BlackRock.

Investment Stewardship Group

Yanzhou Coal Mining Company

As part of our fiduciary duty, BlackRock's Investment Stewardship team (BIS) advocates for sound corporate governance and business practices that are aligned with long-term, sustainable financial performance. This objective underpins all our engagements and votes at company meetings.

We engage company leadership on key topics emphasizing governance practices including management of environmental and social factors that potentially have material economic, operational or reputational ramifications for the company.

We determine our engagement priorities based on our observation of market developments and emerging governance themes and evolve them year over year as necessary. The BIS team's key engagement priorities include:

1. Board quality
2. Environmental risks and opportunities
3. Corporate strategy and capital allocation
4. Compensation that promotes long-termism
5. Human capital management

We are committed to enhancing the transparency of our stewardship practices. Where we believe it will help to understand our voting decisions on key votes at shareholder meetings, we will publish a Voting Bulletin explaining the rationale for how we have voted on select resolutions, and (where relevant) provide information around our engagement with the issuer.

Company	**Yanzhou Coal Mining Company**
Market	China
Meeting Date	9th December 2020
Key Resolutions[1]	**Item 1**: to consider and approve Equity Interests and Assets Transfer Agreement between Yankuang Group Company Limited and Yanzhou Coal Mining Company Limited and to approve the transactions contemplated thereunder
Board Recommendation	The board recommends shareholders to vote FOR Item 1

[1] Meeting information can be accessed at: https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1116/2020111600539.pdf

BlackRock Vote	BIS voted AGAINST the proposed acquisition due to our concerns about the underlying valuation for the terms of the transaction and management's oversight of potential stranded asset risks.[2]

Overview

Yanzhou Coal Mining Company (Yanzhou Coal) is primarily engaged in the coal mining, coal railway transportation and coal chemical businesses, with coal mining accounting for 95% of its pre-tax earnings in 2019. The company is 56.01% controlled by its state-owned parent Yankuang Group and is dual listed in Shanghai and Hong Kong.

In September 2020, Yanzhou Coal proposed to acquire the equity interests held by Yangkuang Group in seven business entities for a total cash consideration of CNY 18.4 billion. The key assets to be acquired include a coal liquefaction project, a supporting coal mine and a coal-fired power plant, as well as other ancillary facilities.

These acquisitions are considered connected transactions given Yankuang Group is both the seller and the significant shareholder of Yanzhou Coal. <u>Under both Shanghai and Hong Kong Listing Rules, the proposal requires majority approval from independent shareholders only.</u>

The capital market reacted negatively to the transaction announcement. On October 5th, 2020, the first day after the market reopening,[3] Yanzhou Coal's Hong Kong-listed H share tumbled 12.85%. Subsequently, Yanzhou Coal announced its 2020-2024 shareholder return plan, committing to distribute a minimum of CNY 0.5 cash dividend per share and at least a 50% cash payout. Yankuang Group also pledged to compensate for any earning shortfalls if the aggregate profits of the acquisition targets fall below CNY 4.31 billion during the next three years.

Rationale for BlackRock's vote

Yanzhou Coal's rationale for making the acquisition, namely to expand its coal chemical business and to extend the industrial chain for profit enhancement, is duly noted. **Nevertheless, BlackRock believes it is in our clients' best long-term economic interests to vote against the proposed acquisition due to two primary concerns:**

- **The underlying valuation for the terms of the transaction; and**
- **Management's oversight of potential stranded asset risks**

We have concerns in respect to the transaction valuation and the underlying assumptions used. The proposed CNY 18.4 billion consideration represents 1.6x price to book (P/B) multiple based on the book value in the first half of 2020, which is mainly from the appreciation of coal mining rights upon revaluation. The underlying assumption of such revaluation, according to the meeting circular, is that the coal price in China would further increase from the current level and remain at that higher level until after 2023.[4]

From a valuation methodology perspective, we find it questionable to project future coal prices by simply extrapolating historical price patterns. It also does not take into account the evolving coal market dynamics, including possible regulatory developments particularly regarding climate change mitigation and China's aspiration to become carbon neutral by 2060. In fact, as noted by the third-party appraiser retained by Yanzhou

[2] Stranded asset risk is the risk that an asset may need to be decommissioned before the end of its economic life.

[3] The Hong Kong market was closed between October 1st and 4th for public holiday.

[4] See meeting circular, p. 631, https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1116/2020111600539.pdf

Coal, should the coal price drop by 15% from the current projection levels, the value of the mining rights would decrease by 23.7%[5]. This alone would reduce the valuation by CNY 2.3 billion.

The commitment on profit distribution and the earnings guarantee do little to address this concern. They are relatively short-term focused, and the guarantee amount covers just a small portion of the total consideration. More importantly, it does not recognize longer-term uncertainties in coal prices and demand that could have more significant implications for the value of these assets. Considering that Yanzhou Coal only trades at 0.5x P/B as a coal mining company, it is not clear whether paying three times more for coal related assets valued at 1.6x P/B could truly be value accretive for shareholders.

Moreover, we are cautious about the potential stranded asset risks at Yanzhou Coal following the asset purchase. The transaction was announced shortly after China pledged to achieve carbon neutrality by 2060 with carbon emissions peaking by 2030. Yet Yanzhou Coal as a state-owned enterprise did not articulate how the acquisition of these coal-related assets aligns with China's stated goals, including the new Nationally Determined Contributions to be updated at the UN Climate Change Conference (COP 26).

In particular, concerns remain about Yanzhou Coal's decision to acquire a coal-fired power plant as part of this transaction. The coal-fired power sector in China is already facing numerous challenges such as tightened emission standards, overcapacity, as well as declining utilization hours. The sector is expected to become even more challenged as more provinces anticipate grid parity for renewable energy.[6] Therefore, such an acquisition could well exacerbate the company's stranded asset risks and delay progress to achieve the company's decarbonization targets.

We have communicated the above concerns with management and requested the company consider reporting on its approach to the energy transition in alignment with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). BIS will continue to closely monitor Yanzhou Coal's progress on sustainability reporting and engage to advocate for business practices aligned with long-term value creation.

---

[5] See meeting circular, p. 634, https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1116/2020111600539.pdf

[6] Carbon Tracker, https://carbontracker.org/reports/how-to-waste-over-half-a-trillion-dollars/