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Solid Energy

Statement of Corporate Intent

For three years commencing 1 July 2014

SOLID ENERGY
Coals of New Zealand

Statement of Corporate Intent
(For Three Years Commencing 1 July 2014)

This Statement of Corporate Intent (SCI) is submitted by Solid Energy New Zealand Limited (Solid Energy) pursuant to Section 14 of the State-Owned Enterprises Act 1986 (the Act). It sets out Solid Energy's objectives and performance targets for the three years to 30 June 2017, and describes the nature and scope of the activities to be undertaken to achieve these objectives.

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1. PREFACE

Financial year 2014 was a year of transition for Solid Energy with the focus on refinancing the company and repositioning the business as a competitive conventional coal company. Considerable progress has been made towards these objectives, particularly in reducing costs across the business and stabilising the future of the domestic businesses, leaving the Company to deal with the challenge of low international coking coal prices which are the basis of Solid Energy's export business. However the short-term outlook for both coking coal prices and the New Zealand dollar is such that a return to profitability in FY15 and potentially FY16 is very unlikely.

2. VISION, VALUES & OBJECTIVES

Solid Energy's Vision is to secure, develop and mine coal resources in order to create value for the shareholder, based on a robust licence to operate from stakeholders.

1.1 Our Values are to

- be value driven in all endeavours
- support the safety, health and wellbeing of our people and our communities
- drive toward and maximise shareholder value
- respect the natural environment in which we operate
- engage with our stakeholders openly, clearly and honestly
- respect cultures, customs and values in our dealings with our people, suppliers and customers; and
- operate in accordance with business sustainability principles.

1.2 Our Current Business Objectives are to

- be a conventional coal business
- retain the confidence of our lenders and our shareholder
- in the medium term, secure earnings and cashflows which will permit:
  - funding of the capital required
  - maintaining/reducing current debt levels
  - retaining longer-term optionality
  - ultimately provide the Shareholder with returns consistent with the resource sector.

3. STRATEGY

Solid Energy's business strategy is based predominantly on a stable domestic market supported by long-term coal supply to contracted customers and continuing global demand for coking coal (albeit at higher prices than the current market) driven primarily by long-term relationships with steelmakers in China, Japan and India.

Solid Energy has competitive advantage as the basis of its long-term strategy, as well as some challenges it must manage to ensure successful implementation.

- *Distinctive coal qualities* – New Zealand coals are soughtafter for low ash, vitrinite, and phosphorous properties but there is a need to manage sulphur and rank. Current export products are out of line with our ability to supply, hence the move from hard coking coal (HCC) to semi hard coking coal (SHCC).
- *Current and future production* – Solid Energy has access to approximately 125 million tonnes (Mt) of HCC, SHCC and specialist resources and 32Mt of reserves at various stages of development.

- *High ranking customers* – Solid Energy counts some of New Zealand's premier companies as its key domestic customers including New Zealand Steel, Genesis Energy, Fonterra, Talley's, Westland Milk, Holcim, Silver Fern Farms, and the Alliance Meat Company. Internationally the company has long-term (three- to five-year) contracts based on longstanding relationships with major international steel makers. These customers value the coal supplied, even though it is a small (~5%) component of their blends, because of its unique blend qualities.
- *Access to export logistic infrastructure* by virtue of long-term (to 2026) agreements with KiwiRail and Lyttelton Port of Christchurch.
- *Continued focus on cost competitiveness* – Continue to reduce operating costs in the export business in response to low international prices.

Solid Energy's strategy is based on its three separate Business Units.

- *North Island* – FY14-18 minimum volume and price are fixed, leaving product quality as the key area of customer focus. Servicing this market will require the full development of the Rotowaro resource and commencing production at Maramarua as soon as possible.
- *South Island* – New production from Ohai and Reddale will address supply issues which caused market share to be lost over the last two to three years, and will create the opportunity to recover volume lost where profitable.
- *West Coast Export* – Solid Energy must, in the short term, retain optionality from this business at current international prices and, over the longer term, de-risk its exposure to the volatile global coking coal market. To achieve this will require the export business to produce coal which:
  - is cost competitive
  - has sufficiently distinctive qualities to continue to command priority in the coking blends of our high-ranking international customers
  - is at global coking coal market prices which justify our long run marginal cost of supply.

