The Treasury

Solid Energy Information Release

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Release Document

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[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information, or who is the subject of the information

[3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[4] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[5] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

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CROWN COMPANY MONITORING ADVISORY UNIT
TE MATA AROTURUKI RAWA A TE KARAUNA

Protecting and enhancing shareholder value

Business Planning for State-owned Enterprises (SOEs): Response to draft Statements of Corporate Intent (SCIs)

Date	26 May 2009	**Priority**	Urgent
Security level		**Reference**	SOE-11/A73427

Minister	Action sought	Deadline
Minister of Finance	Approve recommendations and sign paper.	28 May 2009
Minister for State Owned Enterprises	Approve recommendations and sign letters.	28 May 2009
Associate Minister of Finance (Hon Steven Joyce)	Note recommendations.	28 May 2009

Report summary

- This report provides an initial assessment of nine draft SCIs, submitted as part of the 2009 business planning round.
- SOE financial forecasts over the next three years are generally disappointing.
- Shareholding Ministers are able to improve the financial performance of SOEs, by influencing their capital structure and increasing their levels of transparency and accountability.
- This report advocates an increase in SOE gearing, a higher and more predictable dividend yield, some specific expectations concerning commercial valuations and greater disclosure in the SCI.

Contacts

Chris Jones	Manager - Energy, Land & Environment - CCMAU	[Withheld under s 9(2)(a)]	**First contact**
James Cunningham	Manager - Communications, Services & Infrastructure - CCMAU		

Ministers' comments

Business Planning for State-owned Enterprises (SOEs): Response to draft Statements of Corporate Intent (SCIs)

Purpose

1. This report provides an initial assessment of nine draft SCIs, as part of the 2009 business planning round, and a draft response to each of the SOEs.

Executive summary

2. Officials have received draft SCIs for all SOEs with a June balance date (with the exception of Meridian, which is due by 30 May).

3. The Minister for SOEs is due to meet with nine of these SOEs in early June, to discuss the draft SCIs.

4. This report proposes a number of generic and company-specific messages to communicate back to each SOE, in preparation for these meetings.

5. Shareholding Ministers have indicated a strong desire to challenge SOEs in the areas of: financial performance, dividend policy, capital structure, commercial valuation and levels of disclosure.

6. A significant number of SOEs have forecast disappointing financial performance over the next three financial years.

7. Officials recommend that Ministers communicate a strong expectation that SOEs increase gearing and dividend yield, in accordance with company-specific targets, in order to increase accountability, discipline and financial outcomes.

8. Officials recommend that Ministers communicate an expectation that SOEs conduct credible commercial valuations in accordance with the SOE Act, and transparently report the valuation in their SCI.

9. Officials recommend that Ministers communicate an expectation that SOEs increase the disclosure of relevant financial information in their SCI.

Issues

10. Officials have analysed each draft SCI with respect to the adequacy of each SOE’s forecast financial performance over the planning period, and the three issues agreed to with Ministers, namely:

    - dividend policies and capital structure
    - commercial valuations
    - level of disclosure.

Forecast financial performance

11. A number of SOEs do not appear to have heeded shareholding Ministers' expectation for improved financial performance. Whilst current economic conditions are no doubt having an adverse impact on forecast financial performance, officials are not confident that SOEs are doing enough to mitigate controllable risks, improve productivity and lift performance.

Dividend policies and capital structure

12. Officials recommend that shareholding Ministers express a strong preference for higher gearing[1] and higher dividend yields from SOEs, to reflect Ministers' preference for tighter balance sheets and a higher proportion of profits being returned to the Crown, as shareholder. Refer to Attachment 1 for proposed SOE gearing ratios and dividend policies, which we have standardised where possible, to 40% and 65% (of operating cash flow) respectively.

13. These proposals are designed to stretch each SOE. For example, Contact Energy's gearing ratio is estimated at 28%, whilst Trustpower's is 33%. These compare with current gearing ratios for Mighty River Power, Meridian and Genesis of 19%, 24% and 29% respectively. All are significantly lower than the proposed gearing ratio of 40% for each SOE gentailer. However, we note that the 2008 PWC *Cost of Capital Report* indicates that the main listed energy companies have gearing ratios between 19% and 62%, including Infratil at 58%. A sample of other listed companies (eg Telecom, Ports of Auckland and Freightways) indicates gearing ratios between 35% and 43%.

14. The proposed gearing ratios are best characterised as 'targets', in that they may not be realistically achievable in the short term, without inflicting undue harm on the credit rating and/or investment plans of each SOE. However, the advantage of proposing a specific target is that it forces each SOE to engage with the shareholder about potential trade-offs, as well as sending a clear and unambiguous signal to SOEs that the shareholder's opportunity cost of capital has increased.

