



China coal energy sector

'La Nina' likely a driver for coal prices

	Ticker	Mkt cap		PER		PBR		ROE		EV/EBITDA		Yield	
		(US\$m)	Price	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E	2016E	2017E
Shenhua	1088 HK	43,741	14.16	15.2	14.7	0.8	0.8	5.5	5.5	7.0	6.9	2.4	2.5
China Coal	1898 HK	10,180	4.22	-	-	0.6	0.6	-2.1	-1.1	21.5	17.4	-	0.1
Yanzhou Coal	1171 HK	7,303	5.13	-	-	0.6	0.6	-1.0	-0.3	20.1	16.9	0.3	0.4
Shougang Fushan Resources	639 HK	1,018	1.48	106.4	53.2	0.5	0.5	0.5	0.9	9.5	8.5	2.0	2.0

Source: Bloomberg

- The "276 working days" policy, extended nationwide since April when it was initially introduced in Shanxi province to cap the maximum working days at the coal mines, has led to a reduction in coal production by 8% YoY in 5M16.
- La Nina effect likely to drive coal prices and earnings higher this year
- Sector valuation looks appealing on more positive coal price outlook. Shougang Fushan Resources (639 HK) has been one of the best performers in China's coal sector.

Improving earnings outlook on rising coal prices. We see improving earnings visibility for coal mining companies in China in light of the rising coal prices. More specifically, we see upside momentum in earnings in the next two quarters, as we foresee the benchmark coal price to potentially go up further on the back of the "276 working days" policy that has been implemented in Shanxi Province since April this year and since has been extended nationwide. The policy caps the working days of coal miners to 276 a year as part of the Chinese government's efforts to reduce coal output. Subsequent to the policy launch, China's coal production has dropped 11% YoY and 16% YoY in April and May respectively, whereas coal prices have picked up by one-fifth since, reflecting the effectiveness of the supply side reforms.

Potential occurrence of La Nina effect. Moreover, although El Nino, which was apparent last year, is often followed by La Nina, during a La Nina period, the sea surface temperature across the equatorial Eastern Central Pacific Ocean should be lower than normal this year. Such weather conditions are expected to bring colder winters for the area. As we may recall that in 2008, China suffered from prolonged snowstorms related to La Nina, disrupting transportation, electricity supply and agricultural production; subsequently coal inventories at power plants fell to below the normal levels, with certain regions in power and water shortage. Although we are not expecting similar situations to occur this year, we believe the bad weather would indirectly drive future coal price movement.

Still room for sector-wide re-rating on rising coal prices. The four major coal stocks have outperformed the Hang Seng Index since mid-May. As the sector is currently trading at 0.6x FY16E PBR, compared to historical average of 0.8x PBR, we believe there is still room for further re-rating. Catalysts include firming up coal prices along with potential upcoming companies' positive profit alerts.

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Shenhua (1088 HK, NR, Mkt cap USD43,741mn)

- Based on the effectiveness of the supply side reforms, Shenhua would benefit from the policy-induced coal price rebound, being a low-cost producer with a nationwide comprehensive transport network. However, its power segment remains to be a drag on earnings in the near term due to lower utilisation rates, tariff cuts, higher direct purchases and coal price rebound. This segment is not expected to see a further consumption recovery until the end of this year at the earliest, in our view.
- Shenhua is currently trading at 0.8x FY16E consensus PBR, versus the average of 0.6x and 1.5x during 2011 and 2015 respectively. The modestly improving balance sheet should provide room for further parent assets injection, in our view. With FY16E 2.4% yield, we expect Shenhua to remain the most preferred defensive pick in terms as an integrated holding company in the sector.

China Coal (1898 HK, NR, Mkt cap USD10,180mn)

- China Coal would benefit from the "276 working days" policy, in particularly for its mines located in Shanxi province. Focus would also be on its cost reduction program and subsequent benefits from lower transportation fees. The coal-to-chemical business has also seen steady development and we believe it will remain to be a major earnings driver this year. China Coal has issued positive profit alert, claiming that earnings are expected to see a turnaround from a net loss in the first quarter of this year.
- China coal remains a pure play with a high sensitivity to fluctuation in coal prices, and without access to power operation. China Coal is currently trading at 0.6x FY16E consensus PBR, compared to its historical range of 0.3x-0.8x.

