The Treasury

Solid Energy Information Release

March 2013

Release Document

www.treasury.govt.nz/publications/information-releases/solidenergy

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[1] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[2] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information, or who is the subject of the information

[3] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[4] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[5] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[6] 9(2)(j) - to protect the commercial position of the person who supplied the information, or who is the subject of the information; to enable the Crown to carry out commercial activities without disadvantage or prejudice; and to enable the Crown to negotiate without disadvantage or prejudice

[7] 9(2)(ba)(i) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely to prejudice the supply of similar information, or information from the same source, and it is in the public interest that such information should continue to be supplied

[8] Information is out of scope or not relevant.

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [3] appearing where information has been withheld in a release document refers to section 9(2)(f)(iv).

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.
**Treasury Report:** 2011 Solid Energy Draft Statement of Corporate Intent

**Date:** 13 October 2011  
**Report No:** T2011/2143

### Action Sought

<table>
<thead>
<tr>
<th>Name</th>
<th>Action Sought</th>
<th>Deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minister of Finance (Hon Bill English)</td>
<td>Agree to recommendations</td>
<td>Monday 17 October 2011</td>
</tr>
<tr>
<td>Associate Minister of Finance (Hon Simon Power)</td>
<td>For your information</td>
<td>None</td>
</tr>
<tr>
<td>Minister for State Owned Enterprises (Hon Tony Ryall)</td>
<td>Agree to recommendations and sign letter to Chair</td>
<td>Monday 17 October 2011</td>
</tr>
<tr>
<td>Minister of Transport and Associate Minister of Finance (Hon Steven Joyce)</td>
<td>For your information</td>
<td>None</td>
</tr>
</tbody>
</table>

### Contact for Telephone Discussion (if required)

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Telephone</th>
<th>1st Contact</th>
</tr>
</thead>
<tbody>
<tr>
<td>James Cunningham</td>
<td>Manager, Sector Monitoring</td>
<td>[1]</td>
<td></td>
</tr>
</tbody>
</table>

### Minister of Finance’s Office Actions (if required)

None.

### Minister for State Owned Enterprises’ Office Actions (if required)

Once recommendations have been agreed to, send letter to Chair.

**Enclosure:** Yes

Executive Summary

COMU has received a draft Statement of Corporate Intent (SCI) for Solid Energy New Zealand Ltd (Solid Energy). Solid Energy has previously been granted an extension for delivery of its final SCI. This report advises that the SCI broadly meets shareholder expectations, with the exception of the Board’s disclosure of its estimate of the commercial value of Solid Energy.

This report recommends that shareholding Ministers provide formal feedback that:

- Solid Energy’s draft commercial valuation disclosure in its SCI does not meet the standard of disclosure and the level of transparency which shareholding Ministers had requested of all SOE boards, and
- Shareholding Ministers’ request that the Solid Energy Board reconsiders its commercial valuation disclosure before providing a final SCI suitable for tabling in the House of Representatives.

Given our overall push to increase transparency and disclosure, of SOE performance information, we think it is important to adopt a firm stance on the commercial valuation disclosure. To do otherwise will create ongoing problems with Solid Energy and other SOEs.

We consider that the current scoping exercise being undertaken as part of the Mixed Ownership (MoM) work could potentially have a significant impact on Solid Energy’s strategy, and ultimately its capital expenditure (CAPEX) and the potential to pay dividends in the future. This does not affect the 2011/12 SCI but may lead to changes that will need to be reflected in the 2012/13 SCI.
Recommended Action

We recommend that you:

a **note** that we consider that Solid Energy’s SCI broadly meets shareholder expectations, with the exception of the Board’s disclosure of its estimate of the commercial value of Solid Energy

b **agree** that the Minister for SOEs sign the attached letter, providing a formal comment to the Solid Energy Board that the commercial valuation disclosure in the SCI does not meet shareholding Ministers’ expectations or the level of disclosure of the other companies being considered for the MoM

<table>
<thead>
<tr>
<th>Agree/disagree.</th>
<th>Agree/disagree.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minister of Finance</td>
<td>Minister for State Owned Enterprises</td>
</tr>
</tbody>
</table>

c **note** the forecast dividend for 2011/12 has increased to $50 million, $30 million more than forecast in last year’s SCI, and forecast capital expenditure (CAPEX) over the next two years has decreased significantly in comparison to the forecast contained in the previous year’s SCI

d **note** the current scoping exercise being undertaken as part of the Mixed Ownership (MoM) work could potentially have a significant impact on Solid Energy’s strategy, and ultimately its CAPEX requirements and potential to pay higher dividends

e **note** COMU has been working on comparable company analysis of Solid Energy (attached - Annex 2) and officials would be happy to discuss this in further detail.

