

# **The Treasury**

## **Solid Energy Information Release**

**May 2013**

### **Release Document**

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- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

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**From:** Anthony Burg [Anthony.Burg@solidenergy.co.nz]  
**Sent:** Wednesday, 5 September 2012 6:25 p.m.  
**To:** John Crawford; [4]  
**Cc:** ^SOLID: Don Elder; ^SOLID: Bill Luff; Anthony Burg  
**Subject:** Year End Results  
**Attachments:** [2],[5],[6] or are publically available on Solid Energy website.

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Hi John /[[4]

My apologies that in Bill's absence I neglected to close the loop with you as to where we ended up late last week in finalising the FY12 financial accounts as well as with banking support. In addition, we have announced significant restructuring steps following the significant drop-off of markets post balance date, which are attached for your information. Having spoken with Mark yesterday, I started to realise that he also did not have the latest information.

Accordingly please find attached

- Audited Financial Statements for FY12. Includes description of Impairments on page 15 and Significant After Balance Date transactions on page 47.
- Un-modified KPMG audit opinion
- Compliance certificate for the banks confirming compliance against original covenants as at 30 June 2012 [2]
- [2],[6]

- Full Year profit announcement presentation to media and analysts
- Profit Announcement (NZX, Media, Financial Review)
- CEO's message to staff last week summarising the market situation and the significant restructuring proposals which have been laid out before staff to begin the consultation process. Detailed packs of organisational design accompanied this advice which I have not copied.
- Latest view of FY13 – we are tidying up the latest FY13 forecast pack and will forward through to you in the next couple of days. [2],[6]

- We are also working the latest results through the Business Plan document with a view to having this available to you next week, along with the SCI.

I haven't forwarded this information to [4]

Please let me know if I should do so.

Regards, Anthony

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Thankyou.

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# CEO's Message

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## **Announcement from the CEO**

**29 August 2012**

As I said in July 2011, we are in one of the most significant periods in the company's 110 year history. The decisions we are taking on our future direction will shape the nature of the business far into the future.

Our long-term business strategy remains fundamentally sound, based on global economics and our very significant coal resources. Demand for energy and coal will grow, but after 110 years of mining in NZ our "easy" coal is gone and our future coal resources are much deeper and harder, or shallow but lower quality lignites.

Our objective in the past decade was to identify our best coal resources, and what mining methods, extraction technologies, and conversion technologies would allow us to obtain most value from these more challenging resources, and comparable resources like wood waste. We investigated hundreds of resource and technology opportunities at a concept level but we culled these aggressively and only advanced the best ones through our development pipeline. As a result we delivered new coal production at existing operations, and opened new mines to replace and grow our existing coal production. We led the way in bringing new biomass and biofuel products to market. We created a leadership position internationally in implementing new technologies that create value from previously unmineable or uneconomic coal resources, such as underground coal gasification and lignite upgrading.

## **Impacts of current markets**

From mid-2011 to early 2012 international coal prices fell substantially. Despite a rebound from April to June 2012, since the end of June export coal markets have continued to deteriorate and the outlook has worsened considerably. The New Zealand dollar has remained high unlike during the 2008/09 Global Financial Crisis (GFC), when commodity prices plunged but the New Zealand dollar followed and softened the fall in New Zealand dollar prices, then prices rebounded rapidly and strongly. New Zealand dollar export coal prices are now 20% under the lowest point in the GFC. We expect the current market conditions may continue through FY13 and beyond, and that our FY13 revenues may fall by about \$200 million per annum as a result.

We have implemented extensive cost and expenditure reduction measures, and our plans to exit uneconomic business areas are on track. These alone are not sufficient and cash generation and preservation is now our overriding focus. At current export coal prices a number of our export mines or prospects are no longer economic. Like other coal producers in Australia we have been reviewing our options intensely over the past two months.

The effect of the downturn on our price outlook, and the results of some decisions we have taken, will have a major effect on the company's 2012 result through reduction in carrying value of some assets, and resulting impairments, which despite a respectable underlying operational result will significantly affect our profit for the FY12 year. Our shareholder's equity also decreases by this amount, which significantly decreases our ability to borrow to fund our business. We will provide further detail on these impacts when we release our annual result on Friday 31 August.

## CEO's Message (Continued)

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### ***Business direction***

Today I am confirming changes to our business direction announced previously, and announcing a number of strategic changes or proposals to our business. Most of these are similar to changes announced by other coal and commodity producers and exporters in Australia and other countries in recent weeks. Without these measures our annualised revenues, and our cashflow, would be down over \$200 million compared to a year ago. Our business could not withstand this and we need to achieve a cashflow turnaround of at least \$100 million.

