

Yanzhou Coal Mining - H (1171 HK)

Neutral

Price: HK\$6.11

27 Mar 2015

Price Target: HK\$7.50

PT End Date: 31 Dec 2015

FY14 results first take - Miss, 2015 downgrades likely

Yanzhou Coal reported broadly flat FY14 earnings under IFRS accounting standards, a sharp miss against Street estimates and YZC's own guidance of +80% y/y, under Chinese accounting standards. On a core basis, we estimate earnings fell by 97% y/y. Lower prices more than offset higher (self-produced coal) sales volume (+2% y/y) and lower unit cost (-9% y/y). For 2015, YZC guided for higher (self-produced coal) sales volume (+5% y/y) but forecasts higher capex (+79% y/y). Near-term, we believe FY15 downgrades (JPM c50% lower than Street), weak coal markets and negative FCF generation will weigh on YZC's share price. Stay N rated.

Results highlights

- 2014 results – -1% y/y IFRS versus guidance +80% y/y CAS.** Yanzhou Coal (YZC) released poor 2014 results. Headline net income of RMB766m, under IFRS, was broadly flat (-1% y/y) from 2013 levels. The result was well below market expectations (JPME RMB881m, Street: RMB1.8Bn). We also note that the result was sharply below the company's own profit guidance of +80% y/y (ie. NP Rmb2.3B) dated 24 March. Furthermore, excluding one-off gains from: a) writeback of impairment loss on intangible assets (RMB731m), b) forex gains (RMB154m), and c) inventory writedown (RMB8.6m), we estimate core net profit plunged by 97% y/y to RMB109m.
- Balance sheet deteriorates.** Key drivers of the earnings miss, in our view, included: a) weaker-than-expected (self-produced) coal sales, and b) higher-than-expected income tax (effective tax rate: 70%). For 2014, coal ASP was lower at RMB476/t (-9% y/y) and unit (self-produced) coal cost was RMB278/t (-9% y/y), alongside higher sales volume of self produced coal of 66Mt (+2% y/y) and coal trading of 57Mt (+45% y/y). We estimate unit GP for self produced coal was RMB130/t (2013: RMB182/t) and for coal trading was RMB4/t (2013: RMB3/t). While operating cash flow returned to positive at RMB4.2Bn, FCF remains in negative territory (RMB1.2Bn), which pushed total net debt higher to RMB43.5Bn (2013: RMB40.4Bn), including perpetual bonds of RMB1.9Bn. We estimate net gearing (ND/E) rose to 115% (2013: 92%) adjusted for perpetual bond. The company declared DPS of 2 cents RMB, implying a payout ratio of 13% same as 2013.
- Cautious guidance for 2015.** With China entering into a 'new normal', management expects a structural change in energy consumption mix towards clean and efficient fuels with oversupply to continue to dominate the coal markets. However, coal price fluctuations are expected to ease due to policy support arriving from output controls. Operationally, YZC targets higher sales of self-produced coals (+5% y/y) but lower coal trading (-7%), which will leave overall sales at 122Mt (-1% y/y). Capex is budgeted to sharply rise to RMB9.4Bn (+79% y/y), which we believe will keep gearing levels elevated. In addition, given YZC's poor guidance history (see table below), we see downside risks to its operating targets, especially the high-margin self-produced coal.

Stock Impact

In our view, YZC's sharp earnings miss should see a negative market response and consensus downgrades. At present, our FY15 NP estimates (Rmb559m) are c50% lower than consensus forecasts (Rmb1,103m).

Investor briefing

Date: 30 March 2015 (Monday)

Time: 9:30 a.m.