James Cunningham
Manager, Sector Monitoring
for the Secretary to the Treasury

Hon Bill English
Minister of Finance

Hon Tony Ryall
Minister for State Owned Enterprises
Purpose of Report

1. This report provides advice on the business plan and draft SCI of Solid Energy. If you agree, COMU has provided a letter for you to send to the Chair providing formal feedback on the draft SCI.

Background

2. Under section 14(4) of the State-Owned Enterprises Act 1986 (the SOE Act) shareholding Ministers agreed to extend the date for receipt of the draft SCI to 30 September 2011 so that the Board could fully consider outstanding issues.

3. We have reviewed the draft SCI and do not think it is in a form suitable for tabling in the House of Representatives, due to an inadequate commercial valuation disclosure.

Analysis

4. COMU has assessed the SCI of Solid Energy against shareholders’ priority expectations, specifically dividends, forecast CAPEX and company operating performance.

5. As requested by shareholding Ministers Solid Energy has included in its draft SCI the following financial performance metrics. Overall, these show that the company is expected to perform well, although the soon to be provided scoping study will show that there is capacity for the company to perform even better.

Table 1: Solid Energy Performance Metrics

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder returns</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Shareholder Return</td>
<td>26.7%</td>
<td>521.8%</td>
<td>(15.9)%</td>
<td>37.3%</td>
<td>(13.9)%</td>
<td>NA</td>
</tr>
<tr>
<td>Dividend yield</td>
<td>0.0%</td>
<td>0.0%</td>
<td>2.2%</td>
<td>1.9%</td>
<td>0.7%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Dividend payout</td>
<td>0.0%</td>
<td>0.0%</td>
<td>46.8%</td>
<td>90.4%</td>
<td>14.5%</td>
<td>37%</td>
</tr>
<tr>
<td>Return on equity</td>
<td>33.6%</td>
<td>10.2%</td>
<td>47.5%</td>
<td>11.0%</td>
<td>18.3%</td>
<td>25%</td>
</tr>
<tr>
<td>Profitability/efficiency</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Return on Capital Employed</td>
<td>45.5%</td>
<td>14.8%</td>
<td>60.3%</td>
<td>14.9%</td>
<td>19.8%</td>
<td>25%</td>
</tr>
<tr>
<td>Operating margin</td>
<td>15.6%</td>
<td>15.6%</td>
<td>37.3%</td>
<td>20.2%</td>
<td>22.5%</td>
<td>23%</td>
</tr>
<tr>
<td>Leverage/solvency</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gearing</td>
<td>5.0%</td>
<td>9.0%</td>
<td>13.1%</td>
<td>32.5%</td>
<td>29.9%</td>
<td>35%</td>
</tr>
<tr>
<td>Interest cover (number of times)</td>
<td>21.5</td>
<td>25.0</td>
<td>199.6</td>
<td>17.3</td>
<td>16.0</td>
<td>11.6</td>
</tr>
<tr>
<td>Solvency</td>
<td>2.45</td>
<td>1.57</td>
<td>1.63</td>
<td>1.20</td>
<td>2.06</td>
<td>1.7</td>
</tr>
</tbody>
</table>
Business Strategy

6. There has been no change from last year to Solid Energy’s key objectives or the nature and scope of activities, as described in the SCI, being:

- Resource development, production, processing and marketing of:
  - coal and lignite
  - biomass, including wood pellets and biofuels
  - gas and syngas from coal and biomass, and
  - other natural resources that utilise capabilities to provide future options and value

- Conversion of coal, biomass and other natural resources to value added products including electricity, sold fuels, transport fuels and chemical products.