These changes are designed to achieve three primary objectives: reduce the impact of the downturn by maximising our efficiency, cash generation and preservation; retain as far as possible our future business options and core capability; and position us to accelerate our growth opportunities when the business environment allows us to do this.

We have already announced that we are narrowing the scope of the business and our development pipeline down to our best business opportunities. Coal seam gas, wood pellets and biofuels remain good future prospects in New Zealand but they are not priorities for our increasingly scarce capital.

Underground coal mining in New Zealand geography and geology is increasingly hard, capital intensive, and has poor resource recovery ratios. Except in unique situations underground mines here are near the top of international cost curves and are the first production to be susceptible in market downturns. Our existing underground mines have frequent unexpected difficulties and in the past decade have rarely performed to plan despite efforts by our mine teams. Future underground options look even more challenging. We are reducing our exposure to underground coal mining and will concentrate on opencast mining, and mining methods or conversion technologies that offer better returns or more reliable economics. These include low rank coal upgrading technologies and underground coal gasification to access deep coal.

### ***Business announcements***

I am announcing the following changes today:

- Likely market prices beyond the end of our current contract with New Zealand Steel at June 2013 do not support significant further investment or significant development at **Huntly East Mine**. We are therefore ceasing the major ventilation shaft project, ceasing major underground development, and focusing on winning developed reserves with a reduced mining team. The mine's staff will reduce from 234 positions to 171, and about 60 mainly contracting positions will go at the ventilation shaft site.
- Spring Creek Mine has been consuming \$7-9 million of cash each month as it moves through a long period of development to the next period of coal extraction, which would be January 2013 at earliest. At expected near-term prices this is not supported by the revenue available from the mine once extraction begins. We recognise that the resulting uncertainty has created considerable stress for our people at Spring Creek, and this is not acceptable from a safety perspective. We are therefore suspending operations at Spring Creek Mine while we complete a review that involves many complex issues and interaction with different stakeholders. We will advise the outcome of this review as soon as possible.
- At Stockton Mine, some types of coal produced are uneconomic or only marginally economic in current markets. We are optimising overburden stripping and coal production, and minimising operating costs and capital expenditure, to maximise cash generation through the coming year. Any changes in workforce numbers will be driven by the changes to optimise mine production.

## CEO's Message (Continued)

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- In FY13 we had planned \$144 million of **capital investment** across the business, with almost \$100 million in existing operations including \$36 million at Spring Creek, \$40 million at East Mine and \$20 million at Stockton. A further \$35 million of capex was planned for future growth coal projects as well as over \$20 million of operating expenditure on coal resource assessment and future mine planning, for a total of over \$150 million of coal investment and development. In the current business environment the business case for much of this expenditure is not supportable or affordable. We will reduce this by about \$100 million, to about \$50 million, in FY13 by significantly slowing spend on existing projects and delaying the start of new projects.
- Our **Huntly Underground Coal Gasification (UCG)** plant has been commissioned and operated successfully and has delivered most of the learnings, information and value we sought from this pilot ahead of schedule. We may shift our focus to move more rapidly to commercial UCG projects in Huntly and overseas, utilising funding from partners or customers of syngas.

### ***Organisation change proposals***

I am also today announcing proposals for an organisation restructure that will best meet our three objectives: support our future business direction; reduce the impact of the downturn; and retain the best future business options and core capability to position us to grow in the future.

Our proposed new structure will create stronger and more direct lines of responsibility and accountability to support delivery of our business strategies and corporate governance objectives. Executive and senior managers with responsibility for these objectives will provide the justification, criteria and funding for all other activities, expenditure, and resources.

Functions that provide more services support than governance, with current silos or activity duplication, will move towards 'shared services groups'. This will drive increased internal customer focus, more consistent standards, more efficient service delivery and greater collaboration at lower cost.

The fundamental principle of the new corporate structure is that it is the "owner" of our assets, with responsibility for governance and strategy – setting direction and expectations, making asset decisions and providing assurance – but not doing work other than core governance. Operational activities will be done by operations, and if additional services and support are required they will generally be provided from shared services teams, not from corporate or business management teams that build up resources to do this work.

Based on these new principles there are a number of structural changes in the upper level of the organisation.

Consistent with the decrease in availability of capital to support work in coal resource development in the near term, we propose to disestablish the newly formed Coal Resources Group, including Barry Bragg's new role of Group Manager Resources. I have had extensive discussions about this with Barry, who supports the decision. He subsequently advised me that he does not wish to consider other roles in the new structure, but offered his full support to help the company meet key objectives through this difficult period. Barry and I have reached agreement that he will leave the company in early February 2013 and until then he will work on a range of activities focusing particularly on our markets during this difficult period. Barry has been an outstanding contributor to the company for almost 20 years and he will leave us next year with our warmest gratitude and very best wishes for his future.

