

16 December 2020

# ASX Release:

## Reconsolidation of Watagan Mining

### Trigger event

A commercial arrangement has been entered into between Yankuang Group Co. Ltd (**Yankuang**), its wholly owned subsidiary Yankuang Group (Hong Kong) Limited (**Yankuang HK**) and the other two holders of bonds previously issued by Watagan Mining Company Pty Ltd which will result in Yancoal obtaining accounting control of Watagan Mining Company Pty Ltd and its subsidiaries (together **Watagan**) and the financial results of Watagan will be consolidated in the Yancoal group financial statements (**Yankuang/Bondholder Arrangement**). The effective date of the reconsolidation will be 16 December 2020.

### Existing structure

On 31 March 2016, Watagan completed the issue of US\$775 million of secured debt bonds (**Bonds**) to three external financiers (the **Bondholders**). The Bonds include a 'put option' allowing the Bondholders to put their bonds to Yankuang. The put option is able to be exercised in early January of every second year, commencing January 2019.

Although Watagan is 100% owned and operated by Yancoal, the investment is currently equity-accounted in Yancoal's consolidated financial statements as an associate as it was determined that under the terms of the Bonds, together with other agreements, Yancoal did not control Watagan.

When Yancoal acquires accounting control of Watagan, it will be required to consolidate Watagan as a subsidiary in its consolidated financial statements from the date control is acquired.

### Watagan assets

Watagan has three primary assets: the Ashton, Austar and Donaldson mines. During the first three quarters of 2020, the Ashton mine produced 2.5 million tonnes of ROM coal and 1.1 million tonnes of saleable coal. Ashton's saleable production represents an additional 3.8% over Yancoal's 29.2 million tonnes of attributable saleable coal reported for the first three quarters. The product is typically semi-soft coking coal. Austar and Donaldson are currently on 'care and maintenance'. The operational status of these three assets will be reviewed post reconsolidation.

### **Watagan bonds and control**

In January 2019, the last time the put option was exercisable, one Bondholder elected to put its US\$200 million bonds to Yankuang and, under the terms of the put option Yankuang exercised its right to appoint Yankuang HK as its nominee under the put option. The Yankuang/Bondholder Arrangement includes an agreement that the remaining US\$575 million bonds will be put to Yankuang (the **Put Bonds**), with completion of the transfer of the Bonds to Yankuang HK due to occur on 31 March 2021 (or such earlier date as Yankuang may nominate). The Bondholders have also agreed with Yankuang that their nominated directors will step down from the Watagan Board with effect from 16 December 2020. The resignation of the Bondholder nominated Watagan directors results in Yancoal acquiring control of Watagan from that date.

### **New Yankuang Loan terms**

Simultaneous with the agreement for the US\$575 million bonds being put to Yankuang, Yancoal and Yankuang will execute a new US\$775 million loan facility (**New Yankuang Loan**) whereby Yankuang will provide the loan facility to Yancoal which will be used to refinance all the Watagan bonds on or about 31 March 2021 (or, if the completion of the transfer of the Bonds to Yankuang HK occurs on an earlier date, that date). The all-in interest rate on the existing Bonds is a minimum of 7.0% whereas the interest rate on the New Yankuang Loan will be 4.65% for the first three years and at the Loan Prime Rate <sup>1</sup> for the final three years. The lower rate results in interest savings for the Yancoal group during the first three years. The New Yankuang Loan has a six year duration, which is longer than the existing Bond duration which were repayable in January 2025, whereas the New Yankuang Loan will be repayable on 31 March 2027. After the reconsolidation Yancoal will include the Watagan group entities in its ASIC Deed of Cross Guarantee.

### **Financial reporting**

Yancoal will account for the reconsolidation of Watagan as an acquisition in accordance with AASB 3 *Business Combinations* and be required to consolidate the assets acquired and liabilities assumed of the Watagan group at their fair value at the date of acquisition. This is expected to result in the recognition of a one-off, non-cash loss in Yancoal's 2020 financial result. The unaudited non-cash loss on reconsolidation is currently estimated to be in the range of \$1.3 - 1.5 billion as the estimated value of the liabilities exceeds the estimated value of the assets acquired.

