



Feb 3, 2015  
Company Report  
Rating: HOLD  
TP: HK\$ 20.58

H-Share price (HK\$) 21.15  
Est. share price return -2.70%  
Est. dividend yield 3.91%  
Est. total return 1.2%

Previous Rating & TP BUY, HK\$24.5  
Previous Report Date Oct 27, 2014

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**Key Data**

52Wk H/L(HK\$)	24.4/19.12
Issued shares (mn)	19,890
H-Shares (mn)	3,399
A-Shares (mn)	16,491
Market cap	
H-shares (HK\$ mn)	71,039
A-Shares (HK\$ mn)	305,743
3-mth avg daily turnover (HK\$ mn)	408
Major shareholder(s) (%):	
Shenhua Group Ltd.	73.01

Source(s): Company, Bloomberg, ABCI Securities

**Key operating data in 1H14 (%)**

Coal revenue	64
Power revenue	28
Transportation revenue	2
Coal chemical revenue	2
Other revenue	3

Source(s): Company, ABCI Securities

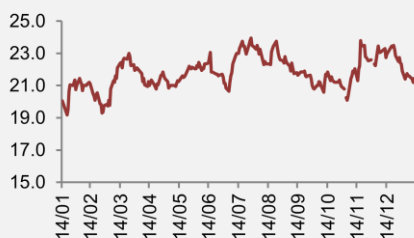
**Share performance (%)**

	Absolute	Relative*
1-mth	(8.64)	(3.19)
3-mth	(1.86)	(9.78)
6-mth	(9.81)	(15.26)

\*Relative to HSCEI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg, ABCI Securities

# China Shenhua (1088 HK)

## Growing costs, falling prices; Downgrade to HOLD

- China's IPPs and coal miners failed to agree on the long-term contract prices. With the peak season ending, the odds are against the coal miners
- Though the local governments have set tax rates at 6~7% of the selling prices, the tax base is yet to be confirmed. Therefore, the real impact on coal producers remains unknown
- Weak prices and fierce market competition will continue to increase costs significantly and lower gross profit margin for the Group. Hence, we revise down FY14E/FY15E EPS
- We believe most negatives have been priced in. Despite its low valuation at present, the lack of short-term positive triggers prompt us to downgrade the counter to **HOLD** with TP revised to HK\$20.58, reflecting 9.7x FY15E P/E and 1.03x FY15E P/B

**China's PMI fell to 49.8, signaling a weak demand from power sector.** Coal miners and IPPs have not established long-term contracts for 2015. The strategic agreement between the Group and China Huaneng also contains no details pertaining to the long-term prices. With the peak season coming to an end and the arrival of Lunar New Year in which demand from downstream sectors will be weak, the odds are against the coal miners concerning their long-term contract negotiation with IPPs.

**Local governments set coal resource tax at 6%-7%; no details were given on tax base.** The rate seems to be moderate at first glance but impact may vary depending on the tax base. As far as we know, local governments are still negotiating with coal producers on the details of the tax base. We consider the tax reform to be neutral to coal prices at this point.

**Weak coal prices on oversupply and severe competition.** According to China National Coal Association (CNCA), over 70% of coal miners suffered from loss in FY14 and significant oversupply will continue to depress coal prices. Due to sluggish global demand and a strong USD, we predict the international coal prices will remain weak in the coming year, capping the growth in China's domestic coal prices.

**Reduce FY14E/15E EPS; downgrade to HOLD.** We believe the slump in 2H14 coal prices and severe competition elevated the Group's costs in FY14. The Group's GPM will continue to shrink as China's economy moderates. Hence, we revise down its FY14E/FY15E GPM from 29.5%/29% to 26.6%/24%. Consequently, FY14E/15E EPS fell to RMB 1.81/RMB1.71, down 12.6%/21.5% from our previous estimates. The Group is currently trading at 10x FY15E P/E. Although the negatives have mostly been priced in, we are unable to see any valuation-accretive triggers in the short term. Thus, we downgrade the counter to **HOLD** with TP at HK\$ 20.58, reflecting 9.7x FY15E P/E and 1.03x FY15E P/B.

**Risk factors:** 1) Further declines in coal prices and electricity tariffs; 2) Supply-demand imbalance; 3) Business cycles of downstream industries; 4) Surging costs; 5) FY14E DPS may drop YoY; 6) A-H share price discrepancy.

