
RELATIONSHIP WITH THE CONTROLLING SHAREHOLDERS

OVERVIEW

As at the Latest Practicable Date, Yankuang was, directly and indirectly, interested in approximately 51.81% of the shares in Yanzhou and Yanzhou was interested in approximately 65.45% of the Shares in the Company. Immediately following the completion of the Global Offering, (i) Yanzhou will be interested in approximately 62.5% of the Shares in issue (assuming the Over-allotment Option is not exercised), (ii) the Company will remain as a non-wholly owned subsidiary of Yankuang and Yanzhou and (iii) Yankuang and Yanzhou will be the controlling shareholders of the Company. Please refer to “*History and Corporate Structure*” for the simplified corporate structure of the Group.

BACKGROUND OF THE CONTROLLING SHAREHOLDERS

The Yankuang Group

Yankuang was established in the PRC in 1996 and is the controlling shareholder of Yanzhou. It is principally engaged in the production and sale of coal, coal chemicals and aluminium, power generation, machinery manufacturing and financial investments.

The Yanzhou Group

Yanzhou was established in the PRC in 1997 and is the controlling shareholder of the Company. It is principally engaged in the production of coal and coal chemicals, manufacturing of mechanical and electrical equipment and power and heat generation. Yanzhou has been listed on the Shanghai Stock Exchange and the Stock Exchange since 1998.

INDEPENDENCE OF THE GROUP FROM THE CONTROLLING SHAREHOLDERS

The Directors are of the view that the Group is able to carry on its business independently from the Controlling Shareholders following the completion of the Global Offering for the following reasons.

(a) Clear Delineation of Business

Geographical location of assets

The Group

All mines in which the Group has interests and operates are located in New South Wales and Queensland in Australia. In particular, the flagship mines of the Group, being HVO (which is operated as an unincorporated joint venture with Glencore), MTW and Moolarben, which in aggregate accounted for approximately 88.7% of total coal sales (on an attributable basis) in 2017 by the Group from the mines in which the Group has interests and operates, on a pro-forma basis (as if the C&A Acquisition, the Warkworth Transaction and the Glencore Transaction had been completed on 1 January 2017), are located in New South Wales.

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The Yankuang Group

All mining assets of the Yankuang Group are located in the Shaanxi and Guizhou Provinces and Xinjiang Autonomous Region in the PRC. The Yankuang Group does not have any interests in mines in Australia other than through its interests in the Yanzhou Group and the Group. There is no overlap in the geographical location of the mining assets of the Yankuang Group and the Group.

The Yanzhou Group

The substantial majority of Yanzhou's mining assets are located in the Shandong and Shanxi Provinces and the Inner Mongolia Autonomous Region in the PRC.

The mining assets of Yanzhou located outside of the PRC, other than through its interest in the Group, are managed and operated by the Company. These mining assets of Yanzhou comprise (i) the Cameby Downs mine located in Queensland, Australia, which includes exploration projects not currently in production and (ii) the Premier mine located in Western Australia (the "**Managed Mines**"). Pursuant to a long term management services agreement, the Company is responsible for, among others, HR, treasury and the operations, exploration and development of the Managed Mines. See "*Business – Our Mining Operations – Managed Mines*" and "*Connected Transactions – 3. Provision of Management Services by the Company*".

Based on the foregoing and in particular, taking into consideration the management arrangement in respect of the Managed Mines, the geographical locations of mine assets of the Group are clearly delineated from the Yankuang Group and/or the Yanzhou Group.

Geographical location of markets of sales

The Group

The customers of the Group are located throughout the Asia-Pacific region, with China, South Korea, Singapore and Japan comprising the largest jurisdictions by revenue during the Track Record Period. The major customers of the Group are power utilities and steel mills. With respect to the PRC market, customers of the Company are mainly located in coastal regions, including Guangdong Province, Guangxi Province, Zhejiang Province and Jiangsu Province, as the cost of sourcing coal from domestic markets by customers with plants located in coastal regions is greater than that from seaborne market.

The Yankuang Group

Primarily due to market demand, logistic constraints and transportation costs, all coal produced by Yankuang's mines in the PRC are sold to customers located in the PRC, including customers in local provinces and Yankuang Group's chemical products production plants.

