



Rating
Buy

Asia
China

Utilities
Utilities

Company
SDIC Power

Reuters 600886.SS Bloomberg 600886 CH Exchange SHH Ticker 600886

Date
4 September 2017

Forecast Change

Price at 1 Sep 2017 (CNY)	7.42
Price target - 12mth (CNY)	8.50
52-week range (CNY)	8.32 - 6.48
Shanghai Composite	3,367

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An overlooked A-share hydro name

Better earnings stability than a thermal peer, more upside than hydro peers

SDIC enjoys higher earnings visibility, as well as stability, than thermal power peers, due to its 57% capacity exposure to hydropower. Over 2016-1H17, almost all the earnings came from the hydro segments. Meanwhile, SDIC's thermal business can also benefit from accelerating supply-side reform and year-end tariff hikes. We expect SDIC to turn FCF positive starting in 2018, thanks to earnings recovery and better capex discipline, indicating potential upside to our assumed 35% payout ratio and dividend yield of 3%. Relative to Yangtze Power, SDIC is an overlooked A-share hydro name, with an attractive valuation and similarly strong hydro capacity pipeline. Reiterating Buy.

Positive tariff outlook, better capex discipline, improving free cash flow

SDIC's 1H17 results were slightly below expectation, with a 13/37% yoy decline in reported/recurring net profit, but still much better than thermal peers, which are near breakeven. Thermal tariff recovered by 7.5% yoy, due to a lower DPS discount. Hydro tariff dropped 6% yoy in 1H17 but the declining trend slowed in the second quarter. Management expects the discount to narrow going forward, with less competition from peers. Furthermore, its inter-provincial hydro power sales tariff should benefit from the thermal tariff hike in July and potentially another round at year-end. In response to supply-side reform, SDIC is delaying three coal-fired generation units (total 3GW) and plans no other thermal capacity additions over 2017-19E. We expect its free cash flow to reach c.Rmb8.0bn in 2018/19E, supporting a stable dividend outlook.

Earnings revisions

We revise down our 2017/18/19E net profit forecasts by 14%/4%/1% to reflect higher fuel cost, delay in thermal projects, higher thermal tariff due to a lower DPS discount and July tariff hike, and lower hydro tariff due to higher discount.

Valuation and risks

Our TP is based on DCF with WACC of 7.0% and zero TGR. SDIC is trading at 12x 2018E P/E and 1.5x P/B, well below Yangtze's 17x P/E and 2.3x P/B. Risks: lower-than-expected thermal tariff hike, weaker water flow, higher coal prices.

Key changes

TP	8.70 to 8.50	↓	-2.3%
Sales (FYE)	33,577 to 31,010	↓	-7.6%
Op prof margin (FYE)	36.0 to 35.2	↓	-2.2%
Net profit (FYE)	3,843.1 to 3,306.6	↓	-14.0%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-9.8	-6.2	9.1
Shanghai Composite	2.3	8.6	9.9

Source: Deutsche Bank

Forecasts And Ratios

Year End Dec 31	2015A	2016A	2017E	2018E	2019E
Reported NPAT (CNYm)	5,428	3,916	3,307	4,203	4,341
DB EPS FD (CNY)	0.826	0.637	0.487	0.619	0.640
OLD DB EPS FD (CNY)	0.826	0.637	0.566	0.647	0.645
% Change	0.0%	0.0%	-14.0%	-4.2%	-0.8%
PER (x)	13.8	10.5	15.2	12.0	11.6
Price/BV (x)	2.1	1.6	1.6	1.5	1.4
Yield (net) (%)	2.4	3.0	2.3	2.9	3.0
ROE (%)	21.8	14.2	11.2	13.1	12.4

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close



Model updated: 01 September 2017

Running the numbers

Asia

China

Utilities

SDIC Power

Reuters: 600886.SS

Bloomberg: 600886 CH

Buy

Price (1 Sep 17) CNY 7.42

Target Price CNY 8.50

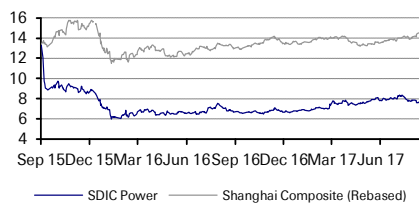
52 Week range CNY 6.48 - 8.32

Market Cap (m) CNYm 50,352
USDm 7,656

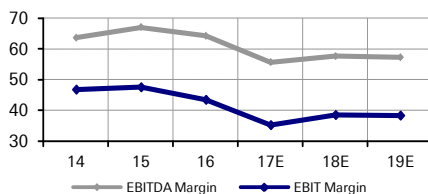
Company Profile

SDIC Power Holdings Co., Ltd. is primarily engaged in thermal and hydro power generation in China. The company has total consolidated capacity of 27GW as of end-2015. State Development & Investment Corp (SDIC), a central SOE under SASAC, is its parentco with a 51.34% stake.

