

JPM-pp1

Asia Pacific Equity Research

22 March 2015

## China Coal Energy - H (1898 HK)

Underweight

Price: HK\$4.13

20 Mar 2015

Price Target: HK\$4.00

PT End Date: 31 Dec 2015

First take 2014 results – Miss, unrealistic FY15 targets for revenues to be flat

China Coal Energy (CCE)'s 2014 results sharply missed Street expectations, with net income (IFRS) of RMB141m (-96% y/y) falling well short of market expectations (JPMe RMB804m, Street RMB906m). We view the company's target for FY15 revenue, coal output and unit coal cost to stay at 2014 levels, as unrealistic. We see significant downside risk, given CCE's poor guidance history. Near-term, we see headwinds from CCE's heavy debt burden and coal chemical investment (given recent oil rout) and aging trade receivables. Stay UW.

- FY14 results – big miss.** While CCE's net income under Chinese Accounting standards (CAS) of RMB754m (-79% y/y) fell within its guidance (75-85% decline) made in late-January (see [note](#)), NP under IFRS of RMB141m (-96% y/y) was significantly below expectations (JPMe RMB804m, Street RMB906m). The discrepancy arrived from RMB629m of profits associated with “special reserves and related deferred tax adjustment”, which were not recognized in IFRS. The primary drivers of the weak results were lower coal sales (-3% y/y) and coal ASP (-12% y/y), FY14 revenue was lower at RMB70.7bn (-15% y/y).
- Weak on all fronts.** Key highlights, in our view, included: 1) a sharp increase in finance costs (+210% y/y) and higher tax expenses (+89% y/y), which wiped out savings from lower unit coal cost (-7% y/y) and SG&A (-6% y/y), 2) FCF remained negative (-RMB14.6bn), pushing net gearing (ND/E) higher to 74% (versus end-2013 57%), 3) 4Q14 net loss (IFRS) of RMB639m (vs 3Q RMB93m loss) was wider than expected, despite higher coal prices (QHD +5% q/q) during the period and 4) bad debts in accounts receivables of RMB403m (vs 2013: RMB70m), highlight risks to its trade receivables of RMB8.2bn, of which Rmb1.8bn are over 12 months. Pleasingly, CCE increased its dividend payout ratio to 40% (vs 2013: 30%) of net income (CAS), leaving DPS of 25 cents RMB in line with consensus estimates.
- 2015 targets of flat revenue, coal output and unit coal are too aggressive.** CCE provided a downbeat assessment of coal markets, noting that a combination of slower coal demand, new production capacity, transportation debottlenecking and robust imports will keep coal prices struggling at low levels. CCE targets 2015 revenue (RMB70bn), coal output (c150Mt) and unit coal cost (below RMB195/t) to be broadly flat at 2014 levels. In our view, this is unrealistic and we note CCE's poor guidance history, with the company missing 2014 raw coal output growth of 5% and revenue growth of 5% set early last year.
- Consensus downgrades ahead.** The China coal market has started the year poorly with QHD coal prices falling further down by 11% ytd to RMB465/t of late, below 2014's average RMB518/t. In such an environment, we believe CCE forecasts are at risk of further downgrades given: a) negative free cash generation from continued heavy capex, b) a rising debt burden and c) low coal chemical profits as a result of weaker oil prices.

### Stock Impact

- Given the weaker-than-expected 2014 results, we see downside risk to consensus estimates.

## Investor Briefing

CCE will host an investor briefing in Hong Kong. Full details below:

**Date:** 23 March 2015 (Monday)

**Time:** 4:00pm – 5:30pm

**Venue:** Atrium, 39/F, Island Shangri-la Hong Kong, Pacific Place, Supreme Court Road, Central, HK

**Language:** Putonghua, English

Table 1: CCE's financial summary (IFRS)