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

Table 1: History of YZC's sales & capex targets vs actual performance

	Location	2013 target (Mt)	2013 actual (Mt)	Diff	2014 target (Mt)	2014 actual (Mt)	Diff	2015 target (Mt)	2015 vs 2014A
Headquarters	Shandong	34.8	33.3	-4%	35.9	34.8	-3%	35.4	2%
Shanxi Nenghua	Shanxi	1.2	1.5	23%	1.2	1.5	25%	1.5	0%
Heze Nenghua	Shandong	2.6	2.4	-9%	3.0	3.1	4%	4.0	29%
Ordos Nenghua	Inner Mongolia	6.0	6.3	6%	7.7	5.8	-25%	7.8	35%
Yancoal Australia	Australia	15.0	15.6	4%	15.3	15.7	3%	13.9	-12%
Yancoal International	Australia	5.3	5.5	4%	6.2	5.2	-17%	6.5	26%
Self-produced coal - total	-	64.9	64.6	0%	69.3	66.1	-5%	69.1	5%
3rd party coal trading	-	25.0	39.4	58%	36.0	57.0	58%	52.9	-7%
Total coal sales	-	89.9	104.0	16%	105.3	123.1	17%	122.0	-1%
Capex		12,005	9,144	-24%	9,414	5,404	-43%	9,687	79%

Source: Company data, J.P. Morgan

Table 2: YZC's financial summary (IFRS)

(Rmb Mills)	1H13	2H13	restated			2014	HoH%	YoY%	YoY%
			2013	1H14	2H14		2H14	2H14	2014
Gross sales of coal	24,261	30,183	54,445	30,005	28,534	58,539	-5%	-5%	8%
Railway transportation service income	211	247	458	215	158	374	-27%	-36%	-18%
Gross sales of electricity power	175	157	332	70	172	241	147%	9%	-27%
Gross sales of methanol	588	568	1,156	631	565	1,195	-11%	-1%	3%
Gross sales of heat supply	5	6	11	13	8	21	-33%	45%	86%
Total sales	25,241	31,161	56,402	30,933	29,437	60,371	-5%	-6%	7%
Transportation costs of coal	-1,045	-980	-2,024	-1,171	-1,120	-2,292	4%	-14%	-13%
Cost of sales and service provided	-18,696	-23,816	-42,512	-24,933	-24,624	-49,558	1%	-3%	-17%
Cost of electricity power	-145	-175	-321	-55	-105	-160	-93%	40%	50%
Cost of methanol	-449	-402	-851	-431	-438	-869	-2%	-9%	-2%
Cost of heat supply	-3	-4	-7	-6	-5	-11	13%	-39%	-67%
Cost of sales	-20,338	-25,376	-45,714	-26,596	-26,293	-52,889	1%	-4%	-16%
Gross Profit	4,903	5,785	10,688	4,337	3,144	7,481	-27%	-46%	-30%
Add: Other operating income	44	345	389	314	1,232	1,546	292%	257%	297%
Less :SG & A	-8,688	-1,692	-10,381	-3,569	-2,501	-6,070	30%	-48%	42%
Operating income	-3,741.43	4,438	696	1,139	1,819	2,948	60%	-59%	323%
Interest income	345	144	489	319	517	836	62%	259%	71%
Interest expenses	-940	-825	-1,766	-1,120	-1,063	-2,184	5%	-29%	-24%
Profit before tax and MI	-4,336	3,756	-580	337	1,273	1,600	277%	-66%	nm
Tax	1,253	-858	395	34	-1,147	-1,113	nm	-34%	nm
MI	1,010	-48	963	216	63	279	-71%	nm	-71%
Net income	-2,073	2,850	777	587	189	766	-68%	-93%	-1%
Exceptional items gain/(loss) (After tax)	-2,911	279	-2,632	-71	549	658	nm	97%	nm
Core Net Profit	838	2,571	3,409	658	-360	109	nm	nm	-97%
EPS (Rmb)	-0.42	0.58	0.16	0.12	0.04	0.16	-68%	-93%	-1%
DPS (Rmb)			0.020			0.020			-94%
Payout ratio			12.7%			12.8%			-16pps
Margins (%)									
Gross Profit	19%	19%	19%	14%	11%	12%	3.3pps	-7.9pps	-6.6pps
Operating income	-15%	14%	1%	4%	6%	5%	-2.5pps	-8.1pps	3.6pps
Net income	-8%	9%	1%	2%	1%	1%	1.3pps	-8.5pps	-0.1pps
Tax rate	29%	23%	68%	-10%	90%	70%	-100pps	67.2pps	1.5pps
Cash flow analysis									
Operating cash flow	-167	-2,034	-2,201	410	3,762	4,172	818%	nm	nm
Investing cash flow	-4,492	-9,012	-13,504	-5,598	-2,937	-8,535	48%	67%	37%
Capex	-4,663	-5,558	-10,221	-1,647	-3,757	-5,404	-128%	32%	47%
FCF	-4,830	-7,593	-12,422	-1,237	5	-1,232	nm	nm	90%
Balance sheet analysis									
Net (Debt)/Cash	35,475.3	40,450.2	40,450.2	42,862.8	41,640.7	41,640.7	-3%	3%	3%
Net (Debt)/Equity	80.2%	92.0%	92.0%	89.0%	90.5%	90.5%	-1.5pps	-1.4pps	-1.4pps
ROA	1.4%	4.1%	5.5%	1.0%	-0.6%	0.2%	1.6pps	-4.7pps	-5.3pps
ROE	4.0%	11.9%	15.8%	3.2%	-1.8%	0.5%	5.0pps	-14pps	-15pps