OUR INVESTMENT STRATEGY

Solid Energy will allocate capital expenditure to ensure compliance, to sustain business-as-usual and to investments with short-term paybacks. We anticipate annual capital expenditure over the period to be considerably less than depreciation. We will continually assess the performance of each of our operating assets and projects to ensure that our invested capital is allocated efficiently and our cost structure is relevant to the market. Our focus will be on reducing cost per tonne, improving margins not volumes and renewing the mine life. Should coal prices recover, Solid Energy will respond to the market cautiously to avoid over-extending the business. However, with lower unit costs, any price increase should immediately improve profitability.

4. PERFORMANCE TARGETS

Solid Energy has the following performance objectives.

Value	Maximise operating cash flow and margins
People	Continually attract, retain and develop highly skilled, motivated and committed staff that perform at a high level, are well led, and see us as an excellent employer
Health & Safety	Safe workplace with zero harm
Environment	Minimise our environmental footprint and impact whilst respecting the environment in which we work
Reputation	Maintain the trust of our Shareholder, banks, customers, suppliers and key stakeholders.

Key performance targets for Solid Energy over the period FY2015-17 are based on price projections that are within consensus forecasts and the forward curve for the NZD/USD exchange rate. We have assumed the international market price for coking coal recovers only modestly through the FY15-FY17 period. The recovery of the business is dependent on the reduction in operating costs while prices recover to a level that returns the business to profitability. Therefore the business will need to outperform these targets over the forecast period to enable debt to be reduced to acceptable levels.

			2014/15	2015/16	2016/17
Value: Operations	Sales Units	Coal (Mt)	3.1	3.4	3.5
	Production Units	Coal (Mt)	2.8	3.1	3.0
Value: Shareholder Returns	Dividend paid ($M)		0	0	0
	Dividend Yield[1]		0%	0%	0%
	Dividend Payout[2]		0%	0%	0%
	Return on Equity[3]		N/M	N/M	50%
Value: Profitability	Return on Capital Employed[4]		-15%	10%	26%
	Operating Margin[5]		-1%	14%	20%
Value: Leverage/Solvency	Gearing Ratio [6]		86%	85%	67%
	EBITDAF ($M)		-4	65	98
	Interest Cover[7]		-0.2	2.7	5.0
	Current Ratio[8]		1.6	1.9	1.9
Future value	Capital Investment ($M)		14	10	10
Health & Safety	All Injury Frequency Rate[9]		7.3	5.5	4.9
	Lost Time Injury Frequency Rate[10]		2.8	2.5	2.2
Environment	Regulatory, Abatement and Enforcement notices		0	0	0

1. Dividends paid / Average commercial value
2. Dividends paid / Net cash flow from operating activities less depreciation expense
3. Net profit after tax / Average Shareholder equity*, the business plan does not provide for any IFRS fair value movements or asset revaluations
4. EBIT / Average capital employed
5. EBITDAF/Revenue
6. Net debt / (Net debt + equity)
7. EBITDAF / Interest expense
8. Current assets / Current liabilities
9. Number of injuries per 1,000,000 hrs requiring first aid or greater treatment
10. Number of injuries per 1,000,000 hrs resulting in more than one lost work day or shift

PERFORMANCE TARGET DISCUSSION

The financial targets reflect a global coal market which remains in a severely depressed part of the commodity cycle. A further fall in coking coal prices in March 2014 and a persistently strong New Zealand dollar has resulted in the need for further cost reductions throughout the company in order to preserve cash and for the company to seek Shareholder and bank support for funding.

5. RATIO OF SHAREHOLDERS' FUNDS TO TOTAL ASSETS

	2014/15	2015/16	2016/17
Shareholders' funds	$41M	$41M	$81M
Total assets	$657M	$653M	$620M
Shareholders' funds / total assets	6.3%	6.2%	13.1%

Where:

- Shareholders' Funds includes share capital, retained earnings and reserves
- Total Assets include current assets, fixed assets and intangibles.

6. ACCOUNTING POLICIES

Solid Energy will maintain accounting policies in accordance with the Financial Reporting Act 1993 and New Zealand International Financial Reporting Standards (NZ IFRS). Solid Energy's current accounting policies are attached as Appendix 1.

7. CAPITAL STRUCTURE

Solid Energy's long-term goal is to move towards a more conservative capital structure given the volatility in export coal prices and currency.

8. PROFIT DISTRIBUTION POLICY

The terms of the capital restructure require that no distributions are made on the ordinary shares of Solid Energy within the term of the agreement (currently September 2016).

