

### COMPANY RESULTS

## Zhaojin Mining Industry (1818 HK)

1H14: In-line Results; Sustained Production Growth Outlook With Cost Pressure

Zhaojin's 1H14 results are in line with market expectation but below our estimates, due mainly to higher-than-expected cost of production and finance cost. Looking ahead, the increasing contribution from non-Zhaoyuan mines will sustain its long-term production growth of around 10%. That said, cost pressure is increasing from high-cost non-Zhaoyuan mines. Better-than-expected cost control will be a positive surprise. Maintain BUY with DCF-based target price revised down to HK\$5.90.

### 1H14 RESULTS

Rmb m	1H13	2H13	1H14	% yoy	% hoh
Revenue	2,371	3,973	2,845	20%	-28%
Cost of sales	(1,329)	(2,774)	(1,815)	37%	-35%
Gross profit	1,042	1,199	1,030	-1%	-14%
SGA expenses	(402)	(516)	(418)	4%	-19%
EBIT	568	768	664	17%	-14%
Finance cost	(162)	(180)	(256)	57%	42%
PBT	405	588	408	1%	-31%
Tax provision	(84)	(142)	(98)	17%	-31%
Net profit	300	434	324	8%	-25%
EPS	0.103	0.149	0.111	8%	-25%
Gross margin	44%	30%	36%		
Operating expenses	17%	13%	15%		
Operating margin	27%	17%	22%		
Effective tax rate	21%	24%	24%		
Net profit margin	13%	11%	11%		
Total gold production	12.4	16.5	15.0	21%	-9%
mined gold production	8.6	11.5	9.7	12%	-16%
Gold output from tolling	3.7	5.0	5.3	42%	5%
Gold sales (tonnes)	6.7	12.4	9.4	41%	-24%
Gold ASP	290	258	260	-10%	1%
SGE Gold Price	307	258	257	-16%	0%
Cash cost	71	78	75	6%	-3%
Comprehensive cost	135	129	134	-1%	4%
% of revenue from gold	82%		86%		

Source: Zhaojin, UOB Kay Hian

### RESULTS

- 1H14 net profit increased by 8% yoy to Rmb324m, in line with market consensus but below our forecasts.
- Revenue rose 20% yoy against a 21% yoy increase in gold production to 15 tonnes, which meets the company's own guidance. Mined gold production rose 12% yoy to 9.7 tonnes.

### KEY FINANCIALS

Year to 31 Dec (Rmbm)	2012	2013	2014F	2015F	2016F
Net turnover	7,604	6,344	6,179	6,733	7,300
EBITDA	3,289	1,887	2,111	2,345	2,583
Operating profit	2,850	1,323	1,435	1,563	1,697
Net profit (rep./act.)	1,924	734	686	742	826
Net profit (adj.)	1,924	734	686	742	826
EPS (Fen)	65.9	24.8	23.1	25.0	27.9
PE (x)	6.1	16.3	17.5	16.2	14.5
P/B (x)	1.4	1.4	1.4	1.3	1.2
EV/EBITDA (x)	6.7	11.7	10.5	9.4	8.6
Dividend yield (%)	6.6	2.4	2.3	2.5	2.8
Net margin (%)	25.3	11.6	11.1	11.0	11.3
Net debt/(cash) to equity (%)	54.2	96.1	106.5	106.4	107.8
Interest cover (x)	16.2	5.8	4.1	4.1	4.4
ROE (%)	25.7	8.7	8.0	8.2	8.9
Consensus net profit	-	-	645	679	741
UOBKH/Consensus (x)	-	-	1.06	1.09	1.12

Source: Zhaojin Mining Industry, Bloomberg, UOB Kay Hian

## BUY

(Maintained)

Share Price	HK\$5.10
Target Price	HK\$5.90
Upside	+15.7%
(Previous TP)	HK\$7.80

### COMPANY DESCRIPTION

Zhaojin Mining Industry Company Ltd. 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):	14,865.8
Market cap (US\$m):	1,918.0
3-mth avg daily t'over (US\$m):	3.2

### Price Performance (%)

52-week high/low HK\$7.50/HK\$4.15

1mth	3mth	6mth	1yr	YTD
7.6	17.2	(4.0)	(24.2)	15.1

### Major Shareholders

	%
Shandong Zhaojin Group	37.6
FY14 NAV/Share (Rmb)	2.97
FY14 Net Debt/Share (Rmb)	3.17

### PRICE CHART



Source: Bloomberg

### ANALYST

**Helen Lau**  
+852 2236 6749  
helen.lau@uobkayhian.com.hk

- Unit comprehensive cost decreased 0.6% yoy to Rmb133.81/tonne. Unit cost for gold mines outside Zhaoyuan declined by 10.46% yoy to Rmb164.25/tonne on production increase.
- Gross margin was squeezed to 36% in 1H14 from 44% in 1H13 due mainly to a decline in gold prices and total cost of sales increase (upon increase in gold sales).
- Net profit rose by only 8% yoy due mainly to increase in finance cost (up 57% yoy) attributable to the increase in borrowings and expansion of gold-leasing business.
- Overall, Zhaojin's results are not as strong as Zijin (2899 HK/BUY), because the latter's diversification and cost of sales reduction in non-gold products protected its margin (unchanged at 16% in 1H14 from 1H13).