Upon reconsolidation and the subsequent refinance of the Watagan Bonds, Yancoal will:

- (i) *Profit and loss impact*: cease to recognise interest income on the Watagan loan provided by Yancoal (**Yancoal loan**), which in the half-year ended 30 June 2020 was A\$35 million; recognise an interest expense on the Watagan Bonds from the date of acquisition up to 31 March 2021 and on the New Yankuang Loan thereafter, the latter being approximately A\$49 million <sup>2</sup> of cash interest per annum during the first three years; forego the margin recognised under the various service agreements, and recognise the operating results of Watagan, including the three Watagan mines; in the Group's statement of profit and loss.
- (ii) *Balance Sheet impact*: de-recognise the Watagan loan receivable, which as at 30 June 2020 was drawn to A\$965 million, and an intercompany payable of \$202 million, as these amounts will

<sup>1</sup> The Loan Prime Rate (LPR) is the new reference rate for lending in China. The People's Bank of China announced the reform in August 2020. The LPR is the interest rate banks charge their most creditworthy customers.

<sup>2</sup> Assuming a AUD:USD exchange rate of 0.74.

become intercompany balances and will be eliminated on consolidation; recognise the fair value of the Watagan Bonds at the date of acquisition which as at 30 June 2020 had a face value of US\$775 million (A\$1,129 million); recognise the fair value of the assets and liabilities of Watagan (including the Watagan Bonds) on the Group's balance sheet at the date of acquisition; recognise the fair value of the New Yankuang Loan when the existing Bonds are repaid.

As at 30 June 2020, the total assets of Yancoal were \$11,514 million and the total liabilities were \$5,029 million, including interest bearing liabilities of \$3,120 million, and the total assets of Watagan were \$901 million and the total liabilities were \$2,274 million, including interest bearing liabilities of \$2,157 million (including the Yancoal loan of \$965 million). The impact of re consolidating Watagan as at 30 June 2020, without reflecting any fair value adjustments that may arise on re consolidation and after intercompany balance eliminations of \$1,171 million (including the Yancoal loan of \$965 million) for both assets and liabilities, would be material, and the Group's gearing ratio (calculated as net debt divided by net debt plus equity at the end of the relevant period) would increase from 29% to 43% based on 30 June 2020 balances.

The fair value of the Watagan assets and liabilities has not yet been finalised, and will necessarily vary from the book values at 30 June 2020 due to, amongst other things:

- the operating performance of Watagan up to the date of acquisition
- changes to the Watagan balance sheet including further debt draw downs
- the AUD:USD exchange rate at the date of acquisition used to translate the US\$775 million bond liability
- the determination by Yancoal directors of the fair value of the operating assets and liabilities of Watagan, based on their intentions, including the potential recognition of unrecorded liabilities including mine closure provisions.

### **Taxation**

Despite Watagan being de consolidated for accounting purposes, the Watagan group has remained part of the Yancoal tax group, such that Yancoal will not treat the re consolidation as an acquisition for income tax purposes and there will be no tax base reset or allocatable cost amount allocation.

### **Hong Kong Stock Exchange Listing Rules implications**

As the existing Bonds and the New Yankuang Loan are on normal commercial terms and no security is given by Yancoal or Watagan in favour of Yankuang under the terms of the Put Bonds or the New Yankuang Loan, the Put Bonds and the New Yankuang Loan will constitute fully exempt connected transactions of Yancoal for the purpose of the Hong Kong Stock Exchange Listing Rules.

In addition, as Watagan has remained wholly-owned by Yancoal notwithstanding that it ceased to be consolidated by Yancoal within its financial statements in 2016, such de consolidation did not constitute a disposal transaction by Yancoal at that time for the purposes of the Hong Kong Stock Exchange Listing Rules. Accordingly, the re consolidation of Watagan by Yancoal as a subsidiary within its consolidated financial statements will not constitute an acquisition by Yancoal for the purposes of the Hong Kong Stock Exchange Listing Rules.

### **Moving to a simpler structure**

The reconsolidation of Watagan will simplify the operational and financial reporting of Yancoal by removing the equity-accounted structure currently in place. The operational and financial performance of Watagan, including saleable production, operating costs and capital expenditure will be reported as part of Yancoal's overall operational and financial performance from 16 December 2020.

Whilst Yancoal will book a non-cash accounting loss this year, overall there will be a net positive impact on Yancoal's future cash flows available to service its obligations arising from the reduced interest rate on the New Yankuang Loan, fund its capital expenditure and make distributions to its shareholders in the future.

**END**

Authorised for lodgement by the Yancoal Board  
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