

Nat Resources & Energy
Metals & Mining
 Equity – China

Hold

Target price (HKD)	1.71		
Share price (HKD)	1.49		
Upside/Downside (%)	14.8		
Performance	1M	3M	12M
Absolute (%)	-2.0	-11.3	-36.3
Relative ^A (%)	0.2	-14.0	-47.3
Index ^A	HSCEI		
RIC	0639.HK		
Bloomberg	639 HK		
Market cap (USDm)	1,019		
Market cap (HKDm)	7,900		
Enterprise value (HKDm)	2467		
Free float (%)	70		

Shougang Fushan (639 HK)

Hold: Relatively well-positioned in a tough market

- **Fushan aims to increase clean coal sales to hedge the negative impact from lower coal selling prices**
- **The company achieved production cost cut of 5% in 2014 and management guides another 5% cut in 2015**
- **We maintain our Hold rating, lift fair value TP to HKD1.71 (from HKD1.62) based on a blend of PE and DCF**

Targeting higher clean coal proportion: Fushan sold 3.0m tonnes of clean coal in 2014 despite total raw coal output drop of 7% y-o-y to 5.7m tonnes, the lowest since 2009. Management aims to increase clean coal sales further by 10%. We note that although clean coals can be sold at higher prices, they also bring higher selling costs as they require transportation, compared to raw coals being sold at mine mouth.

Lower costs, and lower: Unit production costs declined by 5% y-o-y to RMB248/t in 2014. Fushan targets to cut costs by another 5% in 2015. Such cost savings are expected to be achieved through technology upgrade, lower staff costs and self-maintenance.

Strong balance sheet: Fushan virtually had no debt at the end of 2014. The company's net cash per share is HKD1.02 now, representing 68% of the current share price. Despite the bottom-line loss, Fushan achieved RMB100/t net profit from its coal operations, the highest in Shanxi Liulin area. 2014 dividend payout represented c45% of recurring profits.

Still seeking acquisition target: As its current three mines will be depleted by 2030, Fushan needs to grow through acquisitions, which is why it hasn't distributed more dividends to its shareholders. With RMB5.5bn cash on hand, Fushan is well positioned for potential acquisitions. Management has currently located some targets in local Shanxi and other areas in China, as well as some in Australia. However, they believe they need to wait a few more years until those mines struggle and they obtain a good price. Ideally, they prefer mines in local Shanxi which are already in operation as more synergies can be achieved. Fushan is essentially a foreign enterprise and was not qualified to consolidate mines in China previously. Management sees higher likelihood of policy ease now.

Well-positioned in the poor market: China National Coal Association estimated that 70% of the coking coal mines are making losses at the current price. Management expects the percentage to rise to 90% this year. However, as coking coal supplies rely more on the domestic market (vs. iron ore on imports), management expects further mine closure to tighten supply support coking coal prices. Fushan possesses the best quality coal assets in China and enjoys the lowest production costs and thus shall benefit from the supply cuts.

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Financials & valuation

Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Profit & loss summary (HKDm)				
Revenue	4,268	3,255	3,164	3,369
EBITDA	2,011	973	1,122	1,226
Depreciation & amortisation	-566	-529	-502	-487
Operating profit/EBIT	1,445	444	620	740
Net interest	105	165	147	156
PBT	1,830	-139	867	996
HSBC PBT	1,830	-139	867	996
Taxation	-531	-222	-243	-249
Net profit	1,115	-425	531	635
HSBC net profit	1,115	-425	531	635

Cash flow summary (HKDm)

Cash flow from operations	2,065	-131	1,148	1,091
Capex	-283	-71	-350	-350
Cash flow from investment	-260	1,671	-591	-332
Dividends	-673	-196	-239	-286
Change in net debt	-1,432	-207	-243	-453
FCF equity	1,814	880	776	722

Balance sheet summary (HKDm)

