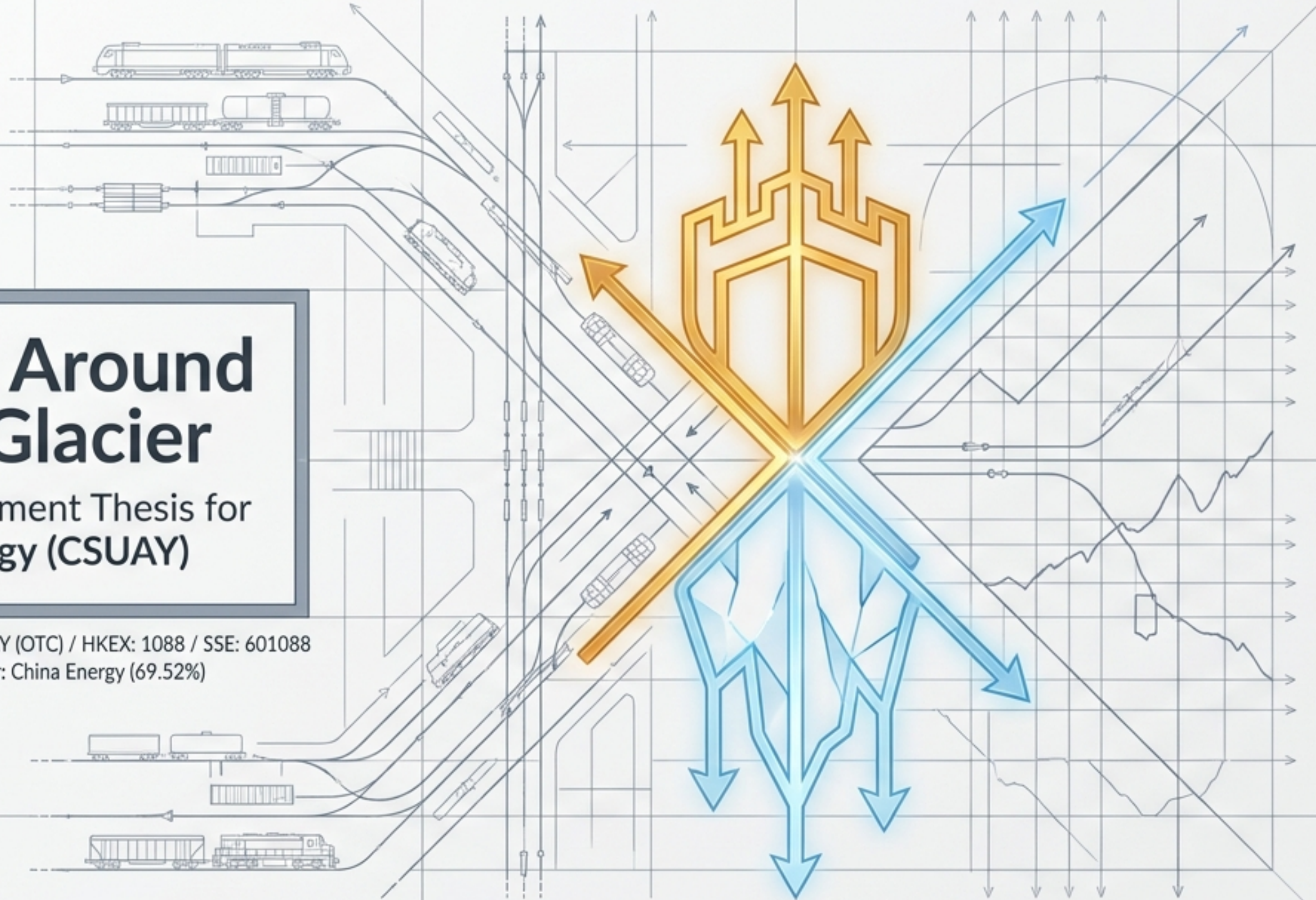


A Fortress Around a Melting Glacier

Evaluating the Investment Thesis for China Shenhua Energy (CSUAY)

Institutional Research Memo | Ticker: CSUAY (OTC) / HKEX: 1088 / SSE: 601088
Date: 2026-06-10 | Controlling Shareholder: China Energy (69.52%)



VERDICT: HOLD the business. **ACCUMULATE** on weakness for the income. Not a short.



Lowest Delivered Cost:
~RMB 167/t bottom-of-curve cash cost.

