

Zhaojin Mining (1818 HK)

1H13: Weak Earnings Priced In; Reiterate BUY On Attractive Valuation

Zhaojin, like others, faces rising cost pressure, yet its cost remained low at US\$358/oz in 1H13 vs global average of US\$761/oz. It will continue to raise gold production at a strong pace (growing about 10% annually in 2013-15). We lift our DCF-based target price to HK\$7.80, based on its increased leverage and improved near-term earnings on the back of our higher gold price assumptions for 2013-14. Maintain BUY.

1H13 Results

Rmb m	1H11	1H12	1H13	% yoy
Revenue	2,500	1,930	2,371	23%
Cost of sales	(1,192)	(817)	(1,329)	63%
Gross profit	1,308	1,113	1,042	-6%
SGA expenses	(279)	(350)	(402)	15%
EBIT	1,028	763	568	-26%
Finance cost	(39)	(96)	(162)	68%
PBT	990	667	405	-39%
Tax provision	(243)	(142)	(84)	-41%
Net profit	720	495	300	-40%
Gross margin	52%	58%	44%	
Operating expenses	11%	18%	17%	
Operating margin	41%	40%	27%	
Effective tax rate	25%	21%	21%	
Net profit margin	29%	26%	13%	
Total gold production	11.4	12.5	12.4	-1%
mine gold production	7.6	7.8	8.6	11%
Gold output from tolling	3.8	4.7	3.7	-22%
Gold sales (tonnes)	7.1	4.6	6.7	46%
Inventory (tonnes)	0.5	3.5	1.0	-71%
Zhaojin's Gold ASP	314	337	290	-14%
SGE Gold Price	306	337	307	-9%
Cash cost	68	72	71	-2%
Production cost	117	122	135	10%
% of revenue from gold	89%	80%	82%	

Source: Zhaojin

Results

- Zhaojin's profit (based on IFRS) declined 40% yoy to Rmb300m in 1H13. Zhaojin has issued a profit warning back on 5 August.
- Total revenue grew 23% yoy despite a 9% yoy decrease in gold prices to Rmb307/g due mainly to increased gold sales in 1H13, up 46% yoy according to our estimate. In 1H12, Zhaojin recorded a high inventory of 3.5 tonnes, hence lower gold sales. In 1H13, its inventory has dropped to the normal level of 1 tonnes.

BUY
(Maintained)

Company Results

Share Price **HK\$6.86**
Target Price **HK\$7.80**
Upside **+13.7%**
(Previous TP **HK\$6.60**)

Company Description

Zhaojin Mining Industry explores, mines and produces gold. The company holds interest in properties in eastern China.

Stock Data

GICS sector **Materials**
Bloomberg ticker: **1818 HK**
Shares issued (m): **874.3**
Market cap (HK\$m): **20,404.0**
Market cap (US\$m): **2,630.9**
3-mth avg daily t'over (US\$m): **6.8**

Price Performance (%)

52-week high/low **HK\$14.40/HK\$4.57**

1mth	3mth	6mth	1yr	YTD
26.4	(6.3)	(32.3)	(36.9)	(42.1)

Major Shareholders

Shandong Zhaojin Group **37.6%**

FY13 NAV/Share (Rmb) **3.05**

FY13 Net Debt/Share (Rmb) **2.46**

Price Chart



Source: Bloomberg

Analyst

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Key Financials

Year to 31 Dec (Rmbm)	2011	2012	2013F	2014F	2015F
Net turnover	5,741	7,603	6,210	6,652	6,977
EBITDA	2,874	3,282	2,305	2,279	2,113
Operating profit	2,393	2,844	1,747	1,611	1,336
Net profit (rep./act.)	1,662	1,924	1,215	1,077	864
Net profit (adj.)	1,662	1,924	1,215	1,077	864
EPS (fen)	57.0	65.9	41.6	36.9	29.6
PE (x)	9.7	8.4	13.3	15.0	18.7
P/B (x)	2.4	1.9	1.8	1.7	1.6
EV/EBITDA (x)	8.4	7.4	10.5	10.6	11.5
Dividend yield (%)	3.8	4.4	2.8	2.5	2.0
Net margin (%)	28.9	25.3	19.6	16.2	12.4
Net debt/(cash) to equity (%)	29.5	54.2	80.7	82.7	83.4
Interest cover (x)	33.5	16.2	10.3	8.3	7.2
ROE (%)	27.8	25.7	15.7	13.4	10.4
Consensus net profit	-	-	1,247	1,086	984
UOBKH/Consensus (x)	-	-	0.97	0.99	0.88

