



## Office of Hon Tony Ryall

Minister of Health  
Minister for State Owned Enterprises

20 DEC 2013

Ms Sarah Smith  
Chair  
Meteorological Service of New Zealand Ltd  
PO Box 722  
WELLINGTON 6140

Dear Ms Smith

### **2014/15 SHAREHOLDER EXPECTATIONS OF STATE OWNED ENTERPRISES**

I am writing on behalf of shareholding Ministers to set out our expectations for 2014/15. The Government continues to seek the maximisation of value from all other commercial assets through performance improvements. The Government remains committed to a return to surplus in 2014/15.

The format of this letter is intended to provide clarity for Meteorological Service of New Zealand Ltd (MetService) on shareholders' expectations for its future performance.

#### *Early notification of any material change in SCI forecast*

As returning to surplus in 2014/15 continues to be a key priority for the Government, it is important that the SOEs advise the Crown of any risk to forecast performance. Therefore, we expect that SOEs will quantify any risk and advise officials on a timely basis, if below forecast performance is expected.

#### *Non-Crown debt assurance*

Please ensure that, should you undertake any borrowing, all lenders are specifically made aware that borrowing by the company does not represent Crown debt, and accordingly is not guaranteed by the Crown.

#### *Strategic Reviews*

Shareholding Ministers are focused on the value management of the entities in the COMU portfolio, and have asked COMU to introduce activities consistent with that focus. As a result, a programme of Strategic Reviews commenced this year, with five entities being the subject of jointly-commissioned Strategic Reviews in 2013/14. The Reviews will occur on a rolling cycle, and are intended to provide closer alignment on company strategy between the Board and senior management, and the shareholders. Accordingly, SOEs and some other COMU-monitored entities can now expect to undergo a Strategic Review every three or four years.

We currently expect MetService's first Strategic Review will occur in 2014/15 and look forward to the full cooperation of the Board, to ensure the most value is obtained from the process.

#### *Update on Post-Investment Reviews*

A system of Post-Investment Reviews has been in place for COMU-monitored entities since 2011. Financial thresholds have been established, over which a post-investment review is required by COMU. These documents have been very useful in enabling Boards and shareholding Ministers to better assess whether the benefits expected to be obtained from capital expenditure and/or new investments, were realised in practice. Therefore, we have decided to request a sample of reviews from investments beneath the prescribed thresholds. You may receive such a request from COMU in due course.

#### *Return on Equity and Dividend payout*

Officials have undertaken analysis with respect to RoE and dividend payout percentages. This work has taken into account the industry in which Metservice operates, and the performance of its comparable industry peers, and is proposed with the intention of improving performance in this regard. Your COMU contact will be seeking to engage with you on the results of the analysis and I look forward to your cooperation in this regard.

#### *Capital Injections*

There is a high threshold for the Crown to approve any new capital injections.

#### *Independent Valuations*

As part of our ongoing focus on the impact of the changing business environment on company financial performance and value, we expect to make continued use of company valuations.


#### *Annexes*

Annex 1 to this letter provides the 2014/15 business planning timetable and Annex 2 provides the model disclosure statement to be used when providing the commercial value of the SOE in the Statement of Corporate Intent.

#### **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, [wh s9(2)(a)] on 04 917 6892. Alternatively, please contact Andrew Turner (Deputy Secretary, 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 Peter Lennox, CEO, Meteorological Service of New Zealand Ltd

## Annex 1

### Timeline

Below is the normal business planning timetable with the final Statement of Corporate Intent due to be received by 1 July 2014.

#### **Key dates for 2014/15**

<i>Due date</i>	<i>Key action</i>
28 February	Board sends strategic issues letter to Ministers
28 February	Board provides details of post investment reviews to COMU
1 May	Board submits draft SCI and business plan
30 June	Board delivers final SCI to shareholding Ministers

All SOEs are expected to provide shareholding Ministers with a *Strategic issues letter*, by **28 February 2014**, setting out the key strategic issues facing the company. Should your company wish to engage with shareholding Ministers to seek clarification (e.g. around equity provision), we would ask that you advise COMU as early as possible of such intentions.

All SOEs are expected to provide shareholding Ministers with a draft SCI and Business Plan, consistent with shareholding Ministers' expectations as detailed in this letter, by **1 May 2014**.

Shareholding Ministers should be alerted as soon as possible if any of these deadlines cannot be met.

Further guidance can be found in the Owner's Expectations Manual, via the COMU website. Here is a link to the site:

<http://www.comu.govt.nz/publications/guidance/owners-expectations-manual/>

## Annex 2

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

#### Example

The Board's estimate of the current commercial value of the Crown's investment in the Company / Group is [\$X billion].

Key points about the manner in which that value was assessed are:

- The valuation was calculated as at [30 June 2014].
- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire SOE 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 SOE Group's 3-year business plan, with forward projections then also made about years 4 to 10, and a terminal value of [\$X 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 SOE 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 [\$X billion] (often referred to as the equity value) was calculated by taking the enterprise value of [\$X billion] and deducting net debt of [\$X 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 2013 of \$X 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....., and
- 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.*