

JPM-pp1

Asia Pacific Equity Research

26 March 2015

Jiangxi Copper - H (358 HK)

FY2014 results first take - miss; Profit warning of >50% fall in 1Q15

Underweight

Price: HK\$13.56

25 Mar 2015

Price Target: HK\$12.00

PT End Date: 31 Dec 2015

Jiangxi Copper (JXC)'s FY14 results, excluding one-time gains, were well below Street estimates, by our estimates. The company cut DPS by 60% y/y and provided a downbeat assessment of copper markets. In addition, JXC warned of >50% fall in 1Q15 profits. We expect sharp consensus downgrades to follow and re-iterate an UW rating.

Result Highlights

- Core 2014 earnings – a big miss.** JXC reported headline 2014 net profit (IFRS) of RMB2.9Bn (-20% y/y), which was boosted by large one-time gains of RMB1.1Bn associated with trading (RMB743m) and a consolidated accounting of a subsidiary (RMB200m). Excluding these items, we estimate core net profit of RMB1.7Bn (-45% y/y), falling well short of JPMe (RMB2.6Bn) and Street estimates (RMB2.8Bn).
- Sharp fall in FCF & dividends.** Lower copper prices (-9% y/y) offset higher sales volume of copper cathode of 1.2Mt (+6% y/y), gold of 26t (+2% y/y) while mined copper output of 210k were flat y/y. Meanwhile, a sharp fall in operating cash flow made FCF breakeven (2013: RMB3.0Bn) and pushed net gearing a little higher to 5% (2013 net cash). This may have caused JXC to cut dividend payout ratio to 24% (2013: 49%), leaving DPS of 20 cents RMB (2013 50 cents RMB).
- Profit warning - 1Q15 NP to fall >50%.** JXC provided a downbeat assessment of copper markets, noting that copper concentrate markets have swung to surplus since 2013. Alongside USD strength, copper will continue to come under pressure. While targeting 2015 output to be broadly the same as 2014 levels - 1.22Mt of copper cathode, 21kt of mined copper and 25.4t of gold, JXC warned that 1Q15 earnings to fall over 50% y/y, should copper price hold at spot levels through end-1Q15.

Stock Impact

- Given weak 1Q15 guidance, we expect negative market response and consensus downgrade.

Investor Briefing

Date: 26 March 2015 (Thursday)

Time: 15:00 – 16:00

Venue: West Room, 23/F, Mandarin Oriental, 5 Connaught Road Central Hong Kong

Medium: Mandarin and with simultaneous interpretation in English

Table 1: JXC's quarterly financial results (CAS)

Income Statement	1Q13	2Q13	3Q13	4Q13	2013	1Q14	2Q14	3Q14	4Q14	2014	4Q14 QoQ	4Q14 YoY	2014 YoY
Revenue	45,979	41,996	43,960	43,955	175,890	41,289	51,647	54,491	51,406	198,833	-6%	17%	13%

