

JPM-pp1

Asia Pacific Equity Research

23 March 2015

Zhaojin Mining Industry (1818 HK)

Neutral

Price: HK\$4.29

20 Mar 2015

Price Target: HK\$4.00

PT End Date: 31 Dec 2015

FY14 results first take - Miss; reduced 2015 output target likely to see Street downgrades

Zhaojin's FY14 net profit of RMB455m (-38% y/y) was 23% below Street forecasts, dragged down by higher-than-expected costs. The company has revised down its production growth of self-produced gold to 5% (previous 10%) for 2015, which along with the results miss and a stretched balance sheet, should see earnings downgrades, in our view. Stay N rated.

Key Highlights

- **FY14 results miss.** Zhaojin's 2014 net profit of RMB455m (-38% y/y) was 15% and 23% below ours and consensus forecasts, respectively. Key earnings drags were higher-than-expected SG&A (+12% y/y) and other expenses (+42% y/y) which more than offset better-than-expected gross profits (-3% y/y). Revenue was lower at RMB5.6Bn (-12% y/y) in the context of lower gold ASP (-11% y/y) and gold sales volume (-1% y/y). Operating performance was better than guidance, with total gold output of 1.06moz (11% above target) and unit cost of USD669/oz (1% y/ y vs target 5% rise). Total gold resources (JORC) at end-2014 increased 2% y/y to 26.1moz.
- **Balance sheet still stretched.** Net gearing (ND/E) edged a little lower to 85% (2013: 87%), thanks to higher equity base, while its debt profile also improved with exposure to short-term loans declining to 49% of total gross debts (2013: 75%). Disappointingly, DPS of RMB0.05/share was declared with a reduced payout ratio of 33% (2013: 40%).
- **Lowered 2015 production growth.** For 2015, Zhaojin revised down FY15 production target of 1.05moz (-1% y/y), of which self-produced gold will be 569.5koz (+5% y/y), along with reduced capex of RMB880m (2014: RMB1.3Bn.). This is lower than its previous guidance of "c10% output growth in coming years", but in-line with our expectations given its stretched balance sheet.

Stock Impact

- Given significant earnings miss, we expect a negative market response to the results along with Consensus downgrades.

Table 1: Zhaojin Mining's 2014 results summary (IFRS)

Profit & loss (Rmb Mn)	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14	3Q14	4Q14	2014	QoQ 4Q14	YoY% 4Q14	YoY% 2014
Revenue	1,164	1,207	1,288	2,685	6,344	1,091	1,755	1,555	1,206	5,606	-22%	-55%	-12%
Cost of sales	(485)	(844)	(487)	(2,288)	(4,104)	(510)	(1,306)	(895)	(724)	(3,434)	-19%	-68%	-16%
Gross profit	679	363	801	398	2,240	581	449	661	482	2,172	-27%	21%	-3%
Other income	-	82	(82)	157	157	-	110	(110)	260	260	nm	66%	66%

