

The Treasury

Solid Energy Information Release

March 2013

Release Document

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CROWN OWNERSHIP
MONITORING UNIT

Treasury Report: Solid Energy: Briefing for meeting with Chair and CEO
on 11 May 2010

Date:	7 May 2010	Report No:	T2010/798
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	For your information	11 May 2010
Minister for State Owned Enterprises (Hon Simon Power)	Note contents	11 May 2010
Associate Minister of Finance (Hon Steven Joyce)	For your information	11 May 2010

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Andrew Blazey	Manager, Sector Monitoring	[1]	
Chris Hewson	Senior Advisor, Sector Monitoring	[1]	✓

Minister for State Owned Enterprises' Office Actions (if required)

None.

Enclosure: **No**

7 May 2010

Treasury Report: Solid Energy: Briefing for meeting with Chair and CEO on 11 May 2010

Executive Summary

You are scheduled to meet with the Chair, Mr John Palmer, and CEO, Dr Don Elder of Solid Energy on Tuesday, 11 May 2010.

The meeting is to discuss:

- Solid Energy's draft 2010 Statement of Corporate Intent (SCI) and business plan
- Solid Energy's informal request for shareholder consultation, by 14 May, on a proposal to purchase a share of an Australian company which has potentially developed game-breaking lignite conversion technology
- any follow-up questions from the previous day's meeting between the Prime Minister, senior Ministers and Solid Energy.

To date, Solid Energy has only provided an early draft of its 2010 SCI, and draft portions of the business plan. From the information provided, the most significant issue is the change in commercial valuation which has increased 60%, from \$2.5 billion to \$3.9 billion. Discussions with senior management have indicated the documents will not include any strategic surprises. However, the failure to provide the planning documents by 1 May, and that final Board approval of the forecasts is not expected until mid-June, is a significant failure against the expected planning timetable.

Solid Energy has alerted officials to an urgent due diligence process it is undertaking for a potential purchase of a [2],[5] minority stake [2],[5] in an Australian mining and technology company. The purchase does not require shareholder approval.

Recommended Action

We recommend that you **note** the contents of this report.

Andrew Blazey
**Manager, Sector Monitoring
for Secretary to the Treasury**

Hon Simon Power
Minister for State Owned Enterprises

Background

1. You are scheduled to meet with the Chair, Mr John Palmer, and CEO, Dr Don Elder of Solid Energy on Tuesday, 11 May 2010.
2. The meeting is to discuss:
 - Solid Energy's draft 2010 SCI and business plan.
 - Solid Energy's informal request for shareholder consultation, by 14 May, on a proposal to purchase a share of an Australian company which has potentially developed game-breaking lignite conversion technology.
 - any follow-up questions from the previous day's meeting between the Prime Minister, senior Ministers and Solid Energy.

Analysis

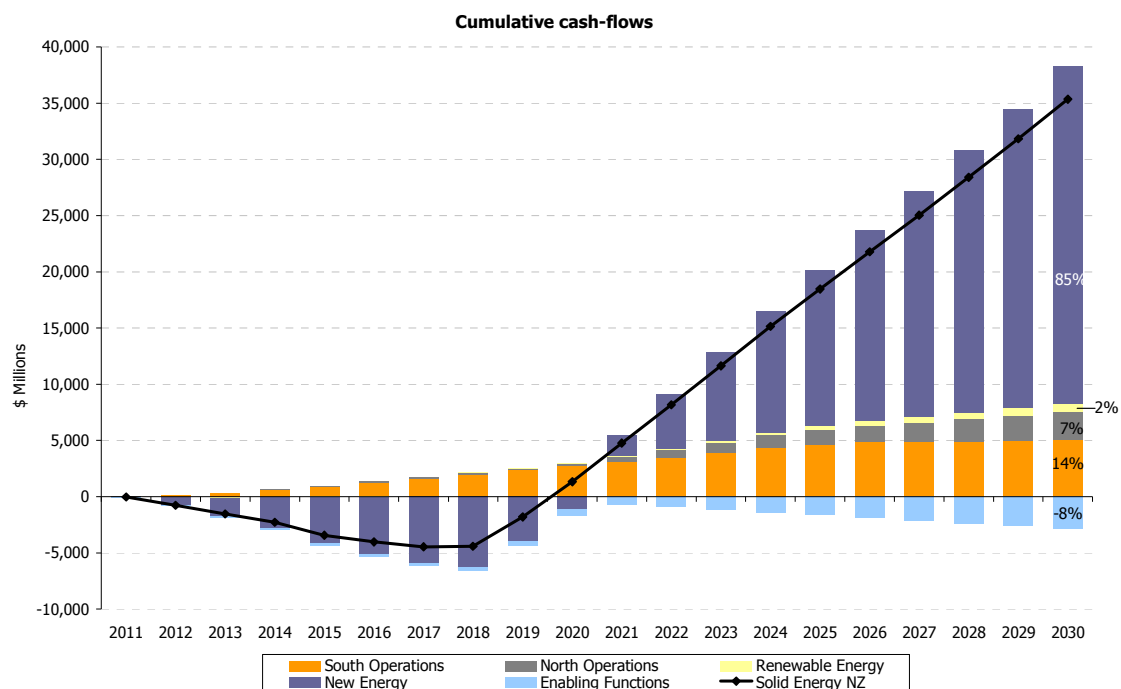
2010 Statement of Corporate Intent and business plan