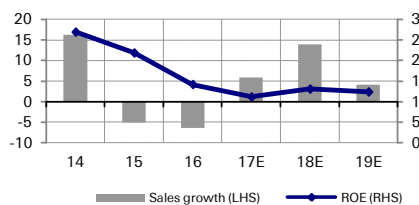
Price Performance



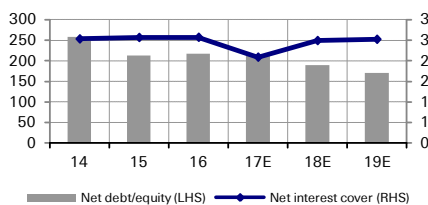
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2014	2015	2016	2017E	2018E	2019E
DB EPS (CNY)	0.80	0.83	0.64	0.49	0.62	0.64
Reported EPS (CNY)	0.82	0.80	0.58	0.49	0.62	0.64
DPS (CNY)	0.29	0.28	0.20	0.17	0.22	0.22
BVPS (CNY)	3.4	3.9	4.2	4.5	5.0	5.4
Weighted average shares (m)	6,786	6,786	6,786	6,786	6,786	6,786
Average market cap (CNYm)	38,120	77,552	45,539	50,352	50,352	50,352
Enterprise value (CNYm)	165,239	209,432	188,020	203,670	205,199	207,375

Valuation Metrics

	2014	2015	2016	2017E	2018E	2019E
P/E (DB) (x)	7.0	13.8	10.5	15.2	12.0	11.6
P/E (Reported) (x)	6.8	14.3	11.6	15.2	12.0	11.6
P/BV (x)	3.36	2.13	1.58	1.64	1.50	1.38
FCF Yield (%)	2.0	0.9	nm	nm	6.2	6.0
Dividend Yield (%)	5.1	2.4	3.0	2.3	2.9	3.0
EV/Sales (x)	5.0	6.7	6.4	6.6	5.8	5.6
EV/EBITDA (x)	7.9	10.0	10.0	11.8	10.1	9.9
EV/EBIT (x)	10.7	14.1	14.8	18.7	15.1	14.7

Income Statement (CNYm)

	2014	2015	2016	2017E	2018E	2019E
Sales revenue	32,957	31,280	29,271	31,010	35,306	36,753
Gross profit	21,828	21,966	19,795	18,203	21,336	22,039
EBITDA	20,967	20,990	18,804	17,267	20,342	21,041
Depreciation	5,213	5,768	5,746	6,013	6,408	6,620
Amortisation	334	346	337	337	337	337
EBIT	15,420	14,875	12,722	10,918	13,597	14,084
Net interest income/(expense)	-6,085	-5,790	-4,943	-5,223	-5,452	-5,579
Associates/affiliates	505	551	631	751	865	874
Exceptionals/extraordinary	0	0	0	0	0	0
Other pre-tax income/(expense)	1,105	1,344	508	639	0	0
Profit before tax	10,944	10,981	8,917	7,084	9,010	9,380
Income tax expense	783	878	1,057	692	889	1,014
Minorities	4,565	4,675	3,943	3,086	3,918	4,026
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	5,597	5,428	3,916	3,307	4,203	4,341
DB adjustments (including dilution)	-168	176	409	0	0	0
DB Net profit	5,428	5,604	4,325	3,307	4,203	4,341

Cash Flow (CNYm)

	2014	2015	2016	2017E	2018E	2019E
Cash flow from operations	15,241	16,995	14,066	8,492	14,356	15,007
Net Capex	-14,478	-16,332	-17,309	-16,046	-11,222	-11,982
Free cash flow	763	663	-3,243	-7,554	3,134	3,024
Equity raised/(bought back)	0	0	0	0	0	0
Dividends paid	-992	-1,959	-1,900	-1,371	-1,157	-1,471
Net inc/(dec) in borrowings	4,489	-94	73,271	9,232	-1,144	-1,412
Other investing/financing cash flows	-857	136	-70,098	0	0	0
Net cash flow	3,403	-1,254	-1,969	308	832	141
Change in working capital	150	723	2,072	-3,501	-98	-21

