Have Higher Coal Prices Improved Financial Risk for Coal Producers?

Our Mid-Year View on 24 Issuers in the Coal Industry

September 30, 2021

From our analysis of the performance of 24 coal producers over the first half of the year, we find that due to the high coal prices bolstered by tightened supplies, the first six months of 2021 saw significant operating cash inflow among the samples, providing good conditions for players to alleviate debt. However, overall debt remains high, and coal producers in Shanxi and Henan have struggled to improve their financial positions. That being said, liquidity pressure has eased for some producers, thanks to the high prices and local government support. In addition, we expect coal prices to remain high for a sustained period, providing a good window for coal producers to lower their financial risks.

In our opinion, despite the positive effect of high coal prices on operating cash flows, the effect on interest-bearing debt in the industry has been minimal, with debt still at a high level. This makes it hard to say that financial risk has improved substantially. Coal prices reached an all-time high at the beginning of 2021. By the end of June, the price of Qinhuangdao 5,500 kcal/kg coal had further increased, reaching 980 RMB/ton. Against this backdrop, profit and cash flow of coal producers improved significantly in the first half of 2021. For our sample, total operating cash inflow was 195 billion RMB. However, interest-bearing liabilities decreased by only 1.4%, from 2.88 trillion RMB in January to 2.84 trillion RMB. Progress made on deleveraging benefitted more from increased EBITDA rather than a substantial reduction in interest-bearing debt, leaving financial risk in the industry at a high level.

Chart 1

Coal Sector Debt and Leverage Level

Note: 1. Within our sample of 24 entities, leverage ratio is based on our adjustments after calculating interest-bearing debt/EBITDA; mid-year figures are estimates. 2. Chart shows median level for sample’s leverage ratio. 3. Debt level based on sample’s absolute debt level. Source: Wind, S&P Global (China) Ratings.

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While the debt level remains largely unchanged, we note some regional variation caused by differences in access to refinancing. In Shanxi, coal producers’ interest-bearing debt fell by around 50 billion RMB, the biggest drop of any province. However, with overall debt exceeding 1 trillion RMB, deleveraging still has a long way to go. Leverage remains high among players in Shaanxi, Henan and Hebei.

The effects of the November 2020 Yongmei default on refinancing are still reverberating, particularly in Shanxi and Henan. In the first half of the year, cash flow from financing was basically negative. However, as operating cash flow was relatively good, producers were able to service their debts, leading to decreases in interest-bearing liabilities of 51.8 billion RMB in Shanxi and 18.3 billion RMB in Henan. In contrast, there has been minimal impact on refinancing in Shaanxi and Shandong. Players in these regions have been able to maintain some investment activity while servicing their debts, with a small increase in debt as well as cash.

While there has been limited improvement in financial risk, liquidity pressure of some players has eased. Improved industry prospects and strong local government support, coupled with relatively tight financial constraints, saw some improvement in liquidity for coal enterprises in Shanxi, Anhui, Shandong and Shaanxi in the first half of the year. In contrast, access to refinancing in Henan lags behind other regions, impacting on the liquidity of coal producers in the region. For coal companies in Guizhou, the amount of debt maturing within one year has increased at a rapid pace, also leading to a decrease in liquidity.
We expect the tight balance between coal supply and demand to continue in the short term as prices and profits stay at a good level. This should provide a good window for players to reduce leverage.

While COVID-19 still lingers over the economic recovery, coal demand is not expected to decline significantly. In terms of supply, growth in fixed-asset investment has slowed in recent years, limiting expansion of production capacity. Stricter safety protocols in the wake of frequent mining accidents along with China’s carbon goals are also constraining supply. Despite strong demand, we don’t expect a significant increase in output in the short term, while coal imports are still restricted by COVID. For these reasons, coal prices should continue to remain at a high level.

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