Yanzhou Coal (1171 HK, NR, Mkt cap USD7,303mn)

- Its coking coal exposure is at risk because it is closely linked to the procurement of steel mills which are currently either in a de-stocking and de-capacity mode.
- Yanzhou Coal is currently trading at 0.6x FY16E consensus PBR, in the mid-range of the historical 0.4x-1.0x. Its proposed A-share issuance plan, which is due to be completed by 4Q16 and likely to lead to a 10% EPS dilution effect, remains an overhang, in our view.

Shougang Fushan Resources (SFR) (639 HK, NR, Mkt cap USD1,018mn)

- SFR is focused on coking coal production and operates three mines located in Shanxi province. The company is pending license approval for its fourth mining project, namely the Lianshan mine, so as to bump up production volume over the next two years.
- SFR had a net cash of HKD2.29bn on hand as of end-2015. Management has distributed a special dividend of HKD0.15 per share in 2015. In sum, total dividend per share has reached HKD0.21. Despite that the special dividend is not warranted for this year, it still offers a 4% yield based on the basic portion.
- SFR has been the best performing stock amid the small coal names this year. SFR is currently trading at 0.5x FY16E consensus PBR, compared to historical range of 0.3x-1.0x. Assuming ROE resumes to the levels of 2013-2014, we foresee a re-rating of its valuation. Based on the mid-range of 0.65x target PBR, there is still attractive upside and back by strong cash position.