15. The potential benefits from the proposed capital structures and dividend policies are very significant. In the (albeit unlikely) event that all SOEs are prepared to increase gearing in the short term to the levels envisaged, and return all surplus capital to the Crown, the shareholder could potentially receive a special dividend in excess of $2,000 million. In addition, the proposed dividend policies could potentially result in a 400% increase in dividends in 2009/10, to around $600 million. Indirect benefits include greater oversight by debt markets and greater investment discipline, created by a scarcity of capital.

16. Most of the large SOEs currently target a credit rating of at least BBB+. We recommend a more appropriate credit rating of BBB flat, consistent with the benchmark agreed by previous shareholding Ministers in September 2003 as part

[1] Gearing provides an indication of a company's capital structure, comprising debt and equity. It is calculated as net debt (ie interest bearing debt less cash) divided by net debt plus shareholders' equity.

of the SOE long-term hold process. The proposed 'target' gearing ratios are more consistent with a BBB flat credit rating.

17. Nearly all SOEs define their dividend policy as a percentage of NPAT. Under IFRS, NPAT has become highly variable for many large companies, due to changes in the fair value of financial instruments, and is therefore less appropriate as a variable for dividend policy[2]. Most of the current dividend policies are also subject to a number of caveats (adequate working capital, capital investment, etc) allowing SOE board's wide discretion in the final level of dividend payout.

18. Officials believe a more consistent and robust dividend policy would be achieved by removing the specified caveats and basing the dividend payout as a percentage of operating cash flow. Operating cash flow focuses on the cash generated from the business and is therefore less affected by accounting changes. In doing so, it provides a more relevant measure of an SOE's ability to pay an annual dividend. Although operating cash flow is less variable than NPAT, any final dividend will always be subject to the underlying short term performance of the company.

19. Current SOE dividend policies range from 40% of (adjusted) NPAT for Solid Energy and Genesis, to 65% of NPAT for Meridian. A standardised policy of a minimum 65% of operating cash flow (including net interest paid) will challenge the SOE companies and achieve a higher dividend yield for the Crown. For example, a brief review of Contact Energy and Trustpower from 2000 to 2008 indicated that dividends as a percentage of operating cash flow averaged 54%, compared to an average of 45% from the three SOE generators[3].

20. [Withheld under s 9(2)(g)(i)] In order to continue with their capital investment plans, the companies will need to:

- improve operational efficiency
- sell (non-core) assets
- raise additional debt financing and/or
- apply to the Crown for additional capital.

21. Two other aspects of the proposed dividend policy are also worth considering. Firstly, officials recommend that Ministers communicate a strong expectation that SOEs pay an interim *and* final dividend each year. At present, many SOEs make just one final dividend payment per year. The second matter concerns the disclosure of dividend information. Officials recommend that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast dividend payment,

[2] Note that a few companies have amended their dividend policy to exclude IFRS-related fair value adjustments from NPAT.
[3] Note that the bulk of dividends paid by the three SOE generators came from Meridian; MRP and Genesis paid far less than 45% of operating cash flow.

then it must notify the shareholder (already an implicit requirement of the "no surprises" policy) and, importantly, publicly disclose the reasons why.

22. [Withheld under s 9(2)(g)(i)]

Commercial valuations

23. Section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

24. As outlined in previous reports, this annual valuation should be *inter alia*:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and utilise a discount rate that reflects the company's expected cost of capital
- based on the latest business plan forecasts
- subject to some reasonable external, independent, scrutiny – for example, over the key valuation assumptions
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

25. Without exception, all draft SCIs have failed to meet these requirements[4]. Therefore, we recommend that you write to all SOEs with a set of clear shareholder expectations about conducting and reporting on commercial valuations. To assist, we have drafted a model commercial valuation disclosure statement for SOEs to use in future; refer to Attachment 2.

Disclosure

26. It is crucial that SOEs disclose more relevant and timely information to the market, in order to ensure greater board accountability. In addition to the prescribed annual reports, private sector listed companies also provide regular investor presentations and/or updates on the company's financial condition and future investment strategy. These presentations provide current and potential shareholders with an indication of where the company is headed and why. In doing so, they provide a crucial reference point with which to judge actual

[4] We have not yet received Meridian's draft SCI, but we note that Meridian's current SCI complies with all the above points except for the last one regarding transparency of assumptions. NZ Post also complies, with the exception of the transparency issue.

performance in the future. The SCI is also designed to provide a crucial reference point from which Ministers and the public can hold the boards and executive accountable.