9. INFORMATION TO BE PROVIDED TO SHAREHOLDER

To enable Shareholding Ministers to be fully aware of investment plans and intentions and to assess the value of their investment in Solid Energy, the following information will be provided:

(a) detailed budget for the next financial year

(b) detailed financial projections for the next three financial years

(c) a strategic and business plan for the group

(d) any proposals likely to represent a major change in Solid Energy's balance sheet ratios or to involve capital expenditure significantly above that foreshadowed in the three-year financial projections

(e) a quarterly report, including a summary and commentary on the previous quarter's financial performance and commentary on our outlook to year-end. This report will include, as appropriate, a discussion of significant variances from previously forecast performance

(f) a half-year report, including an unaudited profit and loss statement, balance sheet, statement of cash flows and such other details as are necessary to enable an informed assessment of performance

(g) an Annual Report and audited financial statements.

In accordance with Section 18 of the Act, the Company will provide other information relating to the affairs of the company as requested by Shareholding Ministers.

10. CAPITAL EXPENDITURE, ACQUISITION, DIVESTMENT AND SHAREHOLDER CONSULTATION

As part of the capital restructure in October 2013, Solid Energy will, in addition to the information above, and in relation to any single transaction, or connected series of transactions that commit the company, consult with its Shareholder and banks on items over agreed thresholds, particularly those which have not been expressly provided for in any Approved Annual Budget and Business Plan including but not limited to:

- capital investment
- an expansion of current activities
- any proposed joint venture
- formation of any subsidiary
- subscriptions for or sale of shares or equity interests in any company
- asset sales over $500,000 (other than non-core land and inventory sales in the ordinary course of business).

11. ACTIVITIES FOR WHICH COMPENSATION IS SOUGHT

Should the Government instruct Solid Energy to undertake activities or assume obligations which will result in a reduction in our net worth, the Board will seek compensation sufficient to allow the financial position of the Company to be restored to the position it would have been in but for the Government's instructions. The Crown's Permanent Process for Land Disposal, which applies to all Crown Agencies, may trigger this provision.

No requests for compensation are currently under consideration.

12. VALUE OF THE CROWN'S INVESTMENT

The key drivers of value remain the revenue assumptions, which rely upon the long-term international price for coking coal and the long-term NZD / USD cross rate.

The value of each asset has been assessed using a variety of assumptions and valuation methodologies including:

- Value in use approach for operating assets or near-term developments where projected near-term cash flows have been discounted using a real after-tax discount rate of 8.7%. Prices are based on independent external industry sources which show an increase from current benchmark hard coking coal prices to US$180/t by 2020. We have adopted the forward NZD/USD exchange rate curve as at 1 July 2014, which shows a fall from 0.878 to 0.685 in FY25.
- Probability adjusted value in use assessments for development options that are within our 10-year plan and where mine plans support further development
- Resource multiples to assess longer-term resource development options using observed multiples of listed peer companies adjusted for specific risk factors
- Realisable value for assets held for sale.

Given that the vast majority of assets have been valued based on an assessed recoverable amount within the 30 June 2014 financial statements, the directors believe a fair assessment of commercial value for the current period is reflected in the book value of $13 million.

Hence the Board's estimate of enterprise value of Solid Energy as at 30 June 2014 is $261 million, equating to an equity value (commercial value) of $13 million after deducting net bank debt and notes of $248 million. Based on the book value in June 2013 of $92 million, Total Shareholders Return was -86%.

Subsequent to balance date, on 19 September 2014, the Crown announced a further support package in the form of a Rehabilitation Indemnity which extended the pre-1987 Rehabilitation Indemnity, the effect of which was to increase equity by a further $103 million.

APPENDIX 1: STATEMENT OF ACCOUNTING POLICIES

1. CORPORATE INFORMATION

The financial statements are for Solid Energy New Zealand Ltd ("Solid Energy"), its subsidiaries and jointly-controlled entities.

Solid Energy is a profit-oriented company incorporated in New Zealand. Solid Energy is registered under the Companies Act 1993.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(A) BASIS OF PREPARATION AND STATEMENT OF COMPLIANCE

The financial statements for the year ended 30 June 2014 will be prepared in accordance with Generally Accepted Accounting Practice in New Zealand and the requirements of the Companies Act 1993, the Financial Reporting Act 1993, and the State Owned Enterprises Act 1986.

The financial statements comply with New Zealand equivalents to International Financial Reporting Standards, and other applicable Financial Reporting Standards, as appropriate for profit-oriented entities. The financial statements comply with International Financial Reporting Standards (IFRS).