Proposed Mixed Ownership Model (MoM)

7. Solid Energy is one of the companies being considered for MoM, and work is currently underway on a scoping study for Solid Energy. The information being considered and the conclusions from the scoping study are likely to be very significant with respect to the appropriateness of the Solid Energy’s business strategy.

8. Given the result of the scoping study will be known soon, the appropriateness of the Solid Energy’s business strategy was not considered when reviewing the SCI. However, our analysis of the business plan did highlight that progress on the major lignite proposals, being to convert lignite to fertiliser and to liquid fuels, are now on a slower path than previously planned.

Revenue

9. Compared with last year’s SCI, Solid Energy is forecasting an increase in revenue of $234 million (+21%) for 2011/12 and These represent aggressive revenue targets, which will be challenging to achieve. The revenue increase is mainly due to higher forecast coal volumes and prices. Solid Energy has forecast prices at approximately 20% higher than independent commentators’ coal consensus price forecasts over the next two years. While there is some risk that this level of pricing may not eventuate, Solid Energy recently indicated to COMU that the contracted prices it is currently achieving are in line with Solid Energy’s forecasts.

<table>
<thead>
<tr>
<th>Table 2: Solid Energy Forecast Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue ($m)</td>
</tr>
<tr>
<td>-------------</td>
</tr>
<tr>
<td>2009/10 Business Plan</td>
</tr>
<tr>
<td>2010/11 Business Plan</td>
</tr>
<tr>
<td>2011/12 Business Plan</td>
</tr>
<tr>
<td>Actual</td>
</tr>
<tr>
<td>Change in forecast revenue 10/11 v 11/12</td>
</tr>
</tbody>
</table>

1 Lignite is a type of low grade coal with high water content.
Net Profit After Tax (NPAT)

10. NPAT is forecast to be $134 million for 2011/12 which is $57 million higher than forecast in last year’s plan. Largely this will be a result of the higher forecast sales volumes and prices. However, in four of the last five years Solid Energy has achieved revenue ahead of its one year forecasts, so we consider its current forecast to be plausible.

Table 3: Solid Energy NPAT

<table>
<thead>
<tr>
<th>NPAT ($ millions)</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10 Business Plan</td>
<td>43</td>
<td>70</td>
<td>89</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010/11 Business Plan</td>
<td>66</td>
<td>77</td>
<td></td>
<td>[2],[5]</td>
<td></td>
</tr>
<tr>
<td>2011/12 Business Plan</td>
<td></td>
<td>134</td>
<td>[2],[5]</td>
<td>[2],[5]</td>
<td></td>
</tr>
<tr>
<td>Actual</td>
<td>68</td>
<td>87</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual v Plan (yr 1)</td>
<td>25</td>
<td>21</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Change in forecast NPAT 10/11 v 11/12*

Table 4: Solid Energy Dividend Forecast

<table>
<thead>
<tr>
<th>Dividend ($m)</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10 SCI</td>
<td>24</td>
<td>10</td>
<td>28</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010/11 SCI</td>
<td>20</td>
<td>20</td>
<td>[2],[5]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011/12 SCI</td>
<td>50</td>
<td></td>
<td>[2],[5]</td>
<td>[2],[5]</td>
<td></td>
</tr>
<tr>
<td><em>Change in forecast dividend 10/11 v 11/12</em></td>
<td>30</td>
<td>[2],[5]</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Actual dividend</td>
<td>54</td>
<td>50</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>% NPAT</td>
<td>79%</td>
<td>57%</td>
<td>37%</td>
<td>[2],[5]</td>
<td>[2],[5]</td>
</tr>
</tbody>
</table>

Dividends and Capital Structure

11. The Solid Energy dividend policy expressed in its SCI effectively sets a minimum dividend (assuming that forecast NPAT is achieved), with an additional dividend (in practice) being paid when actual NPAT is above plan (the above budget NPAT).

12. Solid Energy has significantly increased its forecast dividend for 2011/12 to $50 million and, for 2012/13, [2],[5] Previously the dividend for both years was planned to be [2],[5] his increase in dividends is pleasing because it demonstrates that Solid Energy has responded to Ministerial expectations.

