



Company Report

China Shenhua (1088 HK) – Buy China Coal & Consumable Fuels Industry 12-month target price: HK\$38.9

Key data

Share price (HK\$)	32.3
Target price (HK\$)	38.9
Upside potential (%)	22.4
52Wk H/L(HK\$)	37.8/24.2
Issued shares (mn)	19,889.6
- H Shares (mn)	3,398.6
- A Shares (mn)	16,491.0
Market cap	
- H Shares (HK\$mn)	109,775
- A Shares (Rmbmn)	372,697
3-mth ave daily turnover (HK\$ mn)	441
Auditors	KPMG
Major shareholder (%)	
Shenhua Group Corp Ltd	72.96

Source: Company & Bloomberg

Revenue composition in FY11 (%)

Coal	68.5
Power	28.3
Railway	1.3
Shipping	1.4
Port	0.1
Others	0.4

*Based on FY11 results

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	7.3	4.1
3-mth	11.0	2.3
6-mth	(6.2)	(8.2)

*Relative to Hang Seng Index

Source: Bloomberg

1 year price performance



Source: Bloomberg

Analyst

Report Date: 29 October 2012

Mark Chen

Tel: (852) 2147 8129

Email: markchen@abci.com.hk

Previous report

Date: 17 October 2012

Rating: Buy

Better than expected 3Q12 results

We reiterated our positive stance on China Shenhua for 2012 and 2013 in light of a bright 9M12 results. The company reported better-than-expected net profit growth and gross profit margin in 3Q12. Per our channel check, we forecast coal sale and prices to further recover in 4Q12 and 2013. As a result, we maintain BUY rating and raised our 12-mth TP to HK\$38.9.

Better-than-expected results: The group posted Rmb178,367mn revenue for the first nine months this year, up 15.51%yoy and achieved 75.1%(76%) of 2012 ABCI (Bloomberg) estimates. The reported gross profit margin of 36% was 4 ppts higher than our prediction (32%). This indicated a better-than-expected cost control.

Accordingly, we revised up our 2012E net profit by 15.3% from Rmb42,398 mn to Rmb48,923 mn. 2012E EPS was revised from Rmb2.132 to Rmb 2.46.

Positive growth potential in 4Q and 2013E: Our channel check indicated that the coal sales in 4Q were much stronger than 3Q, which reaffirmed our previous judgments that downstream demand is stabilizing. We believe the coming seasonal peak will support the coal prices and the recovering economy will lead to a strong sequential growth in 2013 and thus reinforce our positive sector stance on this industry.

Rolling over to 2013E based targets. We rolled over the base year of our 12-mth target price to 2013E and set the new TP as HK\$38.9, reflecting 11.25x PER (or 2.06x PB), with 20.44% upside potential.

Risk factors: 1) Weak power consumption growth on slowed economic growth; 2) policy risk; 3) the influx of foreign coal cap the rebound momentum of domestic coal prices.

Performance and Valuation

FY ended Dec 31	2009A	2010A	2011A	2012E	2013E
Turnover (Rmb mn)	121,312	157,662	208,197	237,392	272,070
Chg (%yoy)	13.2	30.0	32.1	14.0	14.6
Net Income (Rmb mn)	31,706	38,834	45,677	48,923	55,918
Chg (%yoy)	19.0	22.5	17.6	7.1	14.3
EPS (Rmb)	1.594	1.952	2.296	2.46	2.81
Chg (%yoy)	19.0	22.5	17.6	7.1	14.3
BVPS (Rmb)	8.58	10.31	11.35	13.22	15.35
Chg (%yoy)	15.8	20.2	10.1	16.4	16.1
P/E (x)	—	—	11.4	10.7	9.3
P/B (x)	—	—	2.3	2.0	1.7
Dividend yield (%)	—	—	3.4	3.5	3.7
ROAE (%)	19.9	20.7	21.2	20.02	19.68

Source: Company, Bloomberg, ABCI Securities estimates (assuming 1Rmb=1.23HKD)



First nine months results review

Better-than-expected results: The group posted revenue of Rmb178,367 mn for the first nine months this year, up 15.51% YoY; net profit was Rmb 38,845mn, up 9.14% YoY.

Strong revenue growth was a result of 15.31%/17% YoY revenue growth from coal/power sections. The production volume of commercial coal reached 230.9 mn tonnes and sales volume reached 329.9 mn tonnes, representing a YoY growth of 10.0% and 15.15% respectively. That partly cushioned off the drop of the spot coal price (-7.5%). Our channel check indicated that the coal sales in 4Q were much stronger than 3Q, which is in line with our previous prediction of the recovering macro-economy and the coming peak season.

As for the power sector, the total power output dispatch reached 144.8 billion kwh, up 9.9% YoY. Note that China increased the on-grid power tariffs for thermal power plants in some provinces and cities last December, and this helped to support the revenue of power generation business. Although the lagged effect of the power tariffs improvement will be alleviated, we remain moderate positive for the power sector as the macro economy is recovering and the coal prices are bottoming.

Coal prices expected to be stabilized. Bohai-Rim thermal coal price edged up to Rmb642/t by Oct. 24, the 8th consecutive week of improvement, and the Qinhuangdao (QHD) coal inventory was significantly reduced to 5.31mnt in as of Oct. 20, 2012, 43.5% drop from June's peak. **We identify these as key near-term catalysts**, which should remove market concerns over coal producers' near-term growth.

