

Credit Opinion

1 August 2023

Ratings	
Category	Corporate
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	BBB _g -
Outlook	Positive

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Zhaojin Mining Industry Company Limited

Surveillance credit rating report

CCXAP affirms Zhaojin Mining Industry Company Limited's long-term credit rating at BBB_g-; changes outlook to positive.

Summary

The BBB_g- long-term credit rating of Zhaojin Mining Industry Company Limited ("Zhaojin Mining" or the "Company") is underpinned by the Company's (1) good market position in the gold mining industry with sufficient resource reserves; (2) recovering gold production; and (3) improving revenue and profitability due to the increase in production volumes.

However, the rating is also constrained by the Company's (1) earnings vulnerability to global economic conditions and gold price volatility; and (2) high debt leverage owing to business expansion.

The rating also reflects Zhaojin Mining's high likelihood of receiving strong support from its parent, Shandong Zhaojin Group Company Limited ("Zhaojin Group"), given its (1) most important status as the sole gold mining subsidiary of Zhaojin Group; and (2) strong parent-subsidiary linkage with Zhaojin Group. It also reflects Zhaojin Mining's high likelihood of receiving support from Zhaoyuan City Government, given its (1) ultimate ownership by the local government; (2) important position in the local economic development; and (3) track record of receiving government support.

The change in outlook on Zhaojin Mining's rating to positive from stable reflects the Company's (1) high production growth potential; and (2) relatively strong synergy with Zijin Mining Group Co., Ltd. ("Zijin Mining").

Rating Drivers

- Good market position in the gold mining industry with sufficient resource reserves
- Recovering gold production, with high production growth potential
- Earnings being vulnerable to global economic conditions and gold price volatility
- Improving revenue and profitability due to the increase in production volumes
- High debt leverage owing to business expansion
- Proven track record of support from Zhaojin Group and the local government

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) commodity prices rise substantially, further boosting the Company's profits; (2) the Company's market position strengthens with material increase in product output; and (3) the Company demonstrates lower debt leverage and improved credit metrics.

What could downgrade the rating?

The rating could be downgraded if (1) commodity prices fell sharply, adversely affecting the Company's earnings; (2) the Company's debt burden rose sharply with aggressive business expansion; or (3) the Company demonstrates deteriorated credit metrics and weakened liquidity profile.

Key Indicators

	2020FY	2021FY	2022FY
Total Assets (RMB billion)	39.6	42.9	45.8
Total Equity (RMB billion)	17.0	19.7	20.0
Total Revenue (RMB billion)	8.2	7.3	8.3
Net Profits (RMB billion)	1.2	0.2	0.5
EBIT/Revenue (%)	24.8	12.1	14.8
EBIT/Average Assets (%)	5.1	2.1	2.8
Total Debt/Total Capital (%)	55.1	58.1	61.8
Total Debt/EBITDA (x)	6.1	11.8	10.9
EBIT/Interest (x)	2.5	1.2	2.0
(CFO-Dividend)/Total Debt (%)	12.6	7.7	-1.2

All ratios and figures are calculated using CCXAP's adjustments.

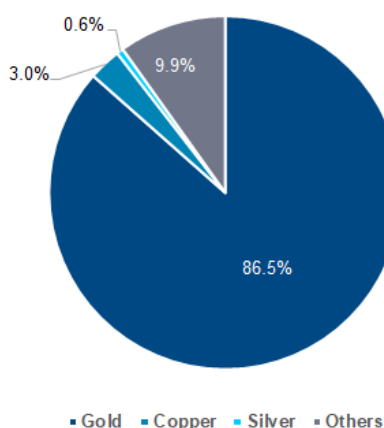
Source: CCXAP research

Corporate Profile

Founded in 2004, Zhaojin Mining (Stock Code: 1818.HK) is one of the leading gold mining companies in China engaged in the exploration, mining, smelting, and sales of gold, copper and silver, with principal products of standard Au9999 and Au9995 gold bullions. The Company was listed on the Stock Exchange of Hong Kong in 2006 and was jointly established by Zhaojin Group, Shanghai Fosun Industrial Investment Co., Ltd, Shanghai Yuyuan Tourist Mart (Group) Co, Ltd., Shenzhen Guangxin Investment Co., Ltd. and Shanghai Laomiao Gold Co., Ltd. In November 2022, Zijin Mining acquired 20% of the Company's shares through its subsidiary, and became the Company's second largest shareholder. As of 31 March 2023, Zhaojin Group directly held 34.74%

