

Equity Research | China | Gold

20 March 2017

## Long-term value emerging

- **Zhaojin's 2016 underlying net profit came in ahead our expectation with blended gross margins widening on higher gold prices.**
- **We revised down our FY17E net profit estimate by 8.3% on the back of management's guidance on potential higher costs and tax rate. However, growth prospects are to remain positive, driven by: (1) Haiyu mine development progressing smoothly, (2) acceleration in overseas M&As, and (3) A-share listing plan.**
- **Still pegging to 2.0x FY17E PBR, our revised target price of HKD9.0 (from HKD10.0) represents 19.8% upside potential. Maintain Buy rating.**

**FY16 underlying earnings beat market expectations.** Excluding exceptional items, Zhaojin's underlying net profit was ahead of consensus. Thanks to the increase in gold unit selling prices and a higher recovery rate, gross profit margin widened by 3.05ppt to 40.95% in 2016. Mined gold production volume was flat for the full-year, which was expected. Based on the company's data, Zhaojin was ranked in the first quartile of low-cost producers globally. We believe Zhaojin's overall results demonstrate its leading position in the domestic gold industry. Meanwhile, although the copper business posted a loss last year, contribution from this segment was small, having accounted for merely 8% of total revenue in FY16.

**Gold remains a safe haven in 2017.** We are optimistic on gold prices in 2017, in view of: (1) the inflationary environment in the US economy is likely to persist going forward, (2) rising gold demand from the emerging economies, (3) political tensions linked to the Trump presidency, Brexit and a host of elections in Europe may spark renewed gold demand later this year, (4) reduction in mined production to offset increasing supply from recycling. Moreover, if the RMB comes under further depreciation pressure in the near-term, it would translate into higher RMB-denominated selling prices for Chinese gold producers.

**Optimistic growth prospects for Zhaojin.** Based on the latest guidance of stable costs and the effective tax rate to rise to 30% (from 25%), we revised down our FY17E net profit estimate by 8.3%. Meanwhile, management also claimed that development of the Haiyu mine, acquired in 2015 with a proven gold reserve of 188 tons and an average conversion rate of 4.6g/ton, is progressing well. We expect this mining project to contribute to a significant portion of the total volume growth of the company in both 2018 and 2019, on the target of adding 15tons output by 2019, which is nearly double the current production and provides potential for improvement in its long-term value driven by the strong growth prospects.

**Valuation is undemanding, maintain Buy with PT revised down to HKD9.0 (from HKD10.0).** Trading at 1.7x FY17E PBR, versus our estimated ROE of 6.5%, we believe Zhaojin's valuation is not expensive as compared to its corresponding five-year historical range during 2013 and 2017, as well as A-share peers. Pegging to 2.0x PBR, our target price represents 19.8% upside potential.

## Zhaojin Mining (1818 HK)

### Buy

(unchanged)

<b>Price Target</b>	<b>HK\$9.0</b>
(Revision)	(-10.0%)
(up/downside)	(+19.8%)

EPS	2017E	2018E
revision	(-8.3%)	(N/A)

Close price HKD7.51

Market cap. HKD22,270 mn

Free float 89.5%

52-week range HKD5.61 – 10.02

3-mth ave. T/O HKD56.8 mn

Price as of 17 March 2017

### Stock rel HSI performance (%)



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**Income statement (RMB mn)**

Year end: Dec	2014	2015	2016	2017E	2018E
Revenue	5,606	5,887	6,665	6,416	6,480
COGS	(3,434)	(3,656)	(3,935)	(3,955)	(3,984)
Gross profit	2,172	2,231	2,729	2,461	2,496
Selling expenses	(120)	(98)	(72)	(69)	(70)
General and administrative	(907)	(957)	(1,055)	(1,015)	(1,025)
Other opex	26	(98)	(344)	35	35
<b>EBITDA</b>	<b>1,889</b>	<b>1,833</b>	<b>1,988</b>	<b>2,148</b>	<b>2,218</b>
Depreciation & Amortization	(691)	(752)	(723)	(731)	(776)
<b>EBIT</b>	<b>1,197</b>	<b>1,081</b>	<b>1,265</b>	<b>1,418</b>	<b>1,442</b>
Interest income	463	41	160	169	194
Interest expense	(977)	(567)	(625)	(509)	(525)
JVs and associates	26	3	6	6	6
Others	-	-	-	-	-
<b>Pretax profit</b>	<b>683</b>	<b>555</b>	<b>799</b>	<b>1,078</b>	<b>1,111</b>
Taxation	(176)	(155)	(366)	(323)	(278)
Minority interests	(51)	(91)	(80)	(140)	(154)
<b>Net profit</b>	<b>455</b>	<b>308</b>	<b>353</b>	<b>615</b>	<b>679</b>
Net profit (adjusted)	455	308	505	615	679
Basic EPS (RMB)	0.15	0.10	0.12	0.21	0.23
Diluted EPS (RMB)	0.15	0.10	0.17	0.21	0.23
DPS (RMB)	0.05	0.04	0.04	0.06	0.07

