



Company Report

Yanzhou Coal (1171 HK) – Hold May 2, 2013 Initiation

Rating: Hold
TP: HK\$ 7.96

Key Data

H-Share price (HK\$)	8.08
Upside potential (%)	(1.5)
52Wk H/L(HK\$)	16.88/8.02
Issued shares (mn)	4,918
- H Shares (mn)	1,958
- A Shares (mn)	2,960
Market cap	
- H Shares (HK\$mn)	15,824
- A Shares (Rmb mn)	44,903
3-mth avg daily turnover (HK\$mn)	287
Major shareholder (%):	
Yankuang Group Company Limited	52.86%

Source: Company, Bloomberg, ABCI Securities

Revenue composition in FY12 (%)

Coal, %	96.65
Railway transportation service, %	0.80
Gross sales of electricity power, %	0.56
Gross sales of methanol, %	1.92
Gross sales of heat supply, %	0.07

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth performance	(22.75)	(22.95)
3-mth performance	(39.06)	(29.07)
6-mth performance	(30.70)	(33.88)

*Relative to HSCEI Index

Source: Bloomberg

1 year price performance



Source: Bloomberg

Analyst

Report Date: 2 May, 2013

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Wait for cost control and market revitalization

Yanzhou Coal faces the following challenges: 1) surging cost of coal sales per tonne; 2) weak domestic and foreign spot prices of coal; and 3) fierce competition within the industry. We believe that unless the Company can effectively control costs and the market starts to rebound, its net profit will continue to deteriorate. Yet the recent slump in stock price has largely reflected these negative factors. We therefore initiate our research coverage with a Hold recommendation. Our TP is HK\$7.96, based on 8.8x FY13 PER.

Coal prices under downside pressure. Yanzhou Coal's 1Q13 revenue/net profit was Rmb10.77bn/Rmb0.48bn, dropped by 26.5%/77.5% YoY due to weak coal prices. Headwinds from weak electricity demand, intense competition, surging domestic coal production capacity and excess supply (due to increasing imported coal) prohibit the Company from restoring growth momentum in profits.

Surging costs need to be controlled. The Company's 1Q13 cost of coal sales per tonne improved 3.34% YoY in headquarter, but surged 35.5% YoY in Australia's subsidiary, a great challenge for the managements who aimed to reduce the subsidiary's annual unit cost by 15% YoY.

Mild economic recovery delaying revival of coal sector. Slower-than-expected 1Q13 China's economic growth lowered the power usage, thus reducing demand for coal. Along with the government policy to diversify the energy consumption pattern, the Company has to enhance operational efficiency so as to minimize the negative impacts on profits.

Initiate coverage with Hold and 12-month target price of HK\$7.96. We predict that the Company's FY13 net profit will shrink 43.2% YoY. In light of the cost burden and weak market conditions, the stock price has slumped significantly recently. Our valuation at 8.8x FY13 PER reflects weak earnings growth outlook which translates to the target price at HK\$7.96, implying 1.4% lower than the recent closing price at HK\$8.07.

Risk factors: 1) Coal price risk; 2) Imbalance of supply and demand; 3) Business cycles of downstream industries; 4) Surging costs.

Results and valuation

FY ended Dec 31	2010A	2011A	2012A	2013E	2014E
Turnover (Rmb mn)	33,944	47,066	58,146	50,627	57,410
Turnover Chg (%.yoy)	64.16	38.66	23.54	(12.93)	13.40
Net Income (Rmb mn)	9,281	8,928	6,219	3,531	4,348
Net Income Chg (%.YoY)	125.42	(3.81)	(30.34)	(43.22)	23.12
EPS (Rmb)	1.89	1.82	1.26	0.72	0.88
EPS Chg (%.YoY)	124.65	(3.81)	(30.34)	(43.22)	23.12
BVPS (Rmb)	7.59	8.67	9.32	9.55	9.89
BVPS Chg (%.yoy)	28.06	14.20	7.49	2.53	3.56
P/E (x)			5.1	8.9	7.2
P/B (x)			0.69	0.67	0.65
Dividend Per Share, Rmb	0.59	0.57	0.36	0.22	0.27
Dividend yield (%)			5.6	3.5	4.3
ROAE (%)	27.9	22.3	14.1	7.6	9.1
ROAA (%)	13.7	10.5	5.7	3.0	3.7

Source: Company, Bloomberg, ABCI Securities estimates (assuming Rmb1.0=HK\$1.26)



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Investment highlights

Positive factors

Corporate level

- Most of the mining resources are concentrated in Shandong, providing geographical advantage;
- Coal sales and production increase steadily and overseas resources development is on track;
- Coal chemical business starts to turn around;
- The Company has access to financing resources in 4 global locations;

Macro level

- Coal will dominate the energy consumption for a relatively long period of time in China;
- The government encourages the consolidation of mineral rights ownership, offering large companies more growth opportunities.

Negative factors

Corporate level

- The Company lacks low-cost coal mines and cost of production per tonne has been increasing in recent years;
- Product competitiveness and market share expansion will be negatively influenced by the lack of a cross-regional railway network,;
- Coal pricing mechanism reform exacerbates the industry competition, but the company does not hold an advantageous position in price negotiation;
- The Company has pressure to consolidate its Australian mines and conduct effective cost control;
- The price slump of potash is not favorable to the Company amid surging expenses for exploring potash resources in Canada.

Macro level

- Coal prices are under downward pressure both domestically and internationally while power suppliers have more options, thus enhancing their bargaining power;
 - Economic growth pace slows in China and domestic thermal power demand decreases as a result;
 - Long-term shifts in energy consumption pattern will change the demand for coal;
 - Weak global economic recovery has a negative impact on overseas coal demand and prices;
 - Oversupply of coal in the U.S. has a negative spillover effect on the international market prices as well as the domestic market prices.
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Business analysis

Geographical advantage

Yanzhou Coal is one of the major thermal coal suppliers with high concentration of coal resources in eastern China. Its parent company, Yankuang Group Company Limited, is among the top 10 coal producers in China by annual production volume in 2011 and 2012.

According to the 12th Five-Year Plan for Coal Production in China, the western China, especially Inner Mongolia, Shaanxi, Shanxi, Gansu, Ningxia, and Xinjiang, is regarded as the key region for coal mining development, with new sites for coal mining that account for 87% of the national level while the eastern China will witness heavier regulatory control on developing new coal mines. However, the Plan points out that unlike other provinces in eastern China, Heilongjiang and Shandong province will maintain stable coal production volume.

We believe that the 12th FYP will benefit Yanzhou Coal as it will enhance the Company's regional competitiveness.

In addition, the eastern China and the coastal regions are the forefront of China's economic development. Compared with other peers listed in Hong Kong, Yanzhou is adjacent to the coal ports in Bohai Rim and major electricity consumption regions, such as Beijing, Tianjin and Shanghai. Also, Shandong's GDP weighs heavily in China, and is a major steel production base in China, which supports the sales of Yanzhou Coal.

In 2012, coal sales volume of Yanzhou in eastern China was 86.7% of its national annual sales (2011: 69.9%). The Company's revenue generated by coal sales in eastern China was 91.5% of the total annual revenue (2011: 77.6%).