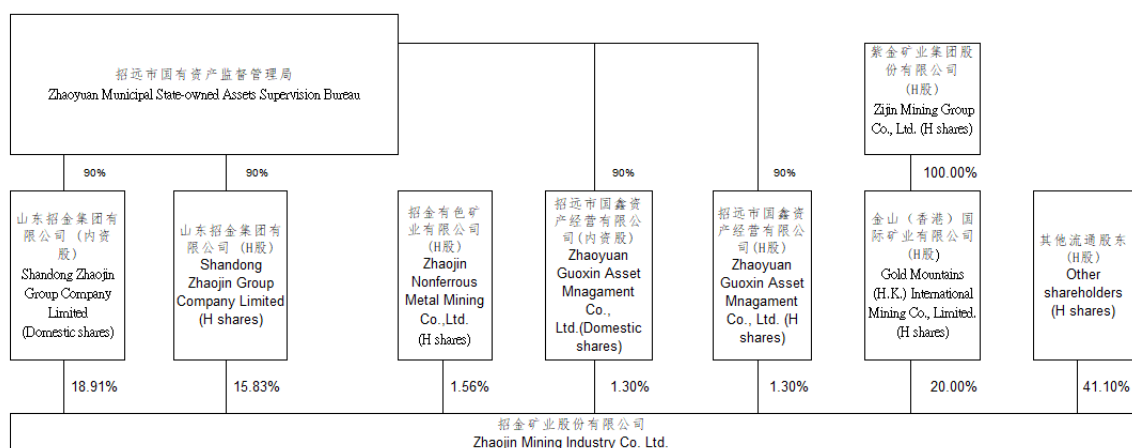
of the equity interest in Zhaojin Mining, and the Zhaoyuan Municipal State-owned Assets Supervision Bureau is the Company's ultimate controller.

Exhibit 1. Revenue structure in 2022



Source: Company data, CCXAP research

Exhibit 2. Shareholding and organization chart as of 31 March 2022



Source: Company information, CCXAP research

Rating Considerations

Good market position in the gold mining industry with sufficient resource reserves

Zhaojin Mining has maintained a good position in China's gold mining industry, ranking 4th among Chinese gold mining companies in terms of production volume. As of 31 December 2022, the Company had over 1,100 tons of gold resource reserves and 480 tons of high-grade recoverable reserves, laying a good foundation for its long-term development opportunities with low average production costs. Zhaojin Mining's resource reserves are geographically diversified, with more than 20 gold mines located not only in Zhaoyuan City, but also in Xinjiang, Gansu, Hebei, Liaoning and other regions, as well as other major gold-producing areas in China. The Company indirectly owns 70% equity interests of Haiyu Gold Mine through its major subsidiary Shandong Ruiyin Mining Industry Development Co., Ltd. ("Shandong Ruiyin"). Haiyu Gold Mine is the largest single gold mine in China, with gold resource reserves of over 560 tons as of end-2022. In addition, Zhaojin Mining is also engaged in copper and silver production. As of 31 December 2022, the Company had over 310 thousand tons of copper resource reserves and 110 thousand tons of recoverable reserves.

Recovering gold production, with high production growth potential

In spite of the ongoing in-depth production safety inspection and rectification in Shandong Province and the clean-up and rectification of non-coal mines in Yantai city, the Company has successfully passed various inspections and its production and operation has recovered to normal. The Company's gold production (including mine-producing and processing gold) increased by 15.6% year-on-year ("YoY") to 27.4 tons in 2022, mainly due to the resumption of production and further releasing the production capacity. However, the Company's copper production dropped significantly to 4.3 thousand tons in 2022 from 7.2 thousand tons in 2021, mainly due to the affection of the local mining regulatory policies.

Exhibit 3. Production volume of mine-produced products from in 2020-2022

	2020	2021	2022
Gold (tons)	35.6	23.7	27.4
Mine-producing gold (tons)	20.1	12.6	19.2
Processing gold (tons)	15.5	11.0	8.1
Copper (thousand tons)	6.0	7.2	4.3