Table 4: Solid Energy Dividend Forecast

13. The current gearing ratio (30%) indicates that there could be flexibility to increase the dividend for 2011/12 to above the forecast $50 million by increasing gearing and paying a special dividend. However, the current gearing ratio does not include the additional $30 million dividend for 2010/12, as per the dividend policy, paid on 30 September 2011. Solid Energy notes its financial plan also incorporates enough

---

2 The gearing ratio also excludes the impact of a final dividend, if any, for the 2010/11 financial year.
headroom in its gearing so that short-term strategic acquisitions can be made (i.e. the assets of the Pike River Coal Mine).

Table 5: Solid Energy forecast gearing level

<table>
<thead>
<tr>
<th>Gearing ($m)</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10 SCI</td>
<td>35%</td>
<td>35%</td>
<td>35%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010/11 SCI</td>
<td>37%</td>
<td>44%</td>
<td>[2],[5]</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011/12 SCI</td>
<td>36%</td>
<td>[2],[5]</td>
<td>[2],[5]</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Actual Gearing</strong></td>
<td>33%</td>
<td>30%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

14. Solid Energy has not, as yet, set its final dividend for 2010/11. Informally, Solid Energy has indicated that a final dividend of $20 million may be paid, bringing the total for the year to $70 million. While we could potentially encourage Solid Energy to forecast a higher forecast dividend for 2011/12 there is a risk that this could be at the expense of a final dividend for 2010/11 and/or could impact on the Solid Energy negotiations to purchase the Pike River mine assets from the Receiver. We are also mindful that the future level of dividends will depend on the other investment opportunities, and the viability of these investments will be considered, in some detail, through the MoM Solid Energy scoping study.

15. On balance we are comfortable with the proposed dividend for 2011/12 and consider that the issue of what is an appropriate level of dividend beyond 2011/12 is best considered in the context of the results of the Solid Energy scoping study.

**Capital Expenditure (CAPEX)**

16. The business plan includes a reduction in the level of forecast CAPEX of $96 million for 2011/12 and [2],[5] for 2012/13. This reduction is consistent with the general slowing of the pace of Solid Energy’s lignite developments. However, CAPEX for 2011/12 does still include $29 million on new developments (i.e. non-coal related projects, including lignite conversion projects).

Table 6: Solid Energy CAPEX Forecast

<table>
<thead>
<tr>
<th>CAPEX ($m)</th>
<th>2009/10</th>
<th>2010/11</th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009/10 SCI</td>
<td>229</td>
<td>123</td>
<td>146</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2010/11 SCI</td>
<td>222</td>
<td>263</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011/12 SCI</td>
<td></td>
<td>167</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Change in forecast CAPEX 10/11 v 11/12</strong></td>
<td></td>
<td>(96)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Actual CAPEX</strong></td>
<td></td>
<td>179</td>
<td>118</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Commercial Valuation**

17. The Solid Energy Board’s estimate of the commercial value of Solid Energy of $2.8 billion is $0.5 billion less than last year’s SCI. The valuation remains significantly higher than the two independent commercial valuations, of approximately $1.7 billion, commissioned by COMU last year. We comment on this valuation in paragraph 25 below.
Table 7: Solid Energy Commercial Valuation

<table>
<thead>
<tr>
<th>$ Billions</th>
<th>2009 SCI</th>
<th>2010 SCI</th>
<th>2011 SCI</th>
<th>2012 SCI</th>
<th>$change</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board’s estimate of commercial value</td>
<td>2.95</td>
<td>2.43</td>
<td>3.28</td>
<td>2.80</td>
<td>(0.48)</td>
<td>(14.5)%</td>
</tr>
</tbody>
</table>

SCI Commercial Value Disclosure

18. All SOEs, as part of the Shareholders’ Expectations Letter of November 2010, were requested to provide in their SCI a comprehensive, up to date, and robust commercial valuation, with major changes in the assumptions from previous valuations being made transparent. SOEs were also provided with a model disclosure statement (See Annex 1). The disclosure is expected to include further detail to increase the transparency of the valuation (and change in value), such as:

- the assumed discount rate (and any change)
- who the valuation was prepared by
- who peer reviewed the valuation
- other material factors, and
- what value is assigned to the terminal value.