SG&A	(14)	(28)	(20)	(36)	(97)	(18)	(33)	(32)	(37)	(120)	16%	3%	23%
Admin costs	(230)	(131)	(363)	(97)	(821)	(225)	(142)	(367)	(173)	(907)	-53%	79%	11%
Other expenses	(12)	(149)	117	(121)	(164)	(33)	(50)	12	(163)	(234)	nm	35%	42%
Finance costs	(69)	(93)	(77)	(103)	(342)	(102)	(158)	(62)	(193)	(514)	209%	87%	50%
Net operating profit	355	45	376	198	973	204	176	101	176	657	74%	-11%	-32%
Investment income	4	2	22	(8)	21	4	20	(3)	5	26	nm	nm	26%
Non-OP income	1	(1)	37	(37)		2	(2)	21	(21)		nm	-44%	nm
Non-OP expenses	(2)	2	(13)	13		(8)	8	(34)	34		nm	167%	nm
Impairment loss						-	4	70			-100%	nm	nm
<i>Others</i>	(0)	0	(5)	5	-	(1)	1	38	(38)		nm	nm	nm
PBT	357	49	417	171	994	202	207	194	155	683	-20%	-9%	-31%
Income tax	(85)	1	(107)	(35)	(226)	(61)	(37)	(39)	(39)	(176)	2%	12%	-22%
Net profit	271	50	310	136	767	140	170	155	116	507	-25%	-15%	-34%
MI	37	(15)	21	(9)	33	(2)	(12)	70	(5)	51	nm	-45%	54%
Net profit	234	66	289	145	734	143	182	84	121	455	43%	-17%	-38%
EPS	0.08	0.02	0.10	0.05	0.25	0.05	0.06	0.03	0.04	0.15	43%	-17%	-38%
Margin													
Gross profit	58%	30%	62%	15%	35%	53%	26%	42%	40%	39%	-3pps	25pps	3pps
Net operating profit	30%	4%	29%	7%	15%	19%	10%	7%	15%	12%	8pps	7pps	-4pps
Profit before tax	31%	4%	32%	6%	16%	19%	12%	12%	13%	12%	0pps	7pps	-3pps
Net margin	20%	5%	22%	5%	12%	13%	10%	5%	10%	8%	5pps	5pps	-3pps
Tax rate	24%	-3%	26%	21%	23%	30%	18%	20%	25%	26%	5pps	5pps	3pps
Cash flow (Rmb M)													
Operating cash flow	(271)	308	261	577	875	100	485	(34)	-	-	nm	nm	nm
Investment cash flow	(1,011)	(890)	(1,534)	(1,006)	(4,442)	(428)	(695)	(457)	-	-	nm	nm	nm
Capex	(414)	(742)	(337)	(1,804)	(3,297)	(467)	(538)	(130)	-	-	nm	nm	nm
Free cash flow	(685)	(434)	(76)	(1,227)	(2,423)	(367)	(53)	(164)	-	-	nm	nm	nm
Ratio													
Net Debt/Equity	56%	82%	72%	87%	87%	69%	83%	86%	85%	85%	0pps	-1pps	-1pps
Current Ratio	1.1	0.6	0.9	0.5	0.5	0.7	0.5	0.8	0.5	0.5	-31%	18%	18%
Quick Ratio	79%	30%	57%	23%	23%	45%	24%	51%	25%	25%	-51%	10%	10%
Inventory T/O Days	387.0	274.2	510.5	99.9	222.7	477.5	187.9	317.5	399.9	337.2	26%	300%	51%
AR T/O Days	257	100	323	39	67	274	57	260	69	59	-74%	75%	-11%
AP T/O Days	204	228	369	86	191	331	146	231	255	215	10%	197%	12%
Cash Conversion Days	440	146	465	53	98	420	98	347	214	182	-38%	300%	85%
ROA	4.9%	1.3%	5.4%	2.5%	3.1%	2.5%	2.9%	1.4%	1.8%	1.7%	0pps	-1pps	-1pps
ROE	10.9%	3.3%	14.2%	6.9%	8.7%	6.7%	8.6%	4.0%	5.6%	5.3%	2pps	-1pps	-3pps

Source: Company reports, JPMorgan

Investment Thesis

Zhaojin is China's fourth-largest gold miner, based primarily in Shandong. Its portfolio provides powerful leverage to gold prices and is less vulnerable (relative to Zijin) to copper weakness. With gold sales generating c90% of its revenue (versus c60% for Zijin), we estimate a 1% rise in gold prices can lift earnings by 5% (versus 2% for Zijin) and vice versa. That said, this is muted under our benign outlook for gold. We see downside risk to its commitment to c10% volume growth in the coming years while its strong reliance on short-term borrowing may make fundraising necessary. Stay Neutral.

Valuation

Our Dec-15 price target of HK\$4.00 equates to 1.0x P/BV, 9.5 x EV/EBITDA, and 1.7% dividend yield for 4% ROE, based on our FY15 estimates, which we consider fair in comparison to global mid-tier gold miners' average (1.8x P/BV, 7.9x EV/EBITDA, 1% div yield for 6% ROE).

Risks to Rating and Price Target

- **Upside risk:** Stronger-than-expected gold prices, better-than-expected cost control, higher-than-expected production growth, less than expected financial burden, M&As.
- **Downside risk:** Weaker-than-expected gold prices, higher-than-expected cost pressure, slower-than-expected production growth, worse-than-expected working capital control, higher-than-expected capex requirement, fund raising.

Asia Metals and Mining

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Date	Rating	Share Price (HK\$)	Price Target (HK \$)
03-Aug-14	N	4.87	5.00
31-Oct-14	N	4.20	4.25
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