Source: Company data, J.P. Morgan

Investment Thesis

Yanzhou Coal (YZC) is among the top-10 coal miners in China, with annual production output of 67Mt, of which 21Mt came from its Australian operations and the remainder from China in 2013. While Yanzhou (YZC) has demonstrated solid cost performance, particularly in its domestic mines, we expect persistently weak seaborne markets to weigh on its Australian operations (30% of output). Our price deck sees sharp earnings downgrades and we now expect 2015 earnings to fall. Stay N rated.

Valuation

Our Dec-15 price target for Yanzhou-H of HK\$7.50 is based on a blended average of: 1) P/BV-ROE valuation, 2) HK\$6.4 using a P/E multiple of 9.5x, and 3) our DCF-based NPV estimate. This equates to 0.8x P/BV on 2015E.

Risks to Rating and Price Target

Upside risks include: 1) stronger-than-expected coal prices, 2) lower-than-expected unit cost/capex, and 3) faster-than-expected additions in coal production.

Downside risks include: 1) weaker-than-expected coal prices, 2) higher-than-expected cost pressure/capex, and 3) slower-than-expected additions in coal production.

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26-Oct-06	N	5.46	6.40
03-Jan-07	N	6.62	7.30
23-Apr-07	OW	7.94	10.00
08-Jun-07	OW	10.12	12.90
26-Jul-07	OW	14.06	17.30
20-Aug-07	OW	10.54	16.00
25-Sep-07	OW	16.82	19.70
29-Oct-07	OW	17.38	23.00
31-Jan-08	OW	13.82	24.20
21-Apr-08	OW	12.20	17.00
29-Apr-08	OW	14.42	22.00
12-Jun-08	OW	15.42	20.30
20-Jun-08	N	13.80	14.60
15-Jul-08	N	15.06	16.40
21-Aug-08	N	11.68	15.80
25-Aug-08	N	12.34	18.20
27-Oct-08	N	3.02	5.90
25-Nov-10	OW	21.35	26.70
16-Dec-10	OW	21.80	29.00
09-Jan-11	OW	24.65	29.20
08-Oct-11	OW	15.24	20.00
20-May-12	N	13.34	14.00
20-Aug-12	N	12.04	13.00
27-Aug-12	N	11.68	12.00
28-Oct-12	UW	12.06	9.00
25-Mar-13	UW	10.78	9.50
25-Apr-13	UW	8.72	8.00
26-Jun-13	UW	5.93	5.50
30-Jul-13	UW	5.80	5.00
02-Aug-13	UW	5.34	4.50
14-Oct-13	N	7.46	7.50
27-Oct-13	N	7.75	8.00
23-Mar-14	OW	5.62	8.00
08-Jan-15	N	7.07	7.50

<http://gps-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=500292&shareClassServerId=4&chartDesignation=1&actionType=C>

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