**Balance sheet (RMB mn)**

Year end: Dec	2014	2015	2016	2017E	2018E
Cash	1,255	2,033	1,438	2,229	1,983
Short term investments	-	-	-	-	-
Accounts receivables	103	67	281	168	169
Inventory	3,172	3,439	3,631	3,552	3,578
Other current assets	1,314	993	2,261	2,261	2,261
<b>Total current assets</b>	<b>5,843</b>	<b>6,533</b>	<b>7,610</b>	<b>8,210</b>	<b>7,991</b>
PP&E	11,145	12,820	12,974	13,886	14,752
Intangible Assets	5,301	9,645	10,297	10,297	10,297
Total investments	450	423	436	436	436
Other long term assets	3,661	1,635	1,646	1,646	1,646
<b>Total long term assets</b>	<b>20,557</b>	<b>24,521</b>	<b>25,353</b>	<b>26,265</b>	<b>27,131</b>
<b>TOTAL ASSETS</b>	<b>26,400</b>	<b>31,054</b>	<b>32,964</b>	<b>34,474</b>	<b>35,122</b>
Short term debt	4,716	9,524	12,082	12,926	12,926
Accounts payables	479	583	390	489	493
Other current liabilities	5,540	2,364	3,404	3,246	3,260
<b>Total current liabilities</b>	<b>10,735</b>	<b>12,471</b>	<b>15,876</b>	<b>16,661</b>	<b>16,679</b>
Long term debt	2,174	1,733	1,088	1,244	1,244
Deferred tax	1,051	1,069	920	920	920
Bonds payable	2,690	2,141	945	945	945
Other long term liabilities	-	-	-	-	-
<b>Total long term liabilities</b>	<b>5,915</b>	<b>4,942</b>	<b>2,952</b>	<b>3,109</b>	<b>3,109</b>
<b>TOTAL LIABILITIES</b>	<b>16,650</b>	<b>17,413</b>	<b>18,828</b>	<b>19,769</b>	<b>19,788</b>
Shareholders' funds	8,667	10,741	11,222	11,652	12,128
Minority Interests	1,083	2,900	2,913	3,053	3,207
<b>TOTAL LIAB AND EQUITY</b>	<b>26,400</b>	<b>31,054</b>	<b>32,964</b>	<b>34,474</b>	<b>35,122</b>
Net cash / (debt)	(8,325)	(11,364)	(12,677)	(12,886)	(13,132)

Source: Company, Bloomberg, CSCI Research estimates

**Cash flow statement (RMB mn)**

Year end: Dec	2014	2015	2016E	2017E	2018E
<b>EBIT</b>	<b>1,197</b>	<b>1,081</b>	<b>1,265</b>	<b>1,418</b>	<b>1,442</b>
Depreciation & amortisation	691	752	723	731	776
Net interest	54	526	465	340	331
Taxes paid	(176)	(155)	(366)	(323)	(278)
Changes in working capital	(588)	(217)	(263)	133	(10)
Others	(570)	(469)	(2,658)	(680)	(662)
<b>Cash flow from operations</b>	<b>1,068</b>	<b>1,519</b>	<b>(834)</b>	<b>1,618</b>	<b>1,600</b>
Capex	(2,178)	(1,211)	(1,642)	(1,642)	(1,642)
Acquisitions	(1,158)	(1,381)	-	-	-
Disposals	75	82	-	-	-
Others	996	(72)	-	-	-
<b>Cash flow from investing</b>	<b>(2,264)</b>	<b>(2,583)</b>	<b>(1,642)</b>	<b>(1,642)</b>	<b>(1,642)</b>
Dividends	(420)	(210)	(119)	(184)	(204)
Issue of shares	-	-	-	-	-
Change in debt	447	1,089	2,000	1,000	-
Others	1,388	963	-	-	-
<b>Cash flow from financing</b>	<b>1,415</b>	<b>1,842</b>	<b>1,881</b>	<b>816</b>	<b>(204)</b>
<b>Change in cash</b>	<b>219</b>	<b>778</b>	<b>(595)</b>	<b>791</b>	<b>(246)</b>
Free cash flow	(1,109)	308	(2,477)	(24)	(42)

**Key ratios**

Year end: Dec	2014	2015	2016E	2017E	2018E
<b>Operating ratios</b>					
Gross margin	38.8	37.9	41.0	38.4	38.5
EBITDA margin (%)	33.7	31.1	29.8	33.5	34.2
Effective tax rate (%)	25.8	27.9	45.8	30.0	25.0
Revenue growth (%)	-	5.0	13.2	(3.7)	10
Net income growth (%)	-	-	14.7	21.7	10.5
EPS growth adj (%)	-	-	62.6	21.7	10.5
DPS growth (%)	-	-	(0.8)	55.5	10.5
<b>Efficiency ratios</b>					
ROE (%)	5.3	2.9	4.5	5.3	5.6
ROCE (%)	7.6	5.8	7.4	8.0	7.8
Asset turnover (x)	0.2	0.2	0.2	0.2	0.2
Op cash / EBIT (x)	0.9	1.4	(0.7)	1.1	1.1
Depreciation / CAPEX (x)	0.3	0.6	0.4	0.4	0.5
Accounts receivable days	9.5	5.3	9.5	12.8	9.5
Accounts payable days	221.8	220.6	229.0	231.7	228.1
<b>Leverage ratios</b>					
Net gearing (%)	96.1	105.8	113.0	110.6	108.3
Net debt / EBITDA (x)	4.4	6.2	6.4	6.0	5.9
Interest cover (x)	2.3	2.1	2.7	4.2	4.4
Current ratio (x)	0.5	0.5	0.5	0.5	0.5
<b>Valuation</b>					
PER (x)	43.5	64.3	56.5	32.5	29.4
EV/EBITDA (x)	18.2	17.5	17.0	15.8	15.4
PBR (x)	2.0	1.5	1.8	1.7	1.6
Dividend yield (%)	0.7	0.6	0.6	0.9	1.0

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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

<b>Buy</b>	12-month absolute total return: $\geq 10\%$
<b>Hold</b>	12-month absolute total return: $> -10\%$ but $< 10\%$
<b>Sell</b>	12-month absolute total return: $\leq -10\%$

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