

Asian Daily

Zhaojin Mining (1818.HK)

Gold mining pure play, beneficiary of strong gold price rally

Upgrade to **OUTPERFORM**

Previous Rating: NEUTRAL

Target price (HK\$): 11.70

Previous target price (HK\$): 9.00

- Beneficiary of gold price rally. With the virus spreading to ex-China countries, the market gets more concerned about economic growth. This would support gold price in the next 3-6 months, in our view. Zhaojin is a top beneficiary. We lift earnings estimates, raise target price to HK\$11.70. Upgrade to OUTPERFORM (from Neutral).
- Fear of uncertainties to support gold price. As the market becomes more concerned about the global economy growth, investors piled into safe haven assets: US treasuries yield fell, while gold price reached seven-year high. Gold ETF holdings also edged higher. If gold price remains strong, 2020E gold price would average higher vs our previous expectations, supporting Zhaojin's earnings.
- Earnings forecasts revision. We revise up Zhaojin's 2020E-21E earnings estimates by 20/5% to reflect higher ASP assumptions. Upgrade Zhaojin to OUTPERFORM from Neutral, given it is beneficiary of higher gold prices and strong earnings sensitivity.
- We derive our target price of HK\$11.70 (from HK\$9) by averaging 13.8x 3-year avg. EV/EBITDA and 2.3x 2020E P/B. Zhaojin is now trading at 24x 2020E P/E.

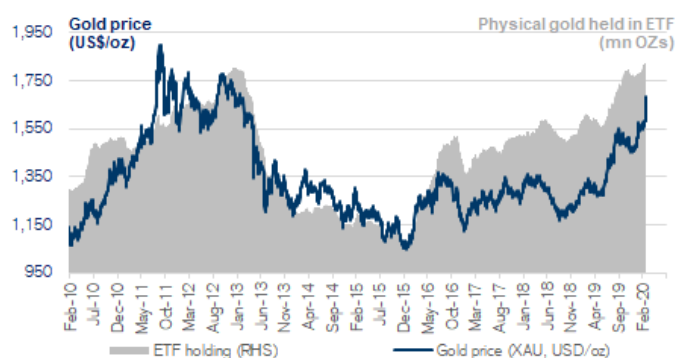
Price (24-Feb-20, HK\$)	9.77	Est. pot. % chg. to TP	19.8
Mkt cap (HK\$/US\$ mn)	31,952 / 4,100	Blue sky scenario (HK\$)	18.0
Number of shares (mn)	3,270	Grey sky scenario (HK\$)	3.0
Free float (%)	67.4	Performance	1M 3M 12M
52-wk range (HK\$)	11.28 - 6.64	Absolute (%)	9.8 20.3 12.7
ADTO-6M (US\$ mn)	9.6	Relative (%)	11.2 14.2 8.8
Year	12/18A	12/19E	12/20E 12/21E
Revenue (Rmb mn)	7,177.1	7,451.9	8,948.4 8,802.6
EBITDA (Rmb mn)	2,516.3	2,715.0	3,853.2 3,739.9
EBIT (Rmb mn)	1,485.1	1,639.1	2,707.4 2,529.5
Net profit (Rmb mn)	474.3	530.0	1,200.0 1,150.0
EPS (CS adj.) (Rmb)	0.15	0.16	0.37 0.36
Chg. from prev. EPS (%)	n.a.	(0.0)	20.0 4.5
Consensus EPS (Rmb)	n.a.	0.21	0.32 0.38
EPS growth (%)	(25.0)	9.7	126.4 (4.2)
P/E (x)	58.8	53.6	23.7 24.7
Dividend yield (%)	0.5	0.5	1.1 1.1
EV/EBITDA (x)	14.4	13.5	9.6 9.8
P/B (x)	2.1	2.07	1.95 1.84
ROE (%)	3.6	3.9	8.5 7.7
Net debt/equity (%)	44.4	46.0	43.8 39.6

Source: Company data, Refinitiv, Credit Suisse estimates

Beneficiary of gold price rally, upgrade to OUTPERFORM

Gold price has reached the seven-year high level recently on fears of uncertainties. However, rate futures are pricing in higher probability of Fed rate cut for the year. Both would support gold prices in the next 3-6 months. Zhaojin, a leading gold miner with strong earnings sensitivity, is a top beneficiary of higher gold prices. We revise up ASP assumptions for Zhaojin Mining and raise earnings estimates. Lift TP to HK\$11.70 from previous HK\$9.00. Upgrade to OUTPERFORM.

Figure 1: Gold price vs. physical gold held in ETF (mn OZs)



Source: the BLOOMBERG PROFESSIONAL™ service, Credit Suisse

Fear of uncertainties to support gold price

Recently, more nCOV cases are confirmed in ex-China countries, such as Japan, South Korea and Italy. Concerned about anti-virus measures causing slower economic growth in these regions, investors piled into safe haven assets: US treasuries yield fell, while gold price reached US\$1,680/oz—a seven year high. Physical gold held in gold ETFs edged higher to 84 mn OZs (+1% WoW, +3% MoM), indicating higher interest in the metal. We expect such trend to continue if the virus situation worsens in ex-China countries. If gold price remains at the current level through 2Q20E on fear of uncertainties, 2020E

gold price would average higher vs our previous expectations, lending support to Zhaojin's earnings. Elsewhere, rate cut probability has been a great indicator for gold price movements. Current rate futures pricing indicates higher probabilities of US Fed rate cut within 2020 (previously no cut for the year).