The financial statements will be prepared on an historical cost basis, except for:

- Investment property, , derivative financial instruments and available-for-sale financial assets that have been measured at fair value
- Provisions and Crown Receivable which are measured at net present value
- Tangible mining assets which include capitalised rehabilitation provisions; and
- Assets classified as held for sale which are measured at the lower of carrying amount or fair value less cost to sell.

The financial statements are presented in New Zealand dollars and all values are rounded to the nearest one-tenth of one million dollars ($million).

New Accounting Standards and Interpretations

(i) Changes in accounting policy and disclosures.

The accounting policies adopted are consistent with those of the previous financial year, with the exception of the impact of the following new accounting standards which have been adopted for the year ended 30 June 2014:

- IFRIC 20 Stripping Costs (effective for the reporting period commencing 1 July 2013).

  This standard provides guidance on the treatment of production phase stripping costs. Stripping In Advance is now classified as a Non-Current Asset in accordance with this interpretation - refer (R) Stripping In Advance.

- The following accounting standards have been adopted but have not had any significant impact on the financial statements for the year ended 30 June 2014:
  - NZ IAS 28 Investments in Associates and Joint Ventures
  - NZ IFRS 10 Consolidated Financial Statements
  - NZ IFRS 11 Joint Arrangements
  - NZ IFRS 12 Disclosure of Interests in Other Entities
  - NZ IFRS 13 Fair Value Measurement

Certain comparatives have been restated to conform to the current period presentation.

(ii) Solid Energy has elected not to early adopt the following relevant standards which have been issued but are not yet effective for the group:

- NZ IFRS 9 Financial Instruments (effective for the reporting period commencing 1 July 2015). At this stage it is expected that the new standard will only have a minor impact on the classification and measurement of Solid Energy's financial instruments.
- NZ IFRS 15 Revenue from Contracts with Customers (effective for the reporting period commencing 1 July 2018)

NZ IFRS 15 clarifies the principles for recognising revenue. At this stage the impact on the group's financial statements has not been concluded.

(B) BASIS OF CONSOLIDATION

The consolidated financial statements comprise the financial statements of Solid Energy and its subsidiaries at year end ("the group"). The financial statements of subsidiaries are prepared for the same reporting period as the parent company; adjustments are made to bring into line any dissimilar accounting policies that may exist.

All intercompany balances and transactions, including unrealised profits arising from intra-group transactions, have been eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered.

Subsidiaries are consolidated from the date on which control is transferred to the group and cease to be consolidated from the date on which control is transferred out of the group. Where there is loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which Solid Energy had control.

Investments in subsidiaries held by Solid Energy are accounted for at cost in the separate financial statements of the parent entity. The acquisition of subsidiaries is accounted for using the purchase method of accounting. The purchase method of accounting involves allocating the cost of the business combination to the fair value of the assets acquired and the liabilities and contingent liabilities assumed at the date of acquisition (refer note 2(C)).

(C) BUSINESS COMBINATIONS

The purchase method of accounting is used to account for all business combinations regardless of whether equity instruments or operations are acquired. Cost is measured as the fair value of the assets given, shares issued or liabilities incurred or assumed at the date of exchange plus costs directly attributable to the combination.

Except for non-current assets or disposal groups classified as held for sale (which are measured at fair value less costs to sell), all identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. The excess of the cost of the business combination over the net fair value of the group's share of the identifiable net assets acquired is recognised as goodwill. If the cost of acquisition is less than the group's share of the net fair value of the identifiable net assets of the subsidiary, the difference is recognised as a gain in profit or loss, but only after a reassessment of the identification and measurement of the net assets acquired.

(D) FOREIGN CURRENCY TRANSLATION

Both the functional and presentation currency of Solid Energy and its New Zealand subsidiaries is New Zealand dollars ($). Transactions in foreign currencies are initially recorded in the functional currency at the exchange rates ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rate of exchange ruling at the reporting date. All differences in monetary assets and liabilities in the consolidated financial statements are taken to profit or loss.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of the initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(E) REVENUE, FINANCE INCOME AND OTHER INCOME

Revenue, finance income and other income are recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

Revenue

Sale of goods

Revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and can be measured reliably. Risks and rewards are considered to have passed to the buyer at the time of delivery of the goods to the customer. For free on board export shipments delivery is deemed to have taken place once the ship is fully loaded and the bill of lading is issued.

Finance Income

Interest

Revenue is recognised as the interest accrues (using the effective interest method, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument) to the net carrying amount of the financial asset.

Dividends

Revenue is recognised when the shareholders' right to receive the payment is established.

Other Income

Rental income

Rental income arising on properties is accounted for on a straight-line basis over the lease term.

