

The Treasury

Solid Energy Information Release

March 2013

Release Document

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CROWN OWNERSHIP
MONITORING UNIT

Treasury Report: Solid Energy NZ Ltd (Solid Energy): Preparation for 2010 Annual General Meeting (AGM)

Date:	19 October 2010	Report No:	T2010/2036
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Note recommendations before Solid Energy's AGM	12.00pm Thursday 21 October 2010
Minister for State Owned Enterprises (Hon Simon Power)	Note recommendations	None
Associate Minister of Finance (Hon Steven Joyce)	Note recommendations	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
[4]	Analyst, Sector Monitoring	[1]	✓
Andrew Blazey	Manager, Sector Monitoring	[1]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: Yes (attached)

Treasury Report: Solid Energy NZ Ltd (Solid Energy): Preparation for 2010 Annual General Meeting (AGM)

Purpose of Report

1. This report provides background material for the Solid Energy AGM scheduled for 12.00pm Thursday 21 October 2010, at which shareholding Ministers are represented by the Minister of Finance.

Background

2. The purpose of the AGMs is for shareholding Ministers to have a free and frank discussion about company performance and to communicate shareholder expectations directly to the board.

Attendees

3. Solid Energy will be represented by its Board and members of the senior management team (refer to Appendix 1 for a list of expected attendees). Officials from COMU will attend as well, subject to your agreement. No media or members of the public will be in attendance.
4. A proxy form has been prepared to allow the Minister of Finance to vote on behalf of the Minister for State Owned Enterprises, who will not be attending the AGM – see Annex 3.

Meeting Agenda and Questions for the Chair

5. Solid Energy has proposed an agenda which is replicated in Appendix 1. Agenda item 'D' (Shareholder Questions), provides an informal forum for discussing the company's performance. We recommend you provide comment on the following issues:
 - Solid Energy's 2009/10 financial year performance;
 - Shareholders SOE expectations for the 2010 business planning round; and
 - Solid Energy's plans to develop its current natural resources.

Solid Energy 2009/10 Financial Year Performance

6. Solid Energy produced a net profit after tax on \$67.8 million for the 2009/10 year. This result is higher than plan but less than the 2009 net profit after tax of \$110.8 million. Revenue and EBITDA at year end were both above forecast. However, 2010 was a year of contrasting fortunes with approximately two thirds of the total revenue coming in the second half of the year. The financial performance also benefited by a price rise for coking, semi-soft and thermal coal in the second half of the year. The total coal sales volumes of 3.8 million tonnes for 2010 met with planned volumes.
7. In 2010 Solid Energy's coal and logistics revenues accounted for 94% of total revenue and were \$8 million ahead of budget. The remaining revenue came from 'renewables', being Switch, Biodiesel and Natures Flame, which performed below their revenue targets and had a cost of goods sold exceeding revenues by \$11 million.

8. The Solid Energy annual report does not provide financial details of the performance attribution of its differing areas of operation. It is therefore not possible to determine from the annual report which areas of the business are profitable. The lack of clarity is inconsistent with expectations of greater disclosure and an increased amount of performance information being made publicly available.
9. Regarding the financial performance for 2009/10, you may like to comment:
 - despite volatility in external markets following the global financial crisis, Solid Energy has performed well to protect export markets and earnings;
 - that this was a year of two halves with two third of the revenue coming in the second half of this year, and that you hope the more positive outlook continues into 2010/11;
 - that although it was a good year for coal and logistics the performance of renewables was poor; what does the board see as the longer-term future of these operations?;
 - Solid Energy is becoming an increasingly diverse business and that one of Ministers expectations for SOEs has been to increase the transparency of SOEs through greater public disclosure. In this context, what consideration has been given to providing greater transparency in public reporting, for instance has Solid Energy considered including an attribution of business operations within its annual report?; and
 - what does the board see as the priorities for the management team for the 2010/11 year?