Captive Logistics Spine:
Irreplaceable 2,400km dedicated rail network.

Protective Price Band:
State-administered RMB 570–770/t floor converts volatility into a quasi-utility annuity.

Fortress Balance Sheet:
Massive net-cash hoard.

Cyclical Down-Slope:
Earnings sliding off the FY2022 peak.

Dividend Inversion:
Free cash flow has fallen below the headline dividend.

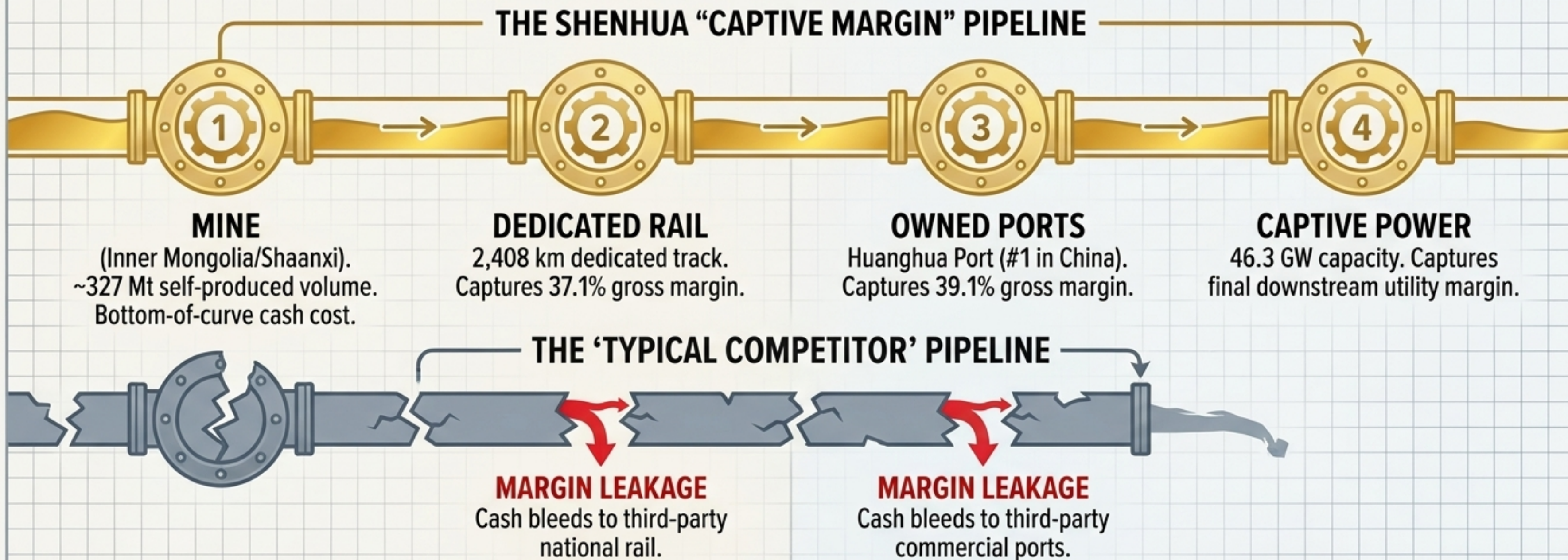
Structural Decarbonization:
A permanently shrinking end-market.

Governance Overhang:
Opaque RMB 133bn related-party asset injection from the 69.5% state parent.



The Valuation Reality: The H-share multiple has re-rated from ~5x to ~7x EV/EBITDA. You are paying a premium for safety on a cyclical down-slope.

