BlackRock

Investment Stewardship

Vote Bulletin: Huadian Power International

Company	**Huadian Power International (SHA: 600027/HKG: 1071)**
Market and Sector	China/Utilities
Meeting Date	30 June 2021
Key Resolutions[1]	**Item 9:** Approve Equity Acquisition Agreements and Related Transactions **Item 10:** Approve Capital Increase Agreement, Assets and Equity Disposal Agreements, and Related Transactions
Key Topics	Related party transaction, minority shareholder rights, climate risk
Board Recommendation	The board recommended voting FOR both related party transactions
BlackRock Vote	BlackRock voted AGAINST both related party transactions

Overview

Huadian Power International (Huadian International) engages in the construction, operation and management of power generation plants in China. As of late 2020, its controlled installed power generation capacity reached 58 GW, of which 74.8% was coal-fired power and 8.51% was wind and solar power.[2] The company is 47% controlled by its state-owned parent, Huadian Group, and is dual listed on the Shanghai and Hong Kong Stock Exchanges.

BlackRock Investment Stewardship (BIS) had multiple engagements with the company in the last 12 months to discuss corporate governance issues that we believe drive long-term shareholder value, including management and board oversight of climate-related risks, corporate strategy and sustainability disclosures.

At the 2021 annual general meeting (AGM), management proposed two major related party transactions between the company and its parent Huadian Group, involving a total consideration of USD 3.76 billion. Specifically, the company sought shareholder approval (i) to acquire three coal-fired power projects with a total capacity of 4.5 GW, and (ii) to reorganize its own wind and solar power portfolio by injecting all related assets into a dedicated renewable energy entity, majority controlled by Huadian Group, in exchange for a minority stake of 37.19% in this entity.

The company stated “rapid economic growth and large potential power demand” and the ability to “better concentrate its resources to promote the construction and mergers and acquisitions of its own high-quality conventional energy projects in the future” were the key rationale for the transaction. Both of the related party

[1] Huadian Power International, “Major and Connected Transactions: (1) Capital Increase In Fuxin Development; (2) Disposals Of New Energy Assets And Equity; (3) Acquisitions Of Hunan Area Companies; And Supplemental Notice Of Annual General Meeting”.

[2] Huadian Power International, “2020 Environmental, Social and Governance Report,” page 6.

transactions required majority support from independent shareholders as per the Listing Rules in Shanghai and Hong Kong.

Rationale for BlackRock's Vote

Item 9: Approve Equity Acquisition Agreements and Related Transactions (AGAINST)

BIS voted against this proposal because we believe that the proposed acquisition of coal-fired power projects is value destructive for minority shareholders as the consideration for assets acquired does not appear to account for carbon-intensive related risks which the markets ascribe to such assets.

At the time of the AGM, 74.8% of Huadian International's installed capacity is in coal-fired power. Its shares have traded at an average 26% discount to its net asset value (NAV) over the last year (16% average discount over the last three years) on the Shanghai exchange while in Hong Kong the shares traded at an average 60% discount over the last year (48% average discount over the last three years). However, the acquisition of the three coal-fired power plants was priced at a 36% premium to the NAV of the target assets themselves, which is a striking contrast to the market valuation of Huadian International.

The deep discount of the company's valuation in relation to its NAV may reflect mounting investor concerns regarding the quality and environmental impact of coal-fired power assets in China. These concerns include declining thermal utilization hours, government policies that aim to reduce coal consumption, expected rising operating expenses due to the launch of the national emissions trading scheme (ETS) in July 2021, among other factors. However, such considerations do not appear to have been reflected in the pricing of the transaction: rather, it appears the valuation used only replacement cost based on an estimate of construction cost of a new coal-fired power plant with similar generation capacity, failing to reflect the risk that the market value of such assets is now significantly below the estimated cost of a new build. The 36% premium is primarily due to the appreciation of the underlying land value.[3]

If similar discounts to those that the equity market currently applies to Huadian International were applied to the value of the three coal-fired power projects under consideration, BIS estimates value destruction of approximately USD 300 million should the transaction go ahead. We are also concerned about the timing of the acquisition given the forthcoming announcement of China's 14th Five-Year Plan for the energy sector, which could have further negative implications for the valuation of domestic coal-fired power assets.

Item 10: Approve Capital Increase Agreement, Assets and Equity Disposal Agreements, and Related Transactions (AGAINST)

BIS voted against this proposal given our concerns about apparent conflict of interest and the impediment it would pose for the company to adequately manage the transition of its assets to a low carbon economy.