Exhibit: Coal supply and demand distribution plan during the 12th FYP



Source: NDRC



Exhibit: 12.5 Plan for coal production in China (2011-2015)

Regions	Development Plan	New construction scale (100mn tonnes/yr)	Weight (%)
West	Highly encourage	5.3	71.7
Central	Moderate encourage	1.85	25
East & northeast	Limit or control	0.25	3.3
Total:		7.4	100
Inner Mongolia, Shaanxi, Shanxi, Gansu, Ningxia, and Xinjiang		6.5	87

Source: NDRC

Exhibit: the sales income and the % of the Group's top 5 customers

NO.	Customers	Sales income (Rmb, 1000)	% of total
1	Huadian Power International Corporation Limited	3,651,630	6.28
2	Yongcheng Coal and Electricity Holding Group Shanghai Co., Ltd	3,207,538	5.51
3	Noble Resources Limited	1,945,730	3.35
4	Linyi Yehua Coking Co., Ltd	1,519,067	2.61
5	Baoshan Iron & Steel Co., Ltd	929,536	1.60
Total		11,253,501	19.35

Source: Company

Exhibit: the Group's coal sales by geographical regions for 2012

	Sales volume (mnt)	Weight (%)	Sales income (Rmb, mn)	Weight (%)
1. China	77.857	82.7%	46,800	82.9%
Eastern China	67.496	71.7%	42,835	75.9%
Southern China	0.109	0.1%	76	0.1%
Northern China	7.875	8.4%	2,958	5.2%
Other regions	2.377	2.5%	931	1.6%
2. Japan	2.220	2.4%	1,770	3.1%
3. South Korea	3.410	3.6%	2,394	4.2%
4. Australia	5.838	6.2%	2,298	4.1%
5. Others	4.823	5.1%	3,158	5.6%
6. Group Total	94.148	100.0%	56,420	100.0%

Source: Company

Core business: coal sales volume keeps growing

Exhibit: Revenue composition in FY12

Products	Weight (%)
Coal	96.65
Gross sales of methanol	1.92
Railway transportation service	0.80
Gross sales of electricity power	0.56
Gross sales of heat supply	0.07
Total	100

Source: Company, ABCI Securities

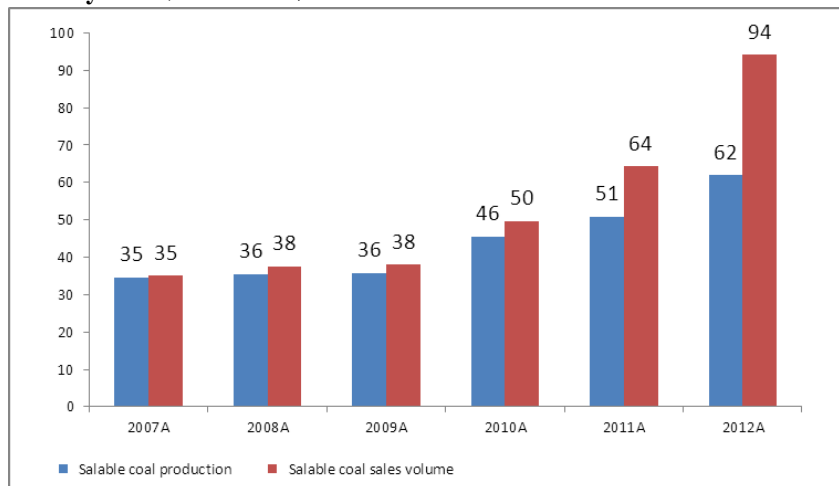
Yanzhou Coal has the following business segments: coal mining business, railway transportation service, methanol business, electricity generation, and heat supply business. About 97% of the company's revenue is generated in the coal mining segments.

In 2012, Yanzhou Coal produced 67.81 million tons of raw coal, up 21% YoY, and 61.94 million tons of commercial coal, up 21.7% YoY. The coal sales increased by 46.5% YoY, reaching 94.15 million tons in 2012. In terms of the coal chemical business, Yanzhou Coal had 0.57 million tons of methanol output, up 1.7% YoY. Total revenue of the Company reached Rmb581.46mn, up 23.5% YoY.

In our view, the measures taken by the Chinese government to reduce the numbers of small and medium (S&M) coal mines will benefit Yanzhou Coal. We also believe that more and more S&M coal mines will be driven out of the market due to the slump in coal price, leaving more room for Yanzhou Coal to gain market share. Our channel check finds that about 20% of the coal producers in both domestic and overseas markets have suffered from net loss in 1Q2013.

According to the Company's plan, production capacity will increase by 65 million tons in the next 3 years, indicating a solid prospect of the company.

Exhibit: Yanzhou Coal's coal sales volume (mnt) improved steadily in recent years (2007~2012)



Source: Company, ABCI Securities

**農銀國際**

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Yanzhou Coal Mining Co. Ltd.

Exhibit: progress of key projects in the coming years of Yanzhou Coal

Project	Equity Interests	Resource Volume (mnt)	Planned capacity (mnt)	Progress
Zhuan Longwan Coal Mine	100%	547.7	5	Under construction, expect to commence operation in 2014
Shilawusu Coal Mine	75%	1,144	10	Under construction, expect to commence operation in 2015
Yingpanhao Coal Mine	100%	2,168.2	12	Under construction, expect to commence operation in 2015
Wanfu Coal Mine	98%	291.3	1.8	Under construction, expect to commence operation during the beginning of "The 13th Five-year Plan"
600,000-Tonne Methanol Project in Ordos	100%	–	0.6	Under construction, expect to commence trial operation in late 2013
CTL Project and Jin Jitan Coal Mine	25%	1,872	8	Under construction, expect to commence operation in 2014
Moolarben Coal Mine	80%	1,222	17	Annual production capacity in existing mining sites have been granted to increase from 7mn tonnes to 8mn tonnes; expansion plan of Phase II commences with plan to raise coal production capacity up to 17 mn tonnes
Ashton Coal Mine	90%	323	5.2	The development application of Southeast open cut mine has been approved by the Australian Planning Ministry, expect to receive final approval from environmental assessment hearing
Middlemount Coal Mine	50%	123	5.4	Production capacity expands from 1.8 mn tonnes to 5.4 mn tonnes

Source: Company



Non-core business: coal chemical business starts to make profit

Yanzhou Coal also has business engagements in coal railway transportation, coal chemical, electricity generation, and heat business. Downward pressure of spot price of coals in recent years has eroded the core business segment's margin quickly but the margin of non-core business segments has not shown signs of deterioration.

Exhibit: Yanzhou Coal's gross profit margin of non-core segments shows signs of improvement

GPM (%)	2008A	2009A	2010A	2011A	2012A
Coal	51.84	48.12	49.45	43.83	25.98
Coal transportation	4.69	5.61	36.14	27.28	29.56
Coal chemical	2.07	(36.34)	(13.91)	12.19	18.49
Electricity power	(47.66)	(1.76)	(5.39)	(10.52)	(2.21)
Heat business	-	44.50	50.49	32.69	37.05

Source: Company, ABCI Securities

Among the current non-core business segments, coal chemical business mainly involves the production and sale of methanol. Since its inception in 2008, the production was mainly filled by Tianhao Chemical Co. Ltd., with an annual production capacity of 100 thousand tons, and Yanzhou Coal Yulin Neng Hua, with a yearly production capacity of 600 thousand tons.

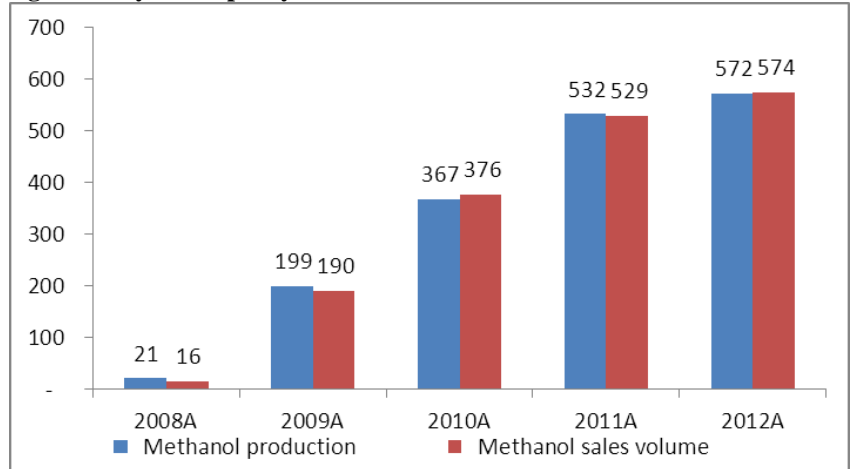
Since the initial capital expenditure was relatively high with unstable supply of raw material and volatile methanol's price, this business segment has been non-profitable. Its profitability was restored in 2012 for the first time with a net profit of Rmb80 million.