THE SHENHUA “CAPTIVE MARGIN” MACHINE vs. TYPICAL COMPETITOR



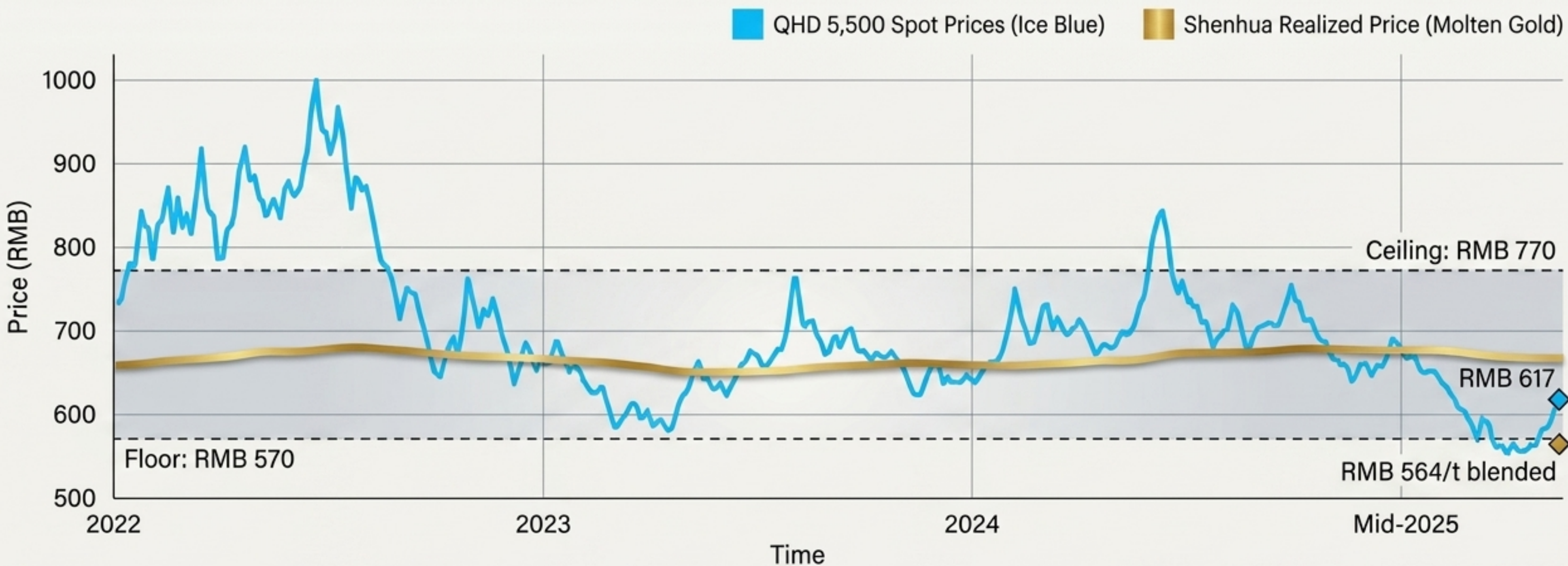
At every logistical node, Shenhua captures a **37-39% margin** that non-integrated miners pay away to third parties, resulting in a staggering **~47% gross margin** on self-produced coal.

OPERATIONAL FORTRESS vs. CYCLICAL VULNERABILITY: STRUCTURAL COST & MARGIN ADVANTAGE

Metric	China Shenhua	Industry Average	Marginal Small Mines
Cash Cost / Tonne	~RMB 167/t	~RMB 286/t	RMB 450–550/t
Gross Margin Resilience	~47% self-produced margin even at cycle lows	Highly volatile	Loss-making at cycle lows
Infrastructure Dependence	Captive network, zero third-party bottlenecks	Subject to national rail congestion/tariffs	Severe third-party reliance

Bottom-of-the-Curve Greenwald Advantage:
Held flat YoY despite inflation. At an average contract price of ~RMB 491/t, Shenhua's structural spread remains fat even when marginal producers bleed.

PRICE VOLATILITY vs. CONTRACT STABILITY: THE CONTAINMENT ZONE ADVANTAGE



The Contract Buffer: ~87% of Shenhua's volume is sold under long-term contracts tied to the NDRC band. This administratively compresses the price range: a protective floor that guarantees utility fuel supply, in exchange for capped upside. A quasi-utility annuity.