19. Although COMU has highlighted to Solid Energy shareholding Ministers’ expectations with respect to the commercial valuation disclosure, the Board has chosen not to comply with the requested disclosure. To date the Board has simply provided the valuation, without detailing assumptions or providing any commentary on how the valuation has changed since the last year’s SCI and nor has the valuation been peer-reviewed. Therefore a reader of the Solid Energy SCI could not meaningfully understand how the valuation is derived.

20. Not only does the Solid Energy disclosure not provide the transparency which shareholding Ministers have requested, it is also questionable if the disclosure fully meets the requirement under the SOE Act (Part 3 - Accountability Section 3) of including "...a statement of the manner in which that value was assessed".

21. We understand that the Board has some sensitivity about the commercial valuation it publishes this time because it is being considered for the proposed MoM. However, we note that all the other companies being considered for the MoM have provided commercial valuation disclosures consistent with shareholding Ministers’ expectations.

22. Given the importance of the commercial valuation for assessing the performance of the company and its current lack of transparency, we recommend that shareholding Ministers write to the Solid Energy Board to provide the following feedback on the commercial valuation disclosure:

- it does not meet the shareholding Ministers’ expectations as previously provided to the Solid Energy Board
- it is not consistent with the level of disclosure of the other companies being considered for the proposed MoM, and
it is also questionable if the commercial value disclosure fully meets the requirement under the SOE Act 1986 of including “…a statement of the manner in which that value was assessed”.

Comparable Company Analysis (COMPCO)

23. COMU has been working on developing COMPCO analysis for SOEs. The work to date has focussed mainly on the larger SOEs including the electricity generator-retailers and Solid Energy. Attached in Annex 2 is a draft of the COMPCO analysis for Solid Energy. COMU has yet to share this analysis or test the robustness of the analysis with Solid Energy.

24. The companies which COMU used as comparators in the COMPCO analysis are a combination of those companies used by the investment banks in last year’s independent commercial valuation of Solid Energy, and comparative companies which were identified when COMU previously commissioned work to estimate the cost of equity for each SOE. While the merits of including specific companies could be debated, in aggregate we consider the analysis provides a reasonable attempt to make a comparison against private-sector peers. More generally it can be argued, that these companies have been considered by market participants as relevant comparators for Solid Energy.

25. Based on the COMPCO analysis (and as demonstrated in diagram 1 of Annex 2) the high level findings are:

- **Using Solid Energy’s current valuation of $2.8 billion results in:**
  - the price to earnings ratio of Solid Energy being significantly above the COMPCO average
  - the ratio of Solid Energy’s enterprise value to underlying earning (EBITDA) (earnings before interest, taxation, depreciation and amortisation) being significantly above the COMPCO average, and
  - the dividend yield for Solid Energy being below the COMPCO average.

- **Using the average of the independent commercial valuations commissioned by COMU of $1.7 billion results in:**
  - the price to earnings ratio of Solid Energy being close to the COMPCO average
  - the ratio of Solid Energy’s enterprise value to underlying earnings being slightly above the market average, and
  - the dividend yield for Solid Energy being below (but not as significantly as using Solid Energy’s own valuation) the market average.

- **Compared to COMPCO comparators, Solid Energy’s level of gearing is high. On average the comparative companies had no debt (some companies had large positive cash balances).**

---

3 The dividends that were used for the analysis were based on last year’s SCI. Therefore they do not take into account the $30 million dividend recently paid by Solid Energy (above the $20 million in the SCI) or the forecast increase in dividends in the draft SCI.
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 2011]

- 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 2010 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.
Dear Mr Palmer

2011 DRAFT STATEMENT OF CORPORATE INTENT (SCI)

Thank you for providing me with the Solid Energy’s business plan and draft SCI. We appreciate the time and effort which has gone into producing these documents.

Shareholding Ministers are pleased to see a greater balance between the Company’s desire for capital investment and the desire of the Crown to receive increased dividends, given its constrained fiscal position. We appreciate this change, and also appreciate the increased profits and dividends paid relating to the 2010/11 financial year. Given the events in Canterbury, we recognise this has been a creditable achievement in a particularly challenging year.