Cost increase is a concern, but we have factored it in. The low coal price and significantly growing costs eroded the gross profit margin of the counter. Its gross profit margin dropped to 36% for the first 9-mth this year, i.e. 4 ppts retreat yoy. But the GPM is still 4 ppts higher than our expectation (32% FY12E), and was 0.6 ppt improved from 1H12. We believe that China's alleviated inflation and the recovering coal price would help to stabilize the gross profit margin in 2013.

Valuation: Maintain Buy. We maintained our sales target of 420mn tonnes this year, **which is higher than their own target sales (about 411 mn tonnes)**. We also rolled over the base year of our 12-month price target to 2013E and raised the target price to HK\$38.9, reflecting 11.25x PER, with 20.44% upside potential.

Risk factors: 1) weak power consumption growth on slowed economic growth; 2) policy risk from government policy changes; 3) the influx of foreign coal cap the rebound momentum of domestic coal prices;

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China Shenhua Energy Company Limited**Exhibit 1: major operational data**

Operational indicators	2012		2011 (Restated)		YoY chg (%)	
	For the 3 months ended 30 Sep.	For the 9 months ended 30 Sep.	For the 3 months ended 30 Sep.	For the 9 months ended 30 Sep.	For the 3 months ended 30 Sep.	For the 9 months ended 30 Sep.
Commercial coal production (million tonnes)	75.1	230.9	69.5	209.9	8.1	10.0
Coal sales (million tonnes)	107.8	329.9	95.3	286.5	13.1	15.1
Of which: Export (million tonnes)	0.6	2.8	1.2	4.4	-50	-36.4
Import (million tonnes)	3.4	5.7	–	–	N/A	N/A
Turnover of self-owned railways transportation (billion tonne km)	42.5	129.5	40.3	121	5.5	7.0
Seaborne coal (million tonnes)	61	181.4	55.8	158.5	9.3	14.4
Huanghua Port seaborne coal (million tonnes)	23.7	67.2	N/A	N/A	N/A	N/A
Shenhua Tianjin Coal Dock seaborne coal (million tonnes)	8.5	20.2	N/A	N/A	N/A	N/A
Shipping volume (million tonnes)	26.2	73.6	22	59.5	19.1	23.7
Shipment turnover (billion tonne nautical miles)	22.6	62.3	19.9	52.6	13.6	18.4
Gross power generation (billion kwh)	52.9	155.63	52.21	141.22	1.3	10.2
Total power output dispatch (billion kwh)	49.14	144.8	48.74	131.73	0.8	9.9

*Source: company data, ABCI Securities***Exhibit 2: Interim result highlights of the group (prepared under IFRSs)**

	For the 9 months ended 30. Sep. 2012			For the 9 months ended 30. Sep. 2011			Change	
	Sales Vol. (mnt)	% to total sales vol.	Price Rmb/t	Sales Vol. (mnt)	% to total sales vol.	Price Rmb/t	Chg in Sales Vol.	Chg in Prices (%)
Domestic sales	326.6	99.0	421.9	282	98.5	431.5	15.8	(2.2)
long-term contract sales	132.5	40.2	348.6	28.2	44.8	336.8	3.4	3.5
Mine mouth	10	3.0	184.1	8	2.8	146.4	25.0	25.8
Direct arrival								
(along railway line)	63.9	19.4	253.1	59.4	20.8	245.4	7.6	3.1
Seaborne	58.6	17.8	480.6	60.8	21.2	451.0	(3.6)	6.6
Spot sales	194.1	58.8	471.9	53.9	53.7	510.4	26.1	(7.5)
Mine mouth	26.7	8.1	137.6	29.8	10.4	170.2	(10.4)	(19.2)
Direct arrival								
(along railway line)	47.5	14.4	416.3	30.9	10.8	510.6	53.7	(18.5)
Seaborne	119.9	36.3	568.3	93.2	32.5	619.0	28.6	(8.2)
Export sales and others	3.3	1.0	817.5	4.4	1.5	702.5	(25.0)	16.4
Total sales volume	329.9	100.0		286.5	100.0		15.1	
Weighted average price			425.7			435.6		(2.3)

Source: company data, ABCI Securities



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Exhibit 3: Interim result highlights of the group (prepared under IFRSs)

By the end of Sep 30 (Rmb mn)	2012	2011	Chg (% YoY)
Revenues	178,367	154,411	15.5
Coal revenue	117,368	101,788	15.31
Power revenue	53,136	45,414	17.00
Other revenues	7,863	7,209	9.07
Total cost of revenues	(114,743)	(92,384)	24.20
Gross profit	63,624	62,027	2.57
GPM	36%	40%	4ppts
SG&A	(8,970)	(7,815)	14.78
Other operating income/expenses, net	(44)	(592)	(92.57)
Total operating expenses	(123,575)	(100,791)	22.79
Profit from operation	54,610	53,620	1.85
Profit before income tax	53,122	52,284	1.60
Income tax	(8,266)	(11,121)	(25.67)
Profit for the year	44,856	41,163	8.97
Attributable to equity shareholders of the Company	38,767	35,722	8.52
Earnings per share (Rmb)	1.949	1.796	8.52
BVPS (Rmb/share)	12.39	11.47	8.02

Source: company data, ABCI Securities



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

Tel: (852) 2868 2183