Figure 1: Shenhua's PBR band



Source: Bloomberg

Figure 2: China Coal's PBR band



Source: Bloomberg

Figure 3: Yanzhou's PBR band



Source: Bloomberg

Figure 4: SFR's PBR band



Source: Bloomberg

Figure 5: Peers valuation

7/12/2016		Close	Mkt cap	PER	EPS Growth		PBR		ROE		EV/EBITDA		Yield	Net debt /			
Company	Ticker	Ccy (Local\$)	(US\$b)	(x)	2016E	2017E	2016E	2017E	(x)	2016E	2017E	(x)	2016E	2016E			
Energy commodities																	
Oil/Coal																	
PETROCHINA-H	857 HK	HKD	5.35	19.1	14.9	20.2	(73.4)	49.6	0.8	0.8	0.6	3.7	8.0	6.4	0.8	40.3	
KUNLUN ENERGY	135 HK	HKD	6.32	6.6	13.0	10.2	118	27.4	10	0.9	7.5	8.7	5.4	4.8	1.6	42.6	
SINOPEC CORP-H	386 HK	HKD	5.59	86.9	20.7	14.3	6.3	45.2	10	0.9	4.8	6.7	5.6	4.9	2.4	19.7	
SINOPEC KANTONS	934 HK	HKD	4.04	13	8.8	8.0	414	10.0	0.9	0.9	11.6	11.1	9.3	9.1	1.7	44.0	
CNOOC	883 HK	HKD	9.64	55.5	535.6	16.9	(95.5)	3,077.8	12	1.1	0.2	6.7	6.3	4.6	2.5	38.9	
CHINA OILFIELD-H	2883 HK	HKD	6.5	6.9	(418)	38.9	(164.2)	(207.5)	0.6	0.6	(14)	1.7	15.7	12.1	0.5	51.0	
CHINA SHENHUA-H	1088 HK	HKD	14.30	42.1	17.1	16.5	(5.8)	3.3	0.9	0.9	5.6	5.5	6.9	6.7	2.2	13.5	
CHINA COAL ENE-H	1898 HK	HKD	4.21	9.7	(214)	(60.1)	(4.4)	(64.5)	0.7	0.7	(2.2)	(11)	212	17.2	-	12.6	
YANZHOU COAL-H	171 HK	HKD	5.12	6.9	(416)	(50.0)	-	29.5	(74.0)	0.7	0.7	(11)	(0.3)	9.5	16.5	0.3	145.1
Metals commodities																	
Steel																	
Hong Kong																	
Angang	347 HK	HKD	3.73	4.2	(233.1)	98.2	(97.4)	(337.5)	0.6	0.6	(0.5)	0.3	9.9	9.3	0.2	47.2	
Magang	323 HK	HKD	1.79	2.7	(32.0)	(38.9)	(91.1)	(7.9)	0.7	0.8	(3.4)	(4.2)	10.6	10.3	-	88.5	
Chonggang	1053 HK	HKD	1.72	1.6	-	-	-	-	-	-	-	-	-	-	-	-	
China Oriental	581 HK	HKD	1.6	0.4	-	-	-	-	-	-	-	-	-	-	-	-	
Shougang	697 HK	HKD	0.23	0.3	-	-	-	-	-	-	-	-	-	-	-	-	
China																	
Inner Mongolia	600010 CH	CNY	3.00	14.6	(230.8)	103.4	(88.2)	(323.1)	2.1	2.1	(10)	2.1	23.9	17.2	-	-	
Baogang	600019 CH	CNY	4.90	12.1	16.0	13.6	420.3	16.9	0.7	0.7	4.3	4.7	7.4	6.7	2.9	37.8	
China Steel	2002 TT	TWD	20.80	10.2	38.4	27.3	13.9	40.6	1.1	1.1	2.8	4.0	12.7	11.4	1.9	86.1	
Wugang	600005 CH	CNY	2.76	4.2	23.0	24.0	(118.4)	(4.2)	10	0.9	4.1	3.3	10.5	10.0	-	-	
Hegang	000709 CH	CNY	2.88	4.6	30.6	30.6	135.0	-	0.7	0.7	2.5	2.3	10.8	9.9	10	-	
Base metals																	
Hong Kong																	
Chalco	2600 HK	HKD	2.69	8.0	(38.4)	117.0	(600.0)	(132.9)	1.1	1.1	(19)	1.8	15.8	12.8	-	235.0	
Jiangxi Copper	358 HK	HKD	9.45	6.5	34.2	25.8	(38.8)	32.6	0.7	0.7	2.2	2.8	16.5	15.0	1.0	12.9	
Hongqiao	1378 HK	HKD	5.39	5.0	7.7	6.2	19.0	25.1	0.9	0.8	1.1	1.3	5.2	4.5	3.2	120.6	
Chinalco Mining	3668 HK	HKD	10.2	1.6	(85.0)	(113.3)	714	(25.0)	22.7	28.3	(23.0)	(22.1)	55.4	21.6	-	-	
MMG	1208 HK	HKD	2.03	1.4	(26.9)	92.3	(54.3)	(237.5)	16.5	214	(43.4)	48.2	14.3	7.9	-	501.0	
Citic Resources	1205 HK	HKD	0.79	0.8	(4.6)	(7.2)	214	(35.3)	1.8	2.4	(33.4)	(27.9)	746.3	39.2	-	-	