With respect to the Solid Energy’s draft SCI there is one area where shareholding Ministers still have concerns. I am disappointed to note that Solid Energy’s intended disclosure of the Board’s estimate of the commercial value of the company does not meet the level of transparency that we expect for this disclosure. As you will be aware, this Government has placed significant emphasis on improving the transparency of SOE performance information.

Consistent with this, in November 2010 shareholding Ministers wrote to all SOEs setting out their expectations for each SOE. This letter included the clear expectation that a fully robust commercial valuation would be prepared and a summary of this would be included in the SCI. The letter also included a model commercial valuation disclosure statement setting out the minimum level of disclosure expected.

I understand that the Solid Energy board has chosen not to comply with the requested commercial valuation disclosure, and has simply provided the valuation without disclosing the relevant assumptions so that a reader can meaningfully understand how the valuation was derived. I also understand no commentary is included on how this has changed since the last year’s SCI and nor has the valuation been peer-reviewed. Overall, shareholding Ministers do not consider the current disclosure provides a sufficient level of transparency as requested, and it is also questionable if the commercial value disclosure fully meets the requirement under
the State Owned Enterprises Act 1986 (Part 3 - Accountability Section 3) of including “...a statement of the manner in which that value was assessed”.

I understand that the board has some sensitivity about the commercial valuation it publishes at the time because it is being considered for the proposed Mixed Ownership Model (MoM). However, we note that all the other companies being considered for the MoM have provided commercial valuation disclosures which are consistent with shareholding Ministers’ expectations.

I would encourage the board to reconsider its position on the commercial valuation disclosure and to resubmit an SCI with a more extensive explanation of the commercial valuation.

I look forward to receiving a revised SCI aligned with shareholding Ministers’ expectations. I would appreciate if this could be provided by 30 November 2011.

Yours sincerely

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

cc:  Dr Don Elder, Chief Executive Officer, Solid Energy
## Annex 2

### SOE Comparable Company Analysis - Solid Energy

**HEADLINE INFORMATION**

<table>
<thead>
<tr>
<th>Company</th>
<th>Size</th>
<th>Value</th>
<th>Dividend</th>
<th>Efficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market Cap (mm)</td>
<td>EV (mm)</td>
<td>EBITDA</td>
<td>Forward P/E</td>
</tr>
<tr>
<td>AQUILA RESOURCES LTD</td>
<td>2,792</td>
<td>2,613</td>
<td>-62.2x</td>
<td>117.9x</td>
</tr>
<tr>
<td>WHITHEAVEN COAL LTD</td>
<td>2,913</td>
<td>2,867</td>
<td>22.2x</td>
<td>41.8x</td>
</tr>
<tr>
<td>GLOUCESTER COAL LTD</td>
<td>1,458</td>
<td>1,469</td>
<td>14.0x</td>
<td>22.8x</td>
</tr>
<tr>
<td>NEW HOPES COAL LTD</td>
<td>4,296</td>
<td>2,809</td>
<td>12.4x</td>
<td>27.2x</td>
</tr>
<tr>
<td>MACARTHUR COAL LTD</td>
<td>3,300</td>
<td>3,147</td>
<td>15.6x</td>
<td>19.6x</td>
</tr>
<tr>
<td>COAL &amp; ALLIED INDUSTRIES</td>
<td>9,920</td>
<td>9,072</td>
<td>7.8x</td>
<td>12.2x</td>
</tr>
<tr>
<td>GUARANTY MINING COY</td>
<td>416</td>
<td>542</td>
<td>3.2x</td>
<td>5.9x</td>
</tr>
<tr>
<td>RIVERSIDE MINING LTD</td>
<td>3,800</td>
<td>3,713</td>
<td>1154.6x</td>
<td>13.5x</td>
</tr>
<tr>
<td>CONSOL ENERGY INC</td>
<td>10,058</td>
<td>14,418</td>
<td>8.2x</td>
<td>16.6x</td>
</tr>
<tr>
<td>PEACH COAL CORP</td>
<td>16,079</td>
<td>17,634</td>
<td>7.2x</td>
<td>13.7x</td>
</tr>
<tr>
<td>CIGARDO COAL INC</td>
<td>5,582</td>
<td>7,099</td>
<td>6.2x</td>
<td>14.8x</td>
</tr>
<tr>
<td>Compco Median</td>
<td>-</td>
<td>-</td>
<td>104.3x</td>
<td>8.6x</td>
</tr>
<tr>
<td>Compco Mean</td>
<td>2,800</td>
<td>3,193</td>
<td>15.7x</td>
<td>32.6x</td>
</tr>
<tr>
<td>Macquarie Research</td>
<td>1,713</td>
<td>1,918</td>
<td>13.7x</td>
<td>27.6x</td>
</tr>
<tr>
<td>Forsyth Bar</td>
<td>1,721</td>
<td>1,935</td>
<td>8.9x</td>
<td>28.9x</td>
</tr>
<tr>
<td>AVG Investment Banks (Lp)</td>
<td>1,702</td>
<td>1,911</td>
<td>11.9x</td>
<td>27.5x</td>
</tr>
</tbody>
</table>

