

**Yanzhou Coal Mining (1171.HK, 600188.SS)**

# Earnings Review: 1H18 mostly in line with expectation: Higher price offsets lower volume

Yanzhou reported 1H18A NP of Rmb4.6bn and EPS of Rmb0.941/sh both up 34% YoY. Excluding one-offs including a Rmb1.0bn one-time social insurance premium charge in SG&A cost offset others, recurring profit would be Rmb4.1bn in our estimates, up 23% YoY, and just 5% behind our estimates, as solid operational results were partly offset by higher-than-expected tax rate and minority interest.

**Self-mined coal sales** was 47.6mnt, up 43% YoY, driven by growth in YAL and non-headquarter China assets. Specifically, YAL sales reached 16.4mnt, up 163% YoY, mostly due to the inclusion of C&A assets post September of 2017A. Sales from Heze Nenghua and Ordos Nenghua nearly doubled YoY to 1.6mnt and 7.4mnt in 1H18A, respectively. Total sales was c.7% short versus our expectation, however, mostly due to the shortfall in Haosheng (down 10% YoY and down 53% HoH).

**ASP of self-mined coal** was Rmb532/t, up 10% YoY, 3% better vs. our estimates. ASP of the headquarters' was Rmb590/t, flat YoY, mostly in line with QHD5500 blended prices. The average price of other China assets was Rmb372/t, up 10% YoY. The average prices of YAL was Rmb613/t, up 28% YoY, consistent with the NEWC's price moves over the period.

**No surprise on costs.** Unit COGS of self-mined coal was Rmb263/t, up 11% YoY, driven mostly by cost hikes in other CN assets especially Haosheng and Ordos Nenghua, and YAL (up 17% YoY) - overall average cost was slightly higher than expected mostly due to mix changes. SG&A was Rmb5.3bn, up 64% YoY, 18% higher than expected due to the one-off charge in social insurance premium (Rmb1.0bn), and Rmb526mn higher royalty cost at YAL due to increasing sales. On a recurring basis, we estimate unit SG&A was Rmb90/t, up 7% YoY, mostly in line with our expectations.

**Income from associate and JV** reached Rmb854mn, more than doubled YoY, partly due to the Rmb358mn contribution from Yanzhou's investment in Zheshang Bank (and re-categorized in 1H18A). Other income was Rmb2.3bn, nearly doubled YoY, well ahead of our expectation, most of which we expect are not earnings on a recurring basis, pending further disclosures from the company. Overall other income and associate income accounted for 31% of EBIT in 1H18A in our estimates.

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**Operating cash flow** was Rmb7.6bn, up 188% YoY. Net debt slightly fell by 2% versus end of 2017A. Net gearing improved from 57% at end of 2017A to 54%.

**We expect the thermal coal market supply to remain tighter than expected in 2018E and 2019E**, due to limited capacity expansion while demand remains mostly stable. We expect the QHD 5500 blended price to reach an average of Rmb595/t in 2018E and Rmb590/t in 2019E (vs. Rmb575/t for 2018E and Rmb550/t for 2019E in prior estimates).

We revise our NP estimates up by 10% for 2018E, 6% for 2019E and 7% for 2020E, to reflect the updated coal prices, and higher other income assumptions. On our higher revised estimates, we increase our 12-month target price for Yanzhou-H to HK\$9.4/sh (from HK\$9.1/sh) and cut our 12-month target price for Yanzhou-A to Rmb12.5/sh (from Rmb13.2/sh). Maintain Neutral on Yanzhou H/A. Our target price methodology remains unchanged, based on historical P/B vs. ROE correlation - or 2019E P/B of 0.7X/1.1X at an ROE of 11.7% - assumptions unchanged.

**Key risks** include: 1) Coal prices in both the domestic China and international seaborne markets, which are affected by both the supply-demand balance in the Chinese and international markets; demand for coal is mostly driven by the power, steel and building materials sectors; transportation capacity for coal, including both rail and ports, is also a key factor affecting coal prices; 2) the Chinese government's export policy on coal, including export VAT rebate changes, export tax changes, and import tariff; and 3) additional unexpected cost imposed on coal producers by the government, especially relating to environmental concerns and resources.

