



# Company Report

## China Shenhua (1088 HK)

July 10, 2013

### Rating: BUY

TP: HK\$27.0

Previous Rating & TP: BUY, HK\$33.00  
Previous Report: May 15, 2013

#### Key Data

H-Share price (HK\$)	19.42
Upside potential (%)	39.03
52Wk H/L(HK\$)	35.45/18.10
Issued shares (mn)	19,890
H-shares (mn)	3,399
A-shares (mn)	16,491
Market cap	
H-shares (HK\$mnn)	66,000
A-shares (Rmb mn)	260,723
3-mth avg daily turnover (HK\$mnn)	527.1
Major shareholder (%):	
Shenhua Group Ltd.	73.01%

Source: Company, Bloomberg, ABCI Securities

#### Revenue composition in FY12 (%)

Coal	66.3
Power	28.4
Others	5.3

Source: Company, ABCI Securities

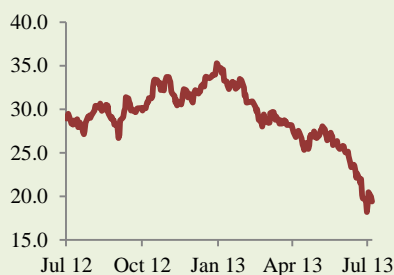
#### Share performance (%)

	Absolute	Relative*
1-mth	(22.5)	(18.3)
3-mth	(28.7)	(22.6)
6-mth	(43.2)	(32.7)

\*Relative to HSCEI Index

Source: Bloomberg, ABCI Securities

#### 1-Year price performance (HK\$)



Source: Bloomberg

#### Analyst Information

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### Defensive play amid price war

We revised down China Shenhua's EPS due to recent price war and weak support from government to restrict imports of low-quality coals. The stock plunged to FY13E P/E of 6.4x. However, the Group's low unit cost would help enlarge market shares in the price war, and its solid power business would make it a defensive play in the thermal coal sector. We maintain our BUY rating but reduced TP to HK\$27.0, reflecting a valuation of 9.1x FY13 PER.

#### Weak support from government to restrict low-quality coal imports.

Though coal producers lobbied actively in the past months to urge the Chinese government to restrict imports of low-quality thermal coals, the IPPs fought against the suggestion strongly and it has been reported that the central government was reluctant to lend support to coal producers. We believe the government is likely to leave the decision to the market, and measures to deter coal imports, if any, would be mild.

#### Price cut hurt China Shenhua, but we expect the loss to be mild.

China Shenhua was reported (for details, please refer our previous report on June 28) to have cut the spot coal price in the price war against China Coal (1898 HK). However, based on its highly competitive cost of Rmb121.4/t, as compared to Rmb216.15/t for China Coal in 1Q13, we expect China Shenhua to suffer less while gaining more market shares amid the price war. We lowered the Company's spot ASP by 10.0% and reduced its FY13E EPS by 5.2% to Rmb2.36.

**Maintain BUY.** We believe that price war will distress the sector's valuation. However, considering China Shenhua's low cost of coal/t, large market share within the power industry, and high double-digit ROE for FY12A & FY13E, we maintain our BUY rating with TP at HK\$27.X, reflecting a valuation of FY13E forward P/E of 9.1x (10.5x previously).

**Risk factors:** 1) Coal price risk; 2) Imbalance in supply and demand; 3) Business cycles of downstream industry

#### Results and Valuation

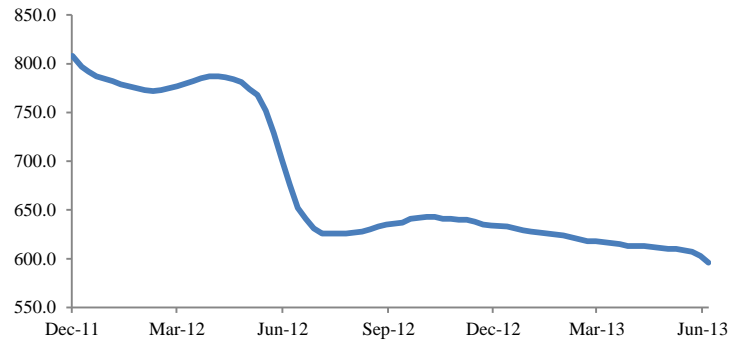
FY ended Dec 31	2011A	2012A	2013E	2014E
Revenue (Rmb mn)	209,225	250,260	258,899	286,124
Chg (% YoY)	32.7	19.6	3.5	10.5
Net Income (Rmb mn)	45,846	48,858	46,980	49,278
Chg (% YoY)	18.1	6.6	(3.8)	4.9
EPS (Rmb)	2.31	2.46	2.36	2.48
Chg (% YoY)	18.1	6.6	(3.8)	4.9
BVPS (Rmb)	11.5	12.9	14.7	16.7
Chg (% YoY)	11.3	12.4	14.2	13.1
P/E (x)	-	6.3	6.53	6.22
P/B (x)	-	1.2	1.05	0.93
DPS (Rmb)	0.90	0.96	0.92	0.97
Yield (%)	-	6.7	6.73	7.38
ROE (%)	21.2	20.16	17.09	15.78
ROA (%)	11.8	11.31	9.98	9.75