27. [Withheld under s 9(2)(g)(i)]

28. Where necessary, we recommend that you communicate the following explicit SCI disclosure expectations to SOEs:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Without limiting the general (minimum) requirements, some specific examples of measures that should be included in an SCI are:
  - (i) a relevant productivity measure(s), eg. gentailers could use EBITDAF/MWh
  - (ii) a forecast return on average shareholder's equity
  - (iii) an Economic Value Added and/or Shareholder Value Added analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
  - (iv) planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives, and (generally) demonstrate a material improvement in performance over the planning period
- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

Consultation

29. Treasury was consulted in the preparation of this report. Treasury fully supports and agrees with the proposals related to commercial valuations and improved disclosure of financial information in SCIs.

30. We also agree that SOEs in general have the capacity to significantly increase their gearing and to pay larger and more predictable dividends. We agree with the proposal that SOEs should pay 65% of their operating cash flow as a dividend. We are not as comfortable with the 40% gearing target for all SOEs. The correct

balance sheet structure will differ for each SOE, and involves the consideration of other variables besides gearing – therefore a blanket 40% target risks being seen as simplistic, unrealistic and therefore not credible. Officials have not yet done the analysis required to assure Ministers that a 40% gearing target for each SOE is achievable (or alternatively, is challenging enough) and to allow Ministers to defend this target against challenge from the SOEs.

31. The CCMAU report also deliberately does not set a target date for SOEs to achieve a 40% gearing ratio. We are comfortable with this as a negotiating tactic to put the pressure on SOEs to come up with their own plan and timetable to achieve the target. The risk is that SOEs reject the proposal completely, if they misinterpret it as being an unrealistic short-term requirement rather than a medium term goal.

32. Ministers can address this by making it clear when they meet the SOEs, that the 40% target is not something we expect SOEs to achieve overnight. Instead, SOEs should set a realistic date for reaching 40% gearing (or whatever number is agreed as being appropriate for each SOE) and then demonstrate progress each year towards the target. Some SOEs could reach 40% gearing quite quickly, others would require several years.

Recommendations

33. We recommend that you:

a **note** that this report provides an initial assessment of draft SCIs from nine SOEs, which the Minister for SOEs is due to meet with in early June

b **note** that the SOE financial forecasts over the next three financial years are generally disappointing

c **note** that the key proposal in this report involves an increase in SOE gearing and dividend yields, which is likely to receive an adverse reaction from SOEs

d **note** the other key proposals in this report, involving the provision of credible commercial valuations and improved disclosure of financial information in SCIs e **agree** that the Minister for SOEs sign the attached letters on behalf of shareholding Minsters.

(agree / disagree)	(agree / disagree)
Minister of Finance	**Minister for State Owned Enterprises**

Chris Jones
Manager - Energy, Land & Environment
CCMAU

Hon Bill English	Hon Simon Power	Hon Steven Joyce
Minister of Finance	**Minister for State Owned Enterprises**	**Associate Minister of Finance**

Attachment 1: SOE gearing and dividend policy expectations

SOE (current S&P credit rating, if available)	Current (and forecast) gearing (1)	Expected gearing	Current dividend policy (2)	Expected dividend policy
Genesis (BBB+)	29% (31%)	40%	40% NPAT	65% operating cash flow
Mighty River Power (BBB+)	19% (28%)	40%	50% NPAT	65% operating cash flow
Meridian (BBB+)	24% (N.A)	40%	65% NPAT (3)	65% operating cash flow
Transpower (AA-)	49% (55%)	60%	0% NPAT	65% operating cash flow
KiwiRail	1% (3%)	(4)	(4)	(4)
Kordia	54% (49%)	(5)	(5)	(5)
Landcorp	11% (11%)	20%	75% net oper-ating profit (6)	100% operating cash flow (7)
NZ Post (AA-)	31% (33%)	40%	60% NPAT (8)	65% operating cash flow
Quotable Value	0% (11%)	40%	50% NPAT	65% operating cash flow
Solid Energy	10% (27%)	40%	50% NPAT	65% operating cash flow
TVNZ (9)	12% (22%)	40%	70% NPAT (3)	65% operating cash flow

Notes:

(1) current gearing as at 31 March 2009; forecast gearing as at 30 June 2010

(2) policies are simplified, in that they are all subject to a number of caveats which increase the board's discretion to 'honour' the policy

(3) excluding IFRS-related fair value adjustments

(4) A decision on KiwiRail's proposed gearing ratio and dividend policy has been deferred until next year, once it has achieved greater certainty about its longer-term funding

(5) as recently agreed with its bankers, Kordia 'cannot' pay any dividends until 2012

(6) over the normal course of the agricultural economic cycle, estimated to be around 5 years; plus 100% of profits from Landcorp Estates. Note that all dividends payments are diverted to itself, until such time as the initial value of properties covered by the protected land agreement are fully compensated

(7) set at 100% of operating cash flow, because of Landcorp's relatively low operating cash flows

(8) effectively 30% NPAT until June 2010 (excluding Kiwibank NPAT and IFRS-related fair value adjustments), under an agreement to preserve the S&P credit rating

(9) whilst TVNZ is not an SOE, it is included for comparative purposes.