Balance Sheet (CNYm)

	2014	2015	2016	2017E	2018E	2019E
Cash and other liquid assets	7,371	6,327	4,341	4,648	5,029	4,591
Tangible fixed assets	149,643	162,881	176,775	186,806	191,619	196,981
Goodwill/intangible assets	5,236	5,012	5,138	4,802	4,465	4,129
Associates/investments	2,503	2,639	8,847	9,598	10,462	11,337
Other assets	7,864	6,686	8,190	8,889	9,529	9,832
Total assets	172,617	183,545	203,291	214,743	221,104	226,870
Interest bearing debt	117,398	116,034	127,630	136,440	135,296	133,884
Other liabilities	12,503	16,121	18,943	16,563	17,105	17,388
Total liabilities	129,901	132,155	146,573	153,003	152,401	151,271
Shareholders' equity	23,121	26,578	28,680	30,616	33,662	36,531
Minorities	19,595	24,811	28,037	31,124	35,042	39,067
Total shareholders' equity	42,716	51,390	56,718	61,740	68,703	75,599
Net debt	110,027	109,707	123,290	131,792	130,268	129,293

Key Company Metrics

	2014	2015	2016	2017E	2018E	2019E
Sales growth (%)	16.3	-5.1	-6.4	5.9	13.9	4.1
DB EPS growth (%)	53.2	3.2	-22.8	-23.5	27.1	3.3
EBITDA Margin (%)	63.6	67.1	64.2	55.7	57.6	57.2
EBIT Margin (%)	46.8	47.6	43.5	35.2	38.5	38.3
Payout ratio (%)	35.0	35.0	35.0	35.0	35.0	35.0
ROE (%)	26.9	21.8	14.2	11.2	13.1	12.4
Capex/sales (%)	43.9	52.2	59.1	51.7	31.8	32.6
Capex/depreciation (x)	2.6	2.7	2.8	2.5	1.7	1.7
Net debt/equity (%)	257.6	213.5	217.4	213.5	189.6	171.0
Net interest cover (x)	2.5	2.6	2.6	2.1	2.5	2.5

Source: Company data, Deutsche Bank estimates

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An undervalued hydro name

As of the end of 1H17, SDIC has a total of 29.6GW, 57% of which is hydro plants. Its hydro assets are mainly concentrated in Yalongjiang, Sichuan (14.7GW), Yunnan (1.4GW) and Gansu (660MW). Over 2016-1H17, the hydro business contributed almost all the reported earnings and provides SDIC with higher earnings visibility and stability than thermal power peers

Hydro tariff discount to narrow, with upside following thermal tariff hikes

In 1H17, the hydro tariff dropped 6% yoy due to a higher discount for market-based volume. But on a quarterly basis, the tariff decline slowed down in the second quarter (-8% yoy in 1H, -4% yoy in 2H). Management expects the discount to narrow going forward, with less competition from peers.

We believe the intra-provincial power sales (especially for Jinping and Guandi) could also enjoy some tariff upside, following the thermal tariff hike in July 2017. Moreover, the year-end thermal tariff hikes will provide further hydro tariff upside.

Thermal tariff discounts narrow, supply-side reform drives structural recovery

In 1H17, SDIC's average thermal tariff recovered by 7.5% yoy due to a lower DPS discount. According to the management, this is due to more rationalized bidding with more coordination between peers, and higher coal prices. Management estimates an Rmb0.7cents/kwh average thermal tariff hike in July 2017 and expects the year-end fuel cost pass-through to be executed; we hold the same view.

In recent few months, we have witnessed an acceleration in supply-side reform in the thermal power sector, with more capex/capacity expansion discipline at a nationwide level and a more stringent control over captive power plants by local governments. These measures, together with the requirements to release advanced coal production capacity, will create a more positive outlook for the thermal sector over 2018-19.

