

Zhaojin Mining | 1818 HK

A closer look back at 9M19

- ▶ **Non-consolidated account, which recorded substantial growth in operating profit, is a better proxy for performance of the core business**
- ▶ **Our preferred sector pick in view of long-term organic growth from commissioning of a new mine**

Core business growth in line with gold prices. Zhaojin's 9M19 results for its unconsolidated accounts appear to be much stronger than those of the consolidated account. Revenue for the unconsolidated/parent account for 9M19 grew 11% YoY, close to the 12% increase seen in gold prices in renminbi terms during the same period. Gross profit and pre-tax profit growth excluding investment income came to 32% and 63% YoY, respectively, versus 2%/2%/-31% YoY growth for revenue/gross profit/pre-tax profit excluding investment income in the consolidated account. In our view, the parent account is a better gauge of the financial performance of Zhaojin's gold mining operations. Zhaojin remains our preferred China gold pick in light of its stronger organic growth beyond 2021-2022F once its Haiyu project begins production.

Digging deeper into the quarterly results. Zhaojin's quarterly results were prepared according to the China Accounting Standard whereas its interim and annual results followed the Hong Kong Accounting Standard. As such, quarterly earnings comparisons of interim/annual data with the quarterly data could be distorted by the different accounting methods applied. This, combined with the seasonality of the unaudited accounting reports of the subsidiaries, contributed to large disparities in revenue growth recorded in the consolidated income report and gold prices changes. As production at Zhaojin has been relatively stable, revenue growth should follow the trend for domestic gold prices.

Pain before gains at the Haiyu project. The launch of Zhaojin's Haiyu project is pending approval by the Ministry of Natural Resources, which could be granted by the end of the year. We assume the project will be approved and will begin production in 2H22F. Full commissioning of this project would increase annualized gold output at Zhaojin by 40-50% YoY. Before production begins, Zhaojin will have to finance the necessary capex, which explains why gearing has been creeping up since 2015.

Forecast and valuation

Year to 31 Dec	2017	2018	2019F	2020F	2021F
Revenue (RMB m)	6,674	7,177	7,369	9,520	9,469
YoY (%)	0.1	7.5	2.7	29.2	(0.5)
Net profit (RMB m)	644	474	815	1,907	1,940
YoY (%)	82.3	-26.3	71.9	133.9	1.8
Fully diluted EPS (RMB)	0.20	0.15	0.25	0.59	0.60
YoY (%)	71.3	-27.8	71.9	133.9	1.7
P/E (x)	37.5	54.5	31.7	13.6	13.3
DPS (RMB)	0.06	0.04	0.06	0.15	0.15
Dividend yield (%)	0.7	0.5	0.8	1.8	1.9
P/B (x)	2.0	1.9	1.8	1.6	1.5
ROAE (%)	5.3	3.6	6.0	12.9	11.8
Net debt/equity (%)	70.8	86.6	82.5	69.0	59.3

Source: Company, CCBIS estimates

Outperform (maintained)

Current price:

HK\$8.82

(as at 17 Oct 2019)

Target:

▶ HK\$15.00

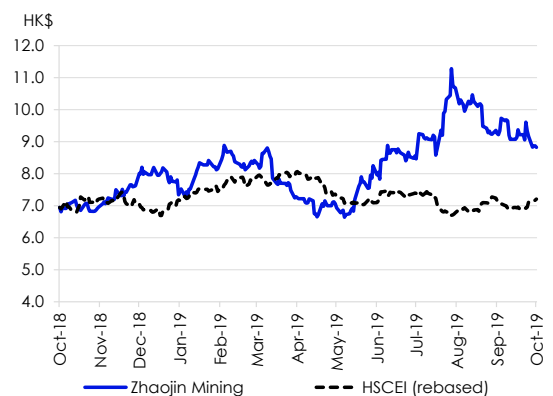
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Trading data

52-week range	HK\$6.50-11.36
Market capitalization (m)(H shr)	HK\$ 28,407/US\$3,621
Shares outstanding (m)	3,221
Free float (%) - H shares	35.2
3M average daily T/O (m share)	10.5
3M average daily T/O (US\$ m)	13.1
Expected 12-month return (%)	71