### OUTLOOK

- Sustained gold production growth outlook from increasing contribution from non-Zhaoyuan gold mines. In 1H14, gold production from non-Zhaoyuan mines (up 34% yoy, vs 4% yoy increase in Zhaoyuan mines) represented 40% of total gold production, up from 35% in 1H13. The production ramp-up at non-Zhaoyuan mines sustained Zhaojin's long-term self-mine gold production growth at around 10% in our estimate. In 1H14, its self-mine gold production grew by 12% yoy, in line with its guidance.
- Cost control at high-cost non-Zhaoyuan mines is the key to containing total cost of production. Cost of production in non-Zhaoyuan mines was 44% higher than that of gold mines in Zhaoyuan. Zhaojin managed to lower the unit cost of production in non-Zhaoyuan mines by 10% yoy in 1H14. As a result, its total comprehensive cost of production decreased by 0.6% yoy. Cost control at its high-cost non-Zhaoyuan mine is the key to containing its total cost, in view of upside pressure from mining cost and depreciation cost, etc.
- Meanwhile, cost of production at Zhaoyuan mines grew by 4% yoy to Rmb 114/tonne because its mines have all reached full capacity, hence leaving little room for production growth. The pace of cost growth of Zhaoyuan mines is faster than Zijin's gold mines, which was up only 2% yoy in 1H14.

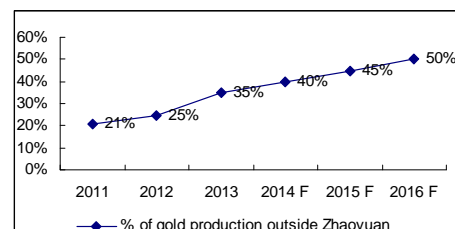
### EARNINGS REVISION/RISK

- We keep our 2014/2015/2016 gold price forecasts unchanged at US\$1,332/oz, US\$1400/oz/US\$1,400/oz respectively. We raise our unit cost of production forecast to Rmb140/g/Rmb141/g/Rmb141/g for 2014/2015/2016, up from previous Rmb136/tonne/Rmb138/tonne/Rmb138/tonne respectively by taking into consideration the increasing contribution from high-cost non-Zhaoyuan mines and higher-than-expected cost increase in Zhaoyuan mines. We also revise up our forecast for its financing cost due mainly to its increase in loans in 1H14, up 41% yoy. As a result, we revise down our earnings forecast for 2014-2016 by 23%/36%/12% respectively for 2014-2016.
- Zhaojin's earnings are sensitive to changes in gold prices, sales volume and cost. In our sensitivity analysis, for every 5% increase in gold prices, net profit will increase 21%. For every 5% decrease in sales volume, net profit will fall 6%. For every 5% increase in comprehensive cost, net profit will fall 15%.

### VALUATION/RECOMMENDATION

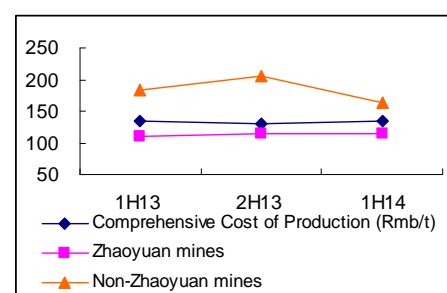
- We like Zhaojin's sustained gold production growth of 10% going forward supported by increasing contribution from non-Zhaoyuan gold mines. Although its average cost of production will have upside pressure due to increased contribution from high-cost non-Zhaoyuan mines, Zhaojin has proved its capabilities in cost control. That said, rising financing cost will squeeze its bottom-line. We prefer Zijin to Zhaojin as the former's balance sheet is much stronger.
- Maintain BUY and revise down DCF-based target price to HK\$5.90 from previous HK\$7.80. Currently Zhaojin is trading at an attractive 16x 2015F PE, vs its mean PE of 20x PE. Our target price implies 18x 2014F PE.

### % OF GOLD PRODUCTION FROM NON-ZHAOYUAN MINES IS RISING



Source: UOB Kay Hian, Zhaojin.

### COST OF PRODUCTION TREND



Source: UOB Kay Hian, Zhaojin.