(F) INCOME TAX

Income tax comprises current and deferred tax. Income tax is recognised in profit or loss except to the extent that it relates to items recognised directly into equity. Deferred income tax is provided on all temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

i) except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

ii) in respect of taxable temporary differences associated with investments in subsidiaries and interests in jointly controlled entities, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets and unused tax losses can be utilised:

i) except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

ii) deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised. The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the reporting date.

(G) GST

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST) except:

i) where the GST incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the GST is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and

ii) for receivables and payables which are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the Statement of Financial Position. Cash flows are included in the Statement of Cash Flow on a gross basis and the GST component of cash flows arising from investing and financing activities, which is recoverable from, or payable to, the taxation authority is classified as an operating cash flow.

Commitments and contingencies are disclosed net of the amount of GST recoverable from, or payable to, the taxation authority.

(H) SHARE CAPITAL

Share capital is classified as equity if it is non-redeemable, or is redeemable only at the company's option, and any dividends are discretionary. Dividends on share capital classified as equity are recognised as distributions within equity in the period in which they are declared.

(I) PROPERTY, PLANT AND EQUIPMENT

The group has five classes of property, plant and equipment:

- Land, buildings and structures
- Leasehold improvements
- Plant and equipment
- Leased infrastructure asset; and
- Capital work in progress.

Depreciation

Land is carried at cost less any impairment losses. Land is not depreciated. Capital work in progress is carried at cost less any impairment losses. Capital work in progress is not depreciated. When an item of capital work in progress is commissioned it transfers to the appropriate property, plant and equipment category and depreciation commences.

All other property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the assets' expected economic life. Leased assets are depreciated over the shorter of the lease term and their useful economic lives. The expected economic lives of assets are as follows:

- Buildings and structures 10 to 25 years
- Leasehold improvements Lease term
- Plant and equipment 5 to 15 years
- Leased infrastructure asset 30 years

Depreciation methods, useful lives and residual values are reassessed at the reporting date. Property, plant and equipment under construction are recorded as work in progress and are not depreciated until they are ready for productive use.

Impairment

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

If any such indication exists, and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amount. The recoverable amount of plant and equipment is the greater of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognised in profit or loss.

(J) MINING ASSETS

Mining assets includes exploration and evaluation, mines in development and mines in production, for both tangible and intangible assets.

Tangible Mining Assets

i) Exploration and evaluation

Exploration, evaluation and development expenditure is stated at cost and is accumulated in respect of each identifiable area of interest. Expenditure is only carried forward to the extent that it is expected to be recouped through the successful development of the area of interest (or alternatively by its sale), or where activities in the area have not yet reached a stage which permits a reasonable assessment of the existence, or otherwise, of economically recoverable reserves.

ii) Mines in development

Once a decision is made to proceed with commercial production, the expenditure incurred on successful areas of interest is reclassified as "Mines in development".

iii) Mines in production

Mining assets are transferred to "Mines in production" in the year production commences.

Mine production assets, comprising successful areas of interest, subsequent development expenditure and capitalised rehabilitation provisions are amortised to profit or loss over the remaining productive life of the operation on a unit of production basis, subject to a maximum production period of 20 years.

Accumulated costs in relation to an abandoned area are written off in full in the period in which the decision is made to abandon the area.

Intangible Mining Assets

Mineral reserve assets comprise mining rights and mining licences and are classified between exploration and evaluation, mines in development and mines in production as per tangible assets above. Mineral reserve assets are stated at cost less any accumulated amortisation and impairment loss. Amortisation is charged to profit or loss on mineral reserve assets on a straight-line basis over the estimated useful life of the mineral right. The estimated useful life of mineral right assets is subject to a maximum of 20 years.

(K) INTANGIBLE ASSETS

Goodwill

Goodwill on acquisition is initially measured at cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is not amortised. Goodwill is reviewed for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. As at the acquisition date any goodwill acquired is allocated to each of the cash-generating units expected to benefit. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised.

Intellectual property

Intellectual property is measured at cost less accumulated amortisation and accumulated impairment losses. The amortisation period is 5 years.

Emission Trading Scheme (ETS) Units

As of 1 July 2010 the transport, energy and industrial sectors joined the forestry sector in having obligations under the New Zealand Emission Trading Scheme (ETS). Solid Energy is required to account for CO2 equivalent emissions associated with designated activities, principally the mining and selling of coal. Solid Energy, as a coal miner, is designated as a default participant for the coal that it mines and is required to surrender eligible emissions units associated with coal sold domestically and directly associated with mining coal that is subsequently exported. Very large customers can elect to manage the obligation themselves.