Source: Company information, CCXAP research

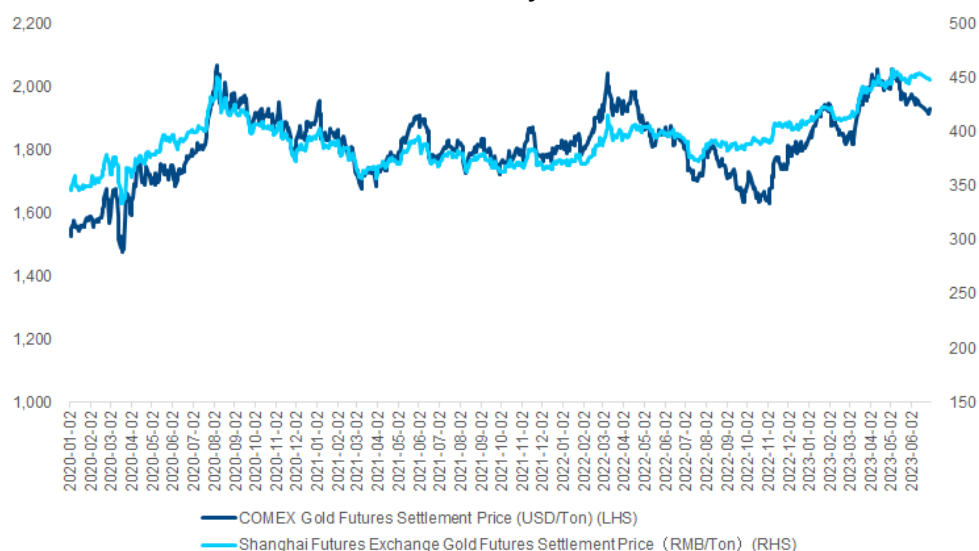
Furthermore, Haiyu Gold Mine has entered into the fast track of full-scale construction. It is the largest gold mine under construction of the Company, with a designed annual gold production capacity of 15-20 tons, and is expected to commence production in 2025. We believe that the Haiyu Gold Mine can not only increase the gold production of the Company, but also reduce its overall production costs. Furthermore, the Company's several key mining construction projects, such as expansion of Xiadian Gold Mine and Dayingezhuang Gold Mine, and in-depth exploration of Dayingezhuang Gold Mine and Zaozigou Gold Mine, will further increase its overall gold production capacity. Given the large reserves of construction projects, we expect the gold output of the Company to grow steadily before 2025, and will grow rapidly after Haiyu Gold Mine commences production.

Relatively strong synergy with Zijin Mining

In 2022, Zijin Mining acquired 30% equity interests of Shandong Ruiyin, which owns 100% interests of Haiyu Gold Mine, with total consideration of RMB4.0 billion. Zijin Mining also acquired 20% equity interests of Zhaojin Mining with total consideration of HKD4.4 billion, becoming the second largest shareholder of the Company and Shandong Ruiyin. Given that both the Company and Zijin Mining are large gold enterprises in China with rich experience in mine operation and management, we believe that relatively strong synergy can be generated effectively between both parties, improving the operation quality and management efficiency of the Company and accelerating the construction of Haiyu Gold Mine.

Earnings being vulnerable to global economic conditions and gold price volatility

In early 2022, the investors' risk aversion increased due to the conflicts between Russia and Ukraine, resulting in a significant increase in gold prices. However, since mid-2022, the Fed has initiated a series of aggressive monetary policies such as rate hike and balance sheet tapering, suppressing the gold prices. In 2022Q4, as the US Federal Reserve slowed down the pace of raising interest rates and the economic recession was expected to heat up, the gold price started an upward trend again. For the first half of 2023, the gold prices continued to increase amid weakening US dollar, geopolitical uncertainties, and persistently high inflation. We expect that with the Fed's slowdown in the pace of rate hike, the downward pressure on gold prices will be reduced, but volatility will continue in the gold prices.

Exhibit 4. Gold Futures Price from January 2020 to June 2023

Source: CCXAP research

Zhaojin Mining's revenue and earnings are highly susceptible to fluctuations in gold prices. The Company has hedged the price risk of gold via gold forward contracts, which could reduce the impact of commodity price volatilities. The price range of the forward commodity contracts is closely monitored by management. Accordingly, we expect that a reasonable fluctuation in commodity prices would have no significant impact on the Company's profit and equity.

Improving revenue and profitability due to the increase in production volume

Zhaojin Mining's revenue has improved, mainly driven by strong gold prices and the growing gold production and sale. The Company's total revenue increased by 13.9% YoY to RMB8.3 billion in 2022. In addition, Zhaojin Mining has cost advantages, resulting in its high gross profit of 35.6% in 2022. The Company's profitability has also improved, due to the increase in production volume and the decrease in period costs. In 2022, the Company's EBIT margin and return on average assets were 14.8% and 2.8%, increasing from 12.1% and 2.1% in 2021, respectively. We expect that, underpinned by relatively high gold prices and good cost management, the Company will continue to demonstrate competitive profitability for the next 12 to 18 months.