Source: Bloomberg, CCBIS estimates

Share price vs HSCEI over the past 12 months



Source: Bloomberg

Stock performance

Performance (%)	1M	3M	12M
Absolute	-4.6	4.3	27.1
Relative to HSCEI	-5.5	6.6	23.3

Source: Bloomberg

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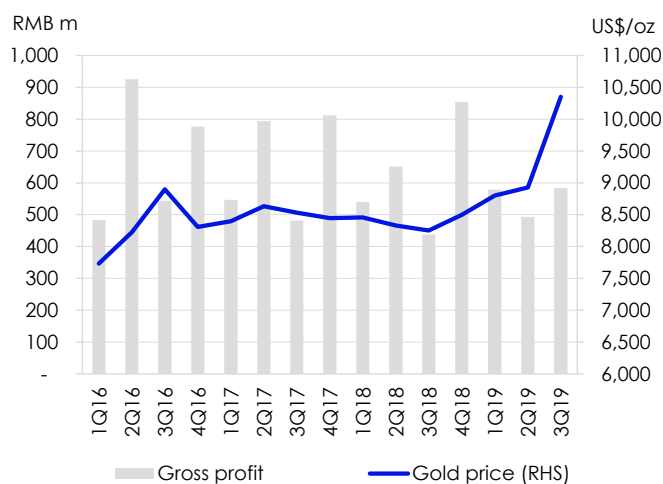
Zhaojin Mining – summary for 9M19 results

RMB m	9M18	9M19	YoY chg (%/pp)	3Q18*	2Q19*	3Q19*	QoQ chg (%/pp)	YoY chg (%/pp)
Consolidated account								
Revenue	4,559	4,634	1.6	1,690.9	1,362.0	1,816.2	33.3	7.4
Gross profit	1,629	1,655	1.6	437.8	493.0	583.4	18.3	33.3
Operating profit	997	950	-4.8	272.4	259.9	354.7	36.5	30.2
Pre-tax profit excl. investment gains	606	418	-30.9	120.2	305.8	-66.9	-121.9	-155.7
Pre-tax profit	637	444	-30.2	151.3	291.9	-41.1	-114.1	-127.2
Net profit	356	317	-10.9	53.9	267.3	-82.4	-130.8	-252.8
Gross margin	35.7	35.7	-0.0	25.9	36.2	32.1	-4.1	6.2
Operating margin	21.9	20.5	-1.4	16.1	19.1	19.5	0.5	3.4
Pre-tax margin	14.0	9.6	-4.4	8.9	21.4	-2.3	-23.7	-11.2
Net margin	7.8	6.8	-1.0	3.2	19.6	-4.5	-24.2	-7.7
Unconsolidated/parent account								
Revenue	2,096	2,325	10.9	-	-	-	-	-
Gross profit	789	1,042	32.1	-	-	-	-	-
Operating profit	544	789	45.0	-	-	-	-	-
Pre-tax profit excl. investment gains	111	182	63.2	-	-	-	-	-
Pre-tax profit	452	379	-16.3	-	-	-	-	-
Net profit	414	350	-15.4	-	-	-	-	-
Gross margin (%)	37.6	44.8	7.2	-	-	-	-	-
Operating margin (%)	26.0	34.0	8.0	-	-	-	-	-
Pre-tax margin (%)	21.6	16.3	-5.3	-	-	-	-	-
Net margin (%)	19.7	15.1	-4.7	-	-	-	-	-

* Quarterly results derived by comparing interim results and results for the first nine months, which are based on the HK accounting standard and China accounting standard, accordingly