Shareholders expectations for the 2010 business planning round

10. In 2010, there were several issues with respect to Solid Energy providing an SCI in a suitable form for Ministers to table, in particular [T2010/1239 and T2010/1655 refer]:
 - the introduction of external equity; and
 - establishing an appropriate balance between the payment of dividends and retaining cash for future investment – initially Solid Energy suspended future dividends.
11. COMU recommends that you should focus the board's attention to your expectations with respect to dividends, namely:
 - shareholding Ministers expect higher and more consistent dividends;
 - an appropriate balance needs to be established between dividends and capital investment –Solid Energy plans to pay a dividend equivalent to \$1 for every \$16 of capital investment over the forecast period. Relative to the SOE portfolio such a ratio is very low – See Appendix 2; and
 - the current Solid Energy dividend policy is very loose, being only funds surplus to operating and investment requirement, and would benefit from being more closely tied to an agreed portion of cash flow.

Solid Energy's plans to develop its current natural resources

12. Solid Energy is currently working on proposals such as coal seam gas, underground coal gasification and lignite conversion (high-energy briquettes, fertiliser, petro-chemicals).

13. You will recall that Solid Energy has developed ambitious plans for New Zealand's natural resources, including the National Resource Company (NRC) proposal.
14. On 31 August 2010 the Minister for State Owned Enterprises met with the Chair and Chief Executive Officer of Solid Energy to provide feedback on the NRC proposal [T2010/1609 refers].
15. As the NRC proposal has been well canvassed, we do not propose that you address the topic in detail but rather provide high level observations with respect to future resource development proposals. In particular, we recommend that you provide the following messages to the board:
 - Ministers are supportive of SOEs entering into viable joint venture arrangements as a way of leveraging expertise and capital;
 - Ministers expect to be consulted on significant developments, and receive robust business cases for consideration/approval;
 - Ministers expect Solid Energy to carefully consider what resource development path would maximise shareholder value, be that investing in early stage development of technology and evidence of feasibility and then spinning off as a separate company, or developing joint ventures and partnering arrangements. Which path Solid Energy chooses should depend on such factors as:
 - the objective of the proposal;
 - the most efficient way risks can be managed; and
 - what is an appropriate level of long-term capital to commit.

Recommended Action

We recommend that you:

- a **note** Solid Energy has provided an agenda for its AGM on Thursday 21 October 2010 (see appendix 1); and
- b **note** that COMU recommends that the Minister of Finance provides comment at the AGM on the following issues (detailed in this report):
 - Solid Energy's 2009/10 financial year performance (see paragraph 9);
 - Shareholders SOE expectations for the 2010 business planning round (see paragraph 11); and
 - Solid Energy's plans to develop its current natural resources (see paragraph 15).

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

Hon Bill English
Minister of Finance

Hon Simon Power
Minister for State Owned Enterprises

Appendix 1: AGM Agenda supplied by Solid Energy

Expected Attendees

Board: John Palmer (Chair), John Fletcher (Deputy Chair), Adrienne Young-Cooper, Alan Broome, John MacDonald, Helen Cull, Simon Masters, David Patterson

Management: Dr Don Elder (Chief Executive Officer), Barry Bragg (Chief Operating Officer), Warren Maslin (Chief Financial Officer), Alison Brown (General Counsel).

Agenda

- A. **Chairs Introduction** – John Palmer
- B. **Chief Executive Officer's review** – Dr Don Elder
- C. **Financial Statements** – In relation to Solid Energy's Annual report for the year ended 30 June 2010, to receive Solid Energy's financial statements for the period and the auditor's report on those financial statements.
- D. **Shareholder Questions**
COMU recommends you provide your view on the following issues (detailed in this report):
 - Solid Energy's 2009/10 financial year performance (**see paragraph 9**);
 - Shareholders SOE expectations for the 2010 business planning round (**see paragraph 11**); and
 - Solid Energy's plans to develop its current natural resources (**see paragraph 15**).
- E. **Ordinary Resolutions** – To consider and, if thought fit, to pass the following ordinary resolutions:

As Minister of Finance and the proxy holder for the Minister for State Owned Enterprises, you are able to cast voting rights for 100% of the shares. There are two normal resolutions which require the shareholders to vote on.

