BEA securities

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Main Board H-share Listing – Research

中國神華能源股份有限公司
China Shenhua Energy Company Limited [Stock Code: 1088]

Joint Global Coordinators, Bookrunners, Sponsors and Lead Managers : China International Capital Corporation Limited
Deutsche Bank AG, Hong Kong Branch
Merrill Lynch Far East Limited

Sector : Energy
Business: Integrated coal-based energy company in China

Total share offer: 3,063,500,000 H shares
(17.23% of the enlarged share capital)

Public Offer:	*153,175,000* H shares	(5%)
Placing:	*2,910,325,000* H shares	(95%)
Greenshoe:	*459,525,000* H shares	(15%)

Price: HK$7.25 – HK$9.25 per H share
Market Cap.: HK$128.9 billion – HK$164.5 billion

Forecast 2005 P/E: 9.7x – 12.3x (pro forma)

Adjusted NTA per share: HK$1.96 – HK$2.26

Staffing: 42,661

Book opens: 26th May 2005
Book closes: 7th June 2005
HK Public Offer period:
2nd June 2005 – 7th June 2005

Receiving bank: HSBC, ICBC (Asia),
Bank of China (Hong Kong)

Share registrar: Computershare Hong Kong
Investor Services Limited

Listing date: 15th June 2005

Business of Shenhua

Shenhua is the leading integrated coal-based energy company focusing on the coal and power businesses in China. The two businesses have experienced compound annual growth rates of 30.4% and 27.8% respectively from 2002 to 2004.

Shenhua is the largest coal producer in China with marketable reserves of 5.9 billion tonnes as of 31st December 2004. Shenhua operates four mining groups – Shendong, Wanli, Zhunge'er and Shengli – with a total of 21 operating mines in the provinces of Shaanxi and Inner Mongolia. The mining groups generated coal output of 101.3 million tonnes in 2004, translating into a reserve life of over 50 years.

Shenhua owns and operates an integrated rail and port network to facilitate its sale of coal. The network consists of four rail lines – Baoshen, Shenshuo, Shuohuang and Dazhun, with a total operating length of approximately 1,300 kilometres – and a dedicated port, Huanghua port, with a 65 million tonne throughput capacity per annum.

Shenhua has a sizable and rapidly growing power generation business. As of 31st December 2004, Shenhua controlled and operated eight coal-fired power plants, with total installed capacity and equity capacity of 5,960 MW and 3,075 MW respectively.

Major Shareholders after Listing *(Assuming the over-allotment option is not exercised)*

Shenhau Group	82.77%
Anglo American, *a UK-based diversified mining and natural resources company*	0.80%*
Bejoy Holdings (BVI), *a wholly-owned subsidiary of CITIC Pacific Limited*	0.27%*
Maniton (BVI), *wholly beneficially owned by Mr. Yung Chi Kin*	0.27%*
BOCGI, *wholly beneficially owned by Bank of China Limited*	0.53%*
Chow Tai Fook Nominee, *wholly beneficially owned by Dato Dr. Cheng Yu-Tung*	0.53%*
Hillwin, *wholly beneficially owned by Dr. Lee Shau Kee*	0.53%*
Kerry Holdings, *a member of the Kuok Group controlled by Mr. Kuok Hock Nien*	0.53%*
	86.23%

** At mid-point issue price of HK$8.25: 0.80% – US$150 million, 0.53% – US$100 million and 0.27% – US$50 million.*

Use of Proceeds

Net proceeds from the offer are estimated to be HK$21.9 billion.

(Assuming the over-allotment option is not exercised, and at an issue price of HK$8.25 each, which is the mid-point of the indicative price range)

	HK$ billion
Expanding and upgrading coal production and transportation facilities	7.2 (33%)
Developing new power projects	4.8 (22%)
Reducing indebtedness	7.7 (35%)
General corporate purposes	2.2 (10%)

Financial Highlights

	Year ended 31st December		
	2002	2003	2004
	RMB million	RMB million	RMB million
Revenues			
Coal revenue	13,393	17,596	28,079
Power revenue	5,914	7,024	9,866
Other revenues	2,122	2,375	1,322
Total operating revenues	21,429	26,995	39,267
Profit from operations	5,214	7,240	15,499
Income tax	(454)	(854)	(2,820)
Net profit	**1,597**	**2,901**	**8,935**
EBITDA	**9,140**	**11,398**	**20,693**
EBITDA margin	42.7%	42.2%	52.7%
Earnings per share	**RMB0.106**	**RMB0.193**	**RMB0.596**