Yanzhou Coal shut down its methanol production facilities in Shanxi in October, 2012 and started a new production facility with annual production capacity of 600 tons in Ordos.

We believe that Yanzhou Coal's coal chemical business will help improve its profitability. Yet it won't be soon for this segment to contribute significantly to the company's profitability.

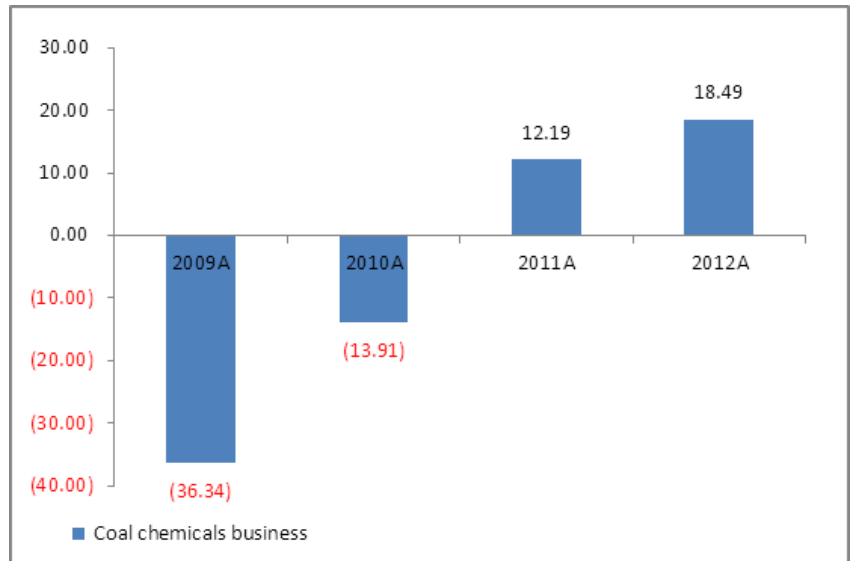


Exhibit: Yanzhou Coal’s methanol production (’1000 tons) improved significantly in the past years.



Source: Company, ABCI Securities

Exhibit: GPM (%) of Yanzhou Coal’s coal chemical business improved from 2009 to 2012



Source: Company, ABCI Securities



International business: efficiency needs to be improved

Yanzhou Coal Group's headquarter is located in Shandong, but it has been aggressively pursuing mining and processing expansion in Shaanxi, Shanxi, Inner Mongolia, and even outside China (mainly in Australia).

Yanzhou Coal set up Yancoal Australia as early as in 2004 and acquired the Astar Coal Mine.

In 2011, Yanzhou Coal acquired Anyuan Coal Mine and mining rights of Zhuan Longwan Coal Mine Zone. It established Yancoal International and acquired Syntech Holdings Pty Ltd. and Syntech Holdings II Pty Ltd. in Australia. It also acquired Potash Exploration Permits in Canada, Inner Mongolia Xintai Coal Mining Company Limited and Wesfarmers Premier Coal Limited in Australia.

In 2012, Yancoal Australia successfully completed the merger with Gloucester and listed on the Australian Securities Exchange; Yanzhou Coal established Shandong Coal Trading Centre Co., Ltd.

According to the Company's management, 33% of coal production is from overseas with which overseas coal resources is 36.1% of the company's total coal resources and 39.8% of the company's assets are located in foreign countries.

Our channels check indicates that Yanzhou Coal is still actively looking for profitable M&A projects in overseas markets.

Efficiency enhancement is imminent

Low spot coal prices in the international market and sharp decrease in demand for coal in the United States will benefit Yanzhou Coal's potential acquisition. The lower acquisition cost will help reduce its sales costs in the future. However, the Company needs to significantly improve its efficiency in overseas projects, as we find that:

- i) **Yancoal Australia suffered from substantial profit decline.** Yancoal Australia's reported after-tax profit was A\$403mn, representing a 31.6% YoY increase. Yet, if we factor in the income tax benefit and other favourable policies, the actual EBIT of Yancoal Australia was only A\$161 million, which decreased by 63.3% YoY. The management has realized the importance of cost control and proposed to cut expenses in Yancoal Australia by A\$ 12 million in 2013 (about Rmb78 million). The management also proposed to lower the selling cost per ton by 15% for Yancoal Australia. If the cost cutting is effective, the Company can improve its profitability significantly.
- ii) **Risk management & due diligence deserves more attention.** Yanzhou Coal reported significant changes in the coal reserves volume of Cameby Downs and Premier after the acquisition, resulting in substantial asset and goodwill impairment. Such impairments reflect the weak due diligence capability and risk management controlling.
- iii) **The exploration of potash resources project will not be profitable in the next few years.** The project is still at preliminary exploration stage. Yanzhou Coal bought the



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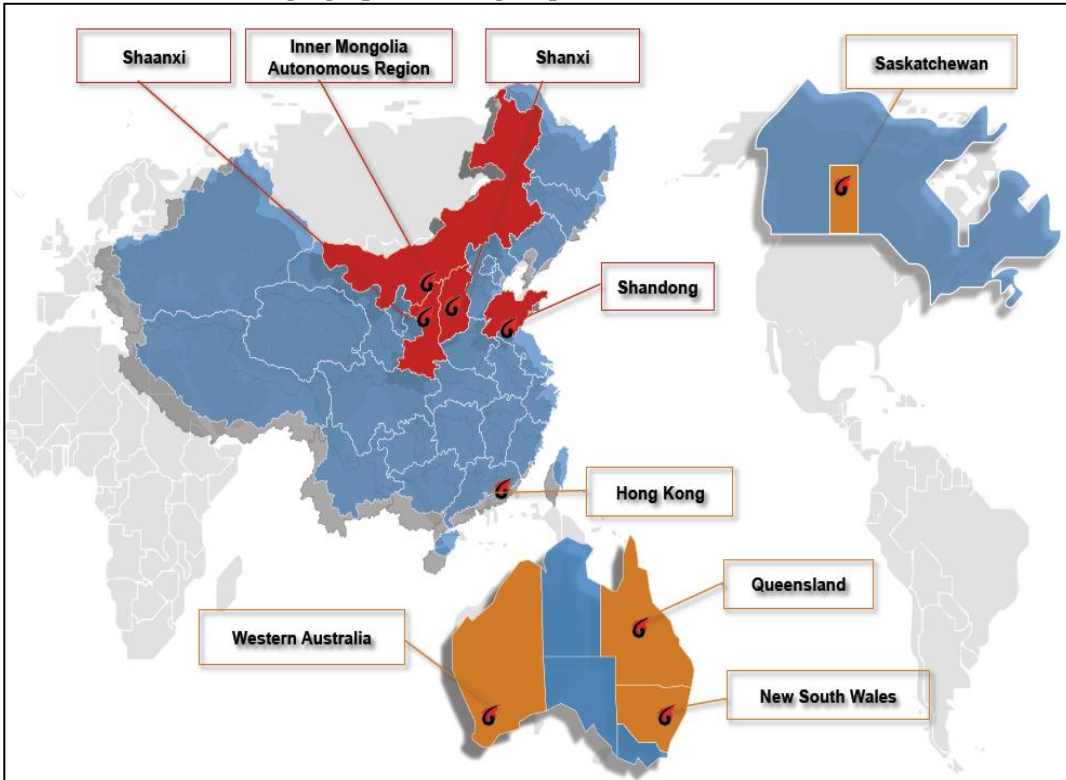
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exploration permits when the potash was relatively overpriced. If the confirmed reserve and the cost of mining after end of the exploration phase cannot match the Company's expectation, the project may turn out to be a loss. We believe the project can be a new growth driver only if the Company can manage its operating costs efficiently and the potash prices start to rebound.