#### Exhibit 1: 1H18 Result Summary - Yanzhou (Financial)

Yanzhou-1H18A financials		1H18A	1H17A	YoY	1H18E	AvE
Net Revenue	Rmb mn	32,220	22,922	41%	33,252	-3%
COGS	Rmb mn	(19,869)	(14,831)	34%	(21,099)	-6%
Gross Profit	Rmb mn	12,352	8,091	53%	12,153	2%
SG&A	Rmb mn	(5,293)	(3,233)	64%	(4,468)	18%
SG&A - recurring	Rmb mn	(4,277)	(2,810)	52%	(4,468)	-4%
Other OP Income	Rmb mn	2,345	1,172	100%	662	254%
EBIT	Rmb mn	10,257	6,373	61%	8,775	17%
EBIT-recurring	Rmb mn	9,526	6,182	54%	8,775	9%
EBIT-ex interest inc	Rmb mn	9,879	6,373	55%	8,264	20%
Interest Expenses	Rmb mn	(1,816)	(1,323)	37%	(1,781)	2%
Profit before taxes	Rmb mn	8,442	5,050	67%	6,994	21%
Income taxes	Rmb mn	(2,494)	(1,131)	121%	(1,609)	55%
Minority	Rmb mn	(1,325)	(468)	183%	(1,090)	22%
NP	Rmb mn	4,623	3,451	34%	4,296	8%
One-offs	Rmb mn	732	191	283%	n.a.	n.a.
NP recurring	Rmb mn	4,074	3,308	23%	4,296	-5%
EPS	Rmb/sh	0.941	0.703	34%	0.875	8%
EPS-recurring	Rmb/sh	0.829	0.673	23%	0.875	-5%
Tax rate	%	30%	22%	32%	23%	28%
AR days	days	60	82	-26%	n.a.	n.a.
AP days	days	50	52	-4%	n.a.	n.a.
Inv days	days	39	40	0%	n.a.	n.a.
OCF	Rmb mn	7,642	2,650	188%	n.a.	n.a.
FCF	Rmb mn	6,457	(4,310)	-250%	n.a.	n.a.
Net debt	Rmb mn	44,605	45,889	-3%	n.a.	n.a.
Net debt/equity	%	92%	109%	-17%	n.a.	n.a.

Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 2: 1H18 Result Summary - Yanzhou (Operational)**

<b>Yanzhou-1H18A operational</b>		<b>1H18A</b>	<b>1H17A</b>	<b>YoY</b>	<b>1H18E</b>	<b>AvE</b>
Sales-total	mnt	55.5	41.7	33%	59.4	-7%
Sales-self	mnt	47.6	33.3	43%	49.9	-5%
Headquarter	mnt	16.4	16.1	2%	16.1	2%
CN others	mnt	11.8	7.6	55%	13.6	-13%
YAL	mnt	16.4	6.2	163%	16.8	-2%
Yancoal Intl	mnt	2.9	3.3	-12%	3.3	-12%
Intl thermal coal	US\$/t	104	81	29%	99	5%
Intl PCI	US\$/t	129	119	8%	129	0%
QHD 5500-Blended (w VAT)	Rmb/t	601	614	-2%	600	0%
QHD 5500-Spot (w VAT)	Rmb/t	671	614	9%	655	2%
China PCI (w VAT)	Rmb/t	1,140	1,007	13%	1,070	7%
ASP	Rmb/t	539	506	6%	528	2%
ASP-self	Rmb/t	532	482	10%	516	3%
Headquarter	Rmb/t	590	588	0%	579	2%
CN others	Rmb/t	372	337	10%	359	4%
YAL	Rmb/t	613	480	28%	595	3%
Yancoal Intl	Rmb/t	387	303	28%	457	-15%
Unit COGS	Rmb/t	296	294	1%	296	0%
Unit COGS-self	Rmb/t	263	238	11%	256	3%
Headquarter	Rmb/t	267	258	3%	266	0%
CN others	Rmb/t	227	181	25%	201	13%
YAL	Rmb/t	285	244	17%	292	-2%
Yancoal Intl	Rmb/t	244	239	2%	253	-4%
GP	Rmb/t	244	213	15%	232	5%
GP-self	Rmb/t	268	244	10%	260	3%
Headquarter	Rmb/t	323	330	-2%	312	4%
CN others	Rmb/t	145	156	-7%	158	-8%
YAL	Rmb/t	329	236	39%	303	8%
Yancoal Intl	Rmb/t	144	64	125%	204	-30%
Unit SG&A	Rmb/t	90	84	7%	90	0%
Unit EBIT	Rmb/t	178	160	11%	170	5%
Unit EBITDA	US\$/t	207	189	10%	195	6%
Unit Depreciation	Rmb/t	28	29	-1%	25	16%

Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 3: Key assumptions and financials - Yanzhou**

<b>Key assumptions and financials - YANZHOU</b>							
YANZHOU		2015A	2016A	2017A	2018E	2019E	2020E
Intl thermal coal	US\$/t	59	66	87	94	75	70
Intl PCI	US\$/t	74	96	119	129	100	90
QHD 5500 (w VAT)	Rmb/t	423	473	612	595	590	575
HB HCC (w VAT)	Rmb/t	755	870	1,429	1,464	1,415	1,355
China PCI (w VAT)	Rmb/t	668	717	1,051	1,088	1,038	979
Sales - self mined	mnt	60.2	60.7	77.7	100.4	110.3	110.9
% in HQ	%	59%	56%	40%	32%	29%	29%
% in Australia	%	33%	30%	33%	42%	38%	38%
% of thermal	%	70%	71%	79%	80%	81%	80%
% of semi coking	%	25%	26%	17%	17%	17%	17%
% of PCI	%	5%	4%	3%	3%	2%	2%
ASP	Rmb/t	342	392	494	522	476	451
Unit cash op cost	Rmb/t	354	350	377	401	395	391
Unit EBIT-self	Rmb/t	(13)	41	115	121	81	60
Unit EBIT-HQ	Rmb/t	(17)	98	223	195	177	151
Unit EBIT-from others	Rmb/t	(104)	39	31	30	21	21
Unit EBIT-Australia	Rmb/t	36	(37)	86	153	89	53
Unit EBITDA-self	US\$/t	3	10.8	21.2	23.5	16.7	13.6
EBIT	Rmb mn	3,107	5,196	14,534	18,344	14,576	11,706
Coal	Rmb mn	(628)	2,569	9,353	12,821	9,577	7,293
Non-coal	Rmb mn	1,085	(894)	303	1,247	2,058	1,702
Non-op income	Rmb mn	2,650	3,521	4,877	4,275	2,941	2,711
EBITDA	Rmb mn	5,251	6,540	15,164	21,031	18,729	15,965
EBITDA-recurring	Rmb mn	5,203	6,690	16,443	20,809	17,285	14,430
Net Profit	Rmb mn	164	1,649	7,363	8,020	6,444	4,863
Net Profit - recurring	Rmb mn	367	2,295	6,464	7,471	6,444	4,863
EPS	Rmb/sh	0.033	0.336	1.499	1.633	1.312	0.990
EPS-recurring	Rmb/sh	0.075	0.467	1.316	1.521	1.312	0.990
Net debt	Rmb mn	46,310	46,710	45,664	39,290	38,103	38,414
Operating cash flow	Rmb mn	4,347	11,221	12,162	15,348	13,516	10,847
Investing cash flow	Rmb mn	(8,203)	(14,955)	(30,841)	(9,924)	(9,224)	(8,586)
Free cash flow	Rmb mn	(3,856)	(3,735)	(18,680)	5,424	4,292	2,261
BV	Rmb/sh	7.19	7.56	9.65	10.81	11.59	12.16
ROE	%	0.4%	4.5%	17.4%	16.0%	11.7%	8.3%
ROE-recurring	%	1.0%	6.3%	15.3%	14.9%	11.7%	8.3%
ROIC	%	0.7%	4.0%	10.5%	10.5%	8.4%	6.7%
ND/(D+M+PPB)	%	101%	87%	57%	45%	41%	39%
(ND+PPB)/(D+M)	%	135%	114%	78%	64%	58%	56%