The Yanzhou Group

All coal produced by Yanzhou's mines in the PRC are sold to customers located in the PRC, which are primarily power plants, metallurgy and chemical plants, primarily located in inland areas of the PRC due to market demand, logistic constraints and

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transportation costs. As the Managed Mines are managed and operated by the Company, sales of coal produced by the Managed Mines are arranged by the Company's marketing and logistics personnel. As at the Latest Practicable Date, other than coal produced by the Managed Mines, Yanzhou was not engaged in coal export business.

Based on the foregoing, the geographical locations of markets of sales of the Group are clearly delineated with that of the Yankuang Group and/or the Yanzhou Group.

Business size

In 2015, 2016 and 2017 and the six months ended 30 June 2018, the revenue from the sale of coal produced by Yanzhou's mines located in the PRC was approximately RMB13,252 million, RMB17,216 million, RMB25,593 million and RMB14,076 million, representing approximately 64.5%, 72.4%, 66.6% and 55.7% of its total revenue from the sale of self-produced coal, respectively.

In 2015, 2016 and 2017 and the six months ended 30 June 2018, the revenue from the sale of coal produced by the Managed Mines was RMB1,836 million, RMB1,745 million, RMB2,395 million and RMB1,129 million, representing an insignificant percentage in terms of the total revenue from the sales of self-produced coal of Yanzhou, being approximately 8.9%, 7.3%, 6.2% and 4.5%, respectively.

In 2015, 2016 and 2017 and the six months ended 30 June 2018, the revenue from the sales of coal produced by the Group's mines, all of which are located in Australia, was approximately A\$1,074 million, A\$967 million, A\$2,204 million and A\$2,075 million, respectively.

Based on the above, the coal production and sale business of the Managed Mines represent a relatively small proportion of Yanzhou's coal production and sales business, and is relatively small in comparison to the Group's coal production and sales business.

For the reasons set out above, the Directors are therefore of the view that there is clear delineation of business of the Group from the businesses of the Controlling Shareholders.

(b) Operational Independence

The Group holds all the relevant licenses, qualifications and permits required for conducting the Group's business independently of the Controlling Shareholders. The Group has its own organisational structure comprising various departments that function and make decisions independently from the Controlling Shareholders. The Group maintains a set of internal control procedures and has adopted corporate governance practices that satisfy the applicable legal and regulatory requirements. The Group is able to formulate and execute operational decisions independently.

The Group from time to time may sell coal to the Yanzhou Group. Such transactions were and will be conducted in the ordinary and usual course of business of the Group, on an arm's length basis and on normal commercial terms or better to the Group. The reason for the purchase of the coal by the Yanzhou Group is for their own trading purposes but may sometimes enter into purchase transactions for back-to-back on sale to end customers. For the years ended 31 December 2015, 2016 and 2017 and the six months ended 30 June 2018, the revenue generated from the sales of coal to the Yanzhou Group was approximately US\$12.6 million, US\$30.6 million, US\$5.1 million and US\$104.5 million, respectively, representing approximately only 1.3%, 3.4%, 0.3% and 3.3% of the total revenue of the Group, respectively. See "*Connected Transactions*".

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The Directors are of the view that the connected transaction entered into with the Yanzhou Group as described above will not have any material impact on the Group's ability to operate independently and the Group's operations are independent from the Controlling Shareholders.

(c) Financial Independence

As at 30 June 2018, except for the guarantee provided by Yankuang in respect of the obligations of Watagan (a wholly owned subsidiary of the Company) under a loan facility agreement between the Company and Watagan, of which, A\$730 million remained drawn-down, there are no loans or guarantees which are provided by the Yankuang Group to or for the benefit of the Group. See "*Connected Transaction – Exempt Continuing Connected Transactions*" for further details.