### PROFIT & LOSS

Year to 31 Dec (Rmbm)	2013	2014F	2015F	2016F
Net turnover	6,344.1	6,179.0	6,733.2	7,300.3
EBITDA	1,886.7	2,111.0	2,344.6	2,582.8
Deprec. & amort.	564.1	675.6	781.2	886.0
EBIT	1,322.6	1,435.4	1,563.4	1,696.8
Total other non-operating income	(23.5)	0.0	0.0	0.0
Associate contributions	20.5	27.3	30.0	30.0
Net interest income/(expense)	(326.1)	(518.1)	(571.8)	(589.4)
<b>Pre-tax profit</b>	<b>993.6</b>	<b>944.7</b>	<b>1,021.7</b>	<b>1,137.4</b>
Tax	(226.2)	(226.7)	(245.2)	(273.0)
Minorities	(33.3)	(31.7)	(34.3)	(38.1)
<b>Net profit</b>	<b>734.1</b>	<b>686.3</b>	<b>742.2</b>	<b>826.3</b>
Net profit (adj.)	734.1	686.3	742.2	826.3

### CASH FLOW

Year to 31 Dec (Rmbm)	2013	2014F	2015F	2016F
<b>Operating</b>	<b>1,170.9</b>	<b>1,004.6</b>	<b>1,786.7</b>	<b>1,595.8</b>
Pre-tax profit	993.6	944.7	1,021.7	1,137.4
Tax	(419.1)	(226.4)	(234.9)	(257.5)
Deprec. & amort.	564.1	675.6	781.2	886.0
Associates	(13.0)	(27.3)	(30.0)	(33.1)
Working capital changes	45.3	(361.9)	248.7	(137.0)
Non-cash items	0.0	0.0	0.0	0.0
Other operating cashflows	0.0	0.0	0.0	0.0
<b>Investing</b>	<b>(2,996.9)</b>	<b>(2,000.0)</b>	<b>(2,000.0)</b>	<b>(2,000.0)</b>
Capex (growth)	0.0	0.0	0.0	0.0
Capex (maintenance)	(2,996.9)	(2,000.0)	(2,000.0)	(2,000.0)
Investments	0.0	0.0	0.0	0.0
Proceeds from sale of assets	0.0	0.0	0.0	0.0
Others	0.0	0.0	0.0	0.0
<b>Financing</b>	<b>1,512.7</b>	<b>703.4</b>	<b>725.5</b>	<b>703.1</b>
Dividend payments	(712.0)	(296.6)	(274.5)	(296.9)
Issue of shares	0.0	0.0	0.0	0.0
Proceeds from borrowings	5,875.0	2,000.0	2,000.0	2,000.0
Loan repayment	(3,520.0)	(1,000.0)	(1,000.0)	(1,000.0)
Others/interest paid	(130.3)	0.0	0.0	0.0
<b>Net cash inflow (outflow)</b>	<b>(313.3)</b>	<b>(292.0)</b>	<b>512.2</b>	<b>298.9</b>
<b>Beginning cash &amp; cash equivalent</b>	<b>1,349.1</b>	<b>1,035.8</b>	<b>743.9</b>	<b>1,256.0</b>
Changes due to forex impact	0.0	0.0	0.0	0.0
<b>Ending cash &amp; cash equivalent</b>	<b>1,035.8</b>	<b>743.9</b>	<b>1,256.0</b>	<b>1,554.9</b>

### BALANCE SHEET

Year to 31 Dec (Rmbm)	2013	2014F	2015F	2016F
Fixed assets	9,475.5	10,940.3	12,299.4	13,553.7
Other LT assets	8,959.3	8,846.3	8,736.0	8,628.7
Cash/ST investment	1,035.8	743.9	1,256.0	1,554.9
Other current assets	3,901.8	3,260.4	3,114.9	3,356.9
<b>Total assets</b>	<b>23,372.5</b>	<b>23,790.8</b>	<b>25,406.3</b>	<b>27,094.2</b>
ST debt	6,824.9	7,824.9	8,824.9	9,824.9
Other current liabilities	3,897.7	2,894.7	3,008.3	3,128.6
LT debt	2,308.2	2,308.2	2,308.2	2,308.2
Other LT liabilities	951.8	951.8	951.8	951.8
Shareholders' equity	8,425.9	8,815.6	9,283.3	9,812.7
Minority interest	896.9	928.6	962.8	1,000.9
<b>Total liabilities &amp; equity</b>	<b>23,372.5</b>	<b>23,790.8</b>	<b>25,406.3</b>	<b>27,094.2</b>

### KEY METRICS

Year to 31 Dec (%)	2013	2014F	2015F	2016F
<b>Profitability</b>				
EBITDA margin	29.7	34.2	34.8	35.4
Pre-tax margin	15.7	15.3	15.2	15.6
Net margin	11.6	11.1	11.0	11.3
ROA	3.6	2.9	3.0	3.2
ROE	8.7	8.0	8.2	8.9
<b>Growth</b>				
Turnover	(16.6)	(2.6)	9.0	8.4
EBITDA	(42.6)	11.9	11.1	10.2
Pre-tax profit	(62.7)	(4.9)	8.2	11.3
Net profit	(61.8)	(6.5)	8.2	11.3
Net profit (adj.)	(61.8)	(6.5)	8.2	11.3
EPS	(62.4)	(6.5)	8.2	11.3
<b>Leverage</b>				
Debt to total capital	49.5	51.0	52.1	52.9
Debt to equity	108.4	114.9	119.9	123.6
Net debt/(cash) to equity	96.1	106.5	106.4	107.8
Interest cover (x)	5.8	4.1	4.1	4.4

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MCI (P) 116/03/2014  
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