Source: Company data, Goldman Sachs Global Investment Research

**Exhibit 4: Earnings and valuation sensitivity**

QHD5500 (Blended) Rmb/t (incl VAT)	HB HCC Rmb/t	NP-19E Rmb mn	EPS Rmb/sh	EBITDA Rmb mn	ROE %	Implied PE on current price (x)
500	1415	3996	0.814	15,404	7.4%	10.3
550	1415	4952	1.008	16,703	9.1%	7.9
600	1415	5908	1.203	18,002	10.8%	6.4
650	1415	6865	1.398	19,300	12.4%	5.3

Source: Company data, Goldman Sachs Global Investment Research

<b>1171.HK</b>	<b>12m Price Target: HK\$9.4</b>	<b>Price: HK\$9.39</b>	<b>Upside: 0.1%</b>
<b>600188.SS</b>	<b>12m Price Target: Rmb12.5</b>	<b>Price: Rmb11.35</b>	<b>Upside: 10.1%</b>

Neutral		GS Forecast			
		12/17	12/18E	12/19E	12/20E
Market cap: Rmb55.7bn / \$8.1bn	<b>Revenue (Rmb mn) New</b>	<b>52,672.1</b>	<b>67,437.7</b>	<b>67,065.0</b>	<b>63,508.7</b>
Enterprise value: Rmb129.9bn / \$18.9bn	Revenue (Rmb mn) Old	52,672.1	62,832.8	62,224.8	60,073.1
3m ADTV :Rmb387.3mn/ \$58.4mn	EBITDA (Rmb mn)	18,330.6	21,884.0	18,421.7	15,655.7
China	<b>EPS (Rmb) New</b>	<b>1.50</b>	<b>1.63</b>	<b>1.31</b>	<b>0.99</b>
A-share Basic Materials	EPS (Rmb) Old	1.50	1.49	1.23	0.92
	P/E (X)	8.1	7.0	8.7	11.5
M&A Rank: 3	P/B (X)	1.3	1.1	1.0	0.9
	Dividend yield (%)	4.0	4.6	3.7	2.8
	CROCI (%)	9.1	10.1	8.6	7.1
		<b>6/17</b>	<b>12/17</b>	<b>6/18E</b>	<b>12/18E</b>
	EPS (Rmb)	0.70	0.80	0.94	0.69

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 24 Aug 2018 close.

# Disclosure Appendix

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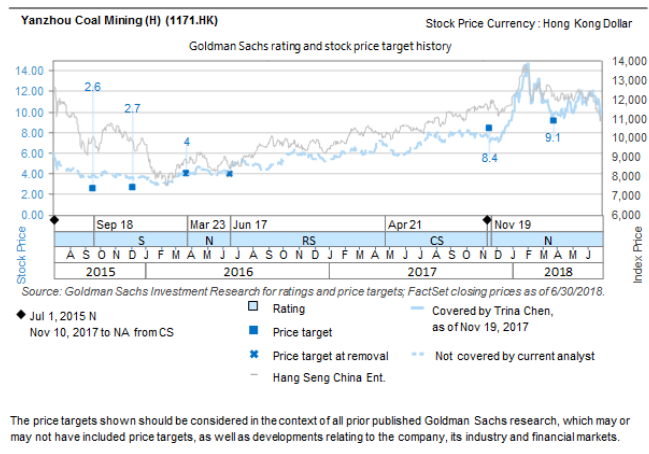
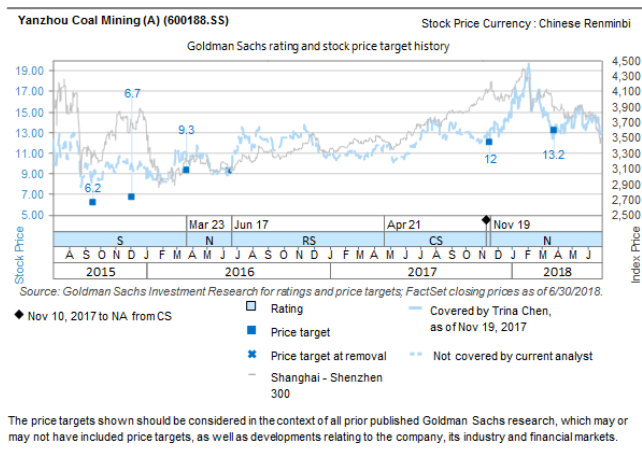
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