

Analyst: Vincent Leung

Main Board H-share Listing – Research

中國中煤能源股份有限公司

China Coal Energy Company Limited [Stock Code: 1898]

**Joint Global Coordinators, Joint Bookrunners,
Joint Sponsors and Joint Lead Managers**

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CICC

Citigroup Global
Markets

Morgan Stanley

Sector : Coal & Consumable Fuels

Business : Coal production, sales and trading as well as coal mining equipment manufacturing and coking operations not affiliated with a steelmaker

Total H share offer: 3,246,374,000 H shares (28.87% of the enlarged share capital) Public Offer: 162,320,000 H shares (5%) Placing: 3,084,054,000 H shares (95%) Greenshoe: 486,956,000 H shares	<u>Business of China Coal Energy (China Coal)</u> <p>China Coal is the second largest coal provider in China in terms of revenue for 2005. It sold 92.2 million tonnes and 43.5 million tonnes of coal in 2005 and the six months ended 30th June 2006 respectively.</p> <p>The Company had total marketable coal reserves of 3,003 million tonnes as of 30th June 2006. It produces high-quality thermal coal and coking coal from 9 operating coal mines and 13 coal processing plants. Located in Shanxi, Shaanxi and Jiangsu Provinces, its 5 mining areas consist of 9 underground mines and 3 open pit mines, two of which, the Antaibao Open Pit Mine and the Anjialing Open Pit Mine, are among the largest open mines in China. Its raw coal output grew from 33.2 million tonnes in 2003 to 50.1 million tonnes in 2005.</p> <p>The Company is one of the largest coal suppliers and its parent company, China National Coal Group Corporation, is the largest coal exporter in China.</p> <p>As an integrated coal enterprise with coal production, sales and trading as its core business, the Company also owns China's largest coal mining equipment manufacturing operations in terms of revenue. It also operates one of China's largest coking operations not affiliated with a steelmaker and engages in other operations, including provision of coal mine design services.</p>
Price: HK\$3.20 – HK\$4.05 per share H-share Market Cap: HK\$11,427.2 million – HK\$14,462.6 million Pro-forma FY2006E P/E: 11.5x – 14.6x Adjusted NTA per share: HK\$1.24 – HK\$1.47 Staffing: 51,792 (as of 30 th June 2006)	
HK Public Offer period: 6 th December 2006 – 11 th December 2006 noon Receiving banks: Bank of China (Hong Kong), Bank of Communications, Standard Chartered Bank (HK) Share registrar: Computershare Hong Kong Investor Services Limited Listing date: 19 th December 2006	

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Shareholding Structure after Listing (Assuming the over-allotment option is not exercised)

China National Coal Group Corporation (Domestic shares)	68.25%
National Council for Social Security Fund of the PRC (H shares)	2.88%
Other public shareholders* (H shares)	28.87%
	<u>100.00%</u>

Remark (*):

First Reserve Corporation, FR XI Offshore AIV, L.P. (a private equity fund) and AMCI Capital L.P. have entered into a strategic placing agreement to subscribe for US\$100 million and US\$25 million worth of shares respectively. Assuming an issue price of HK\$3.625 each, being the midpoint of the indicative price range, shareholdings of First Reserve Corporation and AMCI in China Coal are equivalent to 1.9% and 0.5% of the enlarged share capital or 6.6% and 1.7% of the offer shares in the global offering. H shares subscribed by First Reserve Corporation and AMCI pursuant to the strategic placing agreement are subject to a lock-up period of 18 months from the listing date.

Cheung Kong (Holdings) (stock code: 0001), China Life Insurance (Group) Company (parent of China Life Insurance (stock code: 2628)), Chow Tai Fook Nominee Limited, CITIC Pacific (stock code: 0267) & its chairman Mr. Larry Yung Chi Kin and Shau Kee Financial Enterprises have entered into corporate placing agreements to subscribe for an aggregate US\$250 million worth of shares. Assuming an issue price of HK\$3.625 each, shareholdings of these corporate investors are equivalent to 4.8% of the enlarged share capital or 16.6% of the offer shares in the global offering. H shares subscribed by these corporate investors are subject to a lock-up period of 12 months from the listing date.

Use of Proceeds

Net proceeds from the offer are estimated to be HK\$11.3 billion (Assuming the over-allotment option is not exercised, and at an issue price of HK\$3.625 each, being the midpoint of the indicative price range)

	HK\$ billion
For construction of future open pit mines and underground mines, related coal processing plants and dedicated railways planned for development in the Company's Pingshuo Mining Area	7.3
For repayment of bank loans	2.8
For general working capital	Balance

Financial Highlights

	Year ended 31 st December			Six months ended 30 th June
	2003	2004	2005	2006
	RMB million	RMB million	RMB million	RMB million
Revenue	14,480.8	22,163.8	30,061.3	14,679.7
Gross profit	1,718.1	4,619.8	5,623.5	3,043.8
Operating profit	1,006.6	3,695.4	4,428.6	2,403.0
Net profit	141.0	2,248.2	3,343.5	1,334.4
Gross margin	11.9%	20.8%	18.7%	20.7%
Operating margin	7.0%	16.7%	14.7%	16.4%
Net margin	1.0%	10.1%	11.1%	9.1%

Revenue Breakdown (% of Total Revenues)

	Year ended 31 st December			Six months ended 30 th June
	2003	2004	2005	2006
	%	%	%	%
Coal operations	80.5%	80.0%	83.7%	80.1%
Coking operations	7.4%	9.2%	5.3%	6.9%
Coal mining equipment operations	7.3%	6.7%	6.3%	6.6%
Other operations	4.8%	4.1%	4.8%	6.4%
Total	100.0%	100.0%	100.0%	100.0%



Strengths/Opportunities

- ✓ China Coal is the second largest coal provider in China in terms of revenue for 2005.
- ✓ On the back the governmental support and the prominent industry position of its parent company, the Company can further strengthen its leading position in the coal mining industry through M&A opportunities and consolidation of small-scale coal mines in China.
- ✓ The Company intends to pay out 20%-30% of its net profit as dividends for the periods subsequent to the IPO.
- ✓ Pricing at 11.5x-14.6x FY2006E P/E, China Coal's valuation is not demanding when compared with sector peers China Shenhua Energy (stock code: 1088) and Yanzhou Coal (stock code: 1171). China Shenhua Energy is trading at FY2006E P/E of 15.8x while smaller peer Yanzhou Coal is trading at 10.1x.

Weaknesses/Threats

- × Volatility of coal prices is the major risk given the Company's high sensitivity of net profit to product prices.
- × Overseas coal sales accounted for 30.8% and 21.2% of the Company's total coal sales for 2005 and the six months ended 30th June 2006 respectively. With the export tax refund terminated on 15th September 2006, the Company's profitability will be adversely affected depending on the volume of coal it will export in the future.
- × The Company has substantial indebtedness, with total borrowings of approximately RMB11.6 billion and gearing ratio (i.e. net debt/equity) of 156.6% as of 30th June 2006. Although a portion of the IPO proceeds will be used for repayment of bank loans, gearing ratio will remain high and an upward trend in the mainland's interest rates would undermine the Company's bottom line.

Recommendation: Trading Buy



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