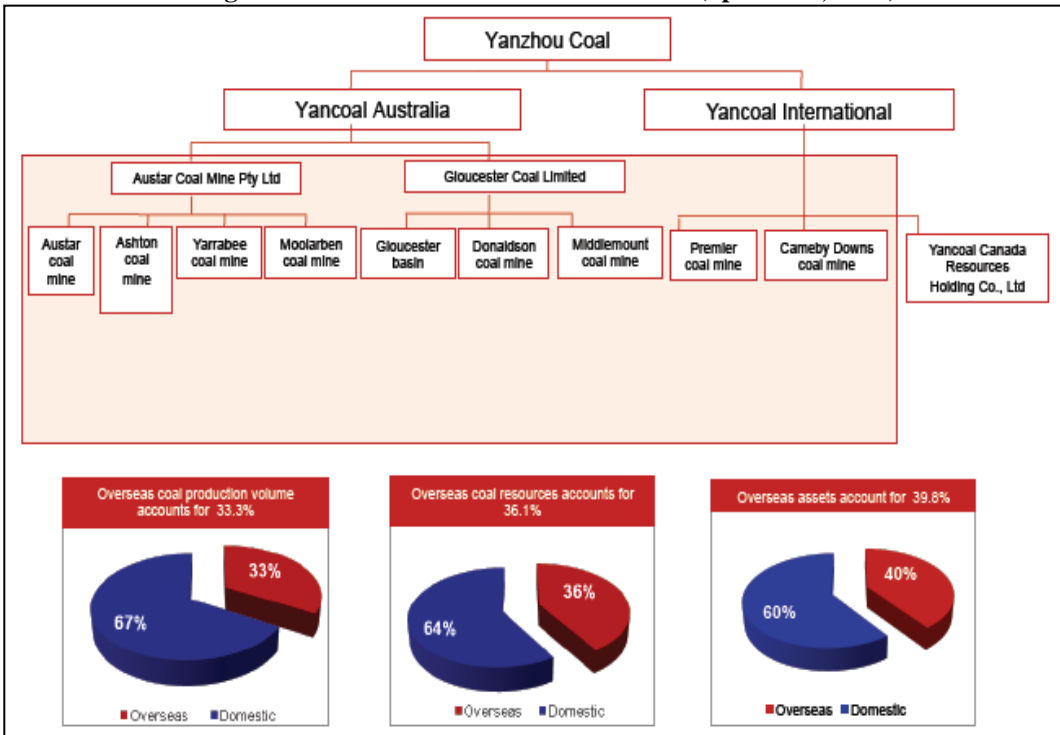


Exhibit: Yanzhou Coal's geographic coverage (up to Dec., 2012)



Source: Company

Exhibit: Yanzhou's global framework and assets distribution (up to Dec., 2012)



Source: Company



Capital markets: shares traded in 4 markets

Yanzhou Coal is the sole company with its shares concurrently listed on four stock exchanges. In 1998, Yanzhou Coal listed in Shanghai (600188 SH), Hong Kong (1171 HK), and United States (YZC). In 2012, Yancoal Australia successfully completed the merger with Gloucester and was listed on the Australian Securities Exchange.

The total number of Yanzhou Coal's H shares accounts for 39.71% of Yanzhou Coal's total common shares, higher than its H-share peers of China Coal (30.97%), Shenhua (17.09%), and Yitai (10.02%). Higher liquidity will make the stock more appealing to international and institutional investors.

Exhibit: Yanzhou Coal enjoys four stock exchanges platforms

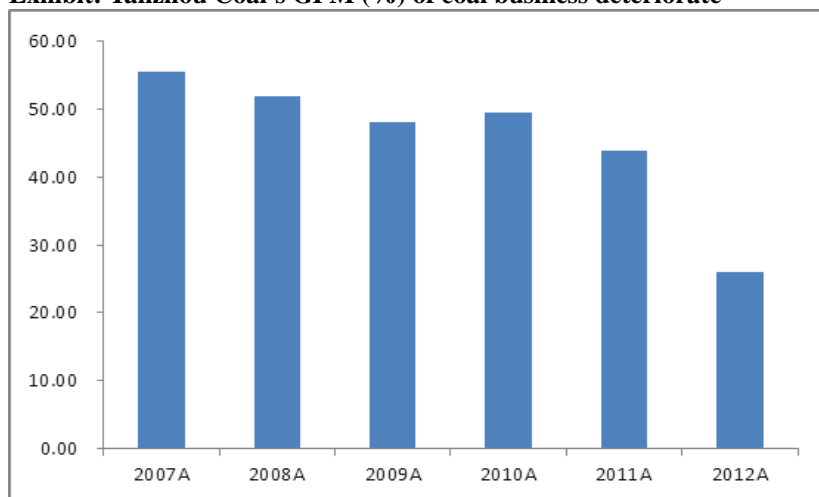
Name	Stock Code	Year of listing	Stock Exchange
Yanzhou Coal -A	600188.SH	1998	Shanghai
Yanzhou Coal -H	1171.HK	1998	Hong Kong
Yanzhou ADS	YZC.N	1998	New York
Yancoal Australia	YAL.ASX	2012	Australia

Source: Company, ABCI Securities

Challenge: surging sales costs reduces core business margin

Although the core business of Yanzhou Coal keeps growing, its coal business margin showed substantial decline in 2012. We believe that the main reasons included substantial drop of spot coal prices in 2012, mild economic recovery of China, surging operating costs in Australia and mining costs in western China.

Exhibit: Yanzhou Coal's GPM (%) of coal business deteriorate

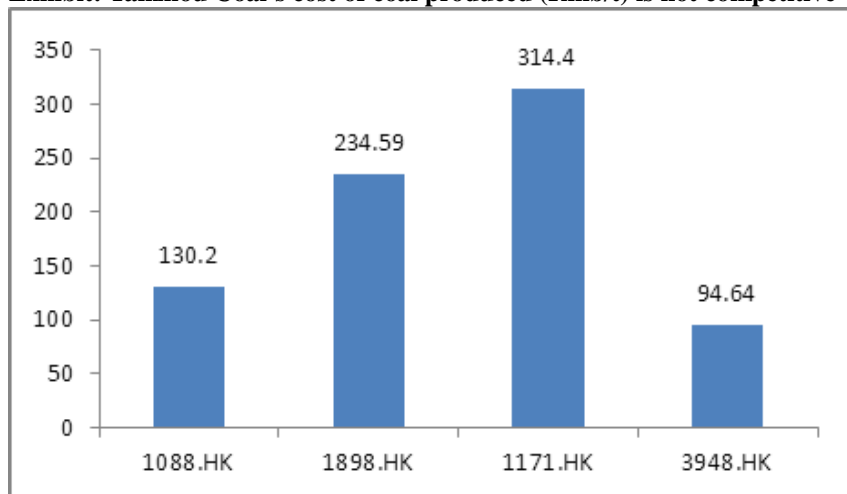


Source: Company, ABCI Securities

In 2012, cost of sales per ton of coal in Yanzhou Coal's main coalfield soared to Rmb314.4 (up 9.0% YoY). Among its subsidiaries, the one in Ordos reported the lowest cost of sales per ton of coal as Rmb168.34 (up 6.15YoY).

In 2012, Shenhua (1088 HK), China Coal (1898 HK), and Yitai (3948 HK) reported cost of coal produced per ton as Rmb130.2, Rmb234.59, and Rmb94.64 respectively and the change of cost of sales per ton of coal as 9.7% YoY, -1.1% YoY, and -4.95% YoY, respectively.

Exhibit: Yanzhou Coal's cost of coal produced (Rmb/t) is not competitive



Source: from 2012 Annual Reports of the Companies; ABCI Securities



The shortage of coal transportation capacity is a bottleneck. In addition to the high cost of coal production, the Company lacks sufficient transportation resources to transport its coal outside the western coal mine areas, thus increasing its coal selling costs. Unlike China Shenhua which has self-owned coal railway lines and coal ports, the Company needs to apply for the national railway quota to sell its coal outside the coal mine regions in western China. In addition, due to the underdeveloped transportation system, the Company is not capable of transporting its coal in Ordos outside the Inner Mongolia. In sum, high cost of production and the lack of cross regional railway system post great challenges for its market expansion as the Company lacks bargaining power in negotiating with IPPs and the market share expansion is limited without the support of a well-developed transportation system.



