

Equity Research | China | Metals

30 August 2017

Riding on continued rally in copper prices

- As alerted, Jiangxi Copper's 1H17 net profit increased 51% YoY thanks to higher copper prices and enhanced margins during the interim period. We believe margins will further improve in 2H17 on the back of rising copper prices, which have gained 9% QTD.
- Copper fabrication capacity utilisation increased amid an improving downstream copper consumption demand.
- We have revised up our price target to HKD16.0 (from HKD15.5), based on 1.0x FY17E PBR, which is at a deep discount to global peers, maintain Buy.

A strong delivery in 1H17 on improving fabrication capacity utilisation.

The company achieved a higher utilisation rate in fabrication capacity. The increase in production of copper rods and processing of fabricated copper have offset the impact of lower mined copper production. The overall gross profit margin improved to 3.3% in 1H17 from 2.7% in 1H16. Meanwhile, in spite of the higher capex investment for the interim, as of end-Jun 2017, net gearing has increased to only c.27.4% which is still a relatively healthy level, in our view.

We see higher copper prices ahead. The global supply of copper concentrate has continued to decline on a yearly basis, as a result of: (1) aging ore grades, (2) higher production costs, and (3) postponement of new projects due to heavy capex requirements. On a short-term basis, various sources suggest that the China Smelters Purchase Team is willing to accept lower TC/RC terms in 4Q17 as compared with the previous quarter, amid the continuing mine disruptions. Based on our rough estimation, if capital costs are included as a cost component, it is estimated that the incentive price for most of the pipeline greenfield projects would be almost USD7,500/ton. Thus, we believe supply growth is likely to remain slow going forward. On the production front, according to SMM data, China's refined copper production was up 0.1% in 7M17, but was down 4.6% yearly in July, mainly due to the insufficient supply of scrap copper materials. In addition, we noticed that the global copper inventory has started to resume on a downtrend since early-Jun. Considering it is the high copper consumption season in China currently, we believe a continuous inventory drawdown, in anticipation of the sales growth of electric vehicles and air-conditioners to remain strong in the near term, will lend support for the copper price to remain on an uptrend.

Bright long-term growth prospects intact. Whilst the current copper price holds well for sustainable robust earnings growth this year, the company's healthy balance sheet should drive potential inorganic growth opportunities, in our view.

Maintain Buy with price target revised up to HKD16.0 (from HKD15.5).

We believe Jiangxi Copper's current valuation is undervalued, as it is trading at only 0.8x FY17E PBR, which is at a deep discount to the global peers' average of 2.7x, taking into consideration that its FY17E ROE has gradually recovered to 4.0% as per our estimate. Pegging to an unchanged target multiple of 1.0x FY17E PBR, we have derived a new price target of HKD16.0, representing 19.9% upside potential, thus, maintain Buy.

Jiangxi Copper (358 HK)

Buy

(unchanged)

Price Target	HK\$16.00
(Revision)	(+3.2%)
(upside)	(19.0%)

EPS	2017E	2018E
revision	(+8.7%)	(+7.9%)

Close price	HKD13.44
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Market cap.	HKD65,680 mn
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Free float	85.7%
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52-week range	HKD8.71 – 14.66
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3-mth ave. T/O	HKD166.7 mn
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Price as of 30 August 2017

Stock rel HSI performance (%)



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Figure 1: 1H17 results highlight