(Rmb Mills)	2H12	2012	1H13	2H13	2013	1H14	2H14	2014	HoH% 2H14	YoY% 2H14	YoY% 2014
Revenue	41,572	87,292	40,398	41,918	82,316	35,435	35,229	70,664	-1%	-16%	-14%
Total cost of revenues	-33,896	-69,989	-33,161	-37,760	-70,920	-31,106	-32,362	-63,468	-4%	14%	11%
Gross Profit	7,676	17,303	7,238	4,158	11,396	4,329	2,867	7,196	-34%	-31%	-37%
less SG & A	-2,234	-4,586	-2,035	-2,585	-4,620	-2,102	-2,802	-4,904	-33%	-8%	-6%
add other income	-36	-32	2	-12	-10	0	16	16	nm	nm	nm
add other gains, net	75	122	16	97	113	63	125	188	96%	29%	67%
Net operating profit	5,480	12,807	5,221	1,658	6,879	2,291	206	2,497	-91%	-88%	-64%
Net financing costs	-81	-254	-156	-474	-630	-894	-1,057	-1,952	-18%	-123%	-210%
Share of profits/(losses) of associates	28	236	141	10	152	92	42	134	-54%	303%	-11%
Profit before tax	5,427	12,789	5,206	1,195	6,401	1,488	-809	679	nm	nm	-89%
Tax	-1,377	-3,214	-1,307	-474	-1,781	-431	239	-192	nm	nm	89%
MI	-390	-733	-677	-138	-815	-277	-70	-346	75%	49%	57%
Profit after tax	3,660	8,842	3,221	584	3,805	780	-639	141	nm	nm	-96%
EPS (Rmb)	0.28	0.67	0.24	0.04	0.29	0.06	(0.05)	0.01	nm	nm	-96%
Ratio											
Gross profit	18.5%	19.8%	17.9%	9.9%	13.8%	12.2%	8.1%	10.2%	-4.1pps	-1.8pps	-3.7pps
Net operating profit	13.2%	14.7%	12.9%	4.0%	8.4%	6.5%	0.6%	3.5%	-5.9pps	-3.4pps	-4.8pps
Profit before tax	13.1%	14.7%	12.9%	2.9%	7.8%	4.2%	-2.3%	1.0%	-6.5pps	-5.1pps	-6.8pps
Profit after tax	8.8%	10.1%	8.0%	1.4%	4.6%	2.2%	-1.8%	0.2%	-4.0pps	-3.2pps	-4.4pps
Tax rate	25.4%	25.1%	25.1%	39.6%	27.8%	29.0%	29.6%	28.2%	0.6pps	-10.0pps	0.4pps
Net Debt/Equity	19.1%	32.9%	32.9%	43.5%	57.0%	57.0%	66.7%	74.4%	7.7pps	17.4pps	17.4pps
Total debt / assets	-20.3%	-25.1%	-25.1%	-27.3%	-32.3%	-32.3%	-36.3%	-38.8%	-2.5pps	-6.5pps	-6.5pps
ROA	4.2%	5.1%	3.6%	0.6%	1.9%	0.7%	-0.6%	0.1%	-1.3pps	-1.2pps	-1.8pps
ROE	8.6%	10.4%	7.5%	1.4%	4.4%	1.8%	-1.5%	0.2%	-3.3pps	-2.8pps	-4.2pps

Source: company data, J.P. Morgan

## Investment Thesis

China Coal Energy (CCE) is the second-largest coal miner in China behind China Shenhua with an annual coal production capacity of c120Mt. It reported disappointing FY13 results, in line with an earlier profit warning. With coal markets still heavily oversupplied, CCE's heavy capex plans and negative free cash generation remains a concern. Stay UW, with a PT of HK\$4.00.

## Valuation

Our Dec-15 price target for China Coal-H is HK\$4.00/share. This equates to 0.5x P/B and 55.9x P/E based on our FY15 estimates. The P/B of 0.5x is based on our forecast of sustainable ROE of c5%, derived from our near-term forecast ROE (c3% in 2014-15) and what we believe is achievable in the longer term (7-

8%).

## Risks to Rating and Price Target

### Upside risks

- Stronger-than-expected coal prices
- Lower-than-expected unit cost/capex
- Faster-than-expected additions in coal production

### Downside risks

- Weaker-than-expected coal prices
- Higher-than-expected cost pressure/capex
- Slower-than-expected additions in coal production

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
24-Jun-08	N	13.70	15.70
27-Oct-08	N	3.62	5.30
31-Oct-08	OW	4.20	11.25
25-Nov-10	UW	12.36	11.50
16-Dec-10	N	11.74	12.00
06-Jan-11	N	12.98	12.10
22-Mar-11	N	11.84	--
08-Oct-11	N	7.07	8.50
23-Oct-11	OW	8.75	9.50
20-Jan-12	OW	9.92	11.00
28-Mar-12	N	8.92	10.00
20-May-12	N	7.44	8.00
20-Aug-12	N	7.39	7.50
07-Feb-13	OW	8.39	9.50
17-Mar-13	OW	7.14	9.00
28-Apr-13	OW	5.91	8.00
26-Jun-13	OW	4.18	6.00
02-Aug-13	N	4.16	4.80
14-Oct-13	N	4.70	4.50
19-Mar-14	N	3.94	4.00
19-Aug-14	UW	4.78	4.00

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