**Results and Valuation**

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Turnover (RMB mn)	254,575	283,797	249,995	255,958	265,814
Chg (%yoy)	21.68	11.48	(11.91)	2.39	3.85
Net Income (RMB mn)	49,708	45,079	36,072	33,926	37,827
Chg (% YoY)	8.42	(9.31)	(19.98)	(5.95)	11.50
EPS (RMB)	2.50	2.27	1.81	1.71	1.90
Chg (% YoY)	8.42	(9.32)	(19.96)	(5.95)	11.50
BVPS (RMB)	13.23	13.92	15.07	16.15	17.35
Chg (%yoy)	15.33	5.21	8.24	7.16	7.45
P/E (x)	—	7.42	9.28	9.86	8.84
P/B (x)	—	1.21	1.12	1.04	0.97
DPS	0.96	0.96	0.67	0.63	0.70
Yield (%)	—	5.71	3.96	3.73	4.16
ROE (%)	20.23	16.69	12.51	10.93	11.35
ROA (%)	11.32	9.15	6.80	6.01	6.28

Source(s): Bloomberg, ABCI Securities estimates



**Consolidated income statement (2012A-2016E)**

<b>FY Ended Dec 31 (RMB mn)</b>	<b>2012A</b>	<b>2013A</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
<b>Revenue</b>	254,575	283,797	249,995	255,958	265,814
Coal revenue	165,989	167,399	132,130	133,224	137,284
Power revenue	71,096	77,423	72,877	73,294	76,959
Transportation revenue	5,403	6,078	6,382	6,829	7,307
Coal chemical revenue	4,084	5,463	6,362	7,960	9,614
Other revenue	8,003	27,434	32,244	34,651	34,651
Cost of sales	(174,677)	(202,431)	(183,496)	(194,528)	(199,361)
<b>Gross profit</b>	<b>79,898</b>	<b>81,366</b>	<b>66,499</b>	<b>61,430</b>	<b>66,454</b>
SG&A	(9,160)	(10,118)	(8,317)	(6,837)	(5,620)
<b>Profit from operations</b>	<b>70,746</b>	<b>70,528</b>	<b>58,259</b>	<b>54,593</b>	<b>60,833</b>
Other income/cost/and loss	(1,874)	(1,600)	(2,322)	(1,983)	(2,175)
Pre-tax profit	68,872	68,928	55,936	52,609	58,658
Profits tax	(10,976)	(13,704)	(11,747)	(11,048)	(12,318)
<b>Net profit</b>	<b>57,896</b>	<b>55,224</b>	<b>44,190</b>	<b>41,561</b>	<b>46,340</b>
Profit attributable to:					
Minority interests	8,188	10,145	8,118	7,635	8,513
<b>Equity shareholders of the Company</b>	<b>49,708</b>	<b>45,079</b>	<b>36,072</b>	<b>33,926</b>	<b>37,827</b>
<b>EPS (Basic), RMB</b>	<b>2.50</b>	<b>2.27</b>	<b>1.81</b>	<b>1.71</b>	<b>1.90</b>
<b>Dividend per share, RMB</b>	<b>0.96</b>	<b>0.96</b>	<b>0.67</b>	<b>0.63</b>	<b>0.70</b>

Source(s): Company, ABCI Securities estimates

**Consolidated balance sheet (2012A-2016E)**

<b>As of Dec 31 (RMB mn)</b>	<b>2012A</b>	<b>2013A</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
Property, plant and equipment	247,031	262,116	301,433	327,822	353,567
Construction in progress	61,737	76,065	79,868	83,862	88,055
Intangible assets	982	1,446	1,446	1,446	1,446
Other non-current assets	49,057	52,263	51,823	54,203	56,463
<b>Total non-current assets</b>	<b>358,807</b>	<b>391,890</b>	<b>434,571</b>	<b>467,333</b>	<b>499,530</b>
Inventories	15,722	17,641	13,924	14,040	14,467
Accounts and bills receivable	20,000	27,221	21,486	21,664	22,324
Prepaid expenses and other current assets	15,817	30,274	30,274	30,274	30,274
Cash and cash equivalents	51,637	38,332	39,017	41,260	47,535
Other current assets	10,102	7,940	7,940	7,940	7,940
<b>Current assets</b>	<b>113,278</b>	<b>121,408</b>	<b>112,642</b>	<b>115,177</b>	<b>122,541</b>
<b>Total assets</b>	<b>472,085</b>	<b>513,298</b>	<b>547,212</b>	<b>582,510</b>	<b>622,071</b>
Short-term borrowings and current portion of long-term borrowings	(28,103)	(38,503)	(25,936)	(23,638)	(14,869)
Accounts and bills payable	(31,632)	(37,800)	(34,716)	(36,258)	(35,487)
Accrued expenses and other payables	(41,825)	(42,692)	(42,259)	(42,475)	(42,367)
Current portion of long-term payables	(824)	(311)	(568)	(439)	(503)
Income tax payable	(4,697)	(2,221)	(3,459)	(2,840)	(3,150)
<b>Total current liabilities</b>	<b>(107,081)</b>	<b>(121,527)</b>	<b>(106,937)</b>	<b>(105,650)</b>	<b>(96,376)</b>
Long-term borrowings, less current portion	(39,624)	(37,084)	(38,354)	(37,719)	(38,037)
Long-term payables, less current portion	(9,158)	(1,867)	(5,513)	(3,690)	(4,601)
Other Non-current liabilities	(3,071)	(8,196)	(3,155)	(12,421)	(12,379)
<b>Total non-current liabilities</b>	<b>(51,853)</b>	<b>(47,147)</b>	<b>(47,021)</b>	<b>(53,830)</b>	<b>(55,016)</b>
<b>Total liabilities</b>	<b>(158,934)</b>	<b>(168,674)</b>	<b>(153,958)</b>	<b>(159,480)</b>	<b>(151,392)</b>
Total equity	313,151	334,642	393,254	423,030	470,679
Non-controlling interests	49,968	57,739	93,536	101,855	125,578
<b>Equity of the firm</b>	<b>263,183</b>	<b>276,903</b>	<b>299,718</b>	<b>321,176</b>	<b>345,101</b>
<b>Book value/share, RMB</b>	<b>13.23</b>	<b>13.92</b>	<b>15.07</b>	<b>16.15</b>	<b>17.35</b>

