

# Oct. 27, 2014 Company Report Rating: BUY TP: HK\$ 24.5

Share price (HK\$) 21  
 Est. share price return 17.09%  
 Est. dividend yield 4.60%  
 Est. total return 21.69%

Previous Rating & TP HK\$30  
 Previous Report Date Dec. 19, 2013

Analyst: March Chen  
 Tel: (852) 2147 8819  
 Email: markybchen@abci.com.hk

## Key Data

52Wk H/L(HK\$)	27/19.12
Issued shares (mn)	19,890
H-Shares (mn)	3,399
A-Shares (mn)	16,491
Market cap	
H-shares (HK\$ mn)	71,379
A-Shares (HK\$ mn)	240,109
3-mth avg daily turnover (HK\$ mn)	358
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	(3.45)	(1.63)
3-mth	(8.70)	(2.13)
6-mth	0.00	(6.26)

\*Relative to HSCEI

Source(s): Bloomberg, ABCI Securities

## Stock performance



Source(s): Bloomberg, ABCI Securities

# China Shenhua (1088 HK)

## Resilient 9M14 performance; maintain BUY with lower TP

- Shenhua's 9M14 operational data showed resilient performance despite the slowdown in thermal coal sector
- The coal sector will remain subdued due to China's moderating economy. We predict the sector to stabilize by mid-2015

With its strong bargaining power, high potential in coal chemical business, and attractive valuation at 1.0x FY15E P/B at present, we maintain **BUY** for the counter. Nonetheless, based on the cloudy sector outlook and low valuation of Shenhua's A-share, we revise our TP down to HK\$ 24.5, reflecting 8.9x FY15E P/E and 1.17x FY15E P/B

**Better-than-expected 9M14 results.** For 9M14, Shenhua's revenue/net profit reached RMB190,442mn/RMB31,423mn, down 4.64%/9.26% YoY, resulting in an EPS of 1.58, which is ~ 79% of Bloomberg's compiled estimate for FY14 EPS. Shenhua's 3Q14 production was up 0.6% but its domestic sales were down 13.7%, indicating a still-weak industrial demand from downstream IPPs. Bloomberg's compiled estimates reflect the expectation of a significant 4Q net profit slump (~20%QoQ). However, with the arrival of peak season in 4Q, which will last till Feb 2015, its ASP and sales may rise in coming months. Thanks to its high-quality coal reserves and strong transportation network, Shenhua still enjoys high bargaining power in the market, according to our channel checks. Contrary to the market estimates, we predict a positive growth in 4Q profit. In addition, its sales volume will continue to grow in coming years as present coal prices has eliminated many medium and small competitors.

**Development in power business to help hedge against slowdown in thermal coal sector.** Shenhua's power ASP was RMB358.1/MWH, down 2.4% YoY, but its cost of power output went down 6.8% YoY. We believe its power business will remain a strong buffer for the Group. We estimate the recent power tariff cut (since Sep.1, 2014) will likely reduce its FY14E profit by ~RMB 610mn, which should not significantly affect the Group's total operation results.

**Recommend BUY with TP reduced to HK\$24.5.** Our target valuation at 8.9x FY15E P/E reflects the competitiveness of the Group's selling cost (9M14: RMB128.6/t vs. China Coal (1898 HK)'s RMB191.6/t) and its sound transportation network. Furthermore, the Bohai-Rim thermal coal index rebounded to RMB490 after 6 weeks' flat and rose to RMB 497 on Oct 22, 2014, indicating the likelihood of a rising thermal coal price in peak season. With more redundant production capacity being eliminated and China's encouraging local governments to remove all administrative fees of coal producers by imposing a coal price-based tariff tax, we believe the coal market will turn more balanced by mid-2015. We estimated Shenhua's profit will fall by 8.65% in FY14E, but a turnaround with positive growth would occur in and after FY15. Considering the counter's attractive valuation (7.6x FY15E P/E and 1.0 FY15E P/B) at present and its 2-digit ROE ratio, we assign Shenhua with a **BUY** rating with TP revised down to HK\$24.5 (HK\$ 30 previously).