Annual Report

The Annual Report 2010 that has been tabled is accepted by shareholders, in particular:

- 1.1 The report of Mr JL Palmer, Chairman of Directors, as set out on pages 4-6 of the Annual Report and Dr DM Elder, Chief Executive Officer, as set out on pages 8-10 of the Annual Report;
- 1.2 The Financial Statements for the year ended 30 June 2010 (dated 23 August 2010) and Notes to those Statements as set out on pages 41-91 of the Annual Report; and
- 1.3 The report of KPMG on behalf of the Auditor-General as set out on page 62.

Dividend

The shareholders note the decision of the directors of the company on 23 August 2010 not to pay a dividend at this time. **COMU comment** – *we have contacted Solid Energy to clarify this noting recommendation. We understand that the Chair will clarify that the Board decided not to pay a final dividend in September for 2009/10 year.*

Other

To note the confirmed Minutes of the Annual Meeting of Shareholders of Solid Energy New Zealand Limited held 15 October 2009.

Appendix 2: SOE Dividend and Capital expenditure intentions

COMU expects that SOEs should find an appropriate balance between the payment of dividends and retaining funds for future capital investment. The below table compares the ratio of capital investment to dividends paid over the last three years and for the next three years.

Ratio of Capital investment to dividend payment		
	Historical	Forecast
SOEs	2007/08 – 2009/10	2010/11 – 2012/13
Meridian Energy	1.4 : 1	2.0 : 1
Mighty River Power	1.6 : 1	3.3 : 1
Solid Energy	2.5 : 1	16.1 : 1
Landcorp Farming	No dividends	3.7 : 1
Genesis Power	4.7 : 1	0.6 : 1
New Zealand Post	3.0 : 1	6.7 : 1
Transpower	No dividends; \$1.2 bn capex	No dividends; \$2.3 bn capex
Average	3.0 : 1	5.4 : 1

Solid Energy's ratio of capital investment to dividends has historically been marginally below the SOE average. However, Solid Energy is forecast to invest at a rate of \$16 of capital expenditure to each \$1 of dividend, and at a rate of approximately three times that of the next highest SOE.

Notwithstanding that the ratio is influenced by the capital intensity of the sector in which the SOE operates, COMU is of the view that Solid Energy is not providing shareholding Ministers with an appropriate level of dividends, and by not providing appropriate dividends Solid Energy is effectively sourcing annual capital injections from the Crown.

In the coming months, as part of the business planning process, COMU will further discuss with Solid Energy the importance of finding a more appropriate balance between dividend payment and capital investment, within the context of shareholding Ministers expectations of higher and more consistent dividends from SOEs.

Appendix 3: Proxy form for the Minister for State Owned Enterprises

VOTING/PROXY FORM
SOLID ENERGY NEW ZEALAND LIMITED
2010

Appointment of Proxy

I, HON SIMON POWER being a shareholder of Solid Energy New Zealand Limited appoint:

Name: HON BILL ENGLISH

Address: c/o PARLIAMENT BUILDINGS, WELLINGTON

or, failing him: ANDREW BLAZEY

c/o COMU, THE TREASURY

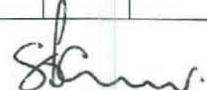
as my proxy to exercise my vote in accordance with my directions below at the Annual Meeting of shareholders of the company to be held on 21 October 2010 and at any adjournment of that meeting.

Voting

You may only tick one box for each resolution. If no box is marked or more than one box is marked the vote on that resolution will be treated as an "abstain"

Resolutions:	For	Against	Abstain	Proxy Discretion
Annual Report Acceptance of Annual Report	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Dividend Note dividend paid by company	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Signed by the shareholder:



Name and Address of Shareholder:

HON SIMON POWER, PARLIAMENT BUILDINGS

Dated:

6/10/10.