Although the asset injection in relation to the reorganization of Huadian International's renewable assets was at fair valuation terms, we had concerns about the conflict of interests inherent in this transaction. As indicated in the Circular,[4] post-reorganization, Huadian International would lose operational control of its wind and solar power portfolio and be barred from making any new investments in those renewable energy projects to prevent competition with its controlling shareholder, Huadian Group. Instead, it would become the de-facto listing

[3] Huadian Power International, "Major and Connected Transactions: (1) Capital Increase In Fuxin Development; (2) Disposals Of New Energy Assets And Equity; (3) Acquisitions Of Hunan Area Companies; And Supplemental Notice Of Annual General Meeting," pages 92-94, 414-417.

[4] Huadian Power International, "Major and Connected Transactions: (1) Capital Increase In Fuxin Development; (2) Disposals Of New Energy Assets And Equity; (3) Acquisitions Of Hunan Area Companies; And Supplemental Notice Of Annual General Meeting," pages 50-51.

vehicle for all the conventional energy projects[5] within the parent Huadian Group, introducing direct exposure to more coal-fired power assets in the coming years.[6]

This group-level strategy puts minority shareholders of Huadian International, such as BlackRock's clients, at a clear disadvantage. Since the reorganization effectively prevents Huadian International from investing in wind or solar power projects, its shareholders are deprived of opportunities to participate in China's renewable energy market. Furthermore, if approved, the transaction would impede Huadian International's ability to manage the low-carbon transition by constraining its efforts to decarbonize its power portfolio. With the remaining business portfolio primarily concentrated in coal and natural gas that emitted 153 million tonnes of CO2 last year,[7] the company could struggle to reach its short-term target to have 45% installed capacity in renewables by 2025, and could risk misalignment with China's long-term commitment of peaking carbon emissions by 2030 and reaching carbon neutrality by 2060. The failure to effectively manage climate risks posed by this transaction could lead to significant regulatory and financial risks for Huadian International and its ability to deliver long-term value for investors.

Accordingly, we view the proposal to acquire the three coal-fired power projects and the reorganization of renewable energy assets into a separate entity as a cause for concern regarding Huadian International's corporate strategy with the risk of the company serving only as a listing vehicle for conventional energy projects within the Huadian Group. BIS believes that a company's sustainability plan, like corporate strategy more broadly, should serve the long-term interests of all shareholders, and key stakeholders. This is particularly important for transactions such as this where the interests of the controlling shareholder and those of minority shareholders may not completely align.

Finally, BIS is concerned with the Board of Huadian International's oversight of climate risk and its ability to adequately manage the conflicts of interests inherent in the two related party transactions. We note that all the directors of Huadian International, including four independent directors, unanimously recommended that minority shareholders support the transactions. As such, we intend to hold incumbent directors not up for re-election at this AGM accountable by voting against their re-election at future shareholder meetings.

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[5] Conventional energy is defined as thermal, hydro and natural gas by Huadian International.

[6] By the end of 2019, Huadian Group had a total installed capacity of 153 GW, of which 108GW was thermal power, including coal and gas. Huadian International's installed capacity of thermal was 43 GW as of end 2020. Source: Reuters.

[7] Huadian Power International, "2020 Environmental, Social and Governance Report," page 44.

About BlackRock Investment Stewardship (BIS)

BlackRock Investment Stewardship (BIS) plays a key role in our fiduciary approach. As an essential component of our responsibility to our clients, we engage with companies to advocate for the sound corporate governance and business practices that drive the sustainable, long-term financial returns that enable our clients to meet their investing goals.

Our approach is from the perspective of long-term, minority shareholders in public companies on behalf of our clients. We look to boards and executive management to serve the interests of long-term shareholders and other stakeholders. Our active and ongoing dialogue with the leaders of these companies gives us a valuable perspective on their long-term strategies, financial performance, and the business challenges they face.

As stewards of our clients' assets we have a responsibility to make sure companies are adequately managing and disclosing environmental, social and governance (ESG) risks and opportunities that can impact their ability to generate long-term financial performance — and to hold them accountable if they are not. Engaging with companies is how BIS builds an understanding of a company's approach to governance and sustainable business practices, how we communicate our views, and how we ensure companies understand our expectations. If a company falls short of our expectations and we have been given the authority to vote the company's shares, we would hold them accountable by voting in the best long-term economic interests of those clients that have given us proxy voting authority. As detailed in our Global Principles, proxy voting involves logistical issues which can affect BlackRock's ability to vote such proxies, as well as the desirability of voting such proxies. As a consequence, BlackRock votes proxies on a "best-efforts" basis.

We are committed to transparency in our stewardship practices. Our vote bulletins provide detailed explanations of key votes relating to a range of business issues including ESG matters that we consider, based on our Global Principles, market-level voting guidelines, and engagement priorities, material to a company's sustainable long-term financial performance. We publish select vote bulletins after the shareholder meeting to provide transparency for clients and other stakeholders into our approach to the votes that we believe require more detailed explanation.