THE FORTRESS BALANCE SHEET vs. THE PAYOUT ENGINE: CAPITAL DISCIPLINE & SHAREHOLDER RETURNS

THE FORTRESS BALANCE SHEET



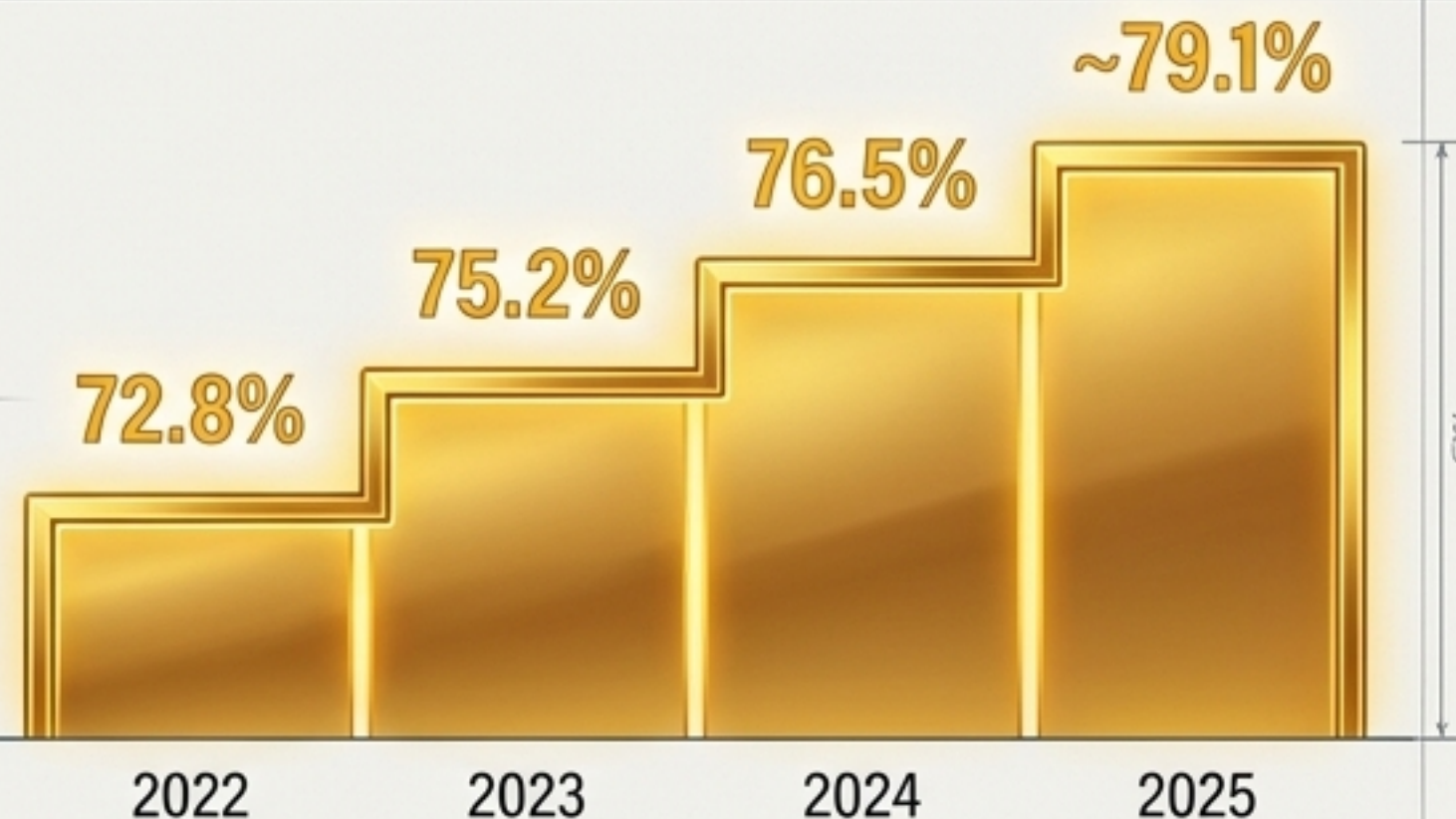
Net Cash:
~RMB 55–65bn
 (Liquid assets ~RMB 89.7bn
 vs. ~RMB 38.0bn debt)

Gearing:
23.2%

Debt-to-Equity:
6.1%

An extraordinarily conservative balance sheet for a heavy-industry operator.