Attachment 2: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis
- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]
- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Mr Wayne Boyd
Chair
Meridian Energy Ltd
PO Box 10840
Wellington 6143

Dear Mr Boyd

Draft Statement of Corporate Intent (SCI)

Notwithstanding that Meridian has yet to submit its draft 2009/10 SCI, I would like to take this opportunity to communicate some specific SCI expectations for the Board's consideration prior to our scheduled meeting on 8 June 2009.

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I would like all SOEs to increase their gearing from current levels, to a level more consistent with a BBB flat credit rating. In this regard, I have been advised by officials that Meridian may have the capacity to sustain a 40% gearing ratio. I urge the Meridian Board to give serious consideration to this proposal, and to release all surplus capital to the shareholder as special dividends.

I would also like to standardise and simplify the dividend policy for all SOEs, to ensure that a larger and more consistent share of profits is returned to the Crown as shareholder. In this regard, I propose that the Meridian Board give serious consideration to adopting a dividend policy equal to 65% of operating cash flows (including net interest paid) from 1 July 2009.

Related to dividend policy, I wish to outline an expectation that all SOEs pay two dividends per year, an interim and a final dividend. Further, I expect that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast interim or final dividend payment, it must promptly notify the shareholder and then make a public disclosure explaining the reasons why.

I acknowledge that Meridian has in the past regularly made both an interim and a final dividend payout, and that Meridian promptly notified shareholders of the recent temporary suspension of dividend payments and the reasons for this.

The adoption of these capital-related expectations is on the understanding that if Meridian is unable to fund a significant commercially-viable investment from its own cash flows or from debt markets, then it can seek an equity injection from its shareholder. A decision on equity funding will be made on a case by case basis, depending on the commercial merits of the proposal.

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

Meridian's current approach to commercial valuations already meets my expectations above, with the exception of the final bullet concerning transparency. To assist Meridian to comply with the final bullet, I have attached a model commercial valuation disclosure statement which I expect all SOEs to adapt for use in their respective SCIs.

As I have yet to receive a draft 2009/10 SCI, I base the following SCI disclosure expectations on Meridian's 2008/09 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific measures that should be included in Meridian's SCI are:
    - a relevant productivity measure(s), eg. EBITDAF/MWh, as per last year's SCI
    - a forecast return on average shareholder's equity, as per last year's SCI
    - an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
    - planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally) demonstrate a material improvement in performance over the planning period

- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures. In the case of Meridian, this would include Arc Innovations, Powershop (on the basis of the forecasts in your previous business plan), Right House and Whispertech.

I encourage you to contact CCMAU if you have any immediate feedback on the expectations outlined above, and look forward to meeting with you on 8 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]

- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis

- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]

- A discount rate of [X%] was assumed

- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board

- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x

- A reduction in year 4 to year 10 cash flows of $X due to…………………

- A reduction in the terminal value assumed of $X million due to……………....

- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Mr Brian Corban
Chair
Genesis Power Ltd
PO Box 17188
Greenlane
Auckland 1546

Dear Mr Corban

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on Genesis' draft 2009/10 SCI and business plan, prior to our scheduled meeting on 3 June 2009.

First of all, I understand that the Board has commissioned an independent commercial valuation of Genesis and that this will be available by 30 June 2009. In order to ensure that I have adequate time to consider this valuation prior to Genesis submitting its final SCI, I hereby grant a two month extension for the final SCI, to 31 August 2009.

[Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)]

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I would like all SOEs to increase their gearing from current levels, to a level more consistent with a BBB flat credit rating. In this regard, I have been advised by officials that Genesis may have the capacity to sustain a 40% gearing ratio. I urge the Genesis Board to give serious consideration to this proposal, and to release all surplus capital to the shareholder as special dividends.

I would also like to standardise and simplify the dividend policy for all SOEs, to ensure that a larger and more consistent share of profits is returned to the Crown as shareholder. In this regard, I propose that the Genesis Board give serious consideration to adopting a dividend policy equal to 65% of operating cash flows (including net interest paid) from 1 July 2009.

Related to dividend policy, I wish to outline an expectation that all SOEs pay two dividends per year, an interim and a final dividend. Further, I expect that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast interim or final dividend payment, it must promptly notify the shareholder and then make a public disclosure explaining the reasons why.

The adoption of these capital-related expectations is on the understanding that if Genesis is unable to fund a significant commercially-viable investment from its own cash flows or from debt markets, then it can seek an equity injection from its shareholder. A decision on equity funding will be made on a case by case basis, depending on the commercial merits of the proposal.

