



Office of Hon Tony Ryall

Minister of Health
Minister of State Services

21 DEC 2011

Mr J Palmer
Chair
Solid Energy New Zealand Limited
PO Box 1303
CHRISTCHURCH 8024

Dear Mr Palmer

2012/13 SHAREHOLDER EXPECTATIONS FOR 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.

As you are aware, the government is seeking to release capital for reallocation to higher priority areas by extending a Mixed Ownership Model (MOM) to certain SOEs, including yours. On 15 December the government announced that it had:

- agreed in principle to proceed with the mixed ownership model
- agreed that Mighty River Power (MRP) should be the first company prepared for an IPO, most likely in the third quarter of 2012, subject to market conditions
- agreed that decisions about share allocations will be made early next year during the design phase of the IPO
- agreed to consult with Maori in early 2012, and
- agreed that legislation will be required to support the mixed ownership programme – including removing the four mixed ownership energy companies – MRP, Genesis, Meridian and Solid Energy - from the State Owned Enterprises Act (the SOE Act).

These decisions will kick off the MOM process. The Government will make final decisions on timing and other details regarding the MRP offer early next year.

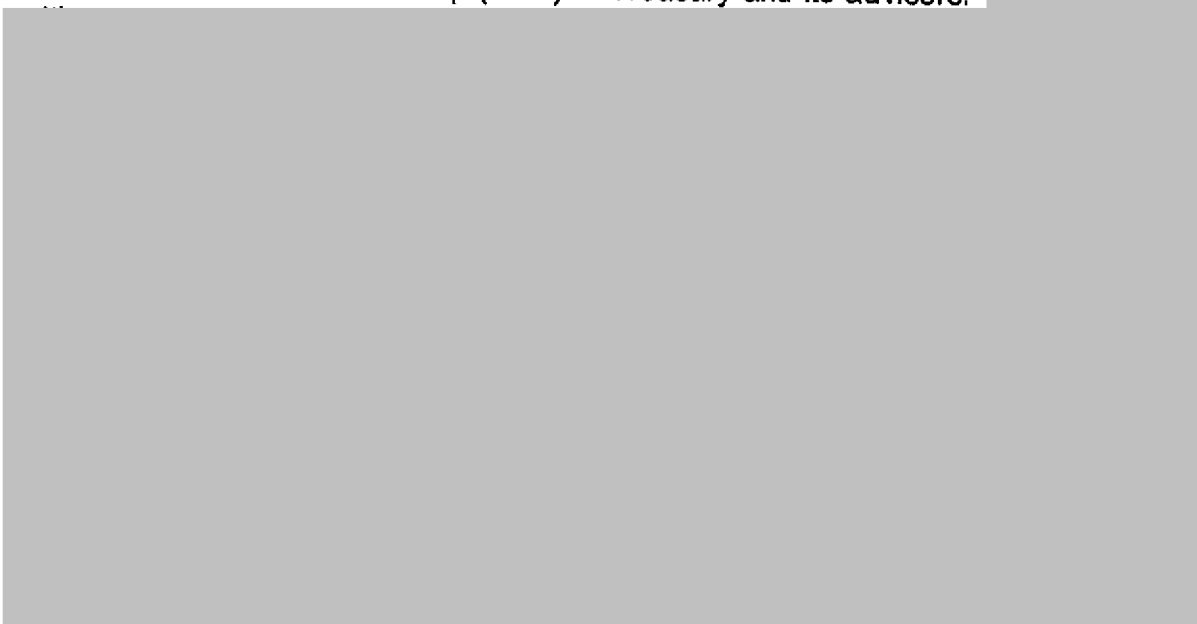
Until Solid Energy is removed from the SOE Act, the provisions of that Act will continue to apply. Additional expectations (such as those set out in the Owners'

Expectations Manual) will be assessed for mixed ownership companies on a case-by-case basis, depending on the likely timing of any partial sale. In general however, we would expect MOM companies to meet the same expectations as other SOEs unless there is a good case for an exception.

Our expectations in this letter are divided into three categories – company specific, priority and general. Priority and general expectations apply across all SOEs. These expectations, which are largely a continuation of those set out in previous expectations letters, are outlined below.

Specific Expectations for Solid Energy

Continuing to prepare Solid Energy for an IPO will obviously be an important focus for the coming year and will involve Solid Energy continuing to work closely with the Commercial Transactions Group (CTG) in Treasury and its advisors. [Withheld under s9(2)(b)(ii)]



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 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 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 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 and Capital Structure:* Shareholders expect SOEs to operate a dividend policy that is commensurate with listed peers. This would include dividends showing a degree of consistency across years, and that an appropriate balance between dividends and re-investment in the business is maintained.

General Expectations

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 companies 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, and
- Publication of a wider range of data and analysis produced or commissioned by COMU.

The Owners' Expectation Manual is currently being updated, now that a new government is in place. This will be finalised and distributed early in 2012. In the meantime, the expectations of the existing Owner's Expectations Manual and the previous two Outlook 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 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:* SOEs are 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.

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 Blazey (Manager, Commercial Transactions Group) on 04 973 3944.

Yours sincerely



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

cc: Don Elder, Chief Executive

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

Example for the SOE Corp Group

The Board's estimate of the current commercial value of the Crown's investment in the SOE Corp 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 SOE Corp 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 Corp 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 SOE Corp 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.