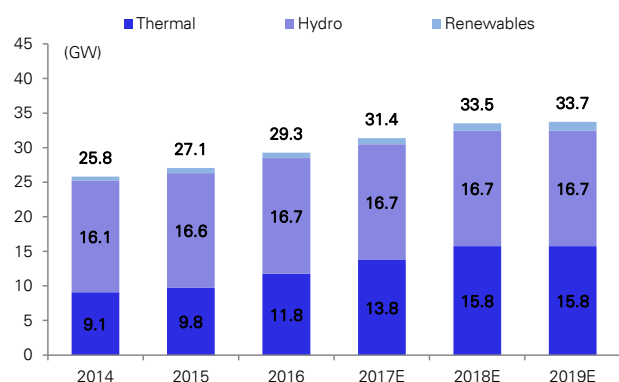
Better capex discipline to support improving free cash flow

According to management, in response to the supply side reform, SDIC has delayed several thermal projects: Meizhouwan II unit 3 (1GW) is delayed to end-2017; and the Beijiang project (2GW) is delayed to 2018. Besides the 3GW, no other coal-fired capacity will be added during 2H17-2019.

With more capex discipline, we expect SDIC to be able to have Rmb8.0bn positive free cash flow in 2018/19, which will support its 35% dividend payout ratio as well as a 3% dividend yield.

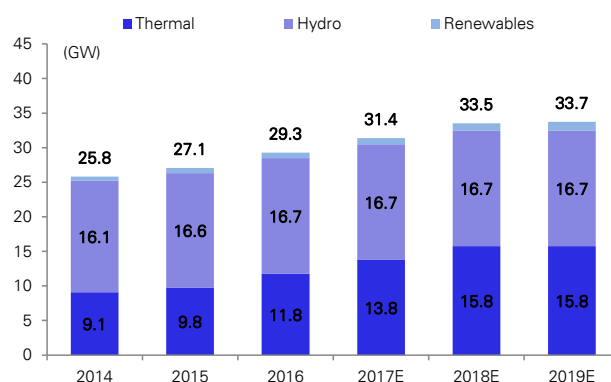


Figure 1: SDIC capacity by power type



Source: Company data, Deutsche Bank estimates

Figure 2: SDIC power generation by power type



Source: Company data, Deutsche Bank estimates

Figure 3: SDIC key project pipelines

Project	Province	Stake	Capacity (MW)	Operational date
Thermal				
Meizhouwan #3	Fujian	51%	1000	end 2017
Beijiang #1	Tianjin	64%	1000	2018
Beijiang #2	Tianjin	64%	1000	2018
Hydro				
Lianghekou	Sichuan	52%	3000	2021-23
Yangfanggou	Sichuan	52%	1500	2021-23

Source: Company data, Deutsche Bank estimates

1H17 results review

1H17 recurring net profit dropped 37% yoy to Rmb1,290mn, mainly dragged by a 60% yoy increase in unit fuel cost, partially offset by a 6% higher net power output and 8% drop in financial cost. At the pre-tax profit level, Rmb3.3bn is from hydro and a loss of Rmb0.2bn is made in the thermal segment.

1H17 hydro output increased slightly by 2%. However, the hydro tariff dropped 6% yoy due to a higher discount for market-based volume.

Thermal output improved by 13% yoy, mainly due to the commencement of Qingzhou units (2GW) in 2H16 and improving utilizations. Thermal tariff recovered by 7.5% yoy due to a lower DPS discount.



Figure 4: SDIC quarterly results

	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	yoy% 2Q17	2016	2H16	1H17	yoy% 1H17
Revenue	6,900	6,239	9,001	7,131	7,631	6,332	2%	13,139	16,132	13,963	6%
Total operating cost	(4,786)	(4,880)	(5,595)	(6,331)	(5,755)	(5,618)	15%	(9,665)	(11,926)	(11,372)	18%
Operational cost	(3,172)	(3,313)	(3,958)	(4,657)	(4,208)	(4,122)	24%	(6,485)	(8,615)	(8,331)	28%
Business tax and surcharges	(108)	(79)	(123)	(148)	(140)	(129)	62%	(187)	(270)	(268)	43%
Selling expenses	(1)	(2)	(1)	(2)	(1)	(2)	-9%	(3)	(3)	(3)	14%
Administrative expenses	(206)	(205)	(280)	(245)	(213)	(183)	-11%	(411)	(524)	(396)	-4%
Financial expenses	(1,298)	(1,258)	(1,233)	(1,253)	(1,193)	(1,163)	-8%	(2,556)	(2,486)	(2,356)	-8%
Asset impairment loss	0	(23)	-	(27)	0	(19)		(23)	(27)	(18)	-18%
Investment income	186	182	328	112	75	97	-47%	367	441	171	-53%
Incl. profits from asso and JCE	186	118	187	141	75	97	-18%	303	328	171	(0)
Operating profit	2,300	1,540	3,735	912	1,951	811	-47%	3,840	4,647	2,762	-28%
Non-operating income	319	190	282	248	156	254	33%	509	530	410	-19%
Non-operating expense	(4)	(575)	(24)	(7)	(2)	2		(578)	(31)	(1)	-100%
Pre-tax profit	2,615	1,156	3,993	1,154	2,105	1,067	-8%	3,771	5,146	3,171	-16%
Income tax	(307)	(232)	(452)	(67)	(251)	(267)	15%	(539)	(519)	(518)	-4%
Net profit	2,309	924	3,540	1,087	1,853	800	-13%	3,232	4,627	2,653	-18%
Minority interest	(1,067)	(679)	(1,617)	(580)	(923)	(440)	-35%	(1,746)	(2,197)	(1,363)	-22%
Net profit to shareholders	1,241	245	1,923	507	930	360	47%	1,486	2,430	1,290	-13%
Recurring NP	1,241	780	1,792	493	930	360	-54%	2,039	2,286	1,290	-37%