China’s thermal coal market overview

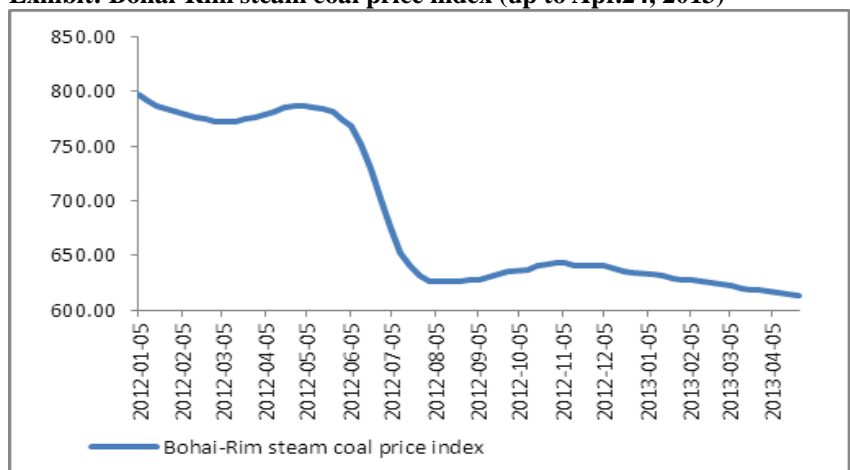
The Bohai-Rim steam coal price index was still weak and dropped to its record low of Rmb613/t on Apr. 24. The downside risk of the price is limited at present level because some of the high-cost coal mines will be wiped out of the market. We have seen some positive signals such as reduced coal inventory at QHD port and number of days available of coal for China’s main IPPs, as well as mild growth recovery in the downstream industry such as raw steel and cement production.

However, China’s 1Q2013 GDP growth is slower than expected, indicating that more positive catalysts are needed to verify a solid recovery of the thermal coal demand.

From short-term and mid-term perspectives, we believe that China thermal coal market will follow certain patterns as follows:

- ❖ Mild economic and downstream demand recovery will not trigger significant rebound of thermal coal demand;
- ❖ Excess coal production capacity in China’s thermal coal market will persist in the near future, which suppresses the thermal coal spot prices.
- ❖ Foreign coal prices are still weak and imported coal volume will continue to grow, posing a cap on the domestic coal price.
- ❖ The Bohai-Rim steam coal price index is still weak, but downside risk is limited because the high-cost coal mines will be wiped out of the market when the prices worsen.
- ❖ The profitability of coal miners largely depends on sales volume and cost control.

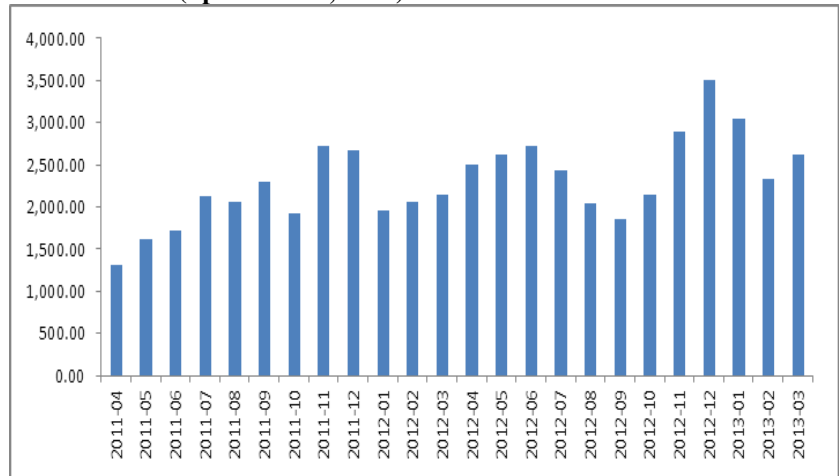
Exhibit: Bohai-Rim steam coal price index (up to Apr.24, 2013)



Source: Wind, ABCI Securities

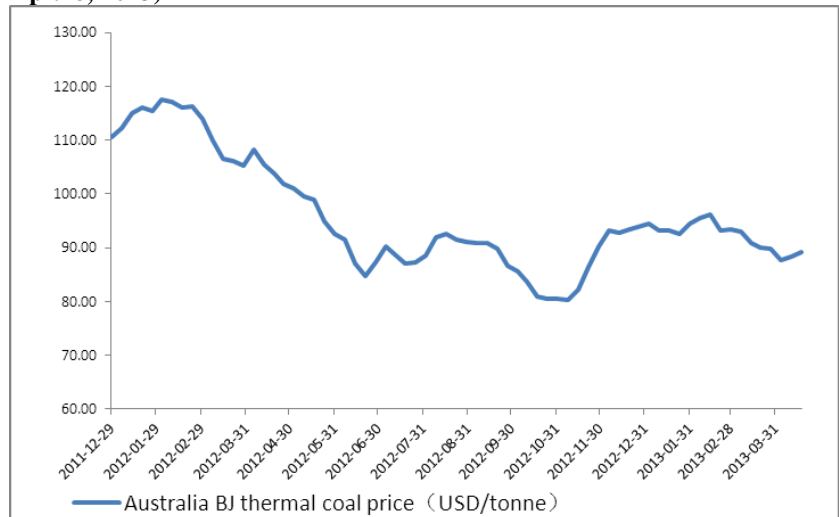


Exhibit: China's imported coal volume (10k tonnes) rose significantly in recent months (up to March, 2013)



Source: Wind, ABCI Securities

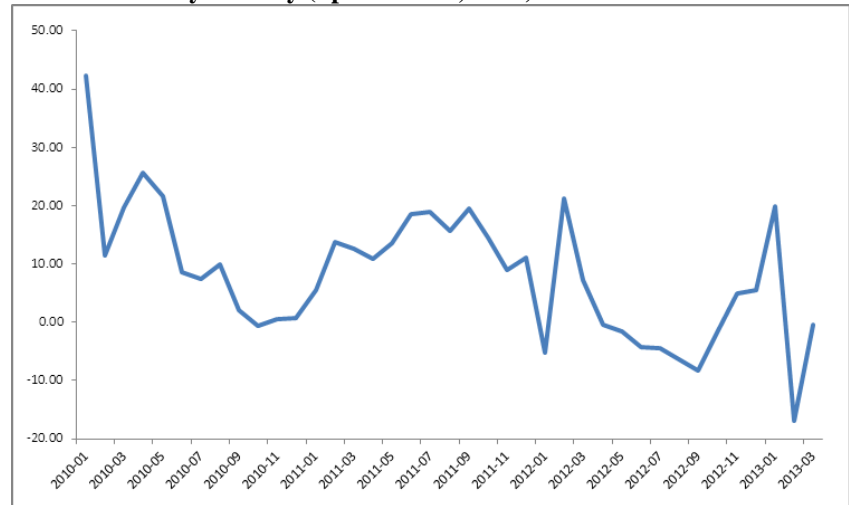
Exhibit: Australia BJ thermal coal price (USD/tonne) still weak (up to Apr.18, 2013)



Source: Wind, ABCI Securities

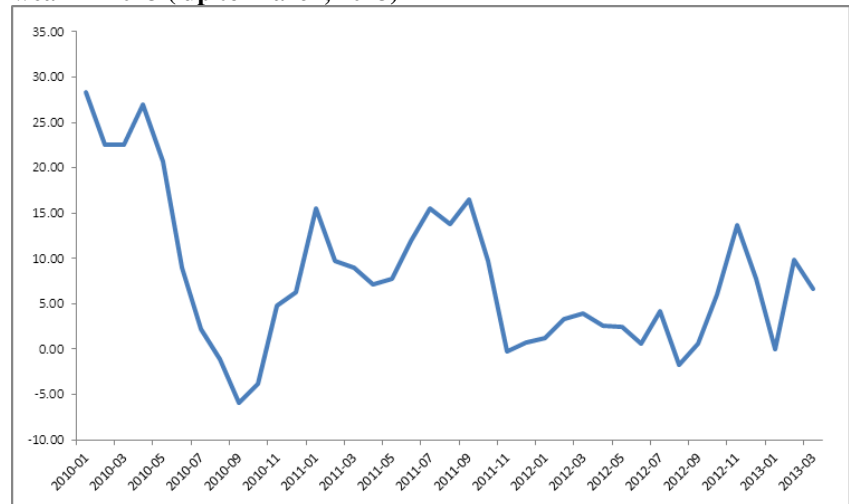


Exhibit: China's monthly thermal power output growth (%YOY) recovered mildly recently (up to March, 2013)