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

To assist Genesis to comply with the final bullet above, I have attached a model commercial valuation disclosure statement which I expect all SOEs to adapt for use in their respective SCIs.

Finally, I wish to communicate some SCI disclosure expectations based on Genesis' draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in Genesis' SCI are:
    - a relevant productivity measure(s), eg. EBITDAF/MWh

- an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
- planned capital expenditure, per annum

- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally) demonstrate a material improvement in performance over the planning period
- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 3 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis
- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]
- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Ms Carole Durbin
Chair
Mighty River Power Ltd
PO Box 90399
Auckland 1142

Dear Ms Durban

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on Mighty River Power's (MRP's) draft 2009/10 SCI and business plan, prior to our scheduled meeting on 4 June 2009.

I understand that the Board intends using the book value of shareholders' funds as a proxy for MRP's commercial value as at 30 June 2009. For the reasons outlined below, I do not consider this to be acceptable. In order to provide the Board with adequate time to address this issue (and others raised in this letter), I hereby grant a one month extension for the final SCI, to 31 July 2009.

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I would like all SOEs to increase their gearing from current levels, to a level more consistent with a BBB flat credit rating. In this regard, I have been advised by officials that MRP may have the capacity to sustain a 40% gearing ratio. I urge the MRP Board to give serious consideration to this proposal, and to release all surplus capital to the shareholder as special dividends.

I would also like to standardise and simplify the dividend policy for all SOEs, to ensure that a larger and more consistent share of profits is returned to the Crown as shareholder. In this regard, I propose that the MRP Board give serious consideration to adopting a dividend policy equal to 65% of operating cash flows (including net interest paid) from 1 July 2009.

Related to dividend policy, I wish to outline an expectation that all SOEs pay two dividends per year, an interim and a final dividend. Further, I expect that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast interim or final dividend payment, it must promptly notify the shareholder and then make a public disclosure explaining the reasons why.

The adoption of these capital-related expectations is on the understanding that if MRP is unable to fund a significant commercially-viable investment from its own cash flows or from debt markets, then it can seek an equity injection from its shareholder. A decision on equity funding will be made on a case by case basis, depending on the commercial merits of the proposal.

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

In summary, I wish to convey a strong expectation that the MRP Board commission a full discounted cash flow valuation of the Group, and publish the results in its 2009/10 SCI. To assist the Board to comply with this expectation, I have attached a model commercial valuation disclosure statement for your adaptation.

Finally, I have the following disclosure-related comments on MRP's draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in MRP's SCI are:
  - a relevant productivity measure(s), eg. EBITDAF/MWh
  - a forecast return on average shareholder's equity (please consider standardising the two return on equity measures currently in your draft SCI)
  - an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
  - planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally)

demonstrate a material improvement in performance over the planning period

- performance targets should also provide a comparison with the previous year’s forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company’s strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 4 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis
- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]
- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Rt Hon Jim Bolger
Chair
KiwiRail Group
PO Box 593
Wellington 6140

Dear Jim

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on KiwiRail Group's (KRG's) draft 2009/10 SCI and business plan, prior to our scheduled meeting on 2 June 2009.

[Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)]

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I am minded to increase the gearing of all SOEs from current levels, to a level more consistent with a BBB flat credit rating, and increase their dividend yield. In this regard, I would ordinarily seek to increase KRG's gearing and adopt a dividend policy equal to 65% of operating cash flows. However, given the current uncertainty involving KRG's longer-term funding, and the forecast operating cash flow deficit in 2009/10, I will defer consideration of this issue until the next planning round.

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

I wish to make my expectations around this clause explicit to all SOEs, because in my experience, most SOE boards fail to produce a credible commercial valuation every year. For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

In summary, I wish to convey a strong expectation that the KRG Board commission a full discounted cash flow valuation of the Group, and publish the results in its 2009/10 SCI. [Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)] [redacted] To assist the Board to comply with this expectation, I have attached a model commercial valuation disclosure statement for your adaptation.

Finally, I have the following specific disclosure-related comments on KRG's draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in KRG's SCI are:
    - a relevant productivity measure(s)
    - a forecast return on average shareholder's equity
    - an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
    - planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally) demonstrate a material improvement in performance over the planning period
- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns

- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I recognise that this is the first SCI for the new combined rail entity, and that policy and funding uncertainty make your task a difficult one. I appreciate the efforts you and your team have made to date, but I also need to insist on improvements to the SCI, as this is a critical document for public accountability.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 2 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis
- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]
- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Mr David Clark
Chair
Kordia Group Ltd
PO Box 2495
Auckland 1140

Dear Mr Clark

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on Kordia Group Ltd's (Kordia's) draft 2009/10 SCI and business plan, prior to our scheduled meeting on 4 June 2009.