Figure 2: Earnings forecasts revisions

Zhaojin Mining (1818.HK)		New			Old			Chg%		
P&L accounts	Unit	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Revenue	Rmb mn	7,452	8,948	8,803	7,475	8,682	8,642	0%	3%	2%
COGS	Rmb mn	(4,782)	(5,283)	(5,194)	(4,782)	(5,123)	(4,948)	0%	3%	5%
Gross profit	Rmb mn	2,670	3,685	3,608	2,693	3,568	3,693	-1%	4%	-2%
EBIT	Rmb mn	1,639	2,707	2,529	1,639	2,418	2,567	0%	12%	-1%
EBITDA	Rmb mn	2,715	3,853	3,740	2,715	3,564	3,778	0%	8%	-1%
Net Profit	Rmb mn	530	1,200	1,150	530	1,000	1,100	0%	20%	5%
EPS	Rmb/sh	0.16	0.37	0.36	0.16	0.31	0.34	0%	20%	5%
CS NP vs. Consensus	%	-20%	18%	-3%	-25%	-4%	-5%	5pps	22pps	2pps
CS EPS vs. Consensus	%	-21%	15%	-7%	-25%	-6%	-9%	4pps	21pps	2pps
BS & CF	Unit	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Cash	Rmb mn	762	699	1,113	761	624	1,072	0%	12%	4%
Total debt	Rmb mn	14,817	14,880	14,942	14,817	14,880	14,942	0%	0%	0%
Net debt	Rmb mn	14,055	14,182	13,829	14,056	14,256	13,870	0%	-1%	0%
Equity	Rmb mn	13,685	14,560	15,399	13,685	14,414	15,216	0%	1%	1%
Net debt/equity	%	103%	97%	90%	103%	99%	91%	0pps	-2pps	-1pps
ROE	%	4%	8%	7%	4%	7%	7%	0pps	1pps	0pps
OCF	Rmb mn	1,646	2,198	2,664	1,646	2,070	2,685	0%	6%	-1%
Capex	Rmb mn	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	(2,000)	0%	0%	0%
FCF	Rmb mn	(354)	198	664	(354)	70	685	0%	183%	-3%
Operation data	Unit	2019E	2020E	2021E	2019E	2020E	2021E	2019E	2020E	2021E
Sales volume	mt	32,853	34,332	35,018	32,853	33,510	34,180	0%	2%	2%
ASP	Rmb/t	202	238	229	202	235	228	0%	1%	0%
Unit COGS	Rmb/t	164	178	170	164	176	163	0%	1%	5%
Unit GP	Rmb/t	365	416	399	365	410	391	0%	1%	2%
Unit GP Margin	%	50%	54%	55%	50%	54%	57%	0pps	0pps	-2pps

Source: Company data, Credit Suisse estimates

Earnings forecasts revisions

We revise up Zhaojin 2020E-21E earnings estimates by 20/5% to reflect higher ASP assumptions. We derive Zhaojin's target price of HK\$11.70 (previous HK\$9.00) by averaging (1) 13.8x three-year average EV/EBITDA and (2) 2.3x 2020E P/B, both at ~0.5xSD above historical mean. We upgrade Zhaojin Mining to OUTPERFORM from Neutral, given the company benefits from higher gold prices, its strong earnings sensitivity (~20% higher earnings on 5% higher gold prices) and its relatively cheap valuation.

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3-Year Price and Rating History for Zhaojin Mining (1818.HK)

1818.HK	Closing Price	Target Price	
Date	(HK\$)	(HK\$)	Rating
21-Mar-17	7.39	6.40	U
15-May-17	6.44	6.40	N
12-Jun-17	6.50		NC
08-Nov-19	8.61	9.00	N*



* Asterisk signifies initiation or assumption of coverage.

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Target Price and Rating

Valuation Methodology and Risks: (12 months) for Zhaojin Mining (1818.HK)

Method: We rate Zhaojin OUTPERFORM. Gold business contributes more than 90% of Zhaojin's revenue. Zhaojin's high-grade mines allow it to produce at lower-than-peers' costs. The production volume has been stable. Recent gold price rally was driven by fear of global economy growth uncertainties. If gold price remains at current levels through 2Q20E, we expect gold price to increase more than 15% in 2020E, which should help support Zhaojin's 2020E earnings. We derive our TP of HK\$11.70 by averaging (1) 2.3x 2020E P/B and (2) 13.8x three year average EV/EBITDA, to reflect the company's asset quality and earnings growth prospects. Our target is at ~0.5x SD above the historical mean.

Risk: Downside risks to our OUTPERFORM rating and TP of HK\$11.70 include lower-than-expected gold prices, likely driven by (1) below-market-expected Fed rate cut, leading to weaker gold prices, (2) slower-than-expected rate cut leading to lower gold prices, and (3) stronger-than-expected economic growth or employment rate leading to weaker rate cut. Company-level risks include higher-than-expected costs, lower-than-expected realised selling prices, lower-than-expected sales volume, production safety issues leading to higher costs or production suspension, environment protection violations, etc.

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