Source: Wind , ABCI Securities

Exhibit: The monthly production growth (%YoY) of the raw steel still weak in 2013 (up to March, 2013)



Source: Wind , ABCI Securities

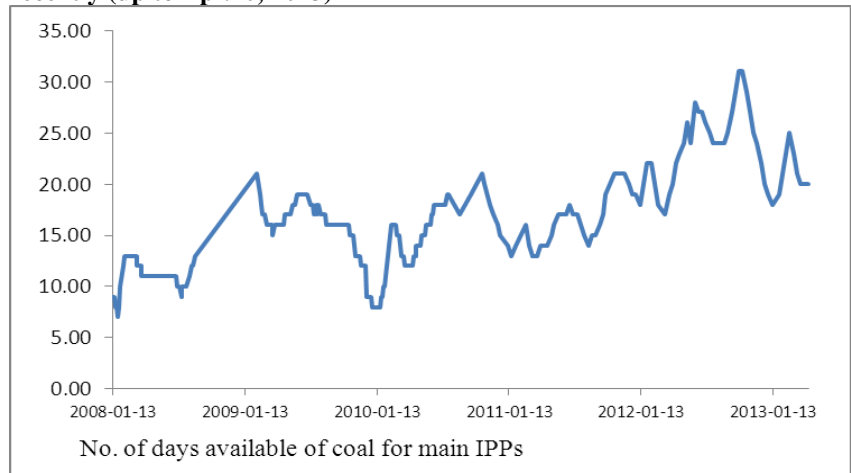


Exhibit: China's monthly cement output growth rate (%) recovered recently (up to March, 2013)



Source: Wind, ABCI Securities

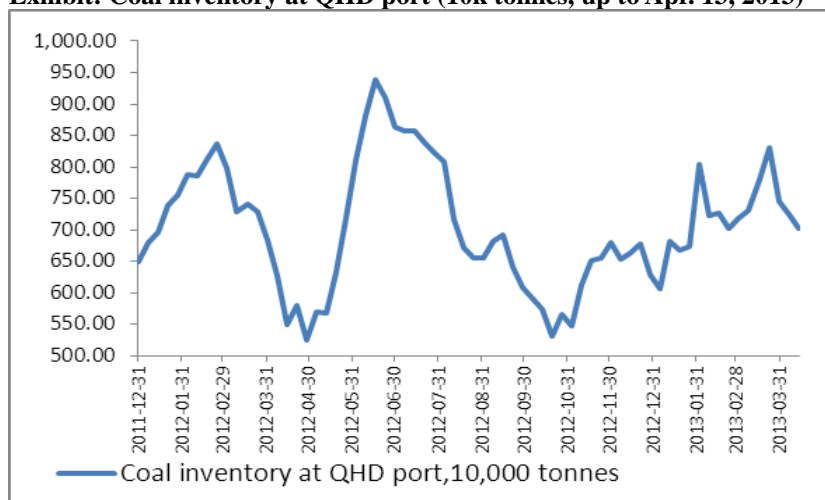
Exhibit: No. of days available of coal for China's main IPPs reduced recently (up to Apr.20, 2013)



Source: Wind, ABCI Securities



Exhibit: Coal inventory at QHD port (10k tonnes, up to Apr. 13, 2013)



Source: Wind, ABCI Securities

Exhibit: China Economic Indicators

	2012										2013		
	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Real GDP (YoY%)	8.1	---	---	7.6	---	---	7.4	---	---	7.9	---	---	7.7
Export Growth (YoY%)	8.9	4.9	15.3	11.1	1	2.7	9.9	11.6	2.9	14.1	25.0	21.8	10.0
Import Growth (YoY%)	5.3	0.3	12.7	6.3	4.7	-2.6	2.4	2.4	0	6	28.8	-15.2	14.1
Trade Balance (USD/Bn)	5.18	18.53	18.13	31.91	25.28	26.43	27.45	32.11	19.63	31.6	29.2	15.3	-0.9
Retail Sales Growth (YoY%)	15.2	14.1	13.8	13.7	13.1	13.2	14.2	14.5	14.9	15.2	12.3		12.6
Industrial Production (YoY%)	11.9	9.3	9.6	9.5	9.2	8.9	9.2	9.6	10.1	10.3	9.9		8.9
PMI - Manufacturing (%)	53.1	53.3	50.4	50.2	50.1	49.2	49.8	50.2	50.6	50.6	50.4	50.1	50.9
PMI - Non-manufacturing (%)	58	56.1	55.2	56.7	55.6	56.3	53.7	55.5	55.6	56.1	56.2	54.5	55.6
FAI(YTD) (YoY%)	20.9	20.2	20.1	20.4	20.4	20.2	20.5	20.7	20.7	20.6	21.2		20.9
CPI (YoY%)	3.6	3.4	3	2.2	1.8	2	1.9	1.7	2	2.4	2.0	3.2	2.1
PPI (YoY%)	-0.3	-0.7	-1.4	-2.1	-2.9	-3.5	-3.6	-2.8	-2.2	-1.9	-1.6	-1.6	-1.9
M2 (YoY%)	13.4	12.8	13.2	13.6	13.9	13.5	14.8	14.1	13.9	13.8	15.9	15.2	15.7
New Lending (Rmb/Bn)	1011.44	681.8	793.23	919.83	540.1	703.9	623.2	505.2	522.9	454.3	1070.0	620.0	1060.0

Source: Wind, ABCI Securities



From long-term perspectives, we will take the following positive and negative factors into consideration.

Positive factors:

- ❖ At least in the next ten years, coal still will be a dominant energy type in China. Due to high costs of exploration, clean energy and shale gas cannot fully replace coal in the near future.
- ❖ China continues to vigorously reshape the coal industry against small and medium size coal mines, shut down backward production capacity, and strictly enhance the entry barriers. All these help reduce the excess supply.
- ❖ Government's support for large coal chemical projects will provide the giant coal companies with more business opportunities.
- ❖ Mengxi-Huazhong Railway (MHR), a major north-to-south coal-line in China will begin operation in 2017 and coal companies with high-quality coal resources in Inner Mongolia will benefit from MHR.
- ❖ Under the new spot-market linked pricing system, once the global and China's economy show strong recovery, the rebound in profitability for the thermal coal producers will be strong.

Negative factors:

- ❖ China has targeted a lower GDP growth rate and thermal coal sector will undergo a lower growth.
- ❖ Increasing support for clean energy will reduce the consumption of thermal coal in total energy consumption. Therefore, thermal coal companies need to explore more new growth drivers.
- ❖ The shale gas revolution in the U.S. reduced the demand for coal and has exerted downward pressure on the international coal price. Imported coal will put downward pressure on China's coal price in the long-term.