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

## Results and Valuation

FY ended Dec 31	2012A	2013A	2014E	2015E	2016E
Revenue (RMB mn)	254,575	283,797	252,215	262,192	269,449
Chg (% YoY)	21.68	11.48	(11.13)	3.96	2.77
Net Profit (RMB mn)	49,708	45,079	41,169	43,360	45,385
Chg (% YoY)	8.42	(9.31)	(8.67)	5.32	4.67
EPS (RMB)	2.50	2.27	2.07	2.18	2.28
Chg (% YoY)	8.42	(9.32)	(8.65)	5.32	4.67
BVPS (RMB)	13.23	13.92	15.23	16.61	18.05
Chg (% YoY)	15.33	5.21	9.40	9.05	8.69
P/E (x)	6.62	7.30	8.00	7.59	7.12
P/B (x)	1.25	1.19	1.09	1.00	0.90
DPS(RMB)	0.96	0.96	0.76	0.80	0.84
Yield (%)	5.80	5.80	4.60	4.84	5.16
ROE (%)	20.23	16.69	14.20	13.69	13.17
ROA (%)	11.32	9.15	7.72	7.53	7.31

Source(s): Bloomberg, ABCI Securities estimates



<b>Operational Indicators</b>	<b>9M14</b>	<b>9M13</b>	<b>YoY Chg,%</b>
Commercial coal production (mnt)	234	236.8	(1.18)
Coal sales (mnt)	341.3	366.3	(6.83)
Of which: Export (mnt)	1.2	1.9	(36.84)
Import (mnt)	5.6	7.4	(24.32)
Gross power generation (Bn kwh)	160.45	169.49	(5.33)
Total power output dispatch (Bn kwh)	149.34	158.01	(5.49)
Coal chemical			
Sales volume of polyethylene	220.4	196.7	12.05
Sales volume of polypropylene	222.4	205	8.49
Transportation turnover of self-owned railways (Bn tonne kilometers)	167.2	155.2	7.73
Seaborne Coal (mnt)	177.7	161.4	10.10
Seaborne coal at Huanghua Port (mnt)	99.3	92.4	7.47
Seaborne coal at Shenhua Tianjin Coal Dock (mnt)	26.4	22.8	15.79
Shipping volume (mnt)	66.9	83.4	(19.78)
Shipment turnover (Bn tonne nautical miles)	55.5	81.7	(32.07)

Source(s): Company, ABCI Securities

**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	29.50	29.00	29.00
EBT margin	27.05	24.54	25.28	25.64	26.12
Net profit margin	19.52	16.14	16.29	16.54	16.84
ROAA	11.32	9.15	7.72	7.53	7.31
ROAE	20.23	16.69	14.20	13.69	13.17
<b>Cost ratio (%)</b>					
Admin/Sales	3.60	3.57	3.30	2.61	2.09
Effective tax rate	15.94	19.68	21.03	21.00	21.00
<b>Leverage (x)</b>					
Current ratio	1.06	1.00	1.11	1.24	1.50
Quick ratio	0.91	0.85	0.98	1.09	1.34
Cash ratio	0.48	0.32	0.42	0.51	0.69
Total debt/total equity (%)	50.75	50.40	38.54	33.53	28.35
Total debt/total asset (%)	33.67	32.86	27.82	25.11	22.09
<b>Working capital data and Ratios</b>					
Inventory turnover	12.19	12.14	11.19	12.57	12.33
Receivables turnover	15.15	12.02	10.29	11.48	11.25
Payables turnover	6.41	5.89	4.81	5.28	5.34
Days' inventory on hand (DOH) = 365/Inv. Turnover	29.94	30.08	32.62	29.03	29.61
Days' of sales outstanding (DSO) = 365/Rec. Turnover	24.10	30.37	35.48	31.81	32.44
Days' payables = 365/Payable Turnover	56.97	62.01	75.92	69.08	68.41
Cash conversion circle	(2.92)	(1.56)	(7.82)	(8.24)	(6.37)