Source: Zhaojin, Bloomberg, UOB Kay Hian

- Zhaojin's unit cost of production rose 10% yoy to Rmb135/g, in line with its target of Rmb130-135/g for 2013. Compared with Zijin's 37% yoy rise to Rmb147/g, Zhaojin's production cost was lower and grew at a slower pace (as it has no high-cost overseas gold mines). The 10% yoy increase in Zhaojin's cost of sales was due mainly to the increase in labour cost and depreciation.
- Zhaojin's gross margin was squeezed to 44% in 1H13 on a 63% yoy surge in cost of sales. For 2Q13, we estimate its gross and net margins were only 30% and 5% respectively (1Q13: 58% and 20%). The poor profitability in 2Q13 was due mainly to a sharp fall in gold prices to Rmb285/g in 2Q13, down 13% qoq.
- Total gold production edged down by 1% yoy to 12 tonnes due to reduced tolling (ie producing gold from third-party gold concentrates), which fell 22% yoy. In 1H13, Zhaojin's self-mined gold production rose 11% yoy to 9 tonnes, faster than Zijin's 6% yoy rise to 15 tonnes. The strong gold production was due mainly to a 33% yoy increase in gold production from mines located outside Zhaoyuan in Shandong province. 1H13 self-mined gold production was 43% of its revised target for 2013.

Stock Impact

- Zhaojin trims its mined gold production by 3% to 28 tonnes for 2013, implying that 2H13 mined gold production will increase 30% hoh. We think the better pricing outlook and an increase in production from its non-Zhaoyuan gold mines attributed to this surge.

Earnings Revision/Risk

- We raise our gold price forecast for 2013 by 8% from US\$1,332/oz to US\$1,445/oz in view of the recent gold price surge (which is supported by stronger-than-expected demand from China and inflationary concerns). We also lift our 2014 gold price forecast by 8% to US\$1,300/oz (from US\$1,200/oz). After the revision, we still expect gold prices to decline 14% yoy in 2013 and 10% yoy in 2014. Our 2015 gold price forecast of US\$1,200/oz and long-term gold price forecast of US\$1,000/oz remain unchanged.
- We fine-tune our 2013 net profit forecast by 0.1%, raise our 2014 forecast by 6% and slash our 2015 forecast by 22%. We are concerned about rising cost pressure. With rising labour cost and depreciation (bringing new mines on line), gold producers' cost pressure will be pointing upwards no matter which direction the gold prices is.

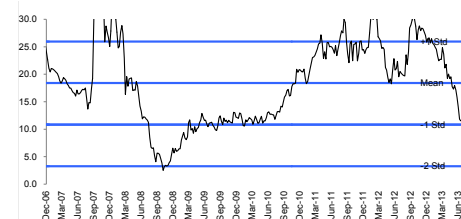
Valuation/Recommendation

- Zhaojin's 1H13 results proved once again that it is a low-cost producer and can still maintain strong growth in gold production (forecast to rise 11% yoy in 2013) amid weak gold prices.
- Our previous target price of HK\$6.60 was based on our gold price forecasts of US\$1,200-1,332/oz for 2013-15, long-term gold price of US\$1,000/oz and WACC of 10.4%.
- Our new DCF-based model takes into consideration: a) our higher gold price assumptions (which resulted in a slight rise in earnings for 2013-14), and b) Zhaojin's increased leverage (net gearing up from 62% in 1H12 to 82% in 1H13). Hence, we derive our new DCF-based target price of HK\$7.80, based on our long-term price gold price of US\$1,000/oz and WACC of 9.8%.
- Since Zhaojin is still trading 0.5SD below its mean PE 19x, its valuation is not excessive. There is also a 15% upside to our target price of HK\$7.80. Reiterate BUY.