Source: Company data, Deutsche Bank

Earnings revisions, valuation and risks

We lower our net profit forecast in 2017/18/19E by 14%/4%/1% mainly to reflect the following changes:

- 1) 4% higher thermal tariff in 2017-19E to reflect a lower DPS discount and the mid-year tariff hike effective on 1 July 2017.
- 2) 3% lower hydro tariff in 2017E to reflect higher DPS discounts offered by hydro plants; a 1% higher hydro tariff in 2018E to reflect tariff hikes for inter-provincial power sales after the thermal tariff hike.
- 3) 10-15% lower wind tariff in 2017-19E to reflect higher price discounts to market-based volume.
- 4) 8%/3%/3% higher unit fuel cost in 2017/18/19E to reflect the latest coal price trends.
- 5) Delay of Meizhouwan II unit 3 to end-2017; delay of Beijiang project (2GW) to Jul 2018.

We lower our TP slightly to Rmb8.5 (from Rmb8.7); it is derived from a DCF with a WACC of 7.0% and a zero terminal growth rate.

SDIC is trading at an attractive 12x 2018E P/E and 1.5x 2018E P/B, which is much lower than the 17x P/E and 2.3x P/B of its hydro peer, Yangtze Power. Besides, its thermal segment can also benefit from the acceleration in supply-side reform, as well as the potential thermal tariff hike at year-end. Reiterating Buy.

Key risks include: higher-than-expected coal prices, lower-than-expected year-end tariff hike, uncertainties in hydro utilization hours.



Figure 5: SDIC operational summary

Key operating metrics	2012	2013	2014	2015	2016	2017E	2018E	2019E
Total consolidated capacity (MW)	16,253	22,303	25,818	27,075	29,285	31,385	33,535	33,735
% chg	27%	37%	16%	5%	8%	7%	7%	1%
Thermal	8,530	9,180	9,096	9,756	11,756	13,756	15,756	15,756
Hydro	7,120	12,520	16,120	16,570	16,720	16,720	16,720	16,720
Renewables	603	603	602	749	809	909	1,059	1,259
Total attributable capacity (MW)	10,528	14,187	15,774	14,928	16,286	17,406	18,836	19,036
% chg	24%	35%	11%	-5%	9%	7%	8%	1%
Utilization hours - thermal	5,074	4,827	4,837	4,105	3,701	3,602	3,625	3,662
% chg		-5%	0%	-15%	-10%	-3%	1%	1%
Utilization hours - hydro	4,662	5,075	4,978	4,592	4,822	4,758	4,806	4,806
% chg		9%	-2%	-8%	5%	-1%	1%	0%
Gross generation (bn kWh)	71.4	93.1	113.1	114.0	120.4	124.3	134.5	138.9
% chg		30%	22%	1%	6%	3%	8%	3%
Thermal	41.6	43.6	42.1	38.7	38.9	43.6	52.8	57.0
Hydro	28.9	48.4	69.9	74.4	80.5	79.6	80.4	80.4
Renewables	0.9	1.1	1.1	0.9	1.1	1.1	1.3	1.5
Tariff - thermal (avg.)		424	424	391	338	357	386	387
Tariff - hydro (avg.)		279	294	291	263	255	258	258
Standard coal consumption (g/kWh)	319	318	316	313	311	311	311	311
Avg. standard coal cost (Rmb/ton)	729	603	541	457	451	586	528	528
% chg	-8%	-17%	-10%	-16%	-1%	30%	-10%	0%
Unit fuel cost (Rmb/MWh)	232	192	171	143	140	182	164	164
Dark spread (Rmb/MWh)	0	171	191	191	149	123	166	167