Solid Energy is required to surrender 1 eligible emission unit for every 2 tonnes of CO2 equivalent emitted. These units can be sourced:

- through the purchase of units
- directly from projects that reduce emissions
- via allocation by the Government as compensation for ETS costs; or

- by paying a fixed price of $25 per emission unit to the government.

New Zealand Units, Removal Units, Certified Emissions Reductions and Emission Reduction Units are all valid ETS units which can be purchased to satisfy ETS obligations. Purchased ETS units are recognised as an intangible asset and measured at cost. ETS units are purchased in order to settle ETS obligations and are therefore not amortised.

(L) INVESTMENT PROPERTY

Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met, and excludes the costs of day-to-day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which is based on active market prices, adjusted if necessary, for any difference in the nature, location or condition of the specific asset at the reporting date. Gains or losses arising from changes in the fair values of investment properties are recognised in profit or loss in the year in which they arise.

Investment properties are de-recognised either when they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in profit or loss in the year of retirement or disposal. Transfers are made to investment property when, and only when, there is a change in use, evidenced by ending of owner-occupation, commencement of an operating lease to another party or ending of construction or development. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sale.

For a transfer from investment property to owner-occupied property or inventories, the deemed cost of property for subsequent accounting is its fair value at the date of change in use. If the property occupied by the group as an owner-occupied property becomes an investment property, the group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

(M) INTEREST IN JOINT ARRANGEMENTS

Joint arrangements are those entities over whose activities the group has joint control established by contractual agreement. The group has an interest in a joint arrangement that is a joint venture.

The interest in a joint venture entity is accounted for in the consolidated financial statements using the equity method of accounting and is carried at cost by the parent entity. Under the equity method, the group's share of the results of the joint venture entity is recognised in profit or loss, and the share of movements in reserves is recognised in the Statement of Financial Position.

(N) OTHER INVESTMENTS

All other investments are initially recognised at fair value, being the consideration given and, in the case of an investment not at fair value, through profit or loss, including acquisition costs associated with the investment. After initial recognition, investments which are classified as available-for-sale are measured at fair value.

Gains or losses on available-for-sale investments are recognised as a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in profit or loss.

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held-to-maturity when the group has the positive intention and ability to hold to maturity. Other long-term investments that are intended to be held to maturity, such as bonds, are subsequently measured at amortised cost using the effective interest method.

Amortised cost is calculated by taking into account any discount or premium on acquisition over the period to maturity. For investments carried at amortised cost, gains and losses are recognised in income when the investments are de-recognised or impaired. Purchases and sales of financial assets that require delivery of assets within the time-frame generally established by regulation or convention in the marketplace are recognised on the trade date, i.e. the date that the group commits to purchase the asset.

(O) LEASES

The determination of whether an arrangement is, or contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Group as a Lessee

Finance leases, which transfer to the group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are included in profit or loss as finance costs. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term. Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as the lease payments. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term. The cost of improvements to leasehold properties is capitalised, disclosed as leasehold improvements, and amortised over the unexpired period of the lease or the estimated useful life of the improvements, whichever is the shorter.

Group as a Lessor

Leases which transfer substantially all the risks and benefits incidental to ownership of the leased item are classified as finance leases. Finance lease receivables are capitalised at the inception of the lease at the fair value of the leased assets or, if lower, at the present value of the minimum lease payments. Operating lease receipts are recognised as other income in profit or loss on a straight-line basis over the lease term.

(P) IMPAIRMENT OF MINING AND OTHER NON-CURRENT ASSETS

The carrying amount of land, mineral reserve assets, exploration, evaluation and development expenditure and stripping in advance are reviewed at each reporting date to determine whether there is an indication of an impairment loss. If any such indication exists, the assets recoverable amount is estimated. For any asset that does not generate largely independent cash flows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. If the carrying amount of the asset (or cash-generating unit) exceeds this recoverable amount, the asset (or cash-generating unit) is written down to the recoverable amount. The recoverable amount of an asset is determined as the higher of its net selling value and value in use. Value in use is determined by estimating future cash flows and discounting them to their present value using a risk-adjusted pre-tax discount rate appropriate to the risks inherent in the asset.