3. Solid Energy is yet to deliver a complete draft 2010 SCI or business plan. However, officials have had regular discussions with the senior management team on the expected contents of the documents, who have advised that that:
 - the business plan will not include any strategic surprises and will essentially be an update on last year's business plan (including the latest project development timelines, financial forecasts and commercial valuation). However, failing to provide the documents by 1 May, and not having final Board approval of the forecasts until mid-June, is a significant failure against the expected SOE planning timetable; and
 - Solid Energy's SCI will meet shareholding Ministers latest disclosure expectations, as it did in 2009.
4. For the current 2009/10 financial year, Solid Energy budgeted a net profit after tax (NPAT) of \$43 million. The first half of the year was heavily impacted by strike action and a loss of \$6.5 million recorded. The second half of the year has been significantly better however, with large "catch-up pricing" from SAIL India related to cancelled shipments in early 2009, improved performance at the Stockton mine under the Alliance model, and higher spot prices for hard coking coal. The latest full year NPAT forecast is now \$54 million.
5. Solid Energy's long-term outlook for the global energy market has not changed from last year's business plan. This includes vigorous economic growth in Asia, placing significant pressure on the supply of energy commodities such as oil and coal leading to prolonged higher prices.
6. Solid Energy remains of the view that it is well positioned to create significant value from the resources under its control as a result of the short- and long-term market outlook. A large part of this value is from projects which are at different stages of development. Several of these projects can be financed by Solid Energy, but others such as the Coal to Fertiliser (CTF) and Coal to Liquids (CTL) projects will require large capital investment, sourced from other parties.

7. For the 2011 year, only draft financials have been provided to date. They forecast 19% revenue growth from 2009/10 to \$812 million, and a near record NPAT of \$104 million. The increases are primarily due to higher international coal prices, but also increased sales and production volume (particularly from Stockton) and improved forecasts for the wood pellet business.

Capital Investment Profile

8. Several of the projects Solid Energy has been developing for several years are approaching critical investment points and the company expects to increase consultation with the Government on these projects and to discuss funding options.
9. Solid Energy summarises its capital programme as follows:
 - the coal business will provide significant free cash flow with relatively modest (affordable) capital requirements in the next 3 to 5 years;
 - current investment plans for renewables (wood pellets), underground coal gasification (UCG), coal seam gas (CSG) and the lignite briquette plant can be accommodated within the current capital structure; and
 - significant capital is required for both the CTF and CTL projects and will require separate capital strategies.
10. The total long-term cash flow implication for all Solid Energy projects is shown below. A detailed Governance & Capital Strategy is being developed separately to the business plan, which will require input from the shareholder in the future. The current plan makes no assumptions about equity and debt requirements and their impacts on cash flow.



11. Solid Energy has not advised officials of when it expects to be in a position to engage further with shareholding Ministers on these projects or what its current preferred financing structure may be.

Draft Commercial Valuation

12. Solid Energy has provided officials with draft commercial valuation work papers and related SCI disclosures. The methodology, which was reviewed externally last year, has not changed, however the projections in the model have, leading to a large valuation increase of 60% from \$2.5 billion to \$3.9 billion.
13. In summary, the valuation is based on a discounted cash-flow model for all parts of the business, however those parts that are not yet in production are discounted to the portion that they are through the development phase. So for example the “new energy” projects such as UCG, CSG, CTL and CTF are discounted by ~95%, but still represent \$798 million (20%) of the valuation.
14. Officials have not had an opportunity to review the valuation, other than to note the increase from 2009 is primarily due to significantly enhanced forecast sales value and volume from the Stockton Plateau (69% of the valuation increase) and improved renewable forecasts (14%). However the scale of the valuation change immediately raises questions about its credibility and the assumption changes, particularly given the long term outlook for the market has not changed. At a minimum, officials will ask Solid Energy to improve the SCI commentary on the change in valuation from 2009 to 2010.

Shareholder consultation on Australian technology acquisition

15. [2],[5]

16. [2],[5]

17. [2],[5]

18. [2],[5]

19. [2],[5]

Suggested list of questions/topics for discussion with Solid Energy

- 2010 Statement of Corporate Intent and business plan
 - How settled are the 2010/2011 contract prices for export coal sales?
 - What portion of export customers have changed to the new global quarterly pricing regime, and how is this shift going to impact the accuracy of forecasts?
 - Do the draft 2011 forecasts allow for further catch-ups from the 2009 cancelled shipments or have these now been resolved?
- Capital Investment Profile
 - When does Solid Energy expect to complete its Governance & Capital Strategy document and engage further on specific proposals with the Crown?
- Draft Commercial Valuation
 - Is it credible to have a commercial valuation increase of 60% year-on-year when Solid Energy's long-term global energy outlook has not significantly changed from last year?
- Shareholder consultation on Australian technology acquisition
 - What is the latest update and assessment of this investment proposal?
 - How significant is the technology to Solid Energy and more widely New Zealand?
 - How much of the investment price is attached to the value of unproven technology as opposed to assets?