Intangible fixed assets	12,729	11,421	11,188	10,954
Tangible fixed assets	3,610	3,412	3,495	3,592
Current assets	8,821	8,422	8,461	8,891
Cash & others	5,807	5,507	5,751	6,204
Total assets	26,871	24,000	23,922	24,215
Operating liabilities	2,480	2,301	2,197	2,112
Gross debt	580	74	75	75
Net debt	-5,227	-5,433	-5,676	-6,129
Shareholders funds	19,927	17,927	18,214	18,575
Invested capital	16,873	15,447	15,195	15,120

Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Y-o-y % change				
Revenue	-24.5	-23.7	-2.8	6.5
EBITDA	-36.8	-51.6	15.3	9.3
Operating profit	-45.5	-69.3	39.8	19.2
PBT	-38.4	-107.6		14.9
HSBC EPS	-37.8	-138.1		19.7

Ratios (%)

Revenue/IC (x)	0.2	0.2	0.2	0.2
ROIC	6.0	7.1	2.9	3.7
ROE	5.7	-2.2	2.9	3.5
ROA	4.9	-1.3	2.6	3.1
EBITDA margin	47.1	29.9	35.5	36.4
Operating profit margin	33.9	13.6	19.6	22.0
EBITDA/net interest (x)				
Net debt/equity	-24.1	-27.8	-28.9	-30.6
Net debt/EBITDA (x)	-2.6	-5.6	-5.1	-5.0
CF from operations/net debt				

Per share data (HKD)

EPS reported (fully diluted)	0.21	-0.08	0.10	0.12
HSBC EPS (fully diluted)	0.21	-0.08	0.10	0.12
DPS	0.11	0.04	0.05	0.05
Book value	3.76	3.38	3.44	3.50

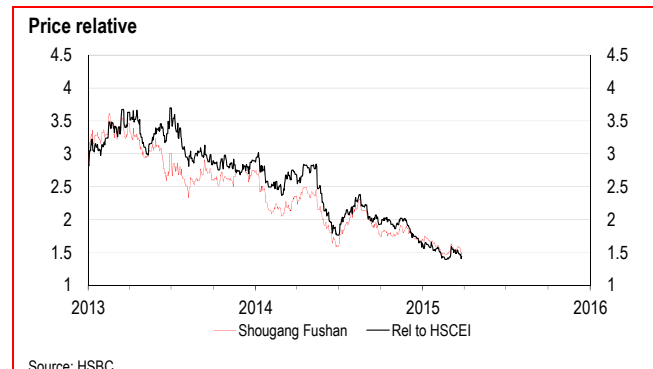
Key forecast drivers

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Raw coal sales volume (kt)	1,960	1,010	900	900
Clean coal sales volume (kt)	2,530	3,000	3,162	3,224
Raw coal ASP (RMB/t)	540	422	401	426
Clean coal ASP (RMB/t)	920	721	680	721
Raw coal unit cost (RMB/t)	260	248	237	242
Clean coal unit cost (RMB/t)	459	433	431	441

Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	0.6	0.8	0.7	0.5
EV/EBITDA	1.3	2.5	2.0	1.4
EV/IC	0.2	0.2	0.1	0.1
PE*	7.1		14.9	12.4
P/Book value	0.4	0.4	0.4	0.4
FCF yield (%)	23.0	11.1	9.8	9.1
Dividend yield (%)	7.0	2.5	3.0	3.6

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 27 Mar 2015

Changing earnings estimates

We raise our earnings estimates slightly by 7% and 1% respectively in 2015e and 2016e to mainly account for lower production costs and higher clean coal sales proportion, offset by lower coal selling prices and higher selling expenses. We expect lower raw coal output now, 6.0 and 6.1m tonnes in 2015 and 2016 versus 6.2m tonnes each previously. Our current estimates are 5% and 10% above consensus estimates in 2015 and 2016.

