Office of Hon Tony Ryall
Minister of Health
Minister of State Services

22 DEC 2011

Mr David Clarke
Chair
Kordia Group Ltd
PO Box 2495
AUCKLAND 1140

Dear Mr Clarke

2012/13 SHAREHOLDER EXPECTATIONS OF STATE OWNED ENTERPRISES

I am writing on behalf of shareholding Ministers to set out the shareholder's expectations for 2012/13. These build on the expectations set out in similar communications for 2011/12. Over the medium term, the government is seeking to release capital for reallocation to higher priority areas by extending a Mixed Ownership Model to certain SOEs, while maximising the value from all other commercial assets through performance improvements.

Our expectations in this letter are divided into three categories – priority, general, and company specific. The first two categories apply across a number of SOEs. The third category is specific to your company.

Priority Expectations

- *Shareholder Returns:* A prime focus for shareholding Ministers is that commercial entities should, over time, deliver returns that meet or exceed the company's cost of equity capital. Over the past year, we have been progressing towards better ways to monitor and measure shareholder returns. The Crown has a long term perspective on returns, and acknowledges that returns will vary from year to year, sometimes due to temporary or non-controllable factors. Emphasis will therefore be placed on total shareholder returns (TSR) over periods of up to the past 5 years. In circumstances where the TSR is persistently below the cost of equity capital, or is not expected to achieve it over the forecast period, we expect the company will develop a plan to take corrective action.

- *Valuation:* As per prior years' expectations, robust and accurate commercial valuations are fundamental to shareholders for understanding the true economic returns achieved by each SOE. As such, we would expect that a comprehensive, up to date, and robust commercial valuation be produced annually. This should be publicly disclosed in the Statement of Corporate Intent (SCI), with any major changes in assumptions from previous valuations being made transparent and justified. We have attached the model disclosure statement to this letter, which we expect you to adopt in your SCI.

- *Investment Review:* We expect SOE Boards to review major past investment decisions to assure themselves that the benefits claimed when such decisions were made are in fact being realised. Our expectation is that such reviews are made available to the shareholders.

- *Dividends:* Shareholders expect SOEs to operate a dividend policy that is commensurate with listed peers. This would include an understanding that dividends show a degree of consistency across years, and that an appropriate balance between dividends and re-investment in the business is maintained. We have asked COMU to work with you to determine an appropriate dividend policy, which in our view should be related to an agreed proportion of a cash flow measure rather than net profit after tax (NPAT). This proportion will, no doubt, reflect the maturity of the business and the investment opportunities the business faces.

- *Capital Retention and Injection:* In general, shareholding Ministers are open to considering either:

  - Allowing SOEs to reduce dividends and thus retain capital to fund particular investments, or
  - Making capital injections.

  While shareholding Ministers will consider capital injections, the hurdle for either this or for retention of profits is higher than in previous years. The Government has committed to funding capital allowances from within its existing balance sheet and encourages SOEs to release surplus capital wherever possible. Any retention of capital or capital injections will only be considered where prospective returns warrant it, and it is the most efficient form of financing available. In either of these situations we expect a fully developed and detailed business case that supports the investment will be provided to COMU.

General Expectations

Expectations in the Owner's Expectations Manual and the previous two Expectations Letters continue to apply in 2012/13 and the forecast period. Particular regard should be given to the following:

- *Strategic issues letters:* All SOEs are expected to provide Ministers with a letter, by **28 February 2012**, setting out the key strategic issues facing the company. Should your company wish to engage with shareholders to seek direction or clarification (e.g. around equity provision), we would ask that you advise COMU as early as possible of such intentions.

- *Draft Statement of Corporate Intent (SCI)/Business Plan:* All SOEs are expected to provide Ministers with a draft SCI and Business Plan by **1 May 2012**, at the latest. Shareholding Ministers should be alerted as soon as possible if this deadline cannot be met.

- *Annual General Meetings (AGMs):* All SOEs are expected to hold an AGM.

- *Continuous disclosure:* As previously communicated, it is intended for the Continuous Disclosure Regime to be extended to cover all SOEs and Television New Zealand Limited. This will be formalised in the revised version of the Owner's Expectation Manual which will be released in 2012. All SOEs will therefore be expected to make timely disclosures, including advising the Ministers' offices prior to the public release of disclosures.

- *Public Meetings:* Significant SOEs are expected to hold a public meeting on an annual basis. We also encourage other SOEs to give consideration to holding a public meeting.

- *OIA requests:* The Office of the Minister for State Owned Enterprises is to be advised by an SOE when it receives a request under the Official Information Act 1982 and of the proposed response.

Company Specific Expectations

- *Returns to the Shareholder:* While Kordia has been successful in diversifying its business and growing revenue over the last few years, this has not yet translated into the level of profitability and financial returns we expect from this company. In the future, we think Kordia needs to significantly improve its profitability and generate higher returns on the Crown's investment in the company.

- *[Withheld under s9(2)(b)(ii)]*

- *Financial reporting transparency:* Recently we have been looking to improve the transparency of SOE operational and financial performance, and believe there are opportunities for Kordia to improve in this area. Given the diverse nature of Kordia's business, we would appreciate if the board would give consideration to increasing the level of financial transparency of its various business activities. In particular, Kordia could consider separately identifying the financial performance of its different business activities in its Annual Report and Statement of Corporate Intent.

As will be apparent, the expectations outlined in this letter are largely a continuation of those set out in previous expectations letters. Since 2009, shareholding Ministers and the Crown Ownership Monitoring Unit (COMU) have been implementing a programme of increased transparency and disclosure of performance information.

Improved transparency and public disclosure of company performance has been achieved via a number of new mechanisms:

- A continuous disclosure regime for key SOEs that mirrors the sort of disclosure expected of publicly-listed companies;
- An expectation that SOEs will each year hold an Annual General Meeting at which shareholding Ministers can engage with the Board about the results the SOE has achieved;

- An expectation that, at least once a year, SOEs will hold a public meeting to give the wider community an opportunity to hear and be heard;
- Publication of a wider range of data and analysis produced or commissioned by COMU, such as:
    - The Annual Portfolio Report which looks at what the Crown owns and how well those assets are performing
    - Independent commercial valuations of all SOEs produced by external specialists, and
    - Boards have been asked to conduct post-investment reviews, and share them with shareholding Ministers, to examine how successful the SOEs' past investments have been – and consequently what can be learnt to inform future decisions.

Now that the new Government is in place, updating of the Owner's Expectation Manual is currently being finalised for distribution in 2012. In the meantime, current arrangements remain in place.

Engagement

Our expectation is that you will engage with officials from COMU shortly after receiving this letter to discuss shareholding Ministers' expectations in more detail. Please make arrangements with your usual contact in COMU, [Withheld under s9(2)(g)(i)] [Withheld under s9(2)(g)(i)] Alternatively, please contact Andrew Turner (General Manager, Crown Ownership Monitoring Unit) on 04 917 6031.

Yours sincerely

Hon Tony Ryall
Minister for State Owned Enterprises
On behalf of shareholding Ministers

cc: Mr Geoff Hunt, CEO, Kordia Group Ltd

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 [30 June 2012]
- 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 (i.e. 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
- The current commercial value of the Crown's investment of [$1.650 billion] (often referred to as the equity value) was calculated by taking the enterprise value of [$1.950 billion] and deducting net debt of [$300 million].
- Other material factors that are relevant to the determination of this valuation are [..................]

The valuation compares with a commercial value as at [30 June 2011 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.