Source(s): Company, ABCI Securities estimates



**Consolidated cash flow statement (2012A-2016E)**

<b>FY ended Dec 31 (RMB mn)</b>	<b>2012A</b>	<b>2013A</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
<b>Profit before income tax</b>	<b>68,872</b>	<b>68,928</b>	<b>55,936</b>	<b>52,609</b>	<b>58,658</b>
(Increase) decrease in inventories	(1,891)	(1,992)	3,717	(115)	(428)
Decrease in trade and bills receivables	(5,380)	(7,218)	5,735	(178)	(660)
Income tax paid	(14,700)	(17,753)	(11,747)	(11,048)	(12,318)
Other adjusted items	27,710	12,323	17,290	24,396	24,150
<b>Net CF of Operating</b>	<b>74,611</b>	<b>54,288</b>	<b>70,931</b>	<b>65,664</b>	<b>69,402</b>
Capital expenditure	(53,516)	(51,148)	(52,332)	(51,740)	(52,036)
Acquisition of subsidiaries	(1,113)	(517)	(815)	(666)	(741)
Others	(3,211)	3,892	4,403	4,442	4,422
<b>Net cash used in investing activities</b>	<b>(57,840)</b>	<b>(47,773)</b>	<b>(48,744)</b>	<b>(47,964)</b>	<b>(48,354)</b>
Proceeds from borrowings	36,109	53,681	44,895	49,288	47,092
Repayments of borrowings	(36,075)	(51,439)	(43,757)	(47,598)	(45,678)
Cash flows from other financing	(26,903)	(22,038)	(22,616)	(17,124)	(16,163)
<b>Net cash from financing activities</b>	<b>(26,869)</b>	<b>(19,796)</b>	<b>(21,478)</b>	<b>(15,434)</b>	<b>(14,749)</b>
<b>Net change in cash</b>	<b>(10,098)</b>	<b>(13,281)</b>	<b>709</b>	<b>2,267</b>	<b>6,299</b>
Cash at the beginning	61,732	51,637	38,332	39,017	41,260
Exchange difference	3	(24)	(24)	(24)	(24)
<b>Cash at the end</b>	<b>51,637</b>	<b>38,332</b>	<b>39,017</b>	<b>41,260</b>	<b>47,535</b>

Source(s): Company, ABCI Securities estimates

**Financial Ratios (2012A-2016E)**

<b>FY Ended Dec 31</b>	<b>2012A</b>	<b>2013A</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
<b>Profitability ratio (%)</b>					
Gross profit margin	31.38	28.67	26.60	24.00	25.00
EBT margin	27.05	24.54	22.34	20.55	22.07
Net profit margin	19.52	16.14	14.40	13.25	14.23
ROAA	11.32	9.15	6.80	6.01	6.28
ROAE	20.23	16.69	12.51	10.93	11.35
<b>Cost ratio (%)</b>					
Admin/Sales	3.60	3.57	3.33	2.67	2.11
Effective tax rate	15.94	19.68	21.03	21.00	21.00
<b>Leverage (x)</b>					
Current ratio	1.06	1.00	1.05	1.09	1.27
Quick ratio	0.91	0.85	0.92	0.96	1.12
Cash ratio	0.48	0.32	0.36	0.39	0.49
Total debt/total equity (%)	50.75	50.40	39.15	37.70	32.16
Total debt/total asset (%)	33.67	32.86	28.13	27.38	24.34
<b>Working capital data and Ratios</b>					
Inventory turnover	12.19	12.14	11.63	13.91	13.99
Receivables turnover	15.15	12.02	10.27	11.86	12.09
Payables turnover	6.41	5.89	4.96	5.48	5.57
Days' inventory on hand (DOH) = 365/Inv. Turnover	29.94	30.08	31.39	26.23	26.10
Days' of sales outstanding (DSO) = 365/Rec. Turnover	24.10	30.37	35.56	30.77	30.20
Days' payables = 365/Payable Turnover	56.97	62.01	73.61	66.55	65.54
Cash conversion circle	(2.92)	(1.56)	(6.66)	(9.55)	(9.24)

Source(s): Company, ABCI Securities estimates



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### Definition of equity rating

Rating	Definition
Buy	Stock return $\geq$ Market return rate
Hold	Market return $- 6\% \leq$ Stock return $<$ Market return rate
Sell	Stock return $<$ Market return $- 6\%$

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2010-2014

Time horizon of share price target: 12-month

### Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 1.5
Low	180 day volatility/180 day benchmark index volatility $<$ 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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