Cost of sales	-44,216	-40,272	-42,276	-41,659	-168,423	-40,481	-49,913	-52,536	-49,295	-192,225	-6%	18%	14%
Taxes & Surcharge	-143	-159	-156	-141	-598	-117	-152	-148	-152	-569	3%	8%	-5%
Gross profit	1,621	1,564	1,528	2,155	6,869	691	1,583	1,807	1,959	6,039	8%	-9%	-12%
Selling expenses	-75	-142	-147	-180	-545	-79	-167	-139	-163	-547	18%	-9%	0%
Admin. expenses	-304	-433	-350	-617	-1,703	-313	-399	-341	-794	-1,846	133%	29%	8%
Asset impairment loss	-67	-504	170	103	-298	-269	209	-176	-1,152	-1,389	553%	nm	366%
Changes in fair value	-69	-41	138	-73	-44	413	-289	345	-193	276	nm	165%	nm
Investment income	337	-290	339	187	574	249	439	99	469	1,256	375%	151%	119%
OP before interest	1,443	155	1,679	1,575	4,852	692	1,376	1,595	126	3,789	-92%	-92%	-22%
Non operating income	31	15	23	120	189	14	70	41	8	134	-80%	-93%	-29%
Non-operating expenses	-3	-5	-4	-92	-104	0	-5	0	-60	-65	49825%	-35%	-37%
EBIT	1,471	166	1,698	1,603	4,937	706	1,442	1,636	75	3,858	-95%	-95%	-22%
Financial costs	-177	14	-53	58	-157	-201	-195	-139	541	6	nm	828%	nm
PBT	1,294	180	1,645	1,661	4,780	504	1,246	1,497	616	3,864	-59%	-63%	-19%
less: income tax	-299	9	-323	-526	-1,138	-154	-407	-340	-114	-1,014	-67%	-78%	-11%
PAT	996	189	1,322	1,135	3,642	351	839	1,157	502	2,850	-57%	-56%	-22%
Minorities	-25	81	-92	-40	-77	-3	10	-29	24	1	nm	nm	nm
Net Income	971	270	1,230	1,095	3,565	347	849	1,128	526	2,851	-53%	-52%	-20%
Non recurring profit/loss	81	18	427	-83	443	27	686	-113	517	1,117	nm	nm	152%
Core profit	890	252	803	1,178	3,122	321	163	1,241	10	1,734	-99%	-99%	-44%
Basic EPS (RMB/sh)	0.28	0.08	0.35	0.32	1.03	0.10	0.25	0.32	0.36	1.03	13%	13%	0%
Diluted DPS (RMB/sh)					0.5					0.2	nm	nm	-60%
Cash flow analysis													
Operating cash flow	912	1,291	715	2,315	5,233	312	3,749	456	-2,781	1,735	nm	nm	-67%
Investing cash flow	-1,020	-161	388	-2,686	-3,479	-833	-1,733	-189	-244	-3,000	29%	-91%	-14%
Capex	-231	-725	-148	-1,037	-2,141.1	-249	-1,204	-394	109	-1,738	nm	nm	-19%
FCF	681	566	567	1,278	3,091	63	2,545	62	-2,672	-2	nm	nm	Nm
Net Debt	-1,568	-3,951	-6,815	-2,161	-2,161	-1,110	-2,646	806	2,556	2,556	217%	nm	nm
Net Debt/ Equity	-3%	-9%	-15%	-5%	-5%	-2%	-6%	2%	5%	5%	4pps	10pps	10pps
ROE	9%	2%	11%	10%	8%	3%	8%	10%	4%	6%	-5pps	-5pps	2pps
ROA	5%	1%	6%	5%	4%	2%	4%	5%	2%	3%	-3pps	-3pps	-1pps

Source: Company data, J.P. Morgan

Investment Thesis

We now expect 2015 earnings to fall (Street is flat) and are 41% below current consensus estimates. With no volume growth, JXC is heavily reliant on copper prices. JXC will clearly face downside earnings risks, with copper prices falling to the lowest in more than five years. We see near-term copper price weakness and Street downgrades as the likely catalysts for stock underperformance. The stock is currently valued at 0.8x P/BV against its three-year range of 0.6-1.0x and our 2015 ROE forecast of 3%. We think the stock will retest its lows. A key upside risk is copper prices rallying but given weak fundamentals, US\$ strength and slowing China, we think this is unlikely in the near term.

Valuation

Our Dec-15 price target for Jiangxi Copper-H of HK\$12.00 equates to 0.7x P/BV and 15.1x P/E based on our FY15 estimates. This compares to its mid-cycle valuation of 1.3x P/BV and 11x P/E since 2009. Our price target is a blended average of: 1) our fair value estimate of HK\$15.8 from our residual income model (P/BV = ROE-g/COE-g), and 2) NPV/share of HK\$8.0 from our DCF model.

Risks to Rating and Price Target

- Upside risks:** Stronger-than-expected copper prices, TC/RCs hike (given JXC's net long smelting position), better-than-expected cost performance, higher dividend distribution, M&As.
- Downside risks:** Weaker-than-expected copper prices, lower TC/RCs (given JXC's net smelting position), delay in mine development (e.g., Aynak and Northern Peru), higher-than-expected cost pressure, poor capital management.

Asia Metals and Mining

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23-Jan-15	UW	13.16	12.00

<http://gfd-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=502059&shareClassServerId=4&chartDesignation=1&actionType=C>

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