[Withheld under s 9(2) (g)(i)]

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I am minded to increase the gearing of all SOEs from current levels, to a level more consistent with a BBB flat credit rating, and increase their dividend yield. In this regard, I would ordinarily seek to increase Kordia's gearing and adopt a dividend policy equal to 65% of operating cash flows.

[Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)]

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

While Kordia's commercial valuation appears to comply with most of these criteria, I encourage the Board to report on the valuation in a more transparent manner. To assist the Board to comply with this expectation, I have attached a model commercial valuation disclosure statement for your adaptation.

Finally, I have the following specific disclosure-related comments on Kordia's draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in Kordia's SCI are:
    - ➢ a relevant productivity measure(s)
    - ➢ an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
    - ➢ planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally) demonstrate a material improvement in performance over the planning period
- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 4 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis
- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]
- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Hon Jim Sutton
Chair
Landcorp Farming Ltd
PO Box 5349
Wellington 6145

Dear Jim

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on Landcorp Farming Ltd's (Landcorp's) draft 2009/10 SCI and business plan, prior to our scheduled meeting on 4 June 2009.

[Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)]

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I am minded to increase the gearing of all SOEs from current levels, to a level more consistent with a BBB flat credit rating. In this regard, I have been advised by officials that Landcorp may have the capacity to sustain a 20% gearing ratio. I urge the Landcorp Board to give serious consideration to this proposal, and to release all surplus capital to the shareholder as special dividends.

I am also minded to standardise and simplify the dividend policy for all SOEs, to ensure that a larger and more reliable share of profits is returned to the Crown, as shareholder. In this regard, I propose that the Landcorp Board gives serious consideration to adopting a dividend policy equal to 100% of operating cash flows (including net interest paid) from 1 July 2009.

Related to dividend policy, I wish to outline an expectation that all SOEs pay two dividends per year, an interim and a final dividend. Further, I expect that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast interim or final dividend payment, it must promptly notify the shareholder and then make a public disclosure explaining the reasons why.

The adoption of these capital-related expectations is on the understanding that if Landcorp is unable to fund a significant commercially-viable investment from its own cash flows or from debt markets, then it can seek an equity injection from its shareholder. A decision on equity funding will be made on a case by case basis, depending on the commercial merits of the proposal.

I am also conscious that this proposal may necessitate a revision of the land sale moratorium imposed on Landcorp as part of the Protected Land Agreement (PLA). I am open to discussion on this matter. I also invite the Board to clarify how it intends honouring clause 12 of the PLA, to repay the balance of the total initial value by 31 October 2010, given current forecasted dividends.

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

While the Landcorp Board's approach to commercial valuation appears to be fit for purpose, I would appreciate greater transparency about how it is calculated and the reasons for change over time. To assist in this regard, I have attached a model commercial valuation disclosure statement which I expect all SOEs to adapt for use in their respective SCIs.

Finally, I have the following specific disclosure-related comments on Landcorp's draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in Landcorp's SCI are:
    - a forecast return on average shareholder's equity
    - an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company (while the RoFI v WACC analysis in Landcorp's

draft 2009/10 SCI is relevant in this regard, it would be benefit from a description)
   - planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally) demonstrate a material improvement in performance over the planning period
- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 4 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis
- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]
- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………….....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Rt Hon Jim Bolger
Chair
New Zealand Post Ltd
Private Bag 39990
Wellington 5045

Dear Jim

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on New Zealand Post Ltd's (NZ Post's) draft 2009/10 SCI and business plan, prior to our scheduled meeting on 3 June 2009.

[Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)]

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I am minded to increase the gearing of all SOEs from current levels, to a level more consistent with a BBB flat credit rating, notwithstanding the requirement for Kiwibank to maintain a higher credit rating. In this regard, I am aware of your discussions with Standard & Poors (S&P) and the commitment made by the previous government to provide dividend relief, to help preserve NZ Post's AA- credit rating. I understand that S&P intends reviewing NZ Post's credit rating in the medium-term. The shareholder reserves the right to review the capital structure of NZ Post at this time, to ensure that it more closely aligns with the rest of the SOE portfolio.

I am also minded to standardise and simplify the dividend policy for all SOEs, to ensure that a larger and more reliable share of profits is returned to the Crown, as shareholder. In this regard, I propose that the NZ Post Board gives serious consideration to adopting a dividend policy equal to 65% of operating cash flows (including net interest paid) as soon as the S&P rating issue is resolved.

Related to dividend policy, I wish to outline an expectation that all SOEs pay two dividends per year, an interim and a final dividend. Further, I expect that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast interim or final dividend payment, it must promptly notify the shareholder and then make a public disclosure explaining the reasons why.