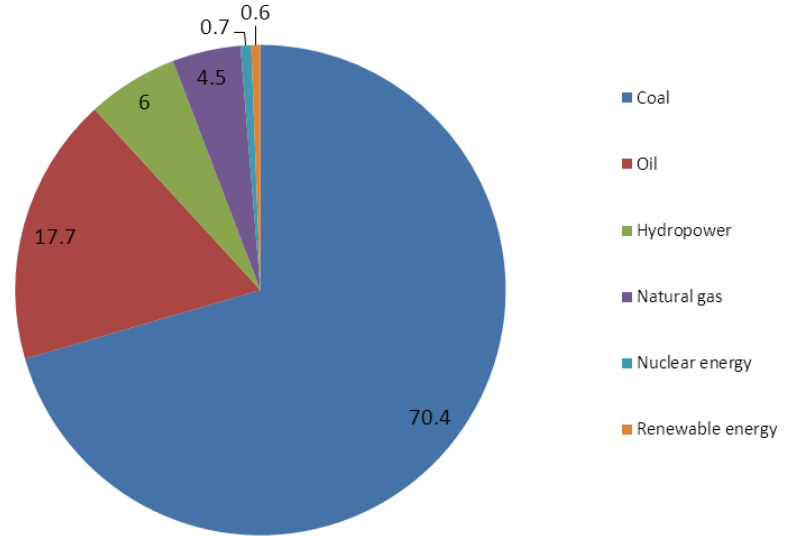
Exhibit: China's 2012 main energy consumption forecast (mn tonnes of oil equivalent)

Energy Type	Consumption (2012 forecast) (mn tonnes of oil equivalent)
Coal	1,839.4
Oil	461.8
Hydropower	157.0
Natural gas	117.6
Nuclear energy	19.5
Renewable energy	17.7
Total	2613

Source: BP Review 2012 (June, 2012), ABCI Securities



Exhibit: China's 2012 forecast energy consumption distribution
(mn tonnes of oil equivalent)



Source: BP Review 2012 (June, 2012), ABCI Securities

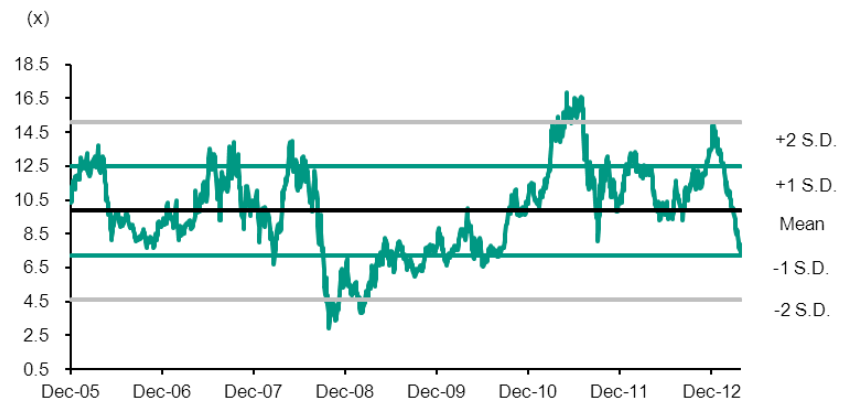


Company valuation

The weak sentiment of the coal market and the high cost of coal production and transportation will contribute to the fluctuation of Yanzhou Coal’s profitability. Yet the recent slump in stock price has largely reflected these negative factors.

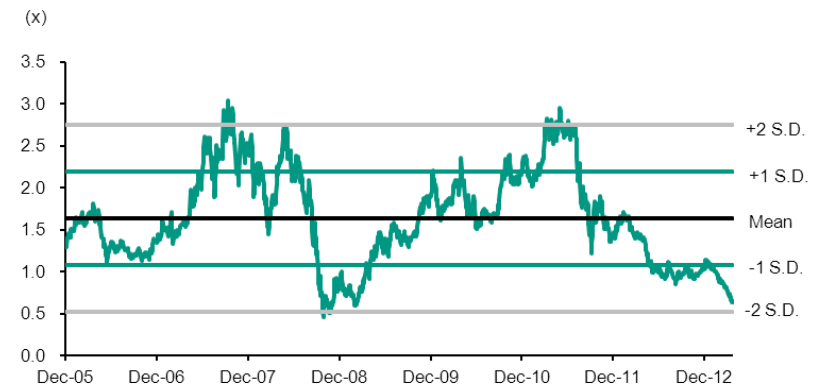
We use both PE and PB multiple methods to value the stock. Based on the PER rating, the stock is currently traded at 8.9x PE (or 0.67x PB) for FY13. We set the 12-month target price of HK\$7.96, which represents 8.8x PE for FY13, or 0.7x PB for 2013, and is 1.4% lower than current price. We initiate with a Hold rating.

Exhibit: Yanzhou Coal’s P/E distribution chart (up to April 30, 2013)



Source: Bloomberg, ABCI Securities estimates

Exhibit: Yanzhou Coal’s P/B distribution chart (up to April 30, 2013)



Source: Bloomberg, ABCI Securities estimates



Financial statement analysis and projection

Yanzhou Coal's revenue is highly concentrated (over 96% of total revenue in FY12) in the coal segments. The cyclical downturn of spot coal market since 1H12 has adversely affected the sales performance of the firm. The Bohai-Rim spot coal prices index dropped to its record low at Rmb613/t on April 24, 2013. We believe that due to the weak recovery from downstream consumption and the competition from overseas, coal prices would not jump up in a short time. Thus, Yanzhou Coal's total revenue would be significantly reduced.

The management indicates that the Company will continue to cut cost and try to achieve reduction on unit selling costs of coal. However, external factors, such as decline in spot price of coal would make it difficult to improve the margins.

In turn, we predict that Yanzhou Coal's FY13 revenue will decline by 12.9% to Rmb50.63 billion, profit attributable to shareholders will decline by 43.2% to Rmb3.53 billion, with EPS drop to Rmb0.72 from Rmb1.26 in FY12.

Exhibit: Key assumptions for revenue prediction and earnings outlook

Operating indexes	2012A	2013 Firm's Target	YoY %	ABC I 2013E	Gap btw target & Prediction
Total self-produced coal sales, mnt	61.73	64.85	5.05	64.85	0%
Sales volume of saleable coal, mnt	94.15	89.85	-4.57	89.85	0%
Capex Plan, Rmb mn	66.24	120.05	53.81	120.05	0%
Sales price change of the group's main coalfield, %	-9.5%	n.a	n.a	-15%	n.a
Gross profit margin, %	22.04	n.a	n.a	25	n.a

Source: Company, ABCI Securities estimates

Earnings expectations and sensitivity tests on performance

We forecast net profit for Yanzhou Coal at Rmb3,531mn in 2013, assuming 15% YoY drop in the coal selling price in its main coalfield in Shandong. Below are the earnings sensitivities in our model to changes in the relevant coal price and to changes of other variables.

- $\pm 5\%$ sales volume for main coalfield == $\pm 6.0\%$ in net profit.
- $\pm 5\%$ price for main coal base == $\pm 6.0\%$ in net profit.
- ± 1 pp in GPM === $\pm 11.4\%$ in net profit.

Exhibit: Sensitivity test on 2013E estimated total profit (Rmb mn)

Original prediction of total profit = Rmb3,531mn	Case I: +5%	Case II: -5%	Chg, %
Sales volume of self-produced coal change by $\pm 5\%$	3,746	3,317	6.0/(6.0)
Sales price of the firm's main coal base change by $\pm 5\%$	3,746	3,317	6.0/(6.0)
GPM change by ± 1 pp	3,934	3,128	11.4/(11.4)

Source: Company, ABCI Securities estimates



Exhibit: Consolidated income statements forecast

As of Dec 31 (Rmb mn)	2011A	2012A	2013E	2014E
Revenue	47,066	58,146	50,627	57,410
Coal	45,181	56,201	48,714	55,280
Railway transportation service income	477	464	561	559
Gross sales of electricity power	328	324	304	355
Gross sales of methanol	1,059	1,118	1,017	1,183
Gross sales of heat supply , Rmb mn	20	40	31	33
Transportation costs of coal	(1,248)	(2,104)	(1,762)	(1,999)
Cost of sales and service provided	(25,725)	(41,962)	(35,146)	(39,855)
Cost of electricity power	(362)	(331)	(277)	(314)
Cost of methanol	(930)	(911)	(763)	(865)
Cost of heat supply	(14)	(25)	(21)	(24)
Gross profit	18,786	12,813	12,657	14,352
SG&A	(6,570)	(7,988)	(8,786)	(9,665)
Other income and gains	305	1,521	566	914
Pre-tax profit	12,521	6,346	4,436	5,602
Income tax	(3,545)	(124)	(887)	(1,232)
Net profit	8,976	6,222	3,549	4,369
Minority interests	48	3	18	22
Equity shareholders of the Company	8,928	6,219	3,531	4,348
EPS (Basic), Rmb	1.82	1.26	0.72	0.88
Dividend per share, Rmb	0.57	0.36	0.22	0.27

