

# Zhaojin Mining (1818 HK)

- ▶ Zhaojin is the major “pure” gold play in Hong Kong with the fastest production volume growth (+16% in 2013e) among major peers
- ▶ We lower earnings estimates by 8% in 2013-14e and target price by 9%, driven by changes in our commodities price forecasts
- ▶ Maintain Overweight (V) on valuation and fast volume growth; target price HKD14.94 from HKD16.50

## Investment thesis

Zhaojin is the major “pure” gold play in Hong Kong. We expect gold to represent c87% of Zhaojin’s revenue in 2013e-14e. As a result, Zhaojin offers the highest earnings leverage to gold among peers with earnings 1.7x sensitive to gold prices in 2013e – Zhaojin should be a major beneficiary of higher gold prices.

In addition, Zhaojin offers strong resource growth and production growth prospects. Zhaojin has been very successful in growing its resources through exploration and acquisition. We think the resources consolidation agreements with several local governments should help future resources growth.

We expect gold production from self-owned mines to grow by 16% in 2013e and by a further 11% in 2014e, the fastest among major peers. We forecast that most volume growth will come from

mines outside Shandong. We expect the expansion at the Zaozigou, Qinghe and Fengcheng mines to come on stream in 2013e and to reach designed capacities in 2014e.

## Changes to our estimates

We raised our earnings forecast by 3% to RMB1.8bn in 2012e as we slightly increased the production volume and lowered the cost. We lowered our earnings forecasts by 8% in 2013e on the back of lower gold price assumptions and lowered our earnings forecasts by 8% in 2014e on lower copper price forecasts and higher costs.

## Valuation and risks

We lower our target price by 9% to HKD14.94. Our target price is based on our blended PE and life-of-mine DCF valuations. We apply a 50:50 blend of our PE valuation of HKD15.26 per share, based on a 17.0x 2013e PE, and our DCF

## Revised forecasts (RMB m)

	Old			New			Change		
	2012E	2013E	2014E	2012E	2013E	2014E	2012E	2013E	2014E
Revenues	7,115	8,721	9,713	7,182	8,569	9,513	1%	-2%	-2%
Net income	1,707	2,312	2,495	1,760	2,116	2,286	3%	-8%	-8%
EPS, Rmb	0.58	0.78	0.84	0.60	0.71	0.77	3%	-8%	-8%

Source: HSBC

valuation of HKD14.62 per share. Our PE valuation is based on a 10% discount to its average PE over the past two years. Our DCF valuation is based on the following assumptions: 1) cost of capital of 6.5%; 2) adjusted beta of 0.71 measured against the HSCEI index; and 3) borrowings representing 30% of EV.

For volatile stocks, the band for Overweight rating is 10ppts above our hurdle rate for China equities at 9.5%. Our target price, together with the expected dividend yield), implies a potential return of 30%, which is within the Overweight band. On this basis, we rate Zhaojin Overweight (V). Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated.

**Catalyst:** We expect Zhaojin's share price performance to be driven by gold prices.

**Downside risk:** Lower-than-expected gold prices, slower-than-expected capacity ramp-ups, higher-than-expected cost increase and management slowing down gold sales in hope for higher gold prices later.

## Financials & valuation: Zhaojin Mining Industry

Overweight (V)

### Financial statements

Year to	12/2011a	12/2012e	12/2013e	12/2014e
<b>Profit &amp; loss summary (CNYm)</b>				
Revenue	5,741	7,182	8,569	9,513
EBITDA	2,864	3,123	3,680	3,949
Depreciation & amortisation	-471	-524	-613	-684
Operating profit/EBIT	2,393	2,599	3,067	3,265
Net interest	-86	-201	-185	-148
PBT	2,287	2,418	2,907	3,142
HSBC PBT	2,287	2,418	2,907	3,142
Taxation	-564	-556	-669	-723
Net profit	1,662	1,760	2,116	2,286
HSBC net profit	1,662	1,760	2,116	2,286

### Cash flow summary (CNYm)

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Cash flow from operations	2,079	3,375	3,374	3,717
Capex	-1,709	-2,316	-2,404	-2,051
Cash flow from investment	-2,269	-2,595	-2,404	-1,951
Dividends	-458	-612	-616	-740
Change in net debt	765	-550	-356	-1,157
FCF equity	158	1,212	1,043	1,801

### Balance sheet summary (CNYm)

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Intangible fixed assets	3,178	3,957	4,562	5,053
Tangible fixed assets	4,927	6,187	7,470	8,450
Current assets	3,962	5,675	6,088	7,315
Cash & others	1,246	3,546	3,903	5,059
Total assets	13,291	17,159	19,460	22,057
Operating liabilities	2,580	3,246	3,924	4,807
Gross debt	3,159	4,910	4,910	4,910
Net debt	1,913	1,364	1,007	-149
Shareholders funds	6,584	7,782	9,282	10,828
Invested capital	8,240	9,027	10,293	10,951

### Ratio, growth and per share analysis

Year to	12/2011a	12/2012e	12/2013e	12/2014e
<b>Y-o-y % change</b>				
Revenue	40.1	25.1	19.3	11.0
EBITDA	38.3	9.0	17.8	7.3
Operating profit	38.7	8.6	18.0	6.5
PBT	38.4	5.8	20.2	8.1
HSBC EPS	-30.9	5.0	19.2	8.1

### Ratios (%)

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Revenue/IC (x)	0.8	0.8	0.9	0.9
ROIC	23.9	23.2	24.4	23.7
ROE	27.8	24.5	24.8	22.7
ROA	15.8	13.4	13.2	12.4
EBITDA margin	49.9	43.5	42.9	41.5
Operating profit margin	41.7	36.2	35.8	34.3
EBITDA/net interest (x)	33.4	15.6	19.9	26.7
Net debt/equity	27.3	16.4	10.2	-1.3
Net debt/EBITDA (x)	0.7	0.4	0.3	0.0
CF from operations/net debt	108.6	247.5	334.9	

### Per share data (CNY)

Year to	12/2011a	12/2012e	12/2013e	12/2014e
EPS Rep (fully diluted)	0.57	0.60	0.71	0.77
HSBC EPS (fully diluted)	0.57	0.60	0.71	0.77
DPS	0.21	0.21	0.25	0.27
Book value	2.26	2.62	3.13	3.65

### Key forecast drivers

Year to	12/2011a	12/2012e	12/2013e	12/2014e
Gold production (t)	23.6	23.6	26.4	28.9
- from own mines	11.8	14.0	16.2	17.9
- from other sources	11.7	9.6	10.3	11.0
Gold prices (USD/oz)	1,571	1,669	1,760	1,775
Unit cost (USD/oz)	598	665	721	766

### Valuation data

Year to	12/2011a	12/2012e	12/2013e	12/2014e
EV/sales	5.1	4.0	3.3	2.9
EV/EBITDA	10.2	9.2	7.7	6.9
EV/IC	3.5	3.2	2.8	2.5
PE*	16.4	15.7	13.1	12.2
P/Book value	4.1	3.6	3.0	2.6
FCF yield (%)	0.6	4.4	3.8	6.6
Dividend yield (%)	2.2	2.2	2.7	2.9

Note: \* = Based on HSBC EPS (fully diluted)

### Price relative



Source: HSBC

Note: price at close of 31 Jan 2013