Revised earnings forecasts

HKD m	Old		New		Change		
	2015E	2016E	2015E	2016E	2014E	2015E	2016E
Revenue	3,192	3,384	3,164	3,369	-1%	-1%	0%
Net income	498	627	531	635	1199%	7%	1%
EPS, HKD	0.09	0.12	0.10	0.12	1199%	7%	1%

Source: HSBC estimates

Revised assumptions

	Old		New		Change	
	2015E	2016E	2015E	2016E	2015E	2016E
Sales volume, tonnes k						
Raw coal	1,200	1,200	900	900	-25%	-25%
Clean coal	3,000	3,000	3,162	3,224	5%	7%
ASP, RMB/t	603	648	618	657	2%	1%
Raw coal	392	421	401	426	2%	1%
Clean coal	688	738	680	721	-1%	-2%
Unit production costs, RMB/t	261	266	237	242	-9%	-9%

Source: HSBC estimates

Valuation and risks

We lift our TP to HKD1.71 from HKD1.62 based on a 50:50 blend between a PE-based value of HKD1.30 (from HKD1.22) based on 13.0x 2015e PE, and a life-of-mine DCF valuation of HKD2.12 (from HKD2.02), as a result of slightly higher earnings estimates and a stronger than previously expected balance sheet. Our PE multiple is based on Fushan's average PE over the past 2 years. Our DCF valuation is based on: (1) a cost of capital of 10.7%; (2) adjusted beta of 1.18 measured against the HSCEI index; and (3) the company remaining in a net cash position in the long run. We maintain our Hold rating.

Upside risks: stronger-than-expected Chinese coking coal prices, lower-than-expected production costs and successful future acquisitions; **Downside risks:** weaker-than-expected coking coal prices and higher-than-expected production costs.

Disclosure appendix

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Rating distribution for long-term investment opportunities

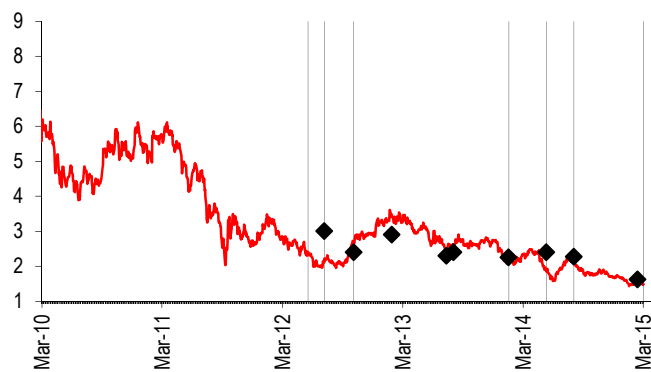
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Hold	39%	(28% of these provided with Investment Banking Services)
Sell	20%	(20% of these provided with Investment Banking Services)

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Share price and rating changes for long-term investment opportunities

Shougang Fushan (0639.HK) Share Price performance HKD Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Overweight (V)	N/A	11 June 2012
N/A	Overweight (V)	31 July 2012
Overweight (V)	Underweight (V)	28 October 2012
Underweight (V)	Neutral (V)	11 February 2014
Neutral (V)	Overweight (V)	05 June 2014
Overweight (V)	Neutral	28 August 2014
Neutral	Hold	26 March 2015
Target Price	Value	Date
Price 1	N/A	11 June 2012
Price 2	3.00	31 July 2012
Price 3	2.40	28 October 2012
Price 4	2.90	21 February 2013
Price 5	2.30	06 August 2013
Price 6	2.40	28 August 2013
Price 7	2.25	11 February 2014
Price 8	2.40	05 June 2014
Price 9	2.27	28 August 2014
Price 10	1.62	09 March 2015

Source: HSBC

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Company	Ticker	Recent price	Price Date	Disclosure
SHOUGANG FUSHAN	0639.HK	1.49	27-Mar-2015	6, 7

Source: HSBC

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