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



*Thermal coal spot price dropped to Rmb596/t after the kick-off of the price war among large coal competitors.*

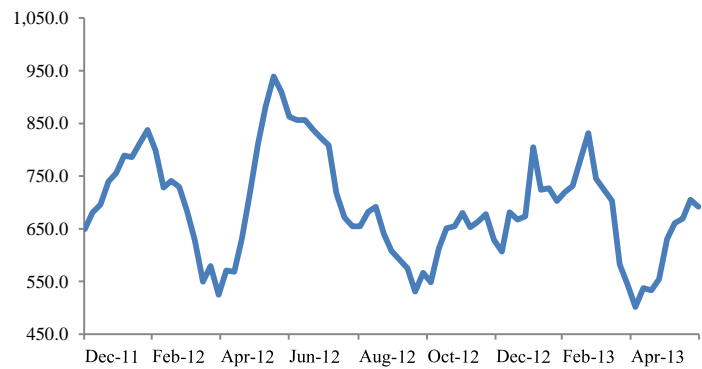
**Bohai-Rim steam coal price index (Rmb/t, till July 8, 2013)**



Source: Wind, ABCI Securities

*The coal inventory at QHD port rebounded to 6.92mnt on June 29, 2013.*

**Coal inventory at QHD port (10k tonnes, up to June 29, 2013)**



Source: Wind, ABCI Securities

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ABCI SECURITIES COMPANY LIMITED

China Shenhua Energy Co. Ltd.

**Consolidated income statement (2010A-2014E)**

<b>FY ended Dec 31 (Rmb mn)</b>	<b>1Q13</b>	<b>2010A</b>	<b>2011RS</b>	<b>2012A</b>	<b>2013E</b>	<b>2014E</b>
<b>Revenue</b>	<b>60,039</b>	<b>157,662</b>	<b>209,225</b>	<b>250,260</b>	<b>258,899</b>	<b>286,124</b>
Coal revenue		106,080	138,263	165,989	164,958	177,473
Power revenue		44,800	61,204	71,096	80,310	93,588
Other revenues		6,782	9,758	13,175	13,630	15,063
Cost of sales		(90,142)	(128,638)	(167,754)	(176,672)	(197,426)
<b>Gross profit</b>		<b>67,520</b>	<b>80,587</b>	<b>82,506</b>	<b>82,226</b>	<b>88,699</b>
SG&A		(9,219)	(11,056)	(12,950)	(15,168)	(17,767)
Other operating expenses, net		(776)	(825)	48	48	48
<b>Profit from operations</b>		<b>57,525</b>	<b>68,706</b>	<b>69,604</b>	<b>67,106</b>	<b>70,980</b>
Other income/cost/and loss		(1,583)	(1,857)	(1,593)	(1,726)	(1,659)
<b>Pre-tax profit</b>		<b>55,942</b>	<b>66,849</b>	<b>68,011</b>	<b>65,380</b>	<b>69,321</b>
Profits tax		(11,473)	(14,041)	(10,965)	(10,526)	(11,784)
<b>Net profit</b>		<b>44,469</b>	<b>52,808</b>	<b>57,046</b>	<b>54,854</b>	<b>57,536</b>
Profit attributable to:						
Minority interests		5,635	6,962	8,188	7,873	8,258
<b>Equity shareholders of the Company</b>	<b>11,625</b>	<b>38,834</b>	<b>45,846</b>	<b>48,858</b>	<b>46,980</b>	<b>49,278</b>
<b>EPS (Basic, Rmb)</b>	<b>0.584</b>	<b>1.95</b>	<b>2.31</b>	<b>2.46</b>	<b>2.36</b>	<b>2.48</b>
<b>Dividend per share (Rmb)</b>		<b>0.75</b>	<b>0.90</b>	<b>0.96</b>	<b>0.92</b>	<b>0.97</b>

Source: Company, ABCI Securities estimates

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**Consolidated balance sheet (2010A-2014E)**

