

The Treasury

Solid Energy Information Release

May 2013

Release Document

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From: Bill Luff [Bill.Luff@solidenergy.co.nz]
Sent: Thursday, 23 February 2012 7:27 a.m.
To: John Crawford
Cc: Juston Anderson; Chris White; ^SOLID: Don Elder; ^SOLID: John PALMER
Subject: Solid Energy BP pdate for UBS SS
Attachments: SE BP Update; UBS SS.docx

Categories: Red Category

John

Attached please find Solid Energy's response to the UBS scoping study.
My apologies for the late delivery of this caused by a misunderstanding on our side.
Regards

Bill Luff

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From: John Crawford [<mailto:John.Crawford@treasury.govt.nz>]
Sent: Wednesday, 22 February 2012 3:07 p.m.
To: Bill Luff
Cc: Juston Anderson; Chris White
Subject:

Bill

I am informed by Juston that we will not be receiving Solid Energy's revised business plan this week.

This is unacceptable.

Your Chairman committed to me yesterday we would receive the plan by COB yesterday. He also committed to Mr Ryall that we would have a copy by the end of last week in a letter dated 27 January. This is on the back of an earlier promise that we would have a formal response to the UBS scoping study before Christmas.

If you are unable to provide this plan today, would you please have Don or John call me directly on my mobile

Regards

John Crawford | Deputy Secretary, Commercial Transactions | **The Treasury**
[1] John.Crawford@treasury.govt.nz

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Solid Energy Business Plan Update; the Response to the UBS Scoping Study

Introduction

- The Board of Solid Energy acknowledges that the sell down of any of New Zealand's SOE's need to meet both political and fiscal objectives set down for the MoM process. Their application by UBS to the partial sell down of Solid Energy has raised several issues which remain unanswered by the scoping study.
- While the market focus of the scoping study has given the company an invaluable insight into the demands of the capitals markets, the board of Solid Energy is concerned that such a narrow focus has driven a series of recommendations that may not be in the best interest of the business nor its future investors, including the Crown.
- We believe that the unique nature of Solid Energy amongst the nominated MoM SOEs; its product mix, its exposure to world commodity markets and exchange rates, its long term growth strategy, all need careful consideration in establishing the most appropriate ownership structure in order to deliver maximum long term value to shareholders. Not only are these factors eschewed in the scoping study, they almost certainly do not fit comfortably within the proposed MoM framework.
- The Board acknowledges that both Solid Energy and the Crown will benefit from exposure to the capital markets and having access to capital. We are keen to work together with Treasury on delivering a capital plan that maximises value for Solid Energy while meeting the Crown's MoM fiscal and political objectives.

Response to UBS scoping study

- UBS have applied their view of future prices paths for coal which are at considerable variance to those of Solid Energy. Our historic analysis (see Appendix 1) suggests not only is Solid Energy's track superior in this regard, (and the motivation for UBS's low case projections transparent), but a significant element of Solid Energy competitive advantage in promoting its growth strategy lies in the company's well worked and proven analysis. Solid Energy's understanding of the fundamentals of global coal and related markets, and its application to the business, has seen the value of Solid Energy growth from close to zero a decade ago to its current SCI value.
- UBS's perception of Solid Energy essentially as a conventional coal producer leads to Solid Energy being benchmarked against a set of peers that may not be appropriate given the unique nature of New Zealand's resources, the existing product mix of the company, the boutique nature of our operations and our strategic projects and aspirations. Determining our peers because of the product we currently sell or the current extraction method is only one part of the picture.
- Within the context of these reservations the Board of Solid Energy accepts that several of the insights of the UBS scoping study have merit and that a concentrated focus on a series of key strategic milestones over the course of the next 12-18 months has the potential to generate short term value uplift for the company and the shareholder.
- Given the uniqueness of Solid Energy amongst the SOEs identified for partial sell down and the seemingly unattractive UBS MoM proposal to the Crown, Solid Energy contents the Crown and the company should investigate other options which fulfil the MoM objectives, and which have the potential to be of direct benefit to Solid Energy.

Modifying Solid Energy's Current Business Plan

- On the basis of the UBS work and given the reservations described above Solid Energy has analysed the UBS recommendations (see Appendix 2) and developed a set of strategic milestones which are more generally applicable to a wider range of capital market options in that they focus on value uplift rather than a retail IPO in the near term.
- The milestone plan has been developed and endorsed by the Solid Energy board is as follows,

Solid Energy Milestones 2012 – 2013

1.	Determine viability of increasing R/P ratios by accelerating West Coast Coal prospecting and development activity
2.	[2], [5]
3.	Optimise West Coast resources position, initially Spring Creek
4.	Determine fit of Renewables businesses within the overall Solid Energy strategy/price discounting and monetise
5.	Commission Briquetting Demonstration Plant and investigate partial sell-down options
6.	Attain value recognition for CTF (CTL on care and maintenance)
7.	Light-up Huntly UCG and develop global UCG business plan
8.	'Farm-in' partner/new equity to CSG programme
9.	Reassess company structure and review overheads
10.	Divestment Review

- The Board of Solid Energy has endorsed these milestones for integration into the company's current year Business Plan and is ensuring they form an integral part of the forthcoming Business Plan. As such they are scheduled to be addressed over the next 12 to 18 months.
- The board has requested regular updates as to progress together with their inclusion in Solid Energy's quarterly reports to the shareholder.

Valuation

- UBS have concluded that an enterprise valuation of Solid Energy is approximately^[5] This is a market valuation based on a set of conservative assumptions and substantially explains the difference when compared to the company's current SCI value. The UBS market value in providing a relative measure of all coal companies based on a conservative view on future price requires careful consideration as to the inherent impact of such prices on the company's future strategy and therefore value given they have the effect of substituting the current market transaction value for future cash flows.
- There are a number of discrepancies in the valuation model which should be noted. These include;
 1. Solid Energy business plans are based on our internal view of price and therefore include mine design based on those future prices and the resultant economics. The UBS study applied Solid Energy production profiles, mine designs, capex and operating cost assumptions to a consensus price path. Solid Energy would consider different sequencing of operations and possibly even different asset mix based on this different view of the long term future price.
 2. There is no explanation as to why our closest comparable company being Bathurst Resources Limited is currently priced at a significant premium to Solid Energy in the New Zealand equity market.

3. The valuation of the New Energy business has been set at [2], [5] which is a point estimate. The Board views the New Energy projects as future options for the business and their true option value needs further assessment and consideration before ascribing a point value for the purposes of valuation.
4. The valuation of Solid Energy's coal development assets is [2], [5] When this is compared to both the corporate coal costs [2], [5] and exploration costs associated with these developments [2], [5], no compelling argument for accelerating the proving and development of these assets, as UBS proposes, exists.

In summary the UBS approach runs the significant risk of sub-optimising the future value of Solid Energy. However the UBS market based approach to the Solid Energy scoping study has highlighted a number of areas where the company can reassess its immediate priorities and adjust its current Business Plan accordingly. The achievement of these milestones is expected to generate value in the near term which will improve the platform from which considered decisions can be taken as to how best to advance the MOM process as it relates to Solid Energy.

Price Paths (Hard Coking Coal): Market Analysts vs Solid Energy