High debt leverage owing to business expansion

Zhaojin Mining's debt leverage remains high owing to its business expansion and upgrade. As of 31 March 2023, the Company's adjusted total debt (including perpetual securities) amounted to RMB26.9 billion, with total capitalization ratio of 64.3%. However, its debt maturity structure has improved. The proportion of the Company's short-term debt to its total debt decreased from 51.5% at end-2021 to 46.3% at end-2022, albeit still at a relatively high level. Zhaojin Mining's credit metrics also slightly improved. The Company's total debt/EBITDA ratio slightly decreased to 10.9x in 2022 from 11.8x in 2021, and its EBIT/interest coverage ratio strengthened to 2.0x from 1.2x in the same period.

However, Zhaojin Mining has large future capital needs on Haiyu Gold Mine project, which may further push up the debt scale. As of 31 March 2023, the Company had invested RMB2.3 billion into its flagship project, with uninvested amount of RMB5.0 billion. Moreover, the Company will continue to increase investment in high-quality gold projects around the world through international mergers and acquisitions, which may rely on debt

financing. Considering the Company's relatively large capital expenditure, we expect its debt leverage to remain relatively high over the next 12 to 18 months.

Improved liquidity profile and good access to capital

Zhaojin Mining's liquidity profile has improved, supported by its increased standby liquidity and good access to capital markets. The Company has sufficient credit lines from large state-owned banks, joint-stock commercial banks and regional banks. As of end-2022, the Company had total credit facilities of RMB31.7 billion and available credit facilities of RMB20.4 billion, as compared with RMB27.0 billion and RMB19.7 billion at end-2021 respectively. Meanwhile, as a H-share listed company and a frequent bond issuer, Zhaojin Mining has a diversified and smooth access to funding. From 2022 to mid-2023, the Company had raised RMB13.5 billion in onshore bond market, with low coupon rates between 1.95% and 3.55%. Besides, the Company's cash reserves to short-term debt ratio has increased. As of 31 March 2023, the Company had cash reserves of RMB5.5 billion, about 0.4x relative to its short-term debt (end-2021: 0.3x). However, due to the increase in inventories and the decrease in deposits from customers, the Company's operating cash flow has decreased. In 2022, the Company's net cash flow from operation ("CFO") decreased by 75.3% YoY to RMB693.0 million. As a result, its adjusted CFO to total debt ratio declined from 7.7% in 2021 to -1.2% in 2022. We believe that with the resumption of its gold production and the expected production from the Haiyu project, the Company's operating cash flow will increase, further improving its liquidity.

External Support

Zhaojin Mining has high likelihood of receiving strong support from its parent, Zhaojin Group, given its (1) most important status as the sole gold mining subsidiary of Zhaojin Group; and (2) the strong parent-subsidiary linkage with Zhaojin Group. We also believe that Zhaojin Mining has high likelihood of receiving support from Zhaoyuan City Government, given its (1) ultimate ownership by the local government; (2) important position in the local economic development; and (3) track record of government support.

Zhaojin Group has an important position in the gold production of Zhaoyuan City. It is the City's leading enterprise and the largest gold producer and the backbone of local economic development. The financial impact of Zhaojin Group's default is also very strong, accounting for over 70% of the total assets of state-owned enterprises in Zhaoyuan City, and it has received continued support from the government in terms of capital injections and subsidies. In addition, as Zhaojin Mining is the only gold mining subsidiary of Zhaojin Group, it holds the majority of Zhaojin Group's mining assets, demonstrating strong parent-subsidiary linkage. Zhaojin Group continues to provide support in terms of asset injection, talent, technology, and financing. Zhaojin Group has injected a number of mining assets into the Company and provided guarantees for the Company's debt financing. As the key gold mining company in Zhaoyuan City, Zhaojin Mining also regularly receives financial support from the local government. From 2020 to 2022, the Company had received government subsidies of RMB201 million.

We believe that Zhaojin Mining will remain a core subsidiary of Zhaojin Group, and the strong willingness to support the Company from the local government and Zhaojin Group is unlikely to change in the near to medium term.

Rating Methodology

The methodology used in this rating is the Rating Methodology for [Mining Industry \(December 2017\)](#).

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