

Zhaojin Mining | 1818 HK

Stabilizing mine output, positive pricing outlook

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- ▶ **Strong gold prices behind robust 3Q20 results**
- ▶ **Big jump in administrative costs**
- ▶ **Final approval of Haiyu project the catalyst investors were hoping for**

Outperform (maintained)

Current price:

HK\$10.08
 (as at 27 Oct 2020)

Target:

HK\$17.00
 (down from HK\$17.50)

Positive gold price outlook; long-term output growth. Zhaojin delivered robust 3Q20 results thanks to rising market prices for gold, which jumped 12% QoQ/30% YoY in US dollar terms. We reaffirm our bullish stance on gold prices for 2021-2022F assuming rising currency debasement risk and a prolonged US-China political conflict. These assumptions were behind our forecast for above-consensus market prices for gold, averaging US\$2,388/oz for 2021F and US\$2,100/oz for 2022F. In the long run, we believe the commercialization of the Haiyu project will unlock value in Zhaojin. The project, still pending final approval, is nevertheless scheduled for completion by 2022F. We reaffirm our Outperform rating on Zhaojin Mining and lower our target price on the stock from HK\$17.50 to HK\$17.00, basing it on an EV/EBITDA multiple of 12.8x for 2021F, two standard deviations below the 2017-2019 mean.

3Q20 results at a glance. Net profit climbed 44% QoQ and 5x YoY to RMB478m largely due to the increase in gold prices. Gross profit more than doubled YoY to RMB1.2b. Operating margin and net margin expanded about 14pp YoY and largely held up QoQ. As usual, no data points were disclosed for production volume or unit cost. A 31% QoQ/56% YoY jump in administrative expenses was the major drawback of the results. For 9M20, net profit was up 1.8x to RMB891m.

Earnings cuts on stronger renminbi and higher operating costs. In view of the stronger renminbi and higher realized administrative expenses in 3Q20, we cut our 2020F/2021F/2022F net profit forecast by 20%/17%/15%.

Forecast and valuation

Year to 31 Dec	2018	2019	2020F	2021F	2022F
Revenue (RMB m)	7,177	6,330	8,519	10,544	10,133
YoY (%)	7.5	-11.8	34.6	23.8	-3.9
Net profit (RMB m)	474	479	1,340	2,476	1,821
YoY (%)	-26.3	1.1	179.6	84.8	-26.5
Fully diluted EPS (RMB)	0.15	0.15	0.42	0.76	0.56
YoY (%)	-27.8	-0.5	186.5	80.3	-26.5
P/E (x)	60.1	60.4	21.6	11.7	15.9
DPS (RMB)	0.04	0.04	0.11	0.20	0.15
Dividend yield (%)	0.5	0.5	1.3	2.3	1.7
P/B (x)	2.1	2.1	1.9	1.7	1.6
ROAE (%)	3.6	3.5	9.2	15.2	10.1
Net debt/equity (%)	86.6	93.1	106.6	105.9	112.9

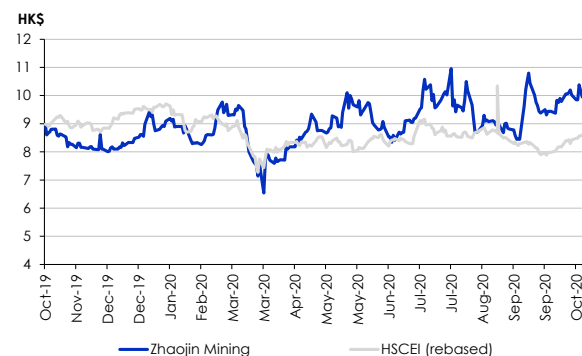
Source: Company, CCBIS estimates

Trading data

52-week range	HK\$6.54-11.52
Market cap (m) (H share)	HK\$32,966/US\$4,254
Shares outstanding (m)	3,221
Free float (%) - H shares	37.5
3M average daily T/O (m share)	14.4
3M average daily T/O (US\$ m)	18.1
Expected 12-month return (%)	70