China Nonferrous	1258 HK	HKD	10.3	0.5	-	-	-	-	-	-	-	-	-	-	-	-	
China																	
Shandong Nanshan	600219 CH	RMB	8.10	3.4	26.3	17.1	3.4	54.2	0.9	0.9	3.6	5.3	12.0	9.0	0.7	-	
Tongling Nonferrous	000630 CH	RMB	2.79	4.0	930.0	132.9	-	600.0	1.9	1.9	0.2	1.4	-	-	-	-	
Yunnan Copper	000878 CH	RMB	11.65	2.5	-	-	-	-	-	-	-	-	-	-	-	-	
China Nonferrous	000758 CH	RMB	10.55	3.1	31.8	24.8	52.3	28.3	3.7	3.3	1.1	1.3	14.6	12.7	0.4	-	
Yunnan Aluminum	000807 CH	RMB	7.35	2.1	29.2	20.9	486.0	39.7	2.4	2.3	10.1	12.5	15.2	11.9	-	-	
Precious metals																	
Hong Kong																	
Zijin	2899 HK	HKD	3.04	11.8	31.7	23.2	215	36.5	2.0	1.9	6.7	8.5	14.5	11.7	1.3	67.7	
Zhaojin	1116 HK	HKD	9.75	3.7	58.4	45.3	19.3	28.7	2.7	2.6	4.6	5.7	18.2	15.9	0.6	86.4	
China Gold	2099 HK	HKD	15.34	0.8	-	-	-	-	-	-	-	-	-	-	-	-	
China																	
Zhongjin Gold	600489 CH	RMB	15.79	8.1	149.0	83.1	278.6	79.2	4.9	4.7	3.6	6.5	24.9	22.0	0.2	-	
Shandong Gold	600547 CH	RMB	49.36	10.5	81.9	67.1	222.5	22.1	6.0	6.4	8.1	9.6	29.0	26.4	0.2	-	
Minor metals																	
Hong Kong																	
CMOC	3993 HK	HKD	1.91	9.9	36.7	33.5	(13.3)	9.6	1.5	1.5	4.7	4.6	46.9	46.0	1.2	-	
Citic Dameng	1091 HK	HKD	0.37	0.2	-	-	-	-	-	-	-	-	-	-	-	-	
Xinxin Mining	3833 HK	HKD	0.89	0.3	9.9	4.9	-	100.0	0.4	0.4	3.9	7.1	-	-	-	-	
Jinchuan Group	2362 HK	HKD	0.30	0.2	-	-	-	-	-	-	-	-	-	-	-	-	
Citic Resources	1205 HK	HKD	0.79	0.8	(4.6)	(7.2)	214	(35.3)	1.8	2.4	(33.4)	(27.9)	746.3	39.2	-	-	
MMG	1208 HK	HKD	2.03	1.4	(26.9)	92.3	(54.3)	(237.5)	16.5	214	(43.4)	48.2	14.3	7.9	-	501.0	
China Rare Earth	769 HK	HKD	0.59	0.2	-	-	-	-	-	-	-	-	-	-	-	-	
Other commodities																	
Paper																	
LEE & MAN PAPER	2314 HK	HKD	5.91	3.5	10.0	9.1	21.6	10.5	1.4	1.3	14.9	14.9	8.9	8.1	3.5	63.2	
NINE DRAGONS PAP	2689 HK	HKD	5.99	3.6	11.9	10.9	52.1	9.4	1.1	1.0	5.6	9.2	8.1	7.3	1.4	85.2	
SHANDONG CHEN-H	1122 HK	HKD	6.12	2.1	-	-	-	-	-	-	-	-	-	-	-	-	
Cement																	
ANHUI CONCH-H	914 HK	HKD	18.80	12.1	13.4	11.6	10.4	15.5	1.3	1.2	9.9	10.4	6.0	5.4	2.2	5.9	
CHINA NATL BLDG-H	3323 HK	HKD	3.49	2.4	13.5	10.4	19.9	29.0	0.4	0.4	3.1	3.8	10.9	10.2	1.3	47.9	
CHINA RES CEMENT	1113 HK	HKD	2.41	2.0	12.2	9.0	(29.9)	36.5	0.6	0.5	4.7	5.5	7.6	6.9	2.7	56.4	
BBMG CORP-H	2009 HK	HKD	2.46	5.7	11.9	9.0	7.6	21.2	0.6	0.6	6.8	7.5	10.2	9.2	1.0	67.4	
CHINA NATL MAT-H	1893 HK	HKD	1.67	0.8	8.4	6.3	48.1	33.5	0.4	0.4	4.5	5.5	6.0	5.5	2.0	92.3	
TCC INTL HLDGS	1186 HK	HKD	1.27	0.8	(81.4)	25.4	(95.0)	(84.3)	0.3	0.3	(0.6)	(0.5)	11.9	8.7	3.1	-	
ASIA CEMENT CH	743 HK	HKD	1.47	0.3	(47.0)	66.8	-	(320.0)	0.3	0.3	(1.4)	0.3	11.5	9.1	2.5	-	

Source: Bloomberg



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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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