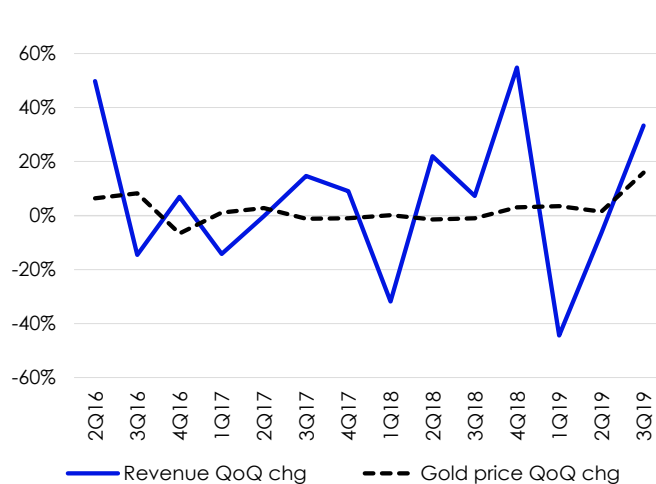
Source: Company, CCBIS

Zhaojin's gross margin not following the gold price trend



Source: Company, CCBIS

Zhaojin's quarterly revenue change disconnected from changes in gold price



Source: Company, CCBIS

Company profile

Zhaojin Mining is a major integrated gold mining company based in Shandong province, China. It was listed in Hong Kong in 2016. Shandong Zhaojin Group is the largest shareholder with a 36.3% stake in the company followed by Fosun International with a 23.7% stake. The company plans to expand overseas through acquisitions.

Valuation and risk assessment

Our HK\$15.00 target price is based on a 2020F EV/EBITDA multiple of 14.2x, the mean for 2011-2018.

A decline in the price of gold is by far the biggest risk to Zhaojin. According to our analysis, every 5% decline in the price of gold would cut earnings by 25% in 2019F and 19% in 2020F. A more promising economic outlook and a stronger US dollar would drive risk appetite out of gold and weigh on gold prices. Tightening mining regulations in China, delays in the commissioning of the Haiyu mine and overpaying for acquisitions are the major risks to investors.

16.4m oz of gold metal reserves as at end-2018 to support over 10-years of operation

Zhaojin Mining | 1818 HK – financial summary

Profit and loss

FYE 31 Dec (RMB m)	2017	2018	2019F	2020F	2021F
Gold	6002	6423	6531	8675	8595
Copper	632	685	688	695	724
Other	40,026	69,417	150	150	150
Revenue	6,674	7,177	7,369	9,520	9,469
COGS	(4,039)	(4,695)	(4,472)	(5,087)	(5,134)
Gross profit	2,635	2,482	2,897	4,434	4,335
Operating expenses	(939)	(997)	(1,012)	(1,076)	(1,084)
Operating profit	1,696	1,485	1,884	3,358	3,251
Net financial income (exp.)	(373)	(377)	(418)	(437)	(442)
JVs and associates	14	24	35	50	45
Other	(446)	(432)	(250)	(250)	(250)
Forex	(3)	57	-	-	-
Profit before tax	888	757	1,252	2,721	2,605
Tax	(134)	(180)	(316)	(694)	(665)
Total profit	754	576	935	2,027	1,940
EBIT	1,373	1,276	1,669	3,158	3,046
EBITDA	2,301	2,293	2,744	4,281	4,216
Minority interest	(110)	(102)	(120)	(120)	-
Net profit attributable to shareholders	644	474	815	1,907	1,940
Core profit	644	474	815	1,907	1,939
Reported EPS (RMB)	0.20	0.15	0.25	0.59	0.60
Diluted EPS (RMB)	0.20	0.15	0.25	0.59	0.60
Core EPS (RMB)	0.20	0.15	0.25	0.59	0.60
Dividend (RMB m)	193	129	204	477	485
Dividend per share (RMB)	0.06	0.04	0.06	0.15	0.15

Cash flow

FYE 31 Dec (RMB m)	2017	2018	2019F	2020F	2021F
Profit before tax	888	757	1,252	2,721	2,605
Amortization & depreciation	928	1,017	1,075	1,123	1,170
Net financial charge adjust.	421	481	418	437	442
Change in working capital	(1,279)	(791)	(235)	(220)	4
Tax paid	(234)	(191)	(316)	(694)	(665)
Other	343	434	(418)	(437)	(442)
Operating cash flow	1,067	1,706	1,776	2,930	3,114
Disposal of fixed assets	35	34	-	-	-
Capex	(1,398)	(1,652)	(1,615)	(1,615)	(1,615)
Investment	414	(767)	-	-	-
Net interest received (paid)	2	2	-	-	-
Other	(83)	(647)	(106)	-	-
Investment cash flow	(1,030)	(3,030)	(1,721)	(1,615)	(1,615)
Change in borrowings	(923)	1,511	3,297	500	500
Equity issues	1,563	-	-	-	-
Amount due	-	-	-	-	1
Dividend paid	(795)	(948)	(129)	(204)	(477)
Other	567	32	109	-	-
Financing cash flow	412	595	3,277	296	24
Change in cash flow	449	(729)	3,332	1,611	1,523
Cash & equivalents, begin	1,438	1,847	1,143	4,476	6,087
Forex	(40)	25	-	-	-
Cash & equivalents, end	1,847	1,143	4,476	6,087	7,610
Free cash flow	(309)	(295)	633	1,789	1,980