The adoption of these capital-related expectations is on the understanding that if NZ Post is unable to fund a significant commercially-viable investment from its own cash flows or from debt markets, then it can seek an equity injection from its shareholder. A decision on equity funding will be made on a case by case basis, depending on the commercial merits of the proposal.

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

. For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

I understand that NZ Post's commercial valuation is largely compliant with these criteria. However, I would appreciate greater transparency in your SCI. To assist in this regard, I have attached a model commercial valuation disclosure statement which I expect all SOEs to adapt for use in their respective SCIs.

Finally, I have the following specific disclosure-related comments on NZ Post's draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in NZ Post's SCI are:
    - a relevant productivity measure(s)
    - planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally) demonstrate a material improvement in performance over the planning period
- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the

company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns

- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 3 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis
- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]
- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Mr Phil Lough
Chair
Quotable Value Ltd
PO Box 5098
Wellington 6145

Dear Mr Lough

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on Quotable Value Ltd's (QV's) draft 2009/10 SCI and business plan, prior to our scheduled meeting on 3 June 2009.

QV's financial forecasts appear to produce an acceptable rate of return over the planning horizon. We understand that the Board has taken a number of steps to respond to the downturn in the property market and current economic conditions and will be in a good position to increase profitability as the market rebounds.
We expect [Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)]

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I would like all SOEs to increase their gearing from current levels, to a level more consistent with a BBB flat credit rating. In this regard, I have been advised by officials that QV may have the capacity to sustain a 40% gearing ratio. I urge the QV Board to give serious consideration to this proposal, and to release all surplus capital to the shareholder as special dividends.

I would also like to standardise and simplify the dividend policy for all SOEs, to ensure that a larger and more consistent share of profits is returned to the Crown as shareholder. In this regard, I propose that the QV Board give serious consideration to adopting a dividend policy equal to 65% of operating cash flows (including net interest paid) from 1 July 2009.

Related to dividend policy, I wish to outline an expectation that all SOEs pay two dividends per year, an interim and a final dividend. Further, I expect that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast interim or final dividend payment, it must promptly notify the shareholder and then make a public disclosure explaining the reasons why.

The adoption of these capital-related expectations is on the understanding that if QV is unable to fund a significant commercially-viable investment from its own cash flows or from debt markets, then it can seek an equity injection from its shareholder. A decision on equity funding will be made on a case by case basis, depending on the commercial merits of the proposal.

As you are no doubt aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

I understand that QV's commercial valuation is largely compliant with these criteria. However, I would appreciate greater transparency in your SCI. To assist in this regard, I have attached a model commercial valuation disclosure statement which I expect all SOEs to adapt for use in their respective SCIs.

Finally, I have the following disclosure-related comments on QV's draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in QV's SCI are:
    - ➢ a relevant productivity measure(s)
    - ➢ an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
    - ➢ planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally)

demonstrate a material improvement in performance over the planning period

- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 3 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

cc: Hon Bill English, Minister of Finance

Attachment: Commercial Valuation Model Disclosure Statement for use in Statements of Corporate Intent

Example for the SOECorp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOECorp Group is [$1.650 billion]. Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [31 March 2009]

- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOECorp Group, including all subsidiaries, on an after-tax basis

- The DCF / NPV was based on the nominal (ie not inflation-adjusted) future cash flows set out in the SOECorp Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [$500 million] was included in the terminal year. The growth assumption assumed in the terminal value was [X%]

- A discount rate of [X%] was assumed

- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board

- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x

- A reduction in year 4 to year 10 cash flows of $X due to…………………

- A reduction in the terminal value assumed of $X million due to……………....

- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.

Mr John Palmer
Chair
Solid Energy Ltd
PO Box 1303
Christchurch 8140

Dear Mr Palmer

Draft Statement of Corporate Intent (SCI)

The purpose of this letter is to provide some preliminary feedback on Solid Energy Ltd's (Solid Energy's) draft 2009/10 SCI and business plan, prior to our scheduled meeting on 9 June 2009.

[Withheld under s 9(2)(b)(ii), (i), (j) and (g)(i)]

The government has a strong desire to improve the effectiveness and efficiency of its balance sheet. As the SOE portfolio represents a significant part of the Crown's balance sheet, I have given considerable thought recently as to the most direct and effective tools I have available to improve the governance, accountability and ultimately financial performance of SOEs.

Capital structure is one such tool. I would like all SOEs to increase their gearing from current levels, to a level more consistent with a BBB flat credit rating. In this regard, I have been advised by officials that Solid Energy may have the capacity to sustain a 40% gearing ratio. I urge the Solid Energy Board to give serious consideration to this proposal, and to release all surplus capital to the shareholder as special dividends.