<b>FY ended Dec31 (Rmb mn)</b>	<b>2010A</b>	<b>2011RS</b>	<b>2012A</b>	<b>2013E</b>	<b>2014E</b>
Property, plant and equipment	188,061	223,329	236,048	271,455	307,405
Construction in progress	33,088	34,384	61,142	64,199	67,409
Intangible assets	3,248	3,610	3,781	3,781	3,781
Other non-current assets	28,273	36,658	45,036	46,801	48,885
<b>Total non-current assets</b>	<b>252,670</b>	<b>297,981</b>	<b>346,007</b>	<b>386,236</b>	<b>427,480</b>
Inventories	11,574	12,939	15,171	15,077	16,221
Accounts and bills receivable	11,424	13,618	20,028	19,904	21,414
Prepaid expenses and other current assets	14,250	12,694	14,480	14,480	14,480
Cash and cash equivalents	77,912	61,652	51,627	38,237	37,001
Other current assets	4,301	7,623	10,054	10,054	10,054
<b>Current assets</b>	<b>119,461</b>	<b>108,526</b>	<b>111,360</b>	<b>97,752</b>	<b>99,169</b>
<b>Total assets</b>	<b>372,131</b>	<b>406,507</b>	<b>457,367</b>	<b>483,988</b>	<b>526,650</b>
Short-term borrowings and current portion of long-term borrowings	(15,317)	(16,489)	(28,093)	(18,627)	(22,808)
Accounts and bills payable	(19,661)	(23,763)	(31,072)	(27,418)	(29,245)
Accrued expenses and other payables	(36,893)	(39,286)	(41,423)	(40,355)	(40,889)
Current portion of long-term payables	(497)	(271)	(283)	(277)	(280)
Income tax payable	(4,558)	(7,940)	(4,686)	(6,313)	(5,500)
<b>Total current liabilities</b>	<b>(76,926)</b>	<b>(87,749)</b>	<b>(105,557)</b>	<b>(92,989)</b>	<b>(98,721)</b>
Long-term borrowings, less current portion	(52,311)	(45,443)	(39,624)	(42,534)	(41,079)
Long-term payables, less current portion	(2,133)	(2,346)	(2,558)	(2,452)	(2,505)
Other Non-current liabilities	(3,334)	(2,855)	(3,071)	(2,963)	(3,017)
<b>Total non-current liabilities</b>	<b>(57,778)</b>	<b>(50,644)</b>	<b>(45,253)</b>	<b>(47,949)</b>	<b>(46,601)</b>
<b>Total liabilities</b>	<b>(134,704)</b>	<b>(138,393)</b>	<b>(150,810)</b>	<b>(140,938)</b>	<b>(145,322)</b>
Total equity	237,427	268,114	306,557	343,050	381,328
Non-controlling interests	32,314	39,915	49,968	49,968	49,968
<b>Equity of the firm</b>	<b>205,113</b>	<b>228,199</b>	<b>256,589</b>	<b>293,082</b>	<b>331,360</b>
<b>Book value/share (Rmb)</b>	<b>10.31</b>	<b>11.47</b>	<b>12.90</b>	<b>14.74</b>	<b>16.66</b>

Source: Company, ABCI Securities estimates

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**Consolidated cash flow statement (2010A-2014E)**

<b>FY ended Dec 31 (Rmb mn)</b>	<b>2010A</b>	<b>2011RS</b>	<b>2012A</b>	<b>2013E</b>	<b>2014E</b>
<b>Profit before income tax</b>	<b>55,942</b>	<b>66,849</b>	<b>68,011</b>	<b>65,380</b>	<b>69,321</b>
(Increase) decrease in inventories	(3,129)	(714)	(2,232)	94	(1,144)
Decrease in trade and bills receivables	(1,947)	(953)	(6,410)	124	(1,510)
Interest received	1,248	978	750	1,175	1,217
Interest paid	(3,760)	(3,300)	(3,554)	(3,313)	(3,321)
Income tax paid	(9,767)	(11,830)	(14,689)	(10,526)	(11,784)
Other adjusted items	19,986	19,919	27,179	16,535	25,716
<b>Net CF of Operating</b>	<b>58,573</b>	<b>70,949</b>	<b>69,055</b>	<b>69,469</b>	<b>78,494</b>
Capital expenditure	(30,538)	(45,082)	(52,256)	(54,869)	(57,612)
Acquisition of subsidiaries	473	(1,666)	(1,072)	(1,369)	(1,221)
Others	(1,067)	(8,507)	(8,602)	611	1,156
<b>Net cash used in investing activities</b>	<b>(31,132)</b>	<b>(55,255)</b>	<b>(61,930)</b>	<b>(55,627)</b>	<b>(57,677)</b>
Proceeds from borrowings	31,548	4,691	36,099	20,395	28,247
Repayments of borrowings	(42,225)	(21,184)	(34,534)	(27,859)	(31,197)
Cash flows from other financing	(11,871)	(14,840)	(18,718)	(19,771)	(19,107)
<b>Net cash from financing activities</b>	<b>(22,548)</b>	<b>(31,333)</b>	<b>(17,153)</b>	<b>(27,235)</b>	<b>(22,057)</b>
<b>Net change in cash</b>	<b>4,893</b>	<b>(15,639)</b>	<b>(10,028)</b>	<b>(13,393)</b>	<b>(1,239)</b>
Cash at the beginning	72,321	77,302	61,652	51,627	38,237
Exchange difference	(2)	(11)	3	3	3
<b>Cash at the end</b>	<b>77,212</b>	<b>61,652</b>	<b>51,627</b>	<b>38,237</b>	<b>37,001</b>

Source: Company, ABCI Securities estimates



## Disclosures

### Analyst Certification

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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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