Source: Company, ABCI Securities estimates



Exhibit: Balance sheet forecast

As of Dec 31 (Rmb mn)	2011A	2012A	2013E	2014E
Property, plant and equipment	31,274	39,503	36,662	34,036
Prepaid lease payments	713	696	712	707
Intangible assets	26,206	33,634	26,491	28,777
Other non-current assets	8,528	18,587	14,164	15,550
Total non-current assets	66,720	92,420	78,030	79,070
Bank balances and cash	8,145	12,717	15,532	23,098
Bills and accounts receivable	7,312	7,460	6,333	7,186
Inventories	1,391	1,566	1,461	1,658
Prepayments and other receivables	3,625	4,197	3,773	4,205
Other current assets	9,958	4,343	5,944	6,778
Current assets	30,431	30,282	33,043	42,925
Total assets	97,152	122,702	111,073	121,995
Bills and accounts payable	(2,241)	(6,812)	(5,846)	(6,667)
Other payables and accrued expenses	(7,345)	(9,014)	(7,866)	(8,845)
Borrowings-due within one year	(19,588)	(7,713)	(9,305)	(12,202)
Other short-term liabilities	(5,547)	(5,085)	(5,065)	(4,973)
Total current liabilities	(34,721)	(28,623)	(28,082)	(32,687)
Borrowings-due after one year	(14,869)	(33,284)	(24,077)	(28,680)
Deferred tax liability	(3,895)	(7,730)	(5,813)	(6,771)
Other Non-current liabilities	(340)	(3,975)	(2,769)	(1,730)
Total non-current liabilities	(19,105)	(44,988)	(32,658)	(37,181)
Total liabilities	(53,827)	(73,611)	(60,740)	(69,868)
Total equity	43,325	49,091	50,333	52,126
Non-controlling interests	691	3,265	3,347	3,467
Equity of the firm	42,634	45,826	46,985	48,660
Book value/share, Rmb	8.67	9.32	9.55	9.89

Source: Company, ABCI Securities estimates



Exhibit: Consolidated cash flow statements forecast

As of Dec 31 (Rmb mn)	2011A	2012A	2013E	2014E
Profit before income tax	12,521	6,346	4,436	5,602
Depreciation of property, plant and equipment	2,266	2,819	2,637	2,438
Interest expenses	839	1,449	1,594	1,721
Interest income	(358)	(722)	(722)	(722)
Decrease (increase) in inventories	403	(59)	104	(197)
Decrease (increase) in bills and accounts receivable	2,800	(93)	1,127	(854)
Other adj. items	(495)	(3,236)	(5,530)	(2,554)
CF Operating	17,977	6,504	3,645	5,434
Purchases of property, plant and equipment	(8,620)	(6,230)	(12,005)	(8,952)
Others	(16,991)	3,043	141	(558)
CF Investing	(25,611)	(3,187)	(11,863)	(9,509)
Proceeds from bank borrowings	16,712	12,282	16,564	17,837
Dividend paid	(2,902)	(2,803)	(1,771)	(1,095)
Cash flows from other financing	(4,369)	(8,333)	(3,684)	(4,969)
CF from/(used) in Financing activities	9,441	1,145	11,109	11,773
Net change in cash	1,807	4,461	2,891	7,699
Cash at the beginning	6,771	8,145	12,717	15,532
Exchange difference	(433)	111	(76)	(133)
Cash at the end	8,145	12,717	15,532	23,098

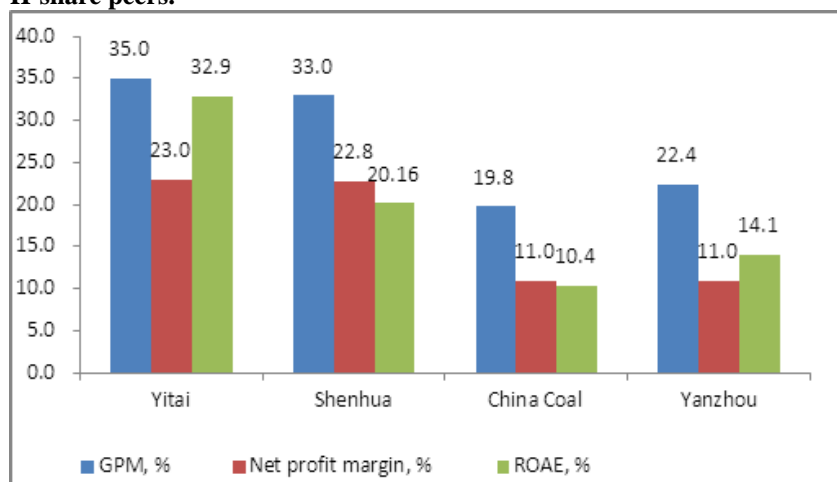
Source: Company, ABCI Securities estimates

Peer comparison

Yanzhou Coal's coal production cost per ton was higher than its peers, resulting in a relatively lower net profit margin. Currently, Yanzhou Coal's gross profit margin was lower than that of Yitai Coal and China Shenhua, though a bit higher than that of China Coal.

The Company has a net profit margin similar to that of China Coal, but significantly lags behind that of Yitai and Shenhua. Its ROAE is higher than that of China Coal, but is far behind the ROAE of Yitai and Shenhua.

Exhibit: Yanzhou Coal's FY12 operating data was no competitive among H-share peers.



Source: from 2012 Annual Reports of the Companies, ABCI Securities

Exhibit: Peer group comparison

FY12	China Shenhua	China Coal	Yanzhou Coal	Yitai Coal
Code	1088 HK	1898 HK	1171 HK	3948 HK
Commercial coal production (mn tonnes)	304	114.4	61.937	49.52
Coal sales (mn tonnes)	464.6	149.54	94.148	73.2
Coal sales/Total Revenue, %	66.3	82.2	96.7	94.8
Coal resources (100 mn tonnes)	251.4	195.1	46.7	29.5
Coal production cost for saleable coal (Rmb/t)	130.2	234.6	314.4	94.6
Revenues (Rmb mn)	250,260	87,292	58,146	31,584
Revenue Growth the last year	19.6%	-3.9%	23.5%	17.0%
Profit to equity shareholders (Rmb mn)	48,858	8,842	6,219	6,454
EPS, Rmb	2.46	0.67	1.26	3.97
BVPS, Rmb	12.90	6.50	9.32	12.11
Dividend (Rmb per share)	0.96	0.21	0.36	1.25
Dividend payout ratio, %	39.0	31.3	28.6	31.5
ROAA, %	11.31	5.1	5.7	15.6
ROAE, %	20.16	10.4	14.1	32.9

Source: from 2012 Annual Reports of the Companies, ABCI Securities



Risk Factors

Economic risk. There would be a weak power consumption growth due to slower-than-expected economic growth. China's 1Q2013 GDP growth indicated that more positive catalysts are needed to verify a solid recovery of the thermal coal demand. Though we believe that Chinese government would impose monetary and fiscal measures to boost the economy, we do not expect a U-shape recovery.

Competition from foreign coal producers. The influx of foreign coal caps the rebound momentum of domestic coal prices. More and more American coal producers turn to India and China market, which would increase the supply of coal to China.

Sector development and policy risk. China is implementing its energy saving policy. One of the directions is to reduce the carbon emission and the weight of thermal power generated in the overall power consumption. This would likely dampen coal consumption.

Increasing cost due to business development and social responsibility. Unlike private firms, state-owned enterprises in China lack the flexibility to lay off its employees, as they are required to bear social responsibility. China's inflation and salary have kept jumping in the past few years which put more pressure on overall profitability of these enterprises.

Other factors that might increase Yanzhou Coal's cost include:

- its new incremental production;
- costs of M&A activities in the vertical business integration;
- more expenses and longer time for exploring potash resources in Canada; and
- China's potential resource tax



Disclosures

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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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