

# Shanxi Coal SOEs' Consolidation Boosts Companies' Competitiveness

October 21, 2020

In our view, Shanxi provincial government's initiatives to consolidate state-owned coal companies this year could have a positive impact on the indicative credit quality of coal companies in the province. The reforms aim to reduce competition within the province, enhance the overall strength of coal companies, reduce overlapping operation, and consolidate resources within coal and non-coal sectors. At the same time, the consolidation of Shanxi coal companies is also conducive to increasing concentration across the entire coal industry.

According to an announcement issued by Jinneng Group<sup>1</sup> and relevant entities on October 10, 2020, Shanxi Province plans to merge Datong Coal Mine Group<sup>2</sup>, JAMG<sup>3</sup>, Jinneng Group, Lu'an Group<sup>4</sup> into an entity called Jinneng Holding Group<sup>5</sup>. We expect this restructuring to increase Jinneng Holding Group's total assets to 1.1 trillion RMB, with coal output of about 300 million tons, which is likely to result in Jinneng Holding Group's becoming the second largest coal producer in the country. Companies involved in this transaction may see major changes to their business scopes.

This move is the third large-scale restructure of coal companies in Shanxi this year. In April, the Shanxi government approved the takeover of SCIEG<sup>6</sup> by Coking Coal Group<sup>7</sup>. In August, Lu'an Chemical Group<sup>8</sup> was established, with Lu'an Group's announcement that it would consolidate 16 companies' assets including Shanxi Lu'an Environmental EnergyDev. Co.,Ltd. under the newly-formed Lu'an Chemical Group.

In our opinion, further consolidation of the industry can help improve the competitiveness of coal enterprises. Although the products from seven state-owned coal enterprises in Shanxi are relatively similar, the firms still differ to some degree in terms of indicative credit quality. Entities with weaker indicative credit quality may obtain more resources through merging with companies of better indicative credit quality in the province, thus improving their operations. In addition, they may receive a certain level of group support, which may improve companies' refinancing capabilities and reduce financing costs. At the same time, the restructuring of Jinneng Holding Group and Coking Coal Group would lead to further concentration of coal and non-coal resources, which would help strengthen the coal industry and optimize non-coal businesses. Before this year's industry consolidation, there were a large number of coal SOEs in Shanxi, with scattered resources, highly similar products and fierce competition. The restructuring of coal SOEs may lead to more concentrated resources and improve specialization. At the same time, competition within the province will also decrease, enhancing the competitiveness of enterprises.

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<sup>1</sup> Jinneng Group Co., Ltd

<sup>2</sup> Datong Coal Mine Group Co., Ltd.

<sup>3</sup> Shanxi Jincheng Anthracite Mining Group Co., Ltd.

<sup>4</sup> Lu'an Mining Industry Group Co., Ltd.

<sup>5</sup> Jinneng Holding Group Co., Ltd.

<sup>6</sup> Shanxi Coal Import & Export Group Co., Ltd.

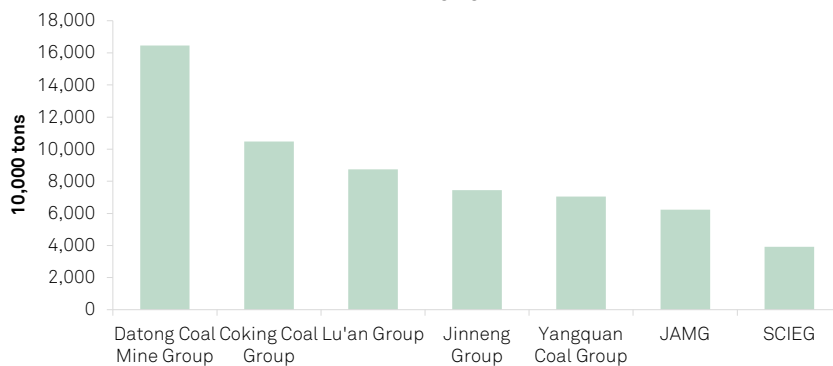
<sup>7</sup> Shanxi Coking Coal Group Co., Ltd.

<sup>8</sup> Lu'an Chemical Group Co., Ltd.

However, the financial leverage of coal enterprises in Shanxi is generally high. In our view, smooth handover of debt payment responsibility and timely payment of the debts are critical during industry consolidation. At present, the consolidation of coal companies in Shanxi is still at an early stage, and we will continue to monitor the progress of this industrial restructuring. But historically, the Shanxi government has always shown strong willingness to support state-owned coal enterprises. In addition, according to recent disclosures by Shanxi State-owned Capital Operation Co., Ltd, SOEs affiliated to Shanxi Province have established a debt repayment funding pool and have an early warning mechanism for bond maturity.

Chart 1

### Shanxi's State-Owned Coal Enterprises' Coal Production, 2019



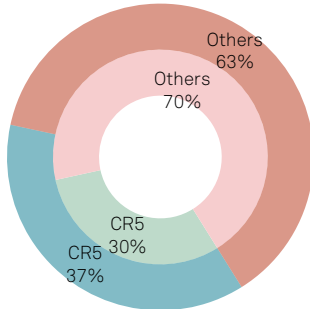
Note: Yangquan Coal Group is the abbreviation of Yangquan Coal Industry (Group) Co.,Ltd.  
 Source: Companies' prospectus, S&P Global (China) Ratings.  
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At the same time, we expect that the two newly-formed coal groups may become more important to the Shanxi government. On the one hand, the two groups would have more concentrated control of core resources in the province, supporting the local economy and employment. On the other hand, compared with the management methods of the seven major coal companies, the group management approach would see the group managing its coal companies on behalf of the government to a certain extent, strengthening the connection between the group and the government.

In our view, the restructuring of Shanxi coal companies may lead to greater concentration across the entire coal industry and benefit the development of leading firms and coal sectors. We expect that after the recently announced restructuring, industry concentration will increase to a certain extent. Concentration ratio of the top 5 companies (CR 5) will increase from 30% at the end of 2019 to about 37% (considering the merger of Shandong Energy Group Co., Ltd and Yankuang Group Co.,Ltd). The increase in concentration will help leading companies increase their bargaining power over downstream companies, which is also in line with relevant national industrial policies.

Chart 2

### Concentration of The Coal Industry is set to Increase



Note: The inner circle is the industry concentration calculated based on the output in 2019; the outer circle is the industry concentration calculated by adding the output of Datong Coal Mine Group, Jinneng Group, and JAMG in 2019 as the output of Jinneng Holding Group.

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