## CEO's Message (Continued)

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We propose that the functions that previously sat under the Group Manager Resources will report in several places within the new structure. Marketing under the General Manager Market Development (Simon Doig) will report to Bill Luff, Group Manager Strategy & Corporate Affairs. Bill also gains two newly created positions in addition to the renamed Stakeholder Relations & Communications team. The General Manager, Business Development will oversee implementation of key strategic investments and early business growth opportunities. This includes Coal Resources Strategy (as capital permits), and also includes establishing Solid Energy's role in a major South Island non-coal infrastructure project that we hope to announce publicly in the next few weeks. Bill also takes responsibility for a newly created position of General Manager Corporate Risk who will focus on risk systems and assurance to meet company requirements, but not on doing technical risk work with businesses.

Logistics will return within Coal Operations, where it has a key strategic and operational role in ensuring a continuing effective link between our optimum production and market strategies and plans.

Under Garry Diack, Group Manager Performance and Organisation Development, we propose to merge the Environment, and Health & Safety responsibilities in a Group General Manager Environment & Corporate Health & Safety. As with the Corporate Risk role under Bill Luff, the safety component of this is as an owner/governance role that is responsible for setting directions, expectations and assurance. Each business will remain responsible for all aspects of its safety performance.

Finance and Human Resources functions across the company will consolidate significantly into those corporate groups to improve the consistency, quality and efficiency of governance activities and of shared service delivery.

In Coal Operations, New Developments and Finance, Larry Hull, Brett Gamble and Anthony Burg will advise proposed changes that are primarily within those groups.

We propose to establish a new Technical Services Group. While it is a shared services group, its creation has a major strategic objective for us. Over recent years we have built teams across the business with international level technical capability. This is reflected in their continued attractiveness to Australian recruiters. We recognise that this capability is a source of strength for the company and a source of key competitive advantage. In the near term we may not have the capital availability to support the work many of these people were previously doing, such as resource proving and mine planning. However we want to keep as much of this capability in house as we can afford in the near-term.

The Technical Services Group will have its own customers and sources of revenue but no independently allocated budgets for specific work. Initially these customers will be Solid Energy Corporate or Operations people who have strategies, plans or governance responsibilities to deliver, but (by organisation design) no additional capability to deliver them. In addition the major infrastructure project identified within the Business Development area above has a need for capability that is nearly an exact match for our existing skills. We expect this project will provide externally funded work, through an internal Solid Energy client.

## CEO's Message (Continued)

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We expect the quality of the capability available within this group will also be attractive to other companies and technical groups. We have already identified and begun discussions with other companies who may be interested in contracting direct with this group for services. Effectively the Technical Services Group will become a highly specialised technical consulting business within Solid Energy, providing services both within and outside Solid Energy. This will offer an additional and major career path route for those who aspire to technical excellence roles. While we are identifying some people or groups who we propose will immediately transfer within the Technical Services Group, many of the positions are being made available for application. Initially we expect to create around 30 positions in the Technical Services Group, and its path from there will depend on the work it attracts and receives internally in Solid Energy and externally.

Out of about 230 non-operational positions in corporate, management, technical services, business support and administrative areas around the country, these proposed organisation structure changes would result in disestablishment of about 108 positions and material reporting changes for up to 20 further positions. Up to 50 new or newly defined roles may be created including those in the Technical Services Group. These will be fully contestable and open to applications. The net effect is that this total of about 230 positions may decrease by up to 70 to about 160 under this proposal. The net annualised cost savings (after transition costs) will be in the order of \$10 million.

Many people across the business will be affected to some degree by these business decisions and by the proposed organisation changes. You will receive further briefings from your managers, all affected staff will be briefed in detail on what the changes mean for you, and you will have an opportunity to consider and comment on the proposed changes. Any suggestions you make will be carefully considered by management before we announce final decisions in late September 2012.

It will be no surprise that there will be no general remuneration increase this year.

I am also announcing today that I have advised the Board of two decisions I have made: I will not be taking the Short Term Incentive payment the Board has awarded me for FY12; and I will be taking a 10% temporary reduction in my Fixed Remuneration from now through FY13. I can also announce that ELT, collectively, have voluntarily taken similar measures equivalent to a 10% reduction in Fixed Remuneration for the year. We have done this to demonstrate our collective commitment to helping the company meet our objectives and emerge strong to pursue our business strategy.

Thank you for your support through this difficult period.

Regards



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