

# "Honey & Ash"

## Hong Kong Email Alert

8 Sep 2010

### Yanzhou Coal (600188; 01171.HK; OVERWEIGHT) – Further resource expansion pending, but still far from reaping profits

#### Event:

On 7 Sep 10, Yanzhou Coal announced the proposed acquisition of shares in Inner Mongolia Haosheng Coal Mining Co. Ltd. (Haosheng). Details of the transaction are as follows. Yanzhou Coal intends to acquire the 15.51% equity in Haosheng currently held by Shanghai Huayi (Huayi), which has been put up for sale at the Shanghai United Assets and Equity Exchange. Yanzhou Coal expressed its intention to acquire: (i) the 23.08% interest in Haosheng held by Ordos Jinchengtai Chemical, for a consideration of Rmb3.01bn and (ii) the 12.41% interest in Haosheng held by Shandong Jiutai Chemical Technology, for a consideration of Rmb1.62bn. Together, the three transactions will give Yanzhou Coal a 51% stake in Haosheng. It has been agreed that the successful completion of the overall acquisition will be based on the premise that Haosheng shall be able to, in its own name, legally obtain the exploration rights of the Shilawusu Minefield and, in the capacity (or apply for the status) of a project entity, submit applications for all necessary approvals, permits or authorizations for the exploration the said minefield, including but not limited to the exploration right certificate, project approval papers and mining permit.

#### Comment:

- ❖ Located near Ordos, the Shilawusu Minefield is a comprehensive mining resource with favorable geological conditions and resources pending development. The acquisition will optimize the structure of Yanzhou Coal's resource reserves, as well as enhance its future competitiveness and sustainable development. As pointed out in Yanzhou Coal's announcement, Haosheng was established for the purpose of obtaining the exploration right of the Shilawusu Minefield. Due to considerable uncertainties in the long administrative process of obtaining the exploration and mining rights to capacity approval, and given the time required in coalmine construction, Haosheng is not expected to contribute earnings over the next few years. We expect it will be a long time before the Minefield can produce.
- ❖ Payment of acquisition money in three installments. (i) The first installment or down payment: Within 3 working days after the Equity Transfer Agreement enters into effect, Yanzhou Coal shall pay 30% (~Rmb2bn) of the total consideration. The deposit already transferred shall be counted as part of the down payment. (ii) Second installment: Within 15 working days of Haosheng obtaining the exploration right certificate for the Shilawusu Minefield, Yanzhou Coal shall pay 40% (Rmb2.66bn) of the total transfer price. (iii) Third installment: The remaining balance shall be payable within one year after Haosheng obtains the said exploration right certificate. As disclosed in its 1H10 report, as of 30 Jun 2010 Yanzhou Coal had an abundant cash balance of Rmb12.07bn. We expect the acquisition will be partially self-financed, with the remainder to be raised through loans or other forms of debt financing.
- ❖ We are bullish about the long-term benefits of the acquisition but it is too early to make any relevant earnings forecasts. Shilawusu Minefield is located in the Dongsheng coal field in Ordos. Taking reference from Shenhua's coal resources in the same area, we expect the coal produced by Haosheng to be a high-quality thermal variety with heat value of over 5,500 calories and an estimated net profit of Rmb70-90/tonne after 2011E. However, it is difficult to either project future output on the basis of information in the announcement or forecast overall profits from the mine.
- ❖ Potential risks of investing in Yanzhou Coal. (i) Uncertainty of acquisition results; (ii) uncertainty regarding follow-up construction of the coal mine since Haosheng has not yet obtained the prospecting rights thereof; and (iii) uncertainty about the short-term profitability of Yanzhou Coal due to its sensitivity to the RMB/AUD exchange rate.

- ❖ Earnings forecast based on existing assets of Yanzhou Coal: reiterate our earnings forecast and OVERWEIGHT rating. We reiterate our forecast based on the counter's existing assets, projecting 2010/11/12E EPS of Rmb1.23/1.65/2.05, respectively. The share is currently trading at Rmb18.67, implying 2010/11/12E PER of 15x / 11x / 9x (A-share), respectively. Considering potential upside such as relatively fast output growth and appreciation of AUD going forward, we set a target price of Rmb24.75 (H-share: HK\$22.7), which represents projected 2011E PER of 15x (A-share). Our OVERWEIGHT rating remains intact.

#### Peers' comparisons - China Coal Industry

Company	Price (HK\$)	PER (x)			PEG (x) 09-11E	P/B (x) 10E	Yield (%) 10E	RoE (%) 10E
		09	10E	11E				
<b>Hong Kong - average</b>		<b>21</b>	<b>14</b>	<b>11</b>	<b>0.6</b>	<b>2.1</b>	<b>2.2</b>	<b>17</b>
China Shenhua (01088.HK)	30.20	17	15	12	0.9	2.6	2.3	20
China Coal (01898.HK)	11.80	17	14	12	0.8	1.9	1.9	15
Yanzhou Coal (01171.HK)	17.14	18	12	9	0.4	2.1	2.8	22
Hidili Industry (01393.HK)	6.79	30	15	10	0.4	1.9	1.6	13

Source: Respective companies, Bloomberg, CSI

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## Investment rating system

Performance of stock or sector relative to MSCI-China Index over next 6 months after research publications

	Rating	Remark
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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