Equity instruments are deemed to be impaired when there is a significant or prolonged decline in the fair value below the original purchase price. The recoverable amount of the group's investments in held-to-maturity debt instruments and receivables carried at cost is calculated as the present value of estimated cash flows, discounted at the original effective interest rate. Receivables with a short duration are not discounted. When an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(Q) INVENTORIES

Inventories of by-product and saleable coal are valued at the lower of weighted average cost or net realisable value. By-product coal is contaminated and diluted coal which requires significant further processing to become saleable. When both saleable coal and by-product coal are produced from an operation the costs are allocated based on the relative net realisable values of the two products at the point they become separately identifiable.

Costs include direct material, labour and transportation expenditure incurred in getting such inventories to their existing location and condition, together with an appropriate portion of overhead expenditure.

Inventories of materials, consumable supplies and maintenance spares expected to be used in production are valued at weighted average cost. Surplus and obsolete inventories are valued at net realisable value if lower than cost.

Net realisable value is the estimated selling price in the ordinary course of business, less estimated costs of completion and the estimated costs necessary to make the sale.

(R) STRIPPING IN ADVANCE

As part of its mining operations, Solid Energy incurs costs for the removal of overburden and other waste materials (stripping costs) both during the development phase (development stripping) and production phase (production stripping) of its operations.

Development stripping

Stripping costs incurred in the development phase of a mine, before the production phase commences, are capitalised in mining assets as part of the cost of constructing the mine. The capitalisation of development stripping costs ceases when the mine is commissioned and ready for use as intended by management.

After the commencement of production further development of a mine may require a phase of stripping that is similar in nature to development phase stripping. The cost of such stripping is accounted for in the same way as development stripping.

Production stripping

Separately identifiable stripping costs incurred during the production phase are capitalised as a stripping in advance asset where the costs are associated with improved access to coal to be mined in the future.

The amount of stripping costs capitalised is based on the strip ratio that is obtained by dividing the total tonnage of waste expected to be mined over the life of the mine by the quantity of coal expected to be mined across the life of the mine. Stripping costs incurred in the period are capitalised to the extent that the current period actual strip ratio exceeds the life of the pit average strip ratio. Significant changes in estimates to the economically recoverable reserves are accounted for prospectively, from the date of the change.

Amortisation

The stripping in advance asset is subsequently amortised using the units of production method over the life of the identified component of coal that became more accessible as a result of the stripping activity. Economically recoverable reserves, which comprise proven and probable reserves, are used to determine the expected useful life of the identified component of coal. The stripping in advance asset is then carried at cost less amortisation and any impairment losses.

(S) DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING

The group uses derivative financial instruments such as foreign currency contracts and interest rate swaps to hedge its risks associated with foreign currency and interest rate fluctuations. Solid Energy's treasury policy does not allow derivative financial instruments to be held or issued for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at fair value and retested on this basis at each reporting period. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss unless the derivatives meet the criteria for hedge accounting (see below).

Cash Flow Hedges

Cash flow hedges (forward foreign currency contracts and interest rate swaps) are used to hedge the foreign currency and interest rate risk of forecast transactions which meet the conditions for hedge accounting. The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and the ineffective portion is recognised in profit or loss. For all cash flow hedges, the gains or losses that are recognised in equity are transferred to profit or loss in the same year in which the hedged forecasted transaction affects the net profit and loss, for example when the future sale actually occurs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to profit or loss for the year.

De-recognition of Derivative Financial Instruments

The de-recognition of a financial instrument takes place when the group no longer controls the contractual rights that comprise the financial instrument, which is normally the case when the instrument is sold, or all the cash flows attributable to the instrument are passed through to an independent third party.

(T) ACCOUNTS RECEIVABLE

Trade Receivables

Accounts receivable, which generally have 30-90 day terms are recognised and carried at the invoice amount less an allowance for any uncollectible amounts.

Collectability of trade receivables is reviewed on an ongoing basis at an operating unit level. Individual debts that are known to be uncollectible are written off when identified. An impairment provision is recognised when there is objective evidence that the group will not be able to collect the receivable. Financial difficulties of the debtor and default on payments are considered objective evidence of impairment. The amount of the impairment loss is the receivable carrying amount compared to the present value of estimated future cash flows, discounted at the original effective interest rate.

Related Party Receivables

An impairment assessment is undertaken each financial year by examining the financial position of the related party and the market in which the related party operates to determine whether there is objective evidence that a related party receivable is impaired. When such evidence exists, the group recognises an allowance for the impairment loss.

(U) CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise cash at bank and in hand, short-term deposits with an original maturity of three months or less and bank overdrafts and overnight cash facilities.

(V) PROVISIONS

Provisions are recognised when the group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the group expects some or all of a provision to be reimbursed, for example the Crown's share of end of mine life rehabilitation costs, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in profit or loss net of any reimbursement, except for rehabilitation costs.