As at 30 June 2018, the Yanzhou Group had also provided to the Group (a) loan facilities with an aggregate drawn-down principal amount of A\$1,611 million and (b) guarantees in respect of loans provided by several financial institutions with an aggregate outstanding principal amount of US\$1,950 million. See "*Connected Transactions – A. Exempt Continuing Connected Transactions*" for further details of these loan facilities and guarantees. All such loan facilities and guarantees are on arm's length and normal commercial terms and no security over the Group's assets has been given by the Group to the Yanzhou Group for the provision of such loan facilities and guarantees to the Group. On completion of the Global Offering, assuming an Offer Price of HK\$24.66 (being the mid-point of the Offer Price Range) and before any exercise of the Over-allotment Option, approximately HK\$600.7 million of the outstanding principal amount of (i) the loans in respect of which guarantees have been provided by the Yanzhou Group or (ii) unsecured loans from related parties will be repaid using the net proceeds of the Global Offering.

Since 30 June 2018, the Company has not drawn down or utilised any of the loan facilities or guarantees mentioned above and has no intention to further draw down on such loan facilities or guarantees before the Listing.

The Group has obtained financing from third party sources on a standalone basis without any credit support from the Yanzhou Group or the Yankuang Group or any of their respective associates. In 2017, the Company obtained a bank guarantee facility from several financial institutions in the amount of A\$1 billion. In addition, in June 2018, the Company obtained an offer letter from a financial institution to provide a loan facility in the aggregate amount of US\$3 billion and a bank guarantee facility of A\$1 billion on arm's length and normal commercial terms. Furthermore, the Company has obtained an offer letter in September 2018 from a financial institution to provide an incremental term loan facility for the amount of US\$700 million on arm's length and normal commercial terms. The facilities under the offer letters obtained in June 2018 and September 2018 have not been utilised by the Company as at the Latest Practicable Date. Each of the above facilities and offer letters were obtained without any credit support from the Yanzhou Group or the Yankuang Group or any of their respective associates.

The Directors are therefore of the view that the Group is able to operate financially independently from the Controlling Shareholders.

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(d) Independence of Directors and Management

The Board of Directors consists of 11 Directors, comprising one Executive Director, six Non-executive Directors and four Independent Non-executive Directors. Of the 11 Directors, five Non-executive Directors currently hold positions in the Controlling Shareholders, details of which are set out below:

<u>Name of Director</u>	<u>Material positions with the Controlling Shareholders as at the Latest Practicable Date</u>
Baocai ZHANG	director, member of Party's standing committee and general counsel of Yankuang
Cunliang LAI	deputy general manager of Yankuang
Xiangqian WU	director and general manager of Yanzhou
Fuqi WANG	chief engineer of Yanzhou
Qingchun ZHAO	chief financial officer and director of Yanzhou

The Directors are of the view that the Board and the senior management of the Group are able to function independently of the Controlling Shareholders for the following reasons:

- (i) more than half of the members of the Board (comprising the Executive Director (being Mr. Fucun WANG), one Non-executive Director (being Mr. Xing FENG) and all of the Independent Non-executive Directors are independent of, and do not have any directorships and/or other roles with, the Controlling Shareholders and/or their respective close associates;
- (ii) none of the members of the senior management of the Group, who are responsible for the day-to-day management of the Group's business, holds any directorship and/or other roles with the Controlling Shareholders; and
- (iii) any Director with an interest in the relevant matters (including matters relating to the transactions between the Group and the Controlling Shareholders) will abstain from voting in respect of those matters. Only Directors who do not have any ongoing roles with the Controlling Shareholders and/or their respective close associates (as the case may be) will vote and decide on relevant matters relating to the transactions between the Group and the Controlling Shareholders and an independent board committee, comprising Independent Non-executive Directors only, will be established as and when required to consider and approve any connected transactions of the Group in accordance with the Company's internal corporate governance policies and/or the Listing Rules.

(e) Independence of Administrative Capability

All essential administrative functions (such as finance and accounting, administration and operations, information technology, human resources and compliance functions) are carried out by the Group without the support of the Controlling Shareholders. Accordingly, the Directors are of the view that the Group is administratively independent from the Controlling Shareholders.

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DIRECTORS' INTEREST IN COMPETING BUSINESS

Except for (i) Mr. Baocai ZHANG, who is a Non-executive Director and also a director of Yankuang and (ii) Mr. Xiangqian WU and Mr. Qingchun ZHAO, who are Non-executive Directors and also the directors of Yanzhou, none of the Directors is interested in any business apart from the Group's business which competes with or is likely to compete, either directly or indirectly, with the Group's business.