THE PAYOUT ENGINE

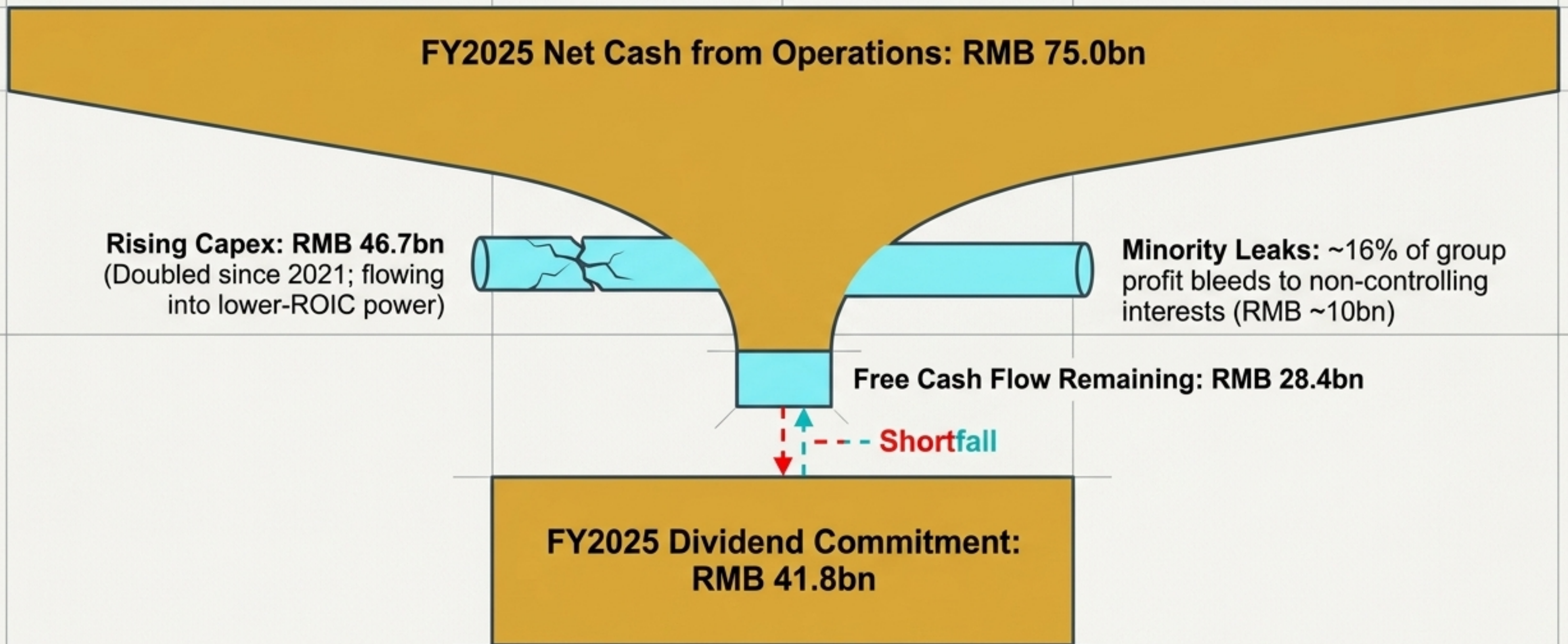


Policy Floor Raised: The new 2025–27 plan raises the payout floor from $\geq 60\%$ to $\geq 65\%$. For the income investor, this is the central bull pillar.

Yield Wedge

Caution: 10% PRC dividend withholding drag applies for USD/ADR holders, widening the gap between quoted yield and realized return.