If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

Onerous Contracts

A provision is made for onerous contracts when the net present value of any contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

Rehabilitation Costs

The group is required under the terms of its mining licences to rehabilitate mine sites at the end of their productive lives to a condition acceptable to the relevant authorities and consistent with the group's environmental policies. The estimated cost of any end of mine life rehabilitation is provided for at the commencement of the mining project, with a corresponding asset recognised in relation to the mine site. Measurement of the rehabilitation provision is on the basis of expected future costs discounted using a risk-free rate. The inflation rate and risk-free rates used are those published by the New Zealand Treasury for use in accounting valuations.

Any increases in the rehabilitation provision that relate to the ongoing production of the mine are expensed as the obligation arises. Any other change in the net present value of rehabilitation costs, including those resulting from new disturbances, updated cost estimates and changes to the lives of operations are capitalised to mine assets. Changes in net present value relating purely to discounting future values are reflected in interest expense.

Mobile Plant Costs

Mobile plant costs comprise mobilisation, demobilisation and mobile plant leased maintenance cost provisions. Mobilisation costs are those costs incurred in relocating contractor mobile plant to the mine site at the start of the contract. Mobilisation costs are initially recorded in prepayments and amortised over the life of the contract. Mobilisation assets are included within prepayments and mobilisation liabilities are included within provisions.

Demobilisation costs are those costs relating to the cost of removing mobile plant fleet from the mine site at the end of the contract. Demobilisation costs are provided for at the start of the contract and are amortised over the life of the contract.

The group is required to maintain leased mine site mobile plant equipment to a minimum standard under the lease agreements and to pay for costs associated with the removal of mobile plant fleets from the mine sites at the end of the contracts. The costs required to replace worn components on mine site mobile plant fleets are provided for based on the number of hours the mobile plant has been used. Costs associated with the removal of the fleet at the end of the contracts are provided for at the start of the mining contract and are amortised over the life of the contract.

(W) CROWN RECEIVABLE

The group has an indemnity from the Crown for its share of end of mine life rehabilitation costs relating to mining assets prior to 1 April 1987. Measurement of the Crown receivable is on the basis of expected future costs discounted using a risk-free rate.

(X) INTEREST-BEARING LOANS AND BORROWINGS

All loans and borrowings are initially recognised at cost, being the fair value of the consideration received net of issue costs associated with the borrowing. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses are recognised in profit or loss when the liabilities are de-recognised and as well as through the amortisation process.

Borrowing Costs

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are capitalised as part of the cost of that asset. Qualifying assets are those that take a significant amount of time to get ready for their intended use or sale. Capitalisation of borrowing costs is not applied to the borrowing costs associated with mining assets in the exploration and evaluation phase or to assets held for potential future mining activities.

Other borrowing costs are recognised as an expense as incurred.

(Y) ACCOUNTS PAYABLE

Trade and other payables are carried at amortised cost. They represent liabilities for goods and services provided to the group prior to the end of the financial year that are unpaid and arise when the group becomes obliged to make future payments in respect of the purchase of these goods and services. The amounts are unsecured and are usually paid within 30 days of recognition.

(Z) EMPLOYEE ENTITLEMENTS

Long-term Employee Entitlements

Long-term employee entitlements such as long service leave and other entitlements that are vesting are recognised when they accrue to employees. Liabilities are accrued on an actuarial basis in respect to entitlements that are vested and expected to crystallise in the future.

Short-term Employee Entitlements

Short-term employee entitlement obligations such as salaries and wages and annual leave are expensed as the related service is provided.

Defined Contribution Plans

Obligations for contributions to defined contribution pension plans are recognised as an expense in profit or loss when they are due.

(AA) NON-CURRENT ASSETS HELD FOR SALE OR DISTRIBUTION

Non-current assets, or disposal groups comprising assets and liabilities, that are expected be recovered primarily through sale or distribution rather than continuing use, are classified as held for sale or distribution. Immediately before classification as held for sale or distribution, the assets, or components of a disposal group, are re-measured in accordance with the group's accounting policies. Thereafter the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. Any impairment loss on a disposal group is first allocated to goodwill and then to remaining assets and liabilities on a pro rata basis except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property or biological assets, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale or distribution and subsequent gains or losses on re-measurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss.

Once classified as held for sale or distribution, intangible assets and property, plant and equipment are no longer amortised or depreciated, and any equity-accounted investee is no longer equity accounted.