Operating data of coal and power segments

	Year ended 31st December		
	2002	2003	2004
Coal Segment			
Coal sales	million tonnes	million tonnes	million tonnes
Domestic sales to external customers	49.3	62.0	85.1
Domestic sales to its power operations	9.0	11.4	15.2
Total domestic sales	58.3	73.4	100.3
Total export sales	18.3	25.7	26.6
Total coal sales	**76.6**	**99.1**	**126.9**
	RMB/tonne	RMB/tonne	RMB/tonne
Average sales price	195	195	245
Unit cost	135	131	133
Power Segment			
	MW	MW	MW
Total installed capacity	4,760	5,360	5,960
Equity capacity	2,322	2,595	3,075
	GWh	GWh	GWh
Total gross generation	23,250	28,544	37,980
Total output dispatch	21,770	26,730	35,491

Strengths/Opportunities

- ✓ Shenhua is the largest coal producer in China with marketable reserves of 5.9 billion tonnes as of 31st December 2004 that translates into a reserve life of over 50 years. Given its huge reserve base, Shenhua is able to sustain its production growth at a high level. Together with its planned expenditure in exploring new mines, the production capacity is projected to grow at 14% per annum in 2005-2007.

- ✓ Coal reserves at most of Shenhau's operating mines have favourable geological conditions, including thick coal seams located at shallow depths, stable ground conditions and simple geological structures. These geological features enable low-cost development of large-scale coal mines. The unit production cost of Shenhua in 2004 was roughly 50% lower than that of Yanzhou Coal Mining (*stock code*: 1171).

- ✓ Shenhua is the only coal-based energy company in China that owns an integrated transportation network. The immediate availability of railway and port facilities provides it a unique advantage over competitors. As the shortage of coal transportation capacity has remained a key bottleneck in the China's energy sector, Shenhua is able to capitalise on its reliable market access.

- ✓ Compared with the national rail system, Shenhuo and Shuohang Rail Lines provide Shenhua more direct routes to ports in eastern China, resulting in a lower average unit transportation cost. With increasing utilisation of its proprietary network, the unit transportation cost is expected to decline in the coming years.

- ✓ Shenhua operates power plants in regions with strong economic growth and attractive power tariffs (such as Beijing-Tianjin-Hebei, Zhejiang and Guangdong) or in proximity to its coal mines or coal transportation network (such as Inner Mongolia and Shaanxi) which enable it to capture the rapid increase in demand for electricity and ensure easy access to coal supplies. Its power plants currently under construction are concentrated in coastal regions of China, which have experienced rapid increases in power demand in recent years.

- ✓ The valuation of Shenhua at 9.7x to 12.3x 2005E P/E is higher than domestic peer of Yanzhou Coal Mining of 8x, but in-line with global mining companies of 8x to 12x. We regard that its dominant market position, high growth perspective and transportation advantage justify a premium to domestic peers.

Weaknesses/Threats

- × The major risk to Shenhua is the fluctuation of coal prices. Domestic coal prices have been volatile historically and subject to changes in supply and demand in the international markets.

- × Effective 1st May 2005, the central government reduced the VAT rebate to coal exporters from 13% to 8% to discourage exports and ease domestic demand pressures amid tight supply due to transport bottlenecks. While Shenhua shipped out 26.59 million tonnes of coal last year, it expects the latest reduction in VAT rebate on coal exports will lead to a revenue loss of 5% of its 2005 earnings forecast.

- × Shenhua should exhibit a rapid growth in power revenue in 2005 due to higher generating capacity. However, its power-segment operating margin is likely to decline, as tariff increases are not sufficient to offset rise in coal prices. The reliability of the recently implemented "coal price pass-through" mechanism is fuelled with scepticism on its application consistency.

- × As of 31st December 2004, Shenhua's debt-to-asset ratio and gearing ratio were 55.2% and 158.3% respectively. Shenhua's debt burden should remain relatively high, as it has been aggressively expanding its coal and power business. With its coal mines located in the provinces of Shannxi and Inner Mongolia, Shenhua has to invest substantially in transportation network to ensure its market access to eastern China.

Recommendation: Subscribe