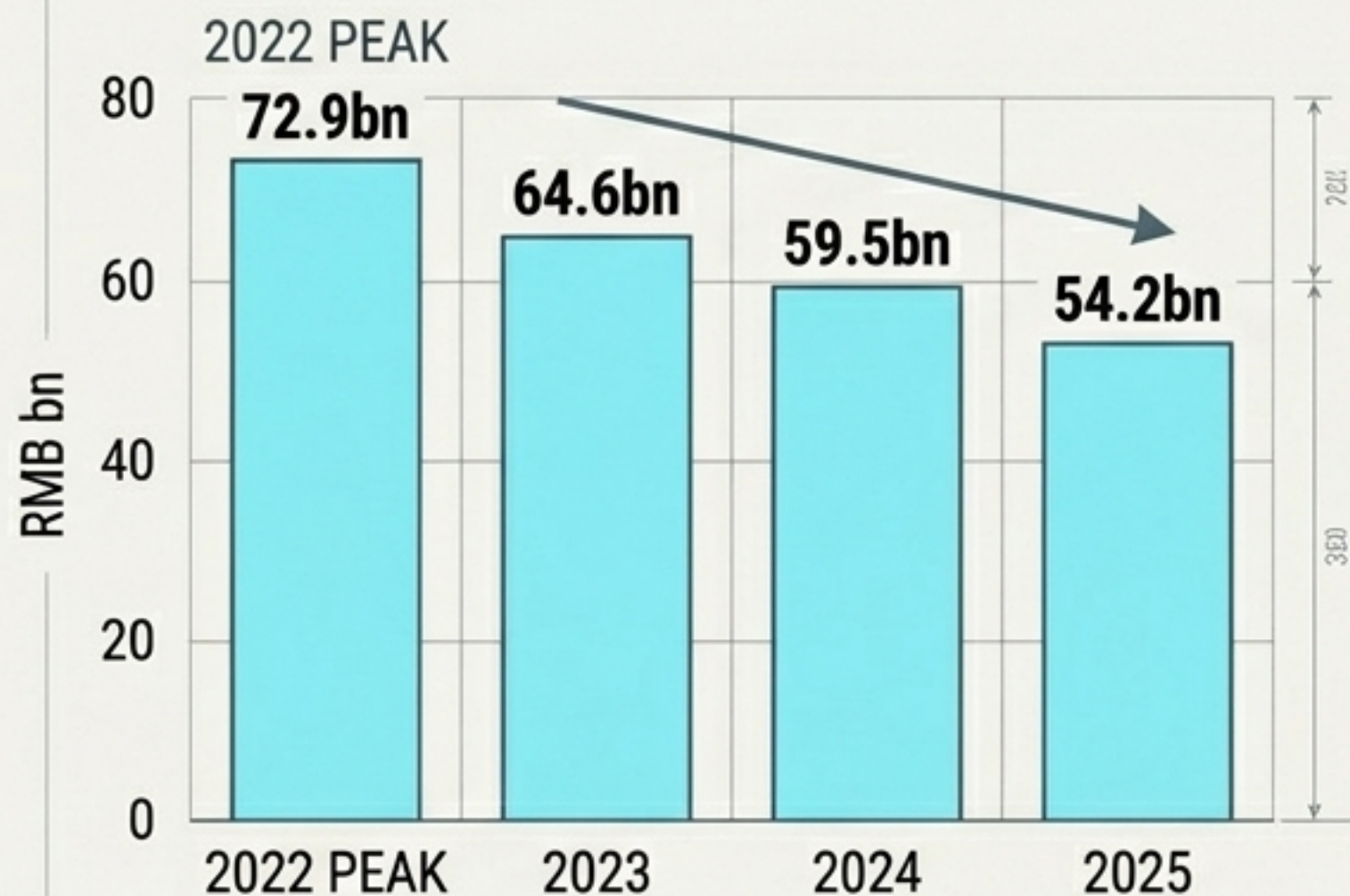
CASH FLOW vs. CAPITAL ALLOCATION FUNNEL: THE 'JAWS' DIAGRAM



Free cash flow no longer covers the dividend. The headline payout is now part-funded by siphoning the cash hoard. Capex runs at ~1.9x depreciation. Sustainable for a few years, but not indefinitely.