Source: Company data, CCBIS estimates

Balance sheet

FYE 31 Dec (RMB m)	2017	2018	2019F	2020F	2021F
Cash and equivalents	1,847	1,143	4,476	6,087	7,608
Pledge dep., restricted cash	278	353	350	350	350
Receivables	236	145	160	162	162
Assets held for sale	279	598	598	598	598
Inventory	3,565	4,191	4,610	4,748	4,748
Other current assets	1,833	2,798	2,805	2,903	2,899
Total current assets	8,038	9,228	12,998	14,848	16,365
Property, plant & equipment	13,630	14,221	14,921	15,573	16,178
Intangible assets	10,096	10,093	9,933	9,773	9,613
JVs and associates	403	851	851	851	851
Other non-current assets	1,646	1,494	1,600	1,600	1,600
Total non-current assets	25,775	26,659	27,305	27,797	28,242
Total assets	33,813	35,887	40,303	42,644	44,607
Short-term borrowings	11,298	9,368	12,000	12,000	12,000
Trade and bills payable	2,395	2,232	2,419	2,437	2,437
Other current liabilities	85	204	220	220	220
Total current liabilities	13,778	11,804	14,639	14,657	14,657
Long-term borrowings	2,414	6,335	7,000	7,500	8,000
Other non-current liabilities	857	941	1,050	1,050	1,050
Total non-current liabilities	3,271	7,276	8,050	8,550	9,050
Total liabilities	17,049	19,080	22,689	23,207	23,707
Share capital	3,221	3,221	3,221	3,221	3,221
Reserves and retained profits	7,315	7,413	7,960	9,523	10,845
Shareholders' equity	13,200	13,298	13,985	15,688	17,150
Minority interest	3,564	3,509	3,629	3,749	3,749
Total equity	16,764	16,808	17,614	19,437	20,899
Total equity and liabilities	33,813	35,887	40,303	42,644	44,607

Ratios

FYE 31 Dec	2017	2018	2019F	2020F	2021F
Growth (%)					
Revenue	0.1	7.5	2.7	29.2	(0.5)
EBITDA	17.2	(0.4)	19.7	56.0	(1.5)
EBIT	5.8	(12.4)	26.9	78.2	(3.2)
Net profit	82.3	(26.3)	71.9	133.9	1.8
Core net profit	82.3	(26.3)	71.9	133.9	1.7
Profitability (%)					
Gross margin	39.5	34.6	39.3	46.6	45.8
EBITDA margin	34.5	31.9	37.2	45.0	44.5
EBIT margin	25.4	20.7	25.6	35.3	34.3
Net margin	9.6	6.6	11.1	20.0	20.5
Core net margin	9.6	6.6	11.1	20.0	20.5
Tax rate	15.1	23.8	25.3	25.5	25.5
Efficiency (days)					
Inventory turnover	325	301	359	336	338
Trades receivable	14	10	8	6	6
Trades payable	38	38	47	45	45
Returns & leverage (%)					
ROAA	1.9	1.4	2.1	4.6	4.4
ROAE	5.3	3.6	6.0	12.9	11.8
Net debt (cash)/equity	70.8	86.6	82.5	69.0	59.3
Payout ratio	29	27	25	25	25
Interest coverage	-4.5	-3.9	-4.5	-7.7	-7.4
Liquidity (x)					
Current ratio	0.6	0.8	0.9	1.0	1.1
Quick ratio	0.3	0.4	0.5	0.6	0.8

Rating definitions:**Outperform (O) – expected return > 10% over the next twelve months****Neutral (N) – expected return between -10% and 10% over the next twelve months****Underperform (U) – expected return < -10% over the next twelve months****Analyst certification:**

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