Source(s): Company, 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	252,215	262,192	269,449
Coal revenue	165,989	167,399	134,163	146,860	147,650
Power revenue	71,096	77,423	72,760	68,102	71,708
Transportation revenue	5,403	6,078	6,686	7,354	8,090
Coal chemical revenue	4,084	5,463	6,362	7,632	9,112
Other revenue	8,003	27,434	32,244	32,244	32,889
Cost of sales	(174,677)	(202,431)	(177,811)	(186,157)	(191,309)
<b>Gross profit</b>	<b>79,898</b>	<b>81,366</b>	<b>74,403</b>	<b>76,036</b>	<b>78,140</b>
SG&A	(9,160)	(10,118)	(8,317)	(6,837)	(5,620)
Other operating expenses, net	8	(720)	77	0	0
<b>Profit from operations</b>	<b>70,746</b>	<b>70,528</b>	<b>66,163</b>	<b>69,199</b>	<b>72,520</b>
Other income/cost/and loss	(1,874)	(1,600)	(2,322)	(1,961)	(2,142)
Pre-tax profit	68,872	68,928	63,841	67,238	70,378
Profits tax	(10,976)	(13,704)	(13,407)	(14,120)	(14,779)
<b>Net profit</b>	<b>57,896</b>	<b>55,224</b>	<b>50,435</b>	<b>53,118</b>	<b>55,599</b>
<b>Profit attributable to:</b>					
Minority interests	8,188	10,145	9,265	9,758	10,214
<b>Equity shareholders of the Company</b>	<b>49,708</b>	<b>45,079</b>	<b>41,169</b>	<b>43,360</b>	<b>45,385</b>
<b>EPS (Basic), Rmb</b>	<b>2.50</b>	<b>2.27</b>	<b>2.07</b>	<b>2.18</b>	<b>2.28</b>
<b>Dividend per share, Rmb</b>	<b>0.96</b>	<b>0.96</b>	<b>0.76</b>	<b>0.80</b>	<b>0.84</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	14,139	15,477	15,560
Accounts and bills receivable	20,000	27,221	21,817	23,881	24,010
Prepaid expenses and other current assets	15,817	30,274	30,274	30,274	30,274
Cash and cash equivalents	51,637	38,332	97,049	157,605	66,477
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>171,218</b>	<b>235,177</b>	<b>144,260</b>
<b>Total assets</b>	<b>472,085</b>	<b>513,298</b>	<b>605,789</b>	<b>702,510</b>	<b>643,790</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)	(3,196)	(3,175)
<b>Total non-current liabilities</b>	<b>(51,853)</b>	<b>(47,147)</b>	<b>(47,021)</b>	<b>(44,605)</b>	<b>(45,813)</b>
<b>Total liabilities</b>	<b>(158,934)</b>	<b>(168,674)</b>	<b>(153,958)</b>	<b>(150,255)</b>	<b>(142,189)</b>
Total equity	313,151	334,642	451,831	552,255	501,602
Non-controlling interests	49,968	57,739	148,889	221,889	142,530
<b>Equity of the firm</b>	<b>263,183</b>	<b>276,903</b>	<b>302,942</b>	<b>330,366</b>	<b>359,072</b>
<b>Book value/share, Rmb</b>	<b>13.23</b>	<b>13.92</b>	<b>15.23</b>	<b>16.61</b>	<b>18.05</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>63,841</b>	<b>67,238</b>	<b>70,378</b>
(Increase) decrease in inventories	(1,891)	(1,992)	3,502	(1,338)	(83)
Decrease in trade and bills receivables	(5,380)	(7,218)	5,404	(2,065)	(128)
Income tax paid	(14,700)	(17,753)	(13,407)	(14,120)	(14,779)
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>76,631</b>	<b>74,111</b>	<b>79,537</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)	(18,997)	(19,629)
<b>Net cash from financing activities</b>	<b>(26,869)</b>	<b>(19,796)</b>	<b>(21,478)</b>	<b>(17,307)</b>	<b>(18,215)</b>
<b>Net change in cash</b>	<b>(10,098)</b>	<b>(13,281)</b>	<b>6,409</b>	<b>8,840</b>	<b>12,968</b>
Cash at the beginning	61,732	51,637	38,332	44,717	53,533
Exchange difference	3	(24)	(24)	(24)	(24)
<b>Cash at the end</b>	<b>51,637</b>	<b>38,332</b>	<b>44,717</b>	<b>53,533</b>	<b>66,477</b>

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 2007-2011

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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**Office address: ABCI Securities Company Limited, 13/F Fairmont House,  
8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**