Source: Bloomberg, CCBIS estimates

Share price vs HSCEI over the past 12 months



Source: Bloomberg

Stock performance

Performance (%)	1M	3M	12M
Absolute	7.5	-8.0	12.2
Relative to HSCEI	-0.1	-7.3	17.6

Source: Bloomberg

Zhaojin Mining – summary of 3Q20 and 9M20 results

RMB m	3Q19	2Q20	3Q20	QoQ chg	YoY chg	9M19	9M20	YoY chg
				(%/pp)	(%/pp)			(%/pp)
Revenue	1,816	1,762	2,669	51.5	46.9	4,634	5,801	25.2
Gross profit	583	876	1,254	43.0	114.9	1,655	2,610	57.7
Operating profit	355	607	901	48.5	154.0	950	1,748	84.0
Pre-tax profit excl. investment gain	93	489	594	21.4	535.3	418	1,173	180.4
Pre-tax profit	119	483	748	55.0	527.1	444	1,328	198.9
Net profit	78	331	478	44.3	513.2	317	891	181.1
<u>Profit margin (%)</u>								
Gross margin	32.1	49.8	47.0	-2.8	14.8	35.7	45.0	9.3
Operating margin	19.5	34.4	33.8	-0.7	14.2	20.5	30.1	9.6
Pre-tax margin	6.6	27.4	28.0	0.6	21.5	9.6	22.9	13.3
Net margin	4.3	18.8	17.9	-0.9	13.6	6.8	15.4	8.5

Source: Company, CCBIS estimates

Zhaojin Mining – revisions to key assumptions and earnings forecasts

	New forecast			vs. old forecast (%/pp)			YoY change (%/pp)		
	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
Gold operations									
Self-produced gold output (000 oz)	520	550	550	-	-	-	3.7	5.8	-
Self-produced gold output (kg)	16,174	17,107	17,107	-	-	-	3.7	5.8	-
Market gold price (US\$/oz)	1,889	2,388	2,100	-	-	-	35.6	26.4	-12.1
Realized gold selling prices (US\$/oz)	1,829	2,268	1,980	0.5	1.3	1.5	34.5	24.0	-12.7
Unit all-in cash cost (US\$/oz)	570	576	576	2.6	2.9	2.9	-2.4	1.1	-
Financial summary (RMB m)									
Revenue	8,519	10,544	10,133	-1.6	-1.4	-1.2	34.6	23.8	-3.9
Gross profit	4,121	5,933	4,839	-3.1	-2.2	-2.1	80.0	44.0	-18.4
Operating profit	2,970	4,734	3,622	-6.3	-2.5	-1.7	132.3	59.4	-23.5
Pre-tax profit	2,292	3,911	2,751	-8.0	-3.0	-2.2	284.8	70.6	-29.7
Core net profit	1,373	2,475	1,819	-19.7	-17.3	-15.2	186.5	80.3	-26.5
EBITDA	4,086	5,924	4,812	-5.3	-2.2	-1.5	82.5	45.0	-18.8
EPS (RMB)	0.42	0.76	0.56	-19.7	-17.3	-15.2	186.5	80.3	-26.5
<u>Profit margin (%)</u>									
Gross margin	48.4	56.3	47.8	-0.7	-0.5	-0.4	12.2	7.9	-8.5
Operating margin	34.9	44.9	35.7	-1.7	-0.5	-0.2	14.7	10.0	-9.2
Pre-tax margin	26.9	37.1	27.1	-1.9	-0.6	-0.3	17.5	10.2	-10.0
Net margin	16.1	23.5	18.0	-3.6	-4.5	-2.9	8.5	7.4	-5.5
EBITDA margin	48.0	56.2	47.5	-1.9	-0.4	-0.1	12.6	8.2	-8.7
<u>Gearing</u>									
Net debt (RMB m)	20,265	22,925	26,061	2.4	17.8	28.7	25.3	13.1	13.7
Net debt to shareholders equity (%)	132.5	131.8	140.5	5.9	24.6	36.6	16.6	-0.7	8.7

Source: CCBIS estimates

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 followed by Fosun International with a 23.7% stake. The company aims to expand overseas through acquisitions.

