

August 27, 2013

Stock Rating
Overweight

Industry View
Attractive

Zhaojin Mining Industry Margin Decline and Inventory Provisions Led to Weak 1H

Quick comment – weak 1H13 should already be priced in: After the recent correction, gold prices have stabilized and remain at a relatively low level. We believe investors already expected the weak 1H13 results and are refocusing on Zhaojin's fundamentals, which remain sound, in our view. The company seeks 14% YoY growth in its mined gold production, to 21 tpa in 2013, and aims to keep its cost increases within 10%. 2013e PB is 1.9x vs. the long-term average of 2.9x.

1H13 net profit was Rmb 299.7mn (EPS of Rmb0.10), down 41% YoY: Implied 2Q13 EPS was Rmb0.02. Zhaojin produced 8.62t of mined gold in 1H, up 11% YoY. Processed gold volume was down 21.5% to 3.7t.

- During the period margin declined to 44% from 58%, reflecting the 12% YoY drop in gold prices. Total costs were up 10% to Rmb 134.63/g, reflecting labor costs and amortization & depreciation, but still within management's previous guidance.
- Zhaojin took inventory provisions of Rmb97.5mn (or 0.03/sh) during the period. We estimate its inventory at ~1t as of the end of 1H.

Gold price reflects September QE tapering: Our commodity team believes the gold price range since mid-June reflects consensus expectations for September QE tapering. Market participants adopted this view widely after the FOMC's statement in June, triggering a sharp decline in gold. Had the FOMC minutes suggested a longer-dated timing, we think gold prices would have advanced more aggressively. Broader FX markets also seem to reflect this view, with little immediate reaction to the minutes. Nevertheless, in our view, the recent gold price rally is likely to fade towards year-end as the headwinds that have pressured gold throughout the year re-emerge. These headwinds are a strengthening US currency, rising nominal and real bond yields, and a continuing erosion in investor faith.

Key Ratios and Statistics

Reuters: 1818.HK Bloomberg: 1818 HK

China Gold

| | |
|---------------------------------|----------------|
| Shr price, close (Aug 26, 2013) | HK\$7.00 |
| 52-Week Range | HK\$14.48-4.46 |
| Sh out, dil, curr (mn) | 2,966 |
| Mkt cap, curr (mn) | Rmb16,385 |
| EV, curr (mn) | Rmb20,678 |
| Avg daily trading value (mn) | Rmb61 |

| Fiscal Year ending | 12/12 | 12/13e | 12/14e | 12/15e |
|----------------------------|-------|--------|--------|--------|
| ModelWare EPS (Rmb) | 0.66 | 0.46 | 0.44 | 0.39 |
| Consensus EPS (Rmb)\$ | 0.62 | 0.42 | 0.37 | 0.34 |
| Revenue, net (Rmb mn) | 7,603 | 6,528 | 6,862 | 6,961 |
| EBITDA (Rmb mn) | 3,296 | 3,122 | 3,294 | 3,301 |
| ModelWare net inc (Rmb mn) | 1,924 | 1,364 | 1,291 | 1,161 |
| P/E | 14.8 | 12.0 | 12.7 | 14.1 |
| P/BV | 3.4 | 2.1 | 1.9 | 1.7 |
| RNOA (%) | 26.4 | 13.6 | 11.6 | 9.9 |
| ROE (%) | 29.2 | 16.2 | 16.2 | 13.3 |
| EV/EBITDA | 10.1 | 7.3 | 7.0 | 7.1 |
| Div yld (%) | 2.5 | 3.0 | 2.9 | 2.6 |
| FCF yld ratio (%) | (3.8) | (7.8) | 0.0 | 0.5 |
| Leverage (EOP) (%) | 54.1 | 80.9 | 78.3 | 75.9 |

Unless otherwise noted, all metrics are based on Morgan Stanley ModelWare framework (please see explanation later in this note).