Source: Company data, Deutsche Bank estimates



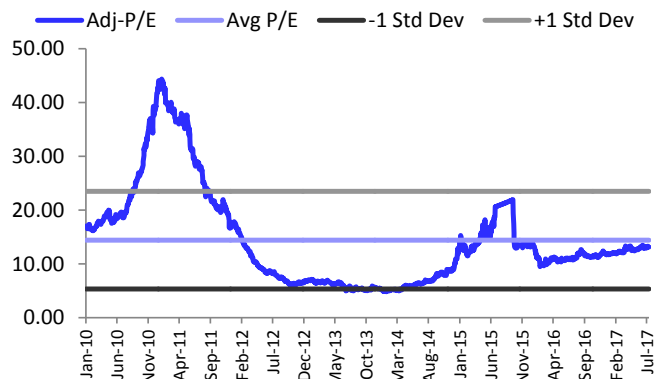
Figure 6: SDIC P&L summary

Income Statement (Rmb million)	2012	2013	2014	2015	2016	2017E	2018E	2019E
Sales revenue	23,867	28,339	32,957	31,280	29,271	31,010	35,306	36,753
- Power	20,989	26,445	31,944	30,918	28,913	30,104	34,401	35,848
- Coal	2,547	1,465	736	0	188	736	736	736
- Others	331	429	278	361	169	169	169	169
Operating costs	(17,831)	(16,859)	(16,240)	(14,950)	(15,101)	(18,683)	(20,175)	(21,109)
Fuel costs	(9,084)	(7,829)	(6,736)	(5,164)	(5,083)	(7,445)	(8,106)	(8,749)
Depreciation & Amortization	(3,492)	(4,681)	(5,547)	(6,114)	(6,083)	(6,350)	(6,744)	(6,957)
Cost of coal sales	(2,474)	(1,408)	(719)	0	0	(719)	(719)	(719)
Others	(2,781)	(2,941)	(3,238)	(3,672)	(3,935)	(4,169)	(4,605)	(4,684)
Business taxes and surcharges	(195)	(275)	(436)	(478)	(458)	(474)	(539)	(561)
Gross profit	5,841	11,204	16,281	15,852	13,713	11,853	14,592	15,083
<i>Gross margin</i>	<i>24%</i>	<i>40%</i>	<i>49%</i>	<i>51%</i>	<i>47%</i>	<i>38%</i>	<i>41%</i>	<i>41%</i>
Sales expenses	(43)	(50)	(17)	(7)	(6)	(6)	(7)	(8)
Admin expenses	(641)	(741)	(805)	(867)	(936)	(929)	(987)	(991)
Financial expenses	(3,083)	(4,410)	(6,156)	(5,890)	(5,042)	(5,223)	(5,452)	(5,579)
Asset impairment losses	(6)	(19)	(39)	(103)	(49)	0	0	0
Investment income	196	548	664	579	808	751	865	874
Operating profit	2,264	6,531	9,928	9,564	8,487	6,446	9,010	9,380
Add: non-operating income	88	68	1,037	1,667	1,039	639	0	0
Less: non-operating expenses	(33)	(21)	(21)	(250)	(609)	0	0	0
PBT	2,318	6,579	10,944	10,981	8,917	7,084	9,010	9,380
Less: income tax expenses	(300)	(702)	(783)	(878)	(1,057)	(692)	(889)	(1,014)
<i>Effective tax rate</i>	<i>-14%</i>	<i>-12%</i>	<i>-8%</i>	<i>-8%</i>	<i>-10%</i>	<i>-11%</i>	<i>-11%</i>	<i>-12%</i>
Profit after tax	2,018	5,877	10,161	10,103	7,860	6,393	8,121	8,366
Minority Interest	(964)	(2,572)	(4,565)	(4,675)	(3,943)	(3,086)	(3,918)	(4,026)
<i>MI %</i>	<i>-53%</i>	<i>-48%</i>	<i>-47%</i>	<i>-49%</i>	<i>-55%</i>	<i>-55%</i>	<i>-54%</i>	<i>-54%</i>
Net Profit Attributable to Shareho	1,054	3,305	5,597	5,428	3,916	3,307	4,203	4,341
<i>Net margin %</i>	<i>4%</i>	<i>12%</i>	<i>17%</i>	<i>17%</i>	<i>13%</i>	<i>11%</i>	<i>12%</i>	<i>12%</i>
Recurring net profit	954	3,278	5,428	5,604	4,325	3,307	4,203	4,341
<i>yoy (%)</i>	<i>369%</i>	<i>244%</i>	<i>66%</i>	<i>3%</i>	<i>-23%</i>	<i>-24%</i>	<i>27%</i>	<i>3%</i>
Recurring EPS (Rmb)	0.17	0.52	0.80	0.83	0.64	0.49	0.62	0.64
<i>growth yoy %</i>	<i>304%</i>	<i>208%</i>	<i>53%</i>	<i>3%</i>	<i>-23%</i>	<i>-24%</i>	<i>27%</i>	<i>3%</i>
DPS (Rmb)	0.06	0.16	0.29	0.28	0.20	0.17	0.22	0.22
<i>growth yoy %</i>	<i>385%</i>	<i>181%</i>	<i>83%</i>	<i>-3%</i>	<i>-28%</i>	<i>-16%</i>	<i>27%</i>	<i>3%</i>
<i>Dividend payout ratio</i>	<i>30%</i>	<i>30%</i>	<i>35%</i>	<i>35%</i>	<i>35%</i>	<i>35%</i>	<i>35%</i>	<i>35%</i>