402 tonnes of total gold metal reserves as at 31 Dec 2019

Risk assessment

A retreat in gold prices is a major earnings risk. Sharp appreciation in the renminbi will also hurt earnings as gold prices in renminbi terms will be lower. We estimate every 5% appreciation in the renminbi will result in an 11%/13% cut in our earnings forecasts for 2021F/2022F. A more promising economic outlook and a stronger US dollar would drive risk appetite out of gold and weigh on gold prices. A decline in gold mining output, delays in the commissioning of the Haiyu mine and/or a new equity issuance are the major risks to investors.

Zhaojin Mining | 1818 HK – financial summary

Profit and loss

FYE 31 Dec (RMB m)	2018	2019	2020F	2021F	2022F
Gold	6423	5665	7865	9832	9417
Copper	685	498	484	541	546
Other	69,417	166,648	170	170	170
Revenue	7,177	6,330	8,519	10,544	10,133
COGS	(4,695)	(4,040)	(4,398)	(4,610)	(5,294)
Gross profit	2,482	2,290	4,121	5,933	4,839
Other income	–	–	–	1	2
Operating expenses	(997)	(1,011)	(1,152)	(1,199)	(1,217)
Operating profit	1,485	1,279	2,970	4,734	3,622
Net financial income (exp/)	(377)	(484)	(571)	(673)	(721)
JVs & associates	24	(48)	30	30	30
Other	(432)	(148)	(270)	(180)	(180)
Forex	57	(3)	–	–	–
Profit before tax	757	596	2,159	3,912	2,753
Tax	(180)	(157)	(517)	(893)	(653)
Total profit	576	438	1,642	3,019	2,100
EBIT	1,276	1,285	2,953	4,584	3,472
EBITDA	2,293	2,264	4,176	5,924	4,812
Minority interest	(102)	41	(302)	(543)	(279)
Net profit attributable to shareholders	474	479	1,340	2,476	1,821
Core profit	474	479	1,373	2,475	1,819
Reported EPS (RMB)	0.15	0.15	0.41	0.76	0.56
Diluted EPS (RMB)	0.15	0.15	0.42	0.76	0.56
Core EPS (RMB)	0.15	0.15	0.42	0.76	0.56
Dividend (RMB m)	129	131	371	668	491
Dividend per share (RMB)	0.04	0.04	0.11	0.20	0.15

Cash flow

FYE 31 Dec (RMB m)	2018	2019	2020F	2021F	2022F
Profit before tax	757	596	2,159	3,912	2,753
Amortization & depreciation	1,017	978	1,223	1,340	1,340
Net financial charge adjust.	481	662	571	673	721
Non-cash items adjusted	–	3	–	–	–
Change in working capital	(791)	(553)	(655)	(632)	(391)
Tax paid	(191)	(155)	(517)	(893)	(653)
Other	434	249	(571)	(673)	(721)
Operating cash flow	1,706	1,780	2,209	3,727	3,049
Disposal of fixed assets	34	3	–	–	–
Capex	(1,652)	(1,404)	(6,515)	(6,015)	(5,515)
Investment	(767)	111	–	–	–
Net interest received (paid)	2	4	–	–	–
Other	(647)	(926)	102	–	–
Investment cash flow	(3,030)	(2,212)	(6,413)	(6,015)	(5,515)
Change in borrowings	1,511	3,685	2,322	–	–
Amount due	–	–	–	1	2
Dividend paid	(948)	(765)	(131)	(371)	(668)
Other	32	(142)	105	–	–
Financing cash flow	595	2,778	2,297	(370)	(666)
Change in cash flow	(729)	2,346	(1,907)	(2,658)	(3,132)
Cash & equivalents, begin	1,847	1,143	3,508	1,735	(925)
Forex	25	19	–	–	–
Cash & equivalents, end	1,143	3,508	1,602	(923)	(4,057)
Free cash flow	(295)	(38)	(3,689)	(1,653)	(1,803)