\$ = Consensus data is provided by Thomson Reuters Estimates.

e = Morgan Stanley Research estimates

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Zhaojin Mining Industry

Exhibit 1

Zhaojin Mining: 2Q13 Results Snapshot

| (Rmb million) | 2Q13 | MS | diff % | Cons. | YoY | QoQ |
|-----------------------|-------|-------|--------|-------|------|------|
| Revenue | 1,207 | 1,086 | 11% | na | 15% | 4% |
| Gross profit | 363 | 575 | -37% | na | -38% | -46% |
| EBIT | 137 | 423 | -68% | na | -68% | -68% |
| Net income | 66 | 250 | -74% | na | -76% | -72% |
| EPS (Rmb) | 0.02 | 0.08 | -74% | 0.28 | -77% | -72% |
| EPS (HK\$) | 0.03 | 0.10 | -74% | | -77% | -72% |
| Total Vol(Gold - kgs) | 5,379 | 3,894 | 38% | na | -20% | 66% |
| ASP (Rmb/g) | 279 | 279 | 0% | na | -15% | -16% |

Source: Company Data, Morgan Stanley Research

Exhibit 2

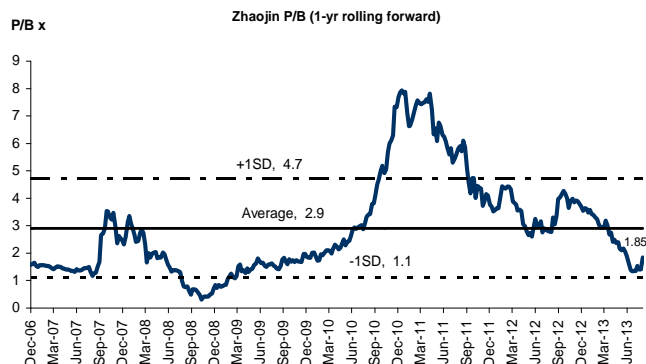
Zhaojin EV/oz Resources below Long-term Average



Source: Company Data, Thomson Reuters, Morgan Stanley Research

Exhibit 3

Zhaojin PB: Below Long-term Average Levels




Source: Company Data, Thomson Reuters, Morgan Stanley Research

Company Description

Zhaojin Mining Industry Company Limited is engaged in exploration, mining, ore processing, smelting and the selling of gold and other metallic products. It is an integrated mining company specializing in the production of gold. The company produces two main gold products - Au9999 and Au9995 gold bullion under the Zhaojin brand.

China Gold

Industry View: Attractive

| | |
|---|--|
|  | <p>Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations. For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.</p> |
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(as of July 31, 2013)

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|--------------------------|-------------------|------------|----------------------------------|----------------|----------------------|
| | Count | % of Total | Count | % of Total IBC | % of Rating Category |
| Overweight/Buy | 1009 | 35% | 410 | 39% | 41% |
| Equal-weight/Hold | 1302 | 45% | 496 | 47% | 38% |
| Not-Rated/Hold | 112 | 4% | 27 | 3% | 24% |
| Underweight/Sell | 467 | 16% | 123 | 12% | 26% |
| Total | 2,890 | | 1056 | | |

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Stock Price, Price Target and Rating History (See Rating Definitions)

Zhaojin Mining Industry (1818.HK) - As of 8/26/13 in HKD
Industry : China Gold



Volatility shading indicates "more volatile" (V) flag. As of Nov-14-2008 the V flag has been discontinued.

Stock Rating History: 8/1/10 : O/I; 10/6/10 : E/I; 10/3/11 : O/I; 12/1/11 : O/A

Price Target History: 6/23/10 : 10.3; 10/6/10 : 13.3; 1/17/11 : 16.7; 7/26/11 : 19; 1/17/12 : 18.61; 6/28/12 : 15.45; 8/20/12 : 12; 10/4/12 : 16.5; 1/24/13 : 16; 4/17/13 : 10; 6/25/13 : 8

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target - - No Price Target Assigned (NA)
 Stock Price (Not Covered by Current Analyst) - - Stock Price (Covered by Current Analyst) - -
 Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
 Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) More Volatile (V) No Rating Available (NA)
 Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

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Zhaojin Mining Industry

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Industry Coverage:China Gold

| Company (Ticker) | Rating (as of) | Price* (08/26/2013) |
|-----------------------------------|----------------|---------------------|
| Rachel L Zhang | | |
| Zhaojin Mining Industry (1818.HK) | O (10/03/2011) | HK\$7 |
| Zijin Mining Group (2899.HK) | O (12/01/2011) | HK\$1.87 |

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