Source: Company data, Deutsche Bank estimates

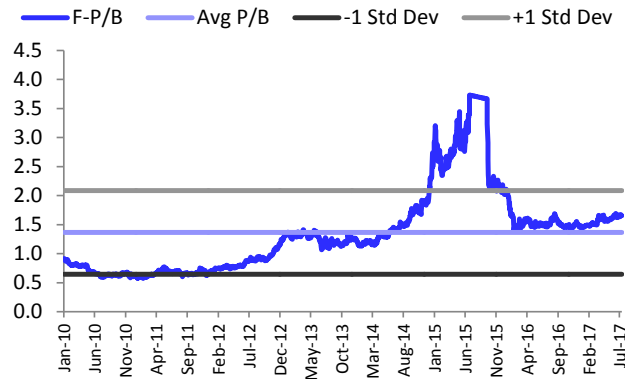


Figure 7: SDIC historical one-year forward P/E



Source: Company data, Bloomberg, Deutsche Bank estimates

Figure 8: SDIC historical one-year forward P/B



Source: Company data, Deutsche Bank estimates

Supply side reform to support structural recovery in thermal power sector

The supply-side reform initiated by the NEA is progressing well, with several successive policies issued at central/local government level to control the oversupply since 1H16. On top of the demand recovery and narrowing tariff discount for market-based volume, better capex discipline and slow capacity expansion are helpful for a structural improvement in the thermal power sector.

1H17 power sector data released by the China Electricity Council (CEC) suggests a much slower thermal capacity expansion (halved yoy), stronger-than-expected investment discipline, and a recovery in China power demand, which confirms our positive view on structural improvement in the thermal power sector, despite an unchanged coal price headwind in the absence of a timely tariff hike. (See more details in: [Supply side reform in thermal power better than expected](#), published on 26 July 2017.)

On 26 July, 16 Ministries of central government jointly issued a notice "Pushing for supply-side reform to mitigate oversupply risks of thermal power" with the main content including:

- To phase out those <300MW units that do not meet the requirement
- To suspend construction/operations of those thermal projects that are without the legitimate approvals
- To stop capacity expansions in those provinces with alarm levels of red and orange
- To cut new capacity by half for projects that transmit power to other provinces

Furthermore, in the notice, the government targets to suspend/delay 150GW capacity and phase out >20GW coal-fired power capacity during 2016-20E. By 2020, coal-fired capacity is to be controlled within 1100GW (vs. 943GW at end-2016). This notice shows the government's continuous efforts and determination to control thermal capacity expansions, which will help to create



a more favorable operational environment for the thermal power sector over 2018-20E.

Moreover, we have witnessed an acceleration of coal mine approvals, which echoes government action to release the advanced coal production capacity. We summarize coal project approvals in July-Aug in the below table, which add up to 82mn tons/year production capacity. We believe the acceleration of coal production capacity release is helpful to easing the supply shortage and therefore putting pressure on coal prices.