Source: Company data, CCBIS estimates

Balance sheet

FYE 31 Dec (RMB m)	2018	2019	2020F	2021F	2022F
Cash & equivalents	1,143	3,508	1,735	(925)	(4,061)
Pledge dep., restricted cash	353	278	300	300	300
Receivables	145	142	150	157	163
Assets held for sale	598	555	555	555	555
Inventory	4,191	4,310	4,741	5,216	5,633
Other current assets	2,798	3,604	3,783	3,944	3,912
Total current assets	9,228	12,398	11,263	9,247	6,501
Property, plant & equipment	14,221	14,989	20,411	25,216	29,521
Intangible assets	10,093	10,270	10,140	10,010	9,880
JVs & associates	851	893	893	893	893
Other non-current assets	1,494	1,702	1,600	1,600	1,600
Total non-current assets	26,659	27,853	33,043	37,718	41,893
Total assets	35,887	40,252	44,306	46,965	48,394
Short-term borrowings	9,368	10,119	15,500	15,500	15,500
Trade & bills payable	2,232	2,139	2,179	2,191	2,191
Other current liabilities	204	277	220	220	220
Total current liabilities	11,804	12,535	17,899	17,911	17,911
Long-term borrowings	6,335	9,559	6,500	6,500	6,500
Other non-current liabilities	941	795	900	900	900
Total non-current liabilities	7,276	10,354	7,400	7,400	7,400
Total liabilities	19,080	22,889	25,299	25,311	25,311
Share capital	3,221	3,270	3,270	3,270	3,270
Reserves and retained profits	7,413	8,015	9,217	11,181	12,192
Shareholders' equity	13,298	13,950	15,292	17,396	18,547
Minority interest	3,509	3,413	3,715	4,258	4,537
Total equity	16,808	17,363	19,007	21,654	23,084
Total equity and liabilities	35,887	40,252	44,306	46,965	48,394

Ratios

FYE 31 Dec	2018	2019	2020F	2021F	2022F
Growth (%)					
Revenue	7.5	-11.8	34.6	23.8	-3.9
EBITDA	-0.4	-1.3	84.5	41.9	-18.8
EBIT	-12.4	-13.9	132.3	59.4	-23.5
Net profit	-26.3	1.1	179.6	84.8	-26.5
Core net profit	-26.3	1.1	186.5	80.3	-26.5
Profitability (%)					
Gross margin	34.6	36.2	48.4	56.3	47.8
EBITDA margin	31.9	35.8	49.0	56.2	47.5
EBIT margin	20.7	20.2	34.9	44.9	35.7
Net margin	6.6	7.6	15.7	23.5	18.0
Core net margin	6.6	7.6	16.1	23.5	18.0
Tax rate	23.8	26.4	24.0	22.8	23.7
Efficiency (days)					
Inventory turnover	301	384	376	394	374
Trades receivables	10	8	6	5	6
Trades payables	38	40	31	30	27
Returns & leverage (%)					
ROAA	1.4	1.3	3.2	5.4	3.8
ROAE	3.6	3.5	9.2	15.2	10.1
Net debt (cash)/equity	86.6	93.1	106.6	105.9	112.9
Payout ratio	27	27	27	27	27
Interest coverage	-3.9	-2.6	-5.2	-7.0	-5.0
Liquidity (x)					
Current ratio	0.8	1.0	0.6	0.5	0.4
Quick ratio	0.4	0.6	0.3	0.2	0.0

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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