	Unit	1H16	1H17	% YoY
Production achieved				
Copper cathode	tons	599,800	644,900	7.5%
Copper concentrates	tons	105,900	104,700	-1.1%
Gold	kg	13,303	12,532	-5.8%
Silver	tons	269	247	-8.2%
Molybdenum concentrates	tons	3,829	3,676	-4.0%
Sulphuric acids	tons	1,860,000	1,700,000	-8.6%
Sulphur concentrates	tons	1,310,000	1,240,000	-5.3%
Copper rods	tons	391,000	462,200	18.2%
Copper processing products	tons	65,900	74,500	13.1%
Revenue				
Copper cathodes	RMB mn	54,976	59,560	8.3%
Copper rods	RMB mn	17,234	20,250	17.5%
Copper processing products	RMB mn	1,672	2,502	49.6%
Gold	RMB mn	3,393	3,337	-1.6%
Silver	RMB mn	1,776	1,672	-5.8%
Sulphuric and sulphuric concentrate	RMB mn	550	393	-28.7%
Rare and other non-ferrous metals	RMB mn	9,271	8,847	-4.6%
Others	RMB mn	1,102	1,200	8.9%
Total	RMB mn	89,973	97,760	8.7%
Cost of sales	RMB mn	(87,546)	(94,579)	8.0%
Gross profit	RMB mn	2,427	3,180	31.0%
Gross profit margin	%	2.7%	3.3%	-
Other income	RMB mn	437	320	-26.7%
Other gains and losses	RMB mn	(182)	(406)	123.2%
Selling and distribution expenses	RMB mn	(265)	(298)	12.7%
Administrative expenses	RMB mn	(846)	(804)	-5.0%
Finance costs	RMB mn	(538)	(363)	-32.6%
Share of results of joint ventures	RMB mn	(21)	(12)	-44.3%
Share of results of associates	RMB mn	13	43	240.8%
Pre-tax profit	RMB mn	1,025	1,661	62.1%
Pre-tax margin	%	1.1%	1.7%	-
Taxation	RMB mn	(287)	(699)	143.6%
Minority interests	RMB mn	95	(11)	-111.7%
Profit attributable to owners	RMB mn	643	974	51.4%
Net margin	%	0.7%	1.0%	-

Source: Company

Income statement (RMB mn)

Year end: Dec	2015	2016	2017E	2018E	2019E
Revenue	185,228	201,728	211,602	212,186	212,856
COGS	(81,454)	(105,164)	(205,942)	(206,148)	(206,387)
Gross profit	3,775	6,564	5,660	6,037	6,469
Selling expenses	(515)	(569)	(597)	(599)	(600)
General and administrative	(2,041)	(1,680)	(1,762)	(1,767)	(1,772)
Other opex	1,203	(1212)	510	510	510
Operating profit	2,422	3,103	3,812	4,182	4,606
Net interest expense	(923)	(969)	(784)	(858)	(958)
JVs and associates	(282)	(51)	(53)	(53)	(54)
Pretax profit	1,216	2,084	2,975	3,270	3,595
Taxation	(478)	(1,089)	(744)	(818)	(899)
Minority interests	(49)	(54)	(346)	(380)	(418)
Net profit	690	841	1,885	2,072	2,278
Net profit (adjusted)	690	841	1,885	2,072	2,278
EBIT	2,091	2,898	3,412	3,748	4,135
Depreciation & Amortization	(1,651)	(1,861)	(2,361)	(2,753)	(2,943)
EBITDA	3,741	4,760	5,774	6,501	7,078
Basic EPS (RMB)	0.20	0.24	0.54	0.60	0.66
Diluted EPS (RMB)	0.20	0.24	0.54	0.60	0.66
DPS (RMB)	0.10	0.15	0.27	0.30	0.33

Balance sheet (RMB mn)

