356)	(14,558)	(15,345)
Profit for the year	**26,893**	**36,277**	**50,056**	**58,232**	**61,381**
Profit/loss for the year from discontinued operations	(796)	56	(400)	(380)	(241)
Non-controlling interest	(173)	(36)	(100)	(103)	(80)
Attributable to equity holders of the company	**26,270**	**36,369**	**49,756**	**57,955**	**61,220**

SOURCE: *Company Data, VSA Capital Research.*

Balance Sheet (US$'000), December Year End

	2016A	2017A	2018F	2019F	2020F
Non-current Assets					
Property, plant and equipment	50,324	460,952	445,371	420,312	395,002
Intangible Assets	40,759	70,321	72,821	72,821	72,821
Other non-current receivables	2,738	2,519	2,519	2,519	2,519
Total non-current assets	**93,821**	**533,792**	**520,711**	**495,652**	**470,342**
Current assets					
Inventories	3,319	6,998	10,834	13,435	13,528
Trade and Other Receivables	919	13,738	14,085	16,121	16,234
Restricted Cash	118	2,812	2,812	2,812	2,812
Cash and bank balances	40,258	43,022	39,036	49,504	61,258
Assets of disposal group classified as held for sale	45	4,516	4,516	4,516	4,516
Total current assets	**44,659**	**71,086**	**71,283**	**86,388**	**98,348**
Total assets	**138,480**	**604,878**	**591,994**	**582,040**	**568,690**
Equity and liabilities					
Ordinary shares	1,121	1,765	1,765	1,765	1,765
Share Premium	-	191,184	191,184	191,184	191,184
Treasury Shares	(7,780)	(7,780)	(7,780)	(7,780)	(7,780)
Currency Translation Reserve	(87,435)	(79,446)	(79,446)	(79,446)	(79,446)
Retained Earnings	209,120	215,479	233,375	256,034	280,936
Profit for the year attributable to the owners	26,270	36,369	49,756	57,955	61,220
Other changes in retained earnings	(19,911)	(20,553)	(33,940)	(42,139)	(45,404)
Non-Controlling Interest	91	55	55	55	55
Total equity	**121,476**	**337,073**	**354,969**	**377,628**	**402,530**
Non-current liabilities					
Borrowings	-	141,839	141,839	103,439	65,039
Deferred revenue	-	17,621	17,621	17,621	17,621
Other non-current payables	-	8,000	8,000	8,000	8,000
Deferred income tax liability	8,541	30,361	30,361	30,361	30,361
Provisions for other liabilities and charges	2,087	5,319	5,319	5,319	5,319
Total non-current liabilities	**10,628**	**203,140**	**203,140**	**164,740**	**126,340**
Current liabilities					
Borrowings	-	40,075	4,075	-	-
Deferred Revenue	-	2,056	2,056	2,056	2,056
Provisions for other liabilities and charges	-	46	46	46	46
Liabilities of disposal group classified as held for sale	356	90	90	90	90
Trade and other payables	6,020	22,398	27,618	37,479	37,628
Total current liabilities	**6,376**	**64,665**	**33,885**	**39,671**	**39,820**
Total liabilities	**17,004**	**267,805**	**237,025**	**204,411**	**166,160**
Total equity and liabilities	**138,480**	**604,878**	**591,994**	**582,040**	**568,690**

SOURCE: *Company Data, VSA Capital Research.*

Statement of Cash Flows (US$'000), December Year End

	2016A	2017A	2018F	2019F	2020F
Cash flows from operating activities					
Net Income	**26,270**	**36,369**	**49,756**	**57,955**	**61,220**
Adjustments for:					
Depreciation & Amortisation	5,083	10,927	31,781	36,059	35,610
Amortisation of deferred revenue - received advances for silver delivery	-	(304)	-	-	-
Gain on Disposal of Property, Plant and Equipment	(64)	-	-	-	-
Foreign Currency Translation	1,234	(3,349)	-	-	-
Share based payments	2,959	2,823	-	-	-
Finance income	(67)	(5,597)	-	-	-
Finance costs	158	2,319	11,915	10,579	7,499
Movements in working capital:					
Change in working capital	2,685	3,792	1,037	5,225	(58)
Interest paid	(4)	(2,127)	(11,915)	(10,579)	(7,499)
Taxes Paid	(9,208)	(12,294)	-	-	-
Net cash generated by operating activities	**35,534**	**45,991**	**82,574**	**99,238**	**96,772**
Cash flows from investing activities					
Acquisition of property, plant and equipment	(12,331)	(4,082)	(16,200)	(11,000)	(10,300)
Purchase of intangible assets	(1,594)	(2,025)	(2,500)	-	-
Proceeds from sale of PPE	147	-	-	-	-
Interest received	67	323	-	-	-
Acquisitions, net of cash acquired	-	(268,008)	-	-	-
Restricted cash decrease/ (increase)	376	(2,694)	-	-	-
Net cash (used in)/generated by investing activities	**(13,335)**	**(276,486)**	**(18,700)**	**(11,000)**	**(10,300)**
Cash flows from financing activities					
Proceeds from Issue of Share Capital	-	142,945	-	-	-
Gains on currency hedge	-	2,977	-	-	-
Proceeds from borrowings	-	120,000	-	-	-
Repayment of borrowings	-	(8,362)	(36,000)	(42,475)	(38,400)
Dividends Paid	(20,360)	(23,146)	(31,859)	(35,295)	(36,318)
Settlement on exercise of share options	(2,436)	(1,491)	-	-	-
Net cash used in financing activities	**(22,796)**	**232,923**	**(67,859)**	**(77,770)**	**(74,718)**
Net increase in cash and cash equivalents	**(1,266)**	**2,915**	**(4,137)**	**10,468**	**11,754**
Effects of exchange rate changes on the balance of cash held in foreign currencies	(669)	487	(151)	-	-
Cash and cash equivalents at the beginning of the year	**41,524**	**40,258**	**43,173**	**39,036**	**49,504**
Cash and cash equivalents at the end of the year	**40,258**	**43,173**	**39,036**	**49,504**	**61,258**

SOURCE: *Company Data, VSA Capital Research.*

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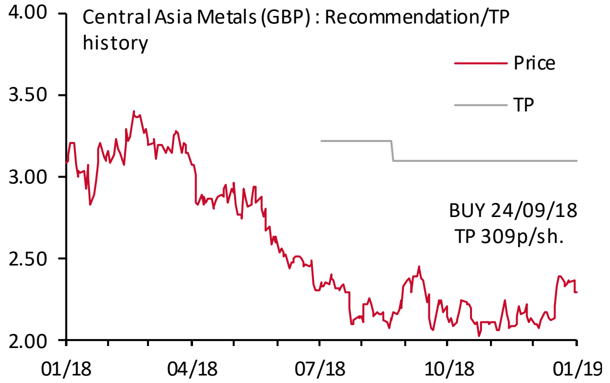
Recommendation and Target Price History



***SOURCE**: FactSet data, VSA Capital Research.*

Valuation basis

Our valuation for Central Asia Metals is based on a 50/50 blend of DCF analysis and EV/EBITDA peer based multiples.

Risks to that valuation

Commodity prices, political risk, execution risk.

This recommendation was first published on 2 August 2018.