### Solid Energy

**EV/EBITDA Multiple**

- **Compco Median**
- **Solid Energy**
- **IB Average**

**Note 1:** The negative numbers for gearing arise where companies hold cash balances.

---

### Graphical Analysis

**EV/EBITDA Multiple**

**Forward P/E Multiple**

- **EV/EBITDA**
- **Average EV/EBITDA**
- **Forward P/E**
1. EV is the enterprise value, defined as the sum of current market capitalisation and net debt. EV gives an indication of the size of the firm.
2. EBITDA is a valuation metric calculated as the firm's EV divided by the mean Bloomberg analyst estimate of earnings for the current financial year. Unlike the P/E ratio, EBITDA is capital structure neutral, and can readily be compared across companies.
3. The P/E ratio is a measure of the price paid for a share relative to the annual net income or profit earned by the firm per share. It can give a reasonable indication of how much the price of a stock is a result of expected earnings growth. The ratio is calculated as the current market price divided by the Bloomberg mean analyst estimate of the EPS for the current financial year.
4. NDEBT is a ratio that measures firm leverage. NDEBT is the sum of short term and long term debt, and Equity is the sum of common equity, minority interests and preferred equity.
5. Interest Cover is the interest coverage of the firm. The data used in this metric is historical. Interest Cover is defined as EBIT divided by interest expense.
6. NDEBIT is the ratio of firm net debt to its historical earnings. It gives an indication of the number of years' earnings that would be necessary to pay off the firm's current debt.
7. Dividend yield is the mean Bloomberg analyst's estimate of the annual dividend to be paid (based on a current calendar year), divided by the current stock price. For DOE's, dividend is based on the latest dividend paid.
8. The EBIT and EBITDA margins are measures of operating profitability, both are sourced from historical data, and are calculated as the EBIT or EBITDA divided by the total sales revenue.
9. DOE data is taken from the latest AFR. More recent, forward-looking estimates should be used if possible.
10. Source of comparable data is the ABN AMRO Credit Risk report in the Gestalters and Solid Energy may use comparable companies from more recent IR valuation or MCM reports.
Mr John Palmer  
Chair  
Solid Energy New Zealand Ltd  
PO Box 1303  
CHRISTCHURCH 8140  

Dear Mr Palmer  

2011 DRAFT STATEMENT OF CORPORATE INTENT (SCI)  

Thank you for providing me with the Solid Energy’s business plan and draft SCI. We appreciate the time and effort which has gone into producing these documents.  

Shareholding Ministers are pleased to see a greater balance between the Company’s desire for capital investment and the desire of the Crown to receive increased dividends, given its constrained fiscal position. We appreciate this change, and also appreciate the increased profits and dividends paid relating to the 2010/11 financial year. Given the events in Canterbury, we recognise this has been a creditable achievement in a particularly challenging year.  

With respect to the Solid Energy’s draft SCI there is one area where shareholding Ministers still have concerns. I am disappointed to note that Solid Energy’s intended disclosure of the Board’s estimate of the commercial value of the company does not meet the level of transparency that we expect for this disclosure. As you will be aware, this Government has placed significant emphasis on improving the transparency of SOE performance information.  