THE CYCLICAL DOWN-SLOPE

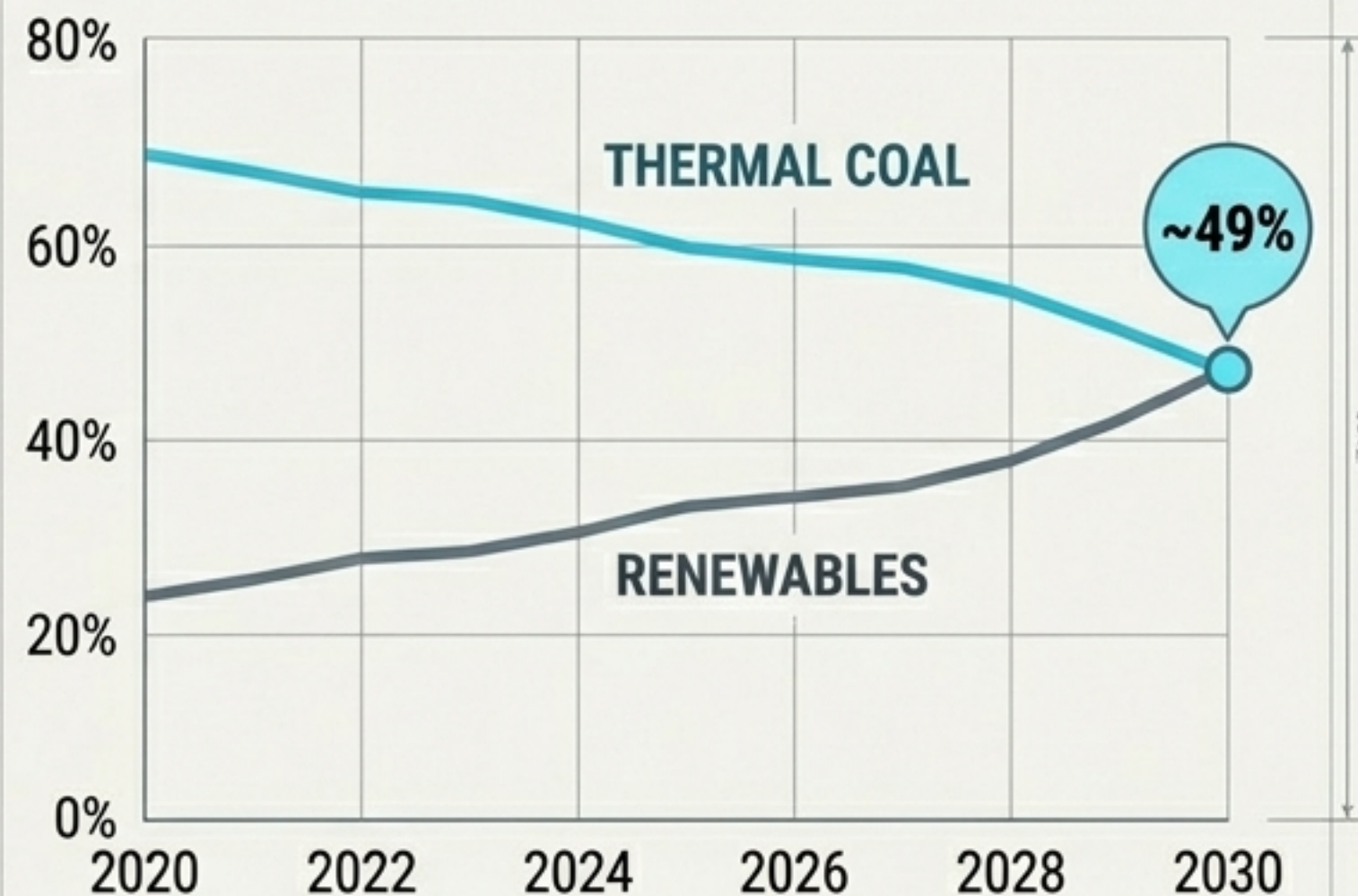
IFRS Parent Net Profit: Decline



Earnings are retreating off a cyclical commodity peak, not climbing off a low. Revenue is flat-to-declining (-13.2% in FY2025).

THE STRUCTURAL THAW

China's energy generation mix projection



China targets peak coal before 2030. While Shenhua's low costs provide "last-man-standing" economics, the total addressable market is a shrinking castle. Output volumes are flat-to-down (~330 Mt self-produced).

THE STATE PARENT: CHINA ENERGY INVESTMENT CORP

(69.52% ownership, central SASAC SOE)