Figure 9: Latest coal mine approvals

Name	Owner	Province	Approval Date	Production capacity (mtpa)
Xinjie Taigemiao Mines	Shenhua	Inner Mongolia	Aug 2017	62
West Heishan	Huadian	Xinjiang	Aug 2017	4
Baishi Lake	Guanghui	Xinjiang	Aug 2017	6
Erdos	Various entities	Inner Mongolia	Jul-Aug 2017	4
Zhundong Dajing	Shenhua	Xinjiang	Jul 2017	6

Source: Industry news, Deutsche Bank



Appendix 1

Important Disclosures

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Disclosure checklist

Company	Ticker	Recent price*	Disclosure
SDIC Power	600886.SS	7.42 (CNY) 1 Sep 17	NA

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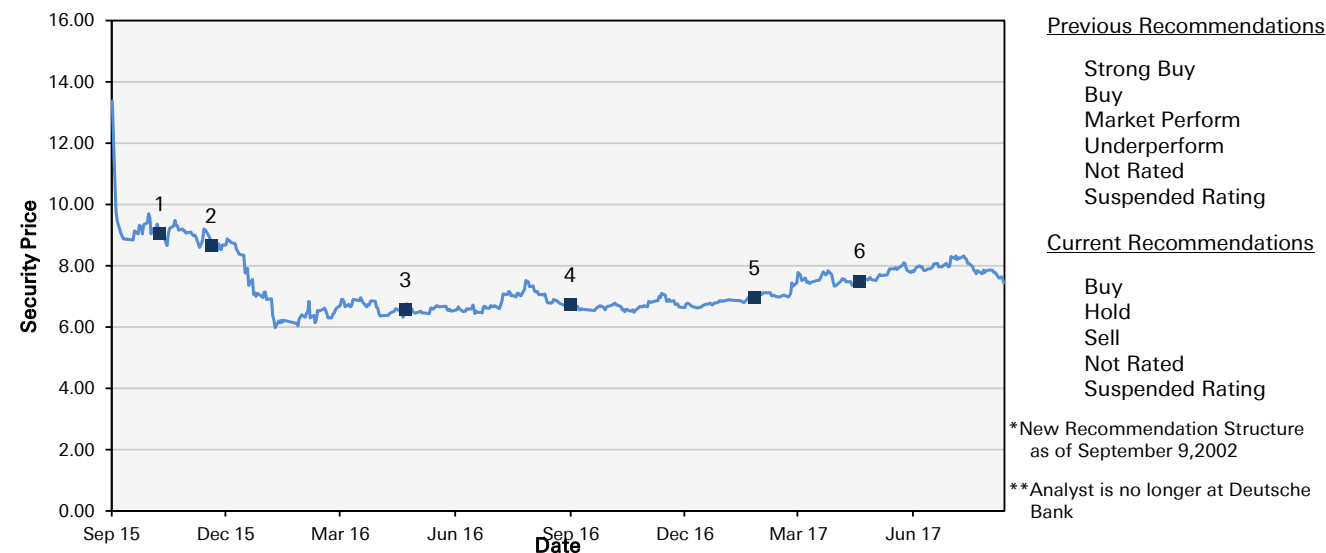
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Historical recommendations and target price: SDIC Power (600886.SS)

(as of 9/1/2017)



1. 29/10/2015: Buy, Target Price Change CNY14.50 Yingying Dong, CFA**	4. 20/09/2016: Buy, Target Price Change CNY8.40 Michael Tong, CFA
2. 09/12/2015: Buy, Target Price Change CNY13.90 Michael Tong, CFA	5. 14/02/2017: Buy, Target Price Change CNY8.30 Michael Tong, CFA
3. 12/05/2016: Buy, Target Price Change CNY9.30 Michael Tong, CFA	6. 09/05/2017: Buy, Target Price Change CNY8.70 Michael Tong, CFA



Equity rating key

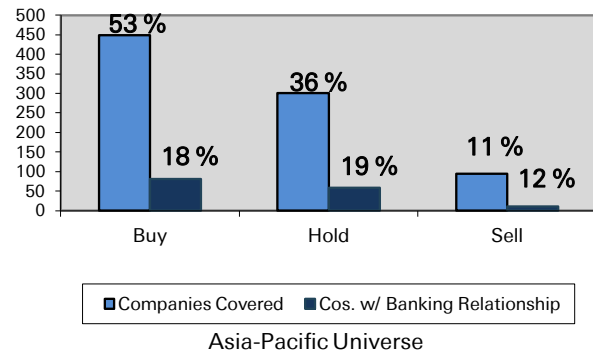
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Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

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