



Office of Hon Bill English

Deputy Prime Minister
Minister of Finance
MP for Clutha-Southland

19 NOV 2012

Mr Phil Lough
Chair
Quotable Value Ltd
PO Box 39818
LOWER HUTT 5045

Dear Phil Lough

2013/14 SHAREHOLDER EXPECTATIONS OF STATE OWNED ENTERPRISES

I am writing on behalf of shareholding Ministers to set out our expectations for 2013/14. These build on the expectations set out in similar communications for 2012/13 and are largely a continuation of previous expectations. 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 two categories – priority and company specific. A business planning timetable is included as an Annex to this letter.

Priority expectations for all SOEs

- **Return to Surplus:** Returning to surplus in 2014/15 is a key priority for the Government and any variation from the expected performance of SOEs will have an impact on the Crown's accounts. Therefore, should you identify any risk to forecast performance this must be quantified and communicated to officials as soon as possible.
- **Shareholder Returns:** Commercial entities should, over time, deliver returns that meet or exceed their cost of capital. In circumstances where the total shareholder return is persistently below the cost of capital, or is not expected to be achieved over the forecast period, we expect that you will develop a plan to take corrective action.
- **Dividends and Capital Structure:** Shareholding Ministers expect SOEs to operate with a capital structure and a dividend policy that are commensurate with listed peers. Dividends should show a degree of consistency across years, and an appropriate balance between dividends and re-investment in the business should be maintained.
- **Meeting:** Along with the other Chairs of SOEs, you have recently been invited to a meeting with shareholding Ministers to discuss how an increase in returns to the Crown can be achieved. We will discuss our preference for an increase in the level of dividends paid and review the past use of capital by each SOE. In a less buoyant economic environment, shareholding Ministers expect SOEs to focus on their core business. This should result in a greater portion of cash flow being returned to the Crown as a dividend, rather than used for reinvestment or growth by acquisition.
- **Investment Reviews:** Further to the recently implemented requirement for SOEs to conduct Post Investment Reviews, shareholding Ministers have noticed a variety in the quality of such reports. It is our expectation that Post Investment Reviews should be robust and prepared in accordance with the Crown Ownership Monitoring Unit (COMU)'s guidelines.

Company specific expectations

- **Returns to the Shareholder:** We see that QV's financial performance has improved in the 2011/12 year, with net profit after tax of \$3.3 million which was \$1.4 million ahead of budget. We note that QV has recommenced dividend payments after they were temporarily suspended last year and we expect dividend payments to continue.
- **Acquisitions and Divestments:** We would like you to keep our officials fully informed, on a timely basis, of your acquisition or divestment proposals. However, it is our preference that the Board and management focus on QV's core business rather than consider any further acquisitions in the near future.
- **Post Investment Reviews:** The standard of the post investment reviews prepared this year was not high, in part due to poor record-keeping with respect to the original business case documentation. Please take the necessary measures to ensure the standard of any future post investment reviews is higher and the information provided is in line with COMU's template.
- **Uncalled Capital Arrangement:** As the expiry of this arrangement in 2014 approaches, the Board may wish to analyse the capital structure of the company and consider whether the arrangement could be unwound earlier than planned.

Since 2009, shareholding Ministers and COMU have held expectations that emphasise commercial performance, and have been implementing a programme of increased transparency and disclosure of performance information. As part of this process, all SOEs must provide a comprehensive and robust directors' estimate of commercial value in their SCI. Annex 2 contains a model disclosure statement which you should follow.

COMU regularly publishes its Commercial Portfolio Report which looks at what assets the Crown owns and how well those assets are performing. The edition to be released later this year includes special topics on Commercial Valuations and CFI holdings in NZX-listed companies. In addition, the Owner's Expectations Manual has recently been updated with new sections on Business Case reviews, Post Investment Reviews and COMU's standardised financial performance measures. The sections on the following subjects have also been updated: disclosures, consultation expectations and thresholds, and diversification.

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, Suzy Morrissey on 04 917 6292. Alternatively, please contact Andrew Turner (Deputy Secretary, Crown Ownership Monitoring Unit) on 04 917 6031.

Yours sincerely



Hon Bill English
Minister of Finance
on behalf of shareholding Ministers

cc: Mr Bill Osborne, CEO, Quotable Value 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 2013.

Key dates for 2013/14

<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 2013**, 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 2013**.

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 2013]
- 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 2012 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.