Consistent with this, in November 2010 shareholding Ministers wrote to all SOEs setting out their expectations for each SOE. This letter included the clear expectation that a fully robust commercial valuation would be prepared and a summary of this would be included in the SCI. The letter also included a model commercial valuation disclosure statement setting out the minimum level of disclosure expected.  

I understand that the Solid Energy board has chosen not to comply with the requested commercial valuation disclosure, and has simply provided the valuation without disclosing the relevant assumptions so that a reader can meaningfully understand how the valuation was derived. I also understand no commentary is included on how this has changed since the last year’s SCI and nor has the valuation been peer-reviewed. Overall, shareholding Ministers do not consider the current disclosure provides a sufficient level of transparency as requested, and it is also questionable if the commercial value disclosure fully meets the requirement under
the State Owned Enterprises Act 1986 (Part 3 - Accountability Section 3) of including "...a statement of the manner in which that value was assessed".

I understand that the board has some sensitivity about the commercial valuation it publishes at the time because it is being considered for the proposed Mixed Ownership Model (MoM). However, we note that all the other companies being considered for the MoM have provided commercial valuation disclosures which are consistent with shareholding Ministers' expectations.

I would encourage the board to reconsider its position on the commercial valuation disclosure and to resubmit an SCI with a more extensive explanation of the commercial valuation.

I look forward to receiving a revised SCI aligned with shareholding Ministers' expectations. I would appreciate if this could be provided by 30 November 2011.

Yours sincerely

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

cc: Dr Don Elder, Chief Executive Officer, Solid Energy
Mr John Palmer  
Chair  
Solid Energy New Zealand Ltd  
PO Box 1303  
CHRISTCHURCH 8140

Dear Mr Palmer

2011 DRAFT STATEMENT OF CORPORATE INTENT (SCI)

Thank you for providing me with the Solid Energy’s business plan and draft SCI. We appreciate the time and effort which has gone into producing these documents.

Shareholding Ministers are pleased to see a greater balance between the Company's desire for capital investment and the desire of the Crown to receive increased dividends, given its constrained fiscal position. We appreciate this change, and also appreciate the increased profits and dividends paid relating to the 2010/11 financial year. Given the events in Canterbury, we recognise this has been a creditable achievement in a particularly challenging year.

With respect to the Solid Energy's draft SCI there is one area where shareholding Ministers still have concerns. I am disappointed to note that Solid Energy's intended disclosure of the Board’s estimate of the commercial value of the company does not meet the level of transparency that we expect for this disclosure. As you will be aware, this Government has placed significant emphasis on improving the transparency of SOE performance information.

Consistent with this, in November 2010 shareholding Ministers wrote to all SOEs setting out their expectations for each SOE. This letter included the clear expectation that a fully robust commercial valuation would be prepared and a summary of this would be included in the SCI. The letter also included a model commercial valuation disclosure statement setting out the minimum level of disclosure expected.

I understand that the Solid Energy board has chosen not to comply with the requested commercial valuation disclosure, and has simply provided the valuation without disclosing the relevant assumptions so that a reader can meaningfully understand how the valuation was derived. I also understand no commentary is included on how this has changed since the last year’s SCI and nor has the valuation been peer-reviewed. Overall, shareholding Ministers do not consider the current disclosure provides a sufficient level of transparency as requested, and it is also questionable if the commercial value disclosure fully meets the requirement under
the State Owned Enterprises Act 1986 (Part 3 - Accountability Section 3) of including "...a statement of the manner in which that value was assessed".

I understand that the board has some sensitivity about the commercial valuation it publishes at the time because it is being considered for the proposed Mixed Ownership Model (MoM). However, we note that all the other companies being considered for the MoM have provided commercial valuation disclosures which are consistent with shareholding Ministers’ expectations.

I would encourage the board to reconsider its position on the commercial valuation disclosure and to resubmit an SCI with a more extensive explanation of the commercial valuation.

I look forward to receiving a revised SCI aligned with shareholding Ministers’ expectations. I would appreciate if this could be provided by 30 November 2011.

Yours sincerely

[Signature]

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

cc: Dr Don Elder, Chief Executive Officer, Solid Energy