RMB 133bn (~US\$18.9bn)
Asset Injection: 12-13
enterprises transferred

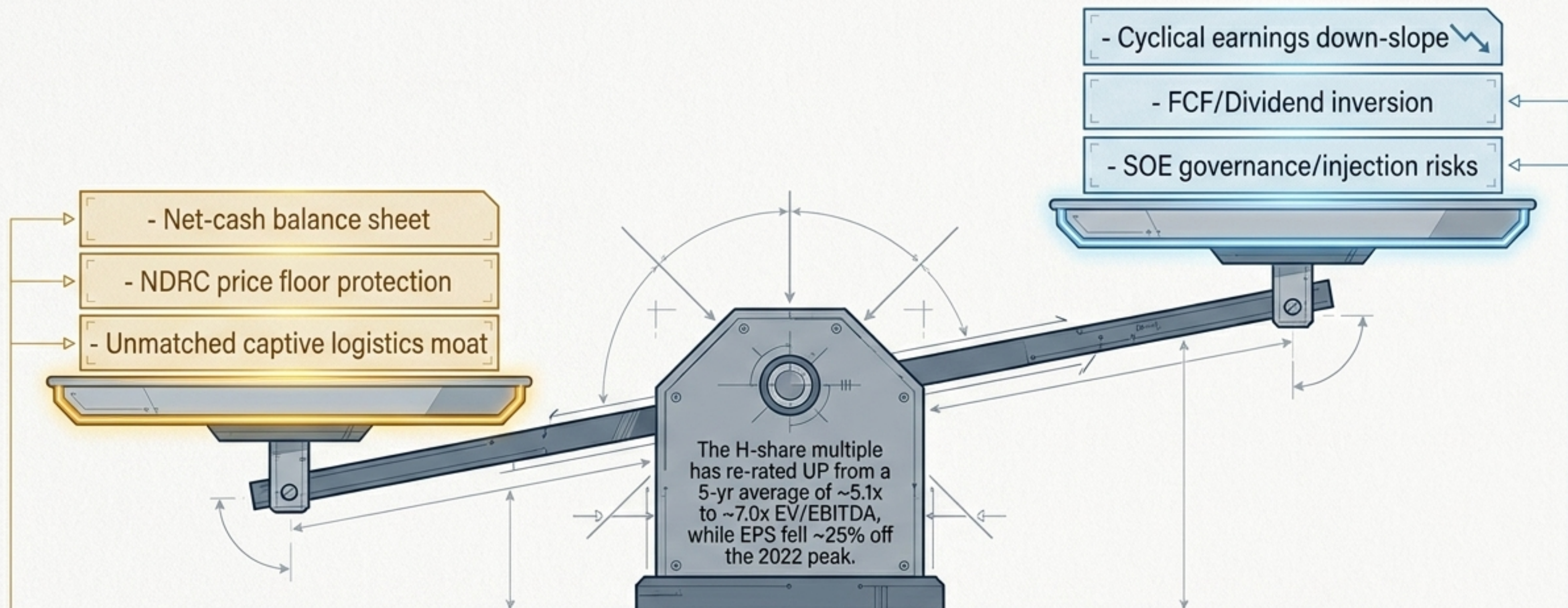
SHENHUA
LISTCO

OPAQUE PRICING:
Valuation methodology, multiple paid, and per-share accretion/dilution remain entirely undisclosed.

DILUTION RISK:
Executed via A-share issuance to the parent, raising its stake above 69.5%.

ENTANGLED OPERATIONS:
~32% of Shenhua's total group revenue is transacted directly with the parent group.

Capital allocation serves the state first. Minorities benefit when state and minority interests temporarily align (high payouts), but remain vulnerable to parent-set pricing on massive M&A.



The market is no longer pricing terminal decline; it is pricing a durable, policy-protected cash annuity. The ~5-6% A/H premium means the 'discounted H-share' edge is gone. You are paying up for safety while the cash generation eases.

Variant Perception Diagnostic Table

Thesis Driver	Bull View	Bear View	Falsification Test (Watch For)
Coal Price (QHD 5,500)	Holds mid-band (RMB 650–740) on supply discipline.	Record domestic supply presses toward/below RMB 570 floor.	QHD 5,500 trades sustainably below RMB 570 for >2 quarters.
Payout Sustainability	Capex drops in 2026; net cash easily bridges temporary FCF gaps.	Sustained FCF shortfall forces a dividend cut once hoard is drawn.	FY2026 capex does <i>not</i> fall, or DPS is cut below 65% floor.
RMB 133bn Parent Injection	Low-cost reserves injected at fair value; scales the cash machine.	Value transfer / dilution at a parent-set premium multiple.	Deal multiple disclosed above listco's own; post-deal metrics dilute EPS.
Decarbonization Timeline	Slow, decade-plus melt buffered by energy-security policy.	Renewables substitution accelerates past expectations.	National coal-power generation declines >5%/yr on trend.

Current State: Maintain HOLD. The valuation is fair-to-full for the quality. Yield is supported by the balance sheet, but margin of safety is thin at $\sim 7x$ EV/EBITDA on falling earnings.

The Trigger to BUY

Target Entry: H-share $\sim 10-11x$ P/E / $\sim 5x$ EV/EBITDA / $\sim 6\%+$ H-yield (Mid-teens ADR).

Fundamental Catalyst: Coal stabilizes mid-band AND the RMB 133bn parent injection is transparently disclosed as per-share accretive with payout held $\geq 75\%$.

The Trigger to AVOID

Fundamental Catalyst: QHD 5,500 sustainably pierces the RMB 570 floor.

Governance Catalyst: Parent injects assets at a value-destructive price, or the dividend is cut to fund the transaction.

A world-class asset perfectly priced for imperfection. Own the cash, mind the thaw, and demand the right multiple.