I note that Solid Energy currently has a gearing target of 35%, including the company's rehabilitation liability as if it were debt. Given that the nature of the rehabilitation liability is significantly different from debt, I am sceptical that this is an appropriate treatment. I have asked my officials to engage with you on this issue.

I would also like to standardise and simplify the dividend policy for all SOEs, to ensure that a larger and more consistent share of profits is returned to the Crown as shareholder. In this regard, I propose that the Solid Energy Board give serious consideration to adopting a dividend policy equal to 65% of operating cash flows (including net interest paid) from 1 July 2009.

Related to dividend policy, I wish to outline an expectation that all SOEs pay two dividends per year, an interim and a final dividend. Further, I expect that as soon as an SOE becomes aware that it is unlikely to be able to make a forecast interim or final dividend payment, it must promptly notify the shareholder and then make a public disclosure explaining the reasons why.

The adoption of these capital-related expectations is on the understanding that if Solid Energy is unable to fund a significant commercially-viable investment from its own cash flows or from debt markets, then it can seek an equity injection from its shareholder. A decision on equity funding will be made on a case by case basis, depending on the commercial merits of the proposal.

As you are aware, section 14(3) of the SOE Act 1986 requires that "each statement of corporate intent shall also include the board's estimate of the current commercial value of the Crown's investment in the group and a statement of the manner in which that value was assessed."

[Withheld under s 9(2)(g)(i)]

For the avoidance of doubt, my expectation is that a credible commercial valuation will be:

- based on a discounted cash flow approach (unless otherwise agreed to by CCMAU) and use a discount rate that reflects the company's expected cost of capital
- conducted every year
- based on the latest business plan forecasts
- subject to some external, independent scrutiny (eg over the key valuation assumptions) and/or completed by an independent external party
- transparently reported in the SCI, including the methodology used, key assumptions and major reasons for any valuation change since last year.

To assist SOEs to comply with the final bullet above, I have attached a model commercial valuation disclosure statement which I expect all SOEs to adapt for use in their respective SCIs.

I understand that the Solid Energy Board has commenced an independent commercial valuation of the company, and that this is due for completion in August. In the meantime, the commercial valuation in your draft SCI is based on the book value of Solid Energy's equity. This is not acceptable.

Solid Energy is aware of the requirements of section 14(3) of the SOE Act and the timing for delivery of a draft SCI. Solid Energy must in future, comply with the SOE Act and deliver its draft SCI, including a credible commercial valuation that is consistent with my expectations as outlined above, not later than 1 month before the commencement of its financial year. The use of the book value of equity is not an acceptable substitute for a commercial valuation.

However, I hereby grant Solid Energy an extension to submit its final SCI until 31 August 2009, to allow for inclusion of the independent commercial valuation currently being prepared.

Finally, I have the following specific disclosure-related comments on Solid Energy's draft 2009/10 SCI:

- financial ratio forecasts/targets – as a minimum, these should cover the profitability, efficiency, liquidity and solvency of the business. Specific additional measures that should be included in Solid Energy's SCI are:
  - a relevant productivity measure(s)
  - an Economic Value Added (or Shareholder Value Added) analysis, showing how well the company expects to perform over the forecast period, relative to the cost of the capital invested in the company
  - planned capital expenditure, per annum
- performance targets should, as a minimum: be clearly described and easily understood, be relevant to the company's objectives and (generally) demonstrate a material improvement in performance over the planning period
- performance targets should also provide a comparison with the previous year's forecasts, and provide an explanation for any material changes
- there should be an informative and objective commentary on the material industry-wide factors impacting (and/or expected to impact) on the company's strategy, forecast investment programme and financial performance over the planning period, with a particular focus on opportunities, risks and returns
- transparency of subsidiary companies – relevant performance targets should be provided for any significant subsidiary companies or joint ventures.

I encourage you to contact CCMAU if you have any short-term feedback on the expectations outlined above. I look forward to meeting with you on 9 June 2009.

Yours sincerely

Hon Simon Power
Minister for State Owned Enterprises
on behalf of Shareholding Ministers

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- A discount rate of [X%] was assumed
- The valuation was prepared [internally by the SOECorp Group's finance team, and was externally peer reviewed by XYZ Corporate Finance Ltd], prior to approval by the Board
- Other material factors that are relevant to the determination of this valuation are [………………..]

The valuation compares with a commercial value as at [31 March 2008 of $1.545 billion]. The key reasons for the [increase] in commercial value are:

- [An increase in year 1 to year 3 cash flows of $X million due to changed expectations for the future price of x
- A reduction in year 4 to year 10 cash flows of $X due to…………………
- A reduction in the terminal value assumed of $X million due to……………....
- A change in the discount rate assumed from XX% to XX% because……………….]

These changes could be represented graphically in a waterfall (or similar type of) diagram.