Year end: Dec	2015	2016	2017E	2018E	2019E
Cash	16,705	8,260	5,844	4,969	6,419
Short term investments	-	-	-	-	-
Accounts receivables	14,206	16,562	16,137	16,182	16,233
Inventory	13,369	15,412	15,185	15,201	15,218
Other current assets	15,772	16,559	16,559	16,559	16,559
Total current assets	60,052	56,794	53,725	52,910	54,428
PP&E	21,447	20,935	25,573	29,820	31,877
Intangible Assets	1,674	1,732	1,732	1,732	1,732
Total investments	4,090	5,422	5,422	5,422	5,422
Other long term assets	2,488	2,501	2,501	2,501	2,501
Total long term assets	29,699	30,590	35,229	39,476	41,533
TOTAL ASSETS	89,751	87,384	88,954	92,386	95,961
Short term debt	16,705	14,956	15,941	17,911	19,881
Accounts payables	8,575	11,817	10,759	10,770	10,782
Other current liabilities	15,224	10,566	10,906	10,911	10,916
Total current liabilities	40,504	37,339	37,606	39,591	41,580
Long term debt	348	228	243	273	303
Deferred tax	1,070	994	994	994	994
Bonds payable	-	-	-	-	-
Other long term liabilities	-	-	-	-	-
Total long term liabilities	1,418	1,222	1,237	1,267	1,297
TOTAL LIABILITIES	41,922	38,561	38,843	40,859	42,877
Shareholders' funds	45,902	46,598	47,541	48,577	49,716
Minority Interests	1,927	2,225	2,571	2,951	3,369
TOTAL LIAB AND EQUITY	89,751	87,384	88,954	92,386	95,961
Net cash / (debt)	(347)	(6,924)	(10,340)	(13,215)	(13,765)

Source: Company, Bloomberg, CSCI Research estimates

Cash flow statement (RMB mn)

Year end: Dec	2015	2016	2017E	2018E	2019E
EBIT	2,422	3,103	3,812	4,182	4,606
Depreciation & amortisation	1,651	1,861	2,361	2,753	2,943
Net interest	923	969	784	858	958
Taxes paid	(478)	(1,089)	(744)	(818)	(899)
Changes in working capital	(75)	(2,206)	(66)	(44)	(51)
Others	(2,175)	1,721	(1,620)	(1,770)	(1,970)
Cash flow from operations	2,268	4,361	4,526	5,162	5,588
Capex	(1,197)	(1,635)	(7,000)	(7,000)	(5,000)
Acquisitions	(4,289)	(5,923)	-	-	-
Disposals	4,317	4,681	-	-	-
Others	2,858	(667)	-	-	-
Cash flow from investing	1,690	(3,544)	(7,000)	(7,000)	(5,000)
Dividends	(693)	(346)	(943)	(1,036)	(1,139)
Issue of shares	-	-	-	-	-
Change in debt	(4,520)	(9,059)	1,000	2,000	2,000
Others	(1,577)	143	-	-	-
Cash flow from financing	(6,789)	(9,261)	57	964	861
Change in cash	(2,831)	(8,445)	(2,416)	(875)	1,449
Free cash flow	1,071	2,726	(2,474)	(1,838)	588

Key ratios

Year end: Dec	2015	2016	2017E	2018E	2019E
Operating ratios					
Gross margin	2.0	3.3	2.7	2.8	3.0
EBITDA margin (%)	2.0	2.4	2.7	3.1	3.3
Effective tax rate (%)	39.3	52.2	25.0	25.0	25.0
Revenue growth (%)	-	8.9	4.9	0.3	0.3
Net income growth (%)	-	219	124.2	9.9	9.9
EPS growth adj (%)	-	219	124.2	9.9	9.9
DPS growth (%)	-	50.0	81.5	9.9	9.9
Efficiency ratios					
ROE (%)	15	18	4.0	4.3	4.6
ROCE (%)	4.9	6.2	7.4	7.9	8.5
Asset turnover (x)	2.1	2.3	2.4	2.3	2.2
Op cash / EBIT (x)	0.9	14	12	12	12
Depreciation / CAPEX (x)	14	1.1	0.3	0.4	0.6
Accounts receivable days	31.1	27.8	28.2	27.8	27.8
Accounts payable days	28.6	27.7	28.3	27.7	27.7
Leverage ratios					
Net gearing (%)	0.8	14.9	21.7	27.2	27.7
Net debt / EBITDA (x)	0.1	15	18	2.0	1.9
Interest cover (x)	2.6	3.2	4.9	4.9	4.8
Current ratio (x)	15	15	14	13	13
Valuation					
PER (x)	57.6	47.2	21.1	19.2	17.4
EV/EBITDA (x)	19.2	14.8	12.4	11.5	10.6
PBR (x)	0.9	0.9	0.8	0.8	0.8
Dividend yield (%)	0.9	13	2.4	2.6	2.9

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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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