Earnings Risks

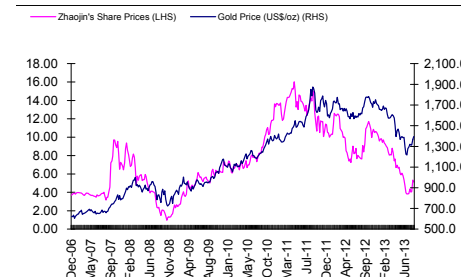
- Decline in gold price, faster growth in cost of production and lower gold production and sales.

PE Band



Source: Bloomberg

Share Price vs Gold Prices



Source: Bloomberg

Profit & Loss					Balance Sheet				
Year to 31 Dec (Rmbm)	2012	2013F	2014F	2015F	Year to 31 Dec (Rmbm)	2012	2013F	2014F	2015F
Net turnover	7,603	6,210	6,652	6,977	Fixed assets	7,373	9,449	11,415	12,773
EBITDA	3,282	2,305	2,279	2,113	Other LT assets	6,214	6,092	5,971	5,854
Deprec. & amort.	439	558	668	777	Cash/ST investment	1,351	717	527	172
EBIT	2,844	1,747	1,611	1,336	Other current assets	3,029	4,410	3,385	3,265
Total other non-operating income	14	100	100	100	Total assets	17,968	20,668	21,298	22,064
Associate contributions	10	11	14	17	ST debt	3,168	5,168	5,668	5,768
Net interest income/(expense)	(203)	(225)	(276)	(292)	Other current liabilities	1,787	1,908	1,344	1,491
Pre-tax profit	2,665	1,634	1,449	1,162	LT debt	2,740	2,740	2,740	2,740
Tax	(618)	(343)	(304)	(244)	Other LT liabilities	955	955	955	955
Minorities	(123)	(76)	(67)	(54)	Shareholders' equity	8,404	8,907	9,535	10,000
Net profit	1,924	1,215	1,077	864	Minority interest	844	919	986	1,040
Net profit (adj.)	1,924	1,215	1,077	864	Total liabilities & equity	17,968	20,668	21,298	22,064
Cash Flow					Key Metrics				
Year to 31 Dec (Rmbm)	2012	2013F	2014F	2015F	Year to 31 Dec (%)	2012	2013F	2014F	2015F
Operating	1,749	578	2,260	1,944	Profitability				
Pre-tax profit	2,665	1,634	1,449	1,162	EBITDA margin	43.2	37.1	34.3	30.3
Tax	(694)	(565)	(316)	(262)	Pre-tax margin	35.0	26.3	21.8	16.7
Deprec. & amort.	439	558	668	777	Net margin	25.3	19.6	16.2	12.4
Associates	(10)	(11)	(14)	(17)	ROA	12.3	7.2	6.2	4.9
Working capital changes	(820)	(1,037)	473	284	ROE	25.7	15.7	13.4	10.4
Non-cash items	0	0	0	0					
Other operating cashflows	170	0	0	0	Growth				
Investing	(3,429)	(2,500)	(2,500)	(2,000)	Turnover	32.4	(18.3)	7.1	4.9
Capex (growth)	0	0	0	0	EBITDA	14.2	(29.8)	(1.2)	(7.3)
Capex (maintenance)	(2,516)	(2,500)	(2,500)	(2,000)	Pre-tax profit	16.5	(38.7)	(11.3)	(19.8)
Investments	(235)	0	0	0	Net profit	15.8	(36.8)	(11.3)	(19.8)
Proceeds from sale of assets	18	0	0	0	Net profit (adj.)	15.8	(36.8)	(11.3)	(19.8)
Others	(696)	0	0	0	EPS	15.6	(36.8)	(11.3)	(19.8)
Financing	1,785	1,288	50	(299)					
Dividend payments	(612)	(712)	(450)	(399)	Leverage				
Issue of shares	1,190	0	0	0	Debt to total capital	39.0	44.6	44.4	43.5
Proceeds from borrowings	6,636	2,000	500	100	Debt to equity	70.3	88.8	88.2	85.1
Loan repayment	(4,565)	0	0	0	Net debt/(cash) to equity	54.2	80.7	82.7	83.4
Others/interest paid	(863)	0	0	0	Interest cover (x)	16.2	10.3	8.3	7.2
Net cash inflow (outflow)	105	(634)	(190)	(355)					
Beginning cash & cash equivalent	1,246	1,351	717	527					
Changes due to forex impact	0	0	0	0					
Ending cash & cash equivalent	1,351	717	527	172					

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