



Strictly Private and Confidential

Mr John Moloney  
Chairman  
Coillte  
Newtownmountkennedy  
Co Wicklow

9 July 2014

Dear John,

As the recently appointed chairman of Coillte, I am fully aware and recognise the uncertainties that have surrounded your company in recent times and the difficulties that these have presented. I am happy to say that the finalisation of recent decisions will provide a more progressive environment for the company to operate and a greater certainty to your future direction. I know that you, the Board and the employees will be fully capable of taking advantage of this new working environment.

The Minister for Public Expenditure and Reform and I have given consideration to the way in which Government objectives for Coillte Teoranta are formulated and shared with Coillte, and our respective Departments have consulted with the NewERA unit of the National Treasury Management Agency ("NewERA") in this regard. Arising from that work we have decided to initiate a more structured approach to confirming Government's objectives for Coillte over the short and medium term with a view to assisting it in its operations and in complying with its obligations under the prevailing governance framework.

This letter is intended to provide guidance to Coillte and its Board of Directors with respect to Government's current objectives for Coillte and the primary considerations which will be taken account of by us (and other relevant Government Ministers) in respect of certain of the matters for which our consent is required under the Forestry Act 1988 (as amended) and the Code of Practice for the Governance of State Bodies. We believe that this letter will be helpful to the company particularly in its corporate and strategic planning processes. It is our intention that we would issue henceforth a similar letter on an annual basis.

The specific objectives outlined in this letter should be considered in the context of the Government's overall current policy objectives for Coillte, namely that:

- The company should maintain financial policies and a capital structure that facilitate the payment of dividends to its shareholders;
- The company focuses on the core purpose as determined when it was established, being to commercially manage the land and forest assets acquired by the company from the State;
- The company should be profitable and cash generative with a capital structure which maintains a level of headroom to have sufficient liquidity and financial flexibility to protect loan covenant requirements.

## Specific Policy Objectives

The Government has a number of priority policy objectives for Coillte which it wishes to see addressed in the short term:

### 1. Merger with Bord na Móna

As per the Government decision of 19 June 2013 it was decided that a robust analysis be carried out to evaluate how to give effect to a beneficial merger of Bord na Móna with Coillte to create a streamlined and refocused commercial state company operating in the bio-energy and forestry sectors, as committed to in the Programme for Government. We acknowledge the significant input from Coillte in providing NewERA with data to enable them to conclude this analysis.

At its meeting on 24th June 2014, the Government noted the very significant up-front costs and risks that would be associated with an immediate merger of the two companies and decided that:

- both companies should now work towards a partial merger of their businesses, focusing on the areas of synergy between the two businesses, to be implemented by establishing a Joint Venture (JV) between the two companies (with subsidiaries or SPVs, as necessary, for different elements of the JV's business) to operate in the areas of
  - Biomass,
  - Wind,
  - Shared Services and
  - Recreation and Tourism.
- the existing Steering Group will oversee progress on implementing the proposed Joint Venture, dealing with any issues as they arise and keeping relevant Ministers and the Government informed of progress, with NewERA managing the detailed interaction with the companies and JV on behalf of the Steering Group and chairing a detailed Implementation Group to be established to progress the proposed JV, in accordance with the next steps outlined in the Memorandum presented to Government.

The full detail of this Decision will be communicated to Coillte separately. However, it is stressed that the Government expects Coillte to fully cooperate with NewERA and the Steering Group to implement the Government's Decision as quickly as is feasible.

As the partial merger of the common businesses of Coillte and Bord na Móna, as agreed by the Government, will leave each company with its own core business to run, Coillte is reminded that the core forestry business (and the associated board mills) itself requires significant restructuring, as identified by Government in June 2013. While there will be significant work involved in implementing the Government Decision in relation to merging the various businesses of both companies, Coillte are also required not to lose sight of the continuing need to address the underlying issues in its own core forestry business.

### 2. Fundamental Restructuring

It was also decided by Government in June 2013 that Coillte is to undergo a fundamental restructuring, to be overseen by NewERA and the relevant stakeholder Departments, which will include operational streamlining, financial de-leveraging and a critical examination of the disposal options for its non-core activities such as telecoms and wind. A priority objective in this regard is the payment of a material annual financial dividend to the State by Coillte in line with the dividend



policy referred to below. In this regard, we note the submission by Coillte of restructuring proposals in the context of the Draft Group Strategy 2014-2018 to NewERA on 2 October 2013. These proposals have been reviewed by NewERA who have advised that further work is necessary in developing these proposals. In this regard, we would appreciate if you could please resubmit restructuring proposals and to engage with NewERA during the process of finalising same to ensure that the shareholder objectives are incorporated into your final submission. We expect that the company and the Board will co-operate fully with NewERA and the stakeholder Departments to ensure that this fundamental restructuring is delivered not least with a view to ensuring that the company is in a position to ensure that material financial dividends are returned to the State.

As you are aware the issue of land and forest valuation, as highlighted in the Proxy Statement at the Coillte AGM on 25<sup>th</sup> July 2013, needs to be examined in this resubmission as the original Group Strategy/Restructuring proposals pointed to potential anomalies in this area. In this regard the Board should also note the requirement under 2 below for an independent commercial equity valuation of the entity to be completed and submitted by the end of September.

## **General Policies**

### **1. Dividends**

It is the Government's wish that Coillte would now develop a new formal dividend policy which would reflect the following principles:

- (A) an appropriate balance should be struck between payment of dividends and re-investment in the business, over the medium term; and
- (B) the proposed policy should also be related to an agreed proportion of a cash flow as well as net profit after tax (NPAT).

The objective of formulating a new dividend policy is to assist the Board by bringing clarity to the Government's objectives as regards future dividend payments over the medium term, thereby avoiding the uncertainty created by special dividends potentially being requested from time to time. It may still be necessary or appropriate for special dividends to be paid from time to time (e.g. in event of sales of assets, windfall gains etc). To the extent that any special dividend is paid, it is our expectation that the likely impact of such payment on the policy would be reviewed at the time.

We ask that you engage actively with NewERA with a view to developing an appropriate new dividend policy. We note and are appreciative of the company's ongoing work in its non-commercial activities including recreation, culture and biodiversity. Notwithstanding this, we expect that Coillte will focus on delivering an increased material financial dividend to the shareholders based on the optimal use of the significant commercial assets, in particular forests, available to the company.

### **2. Shareholder Returns**

We propose to augment our monitoring and measurement of Coillte shareholder returns and in this regard we will be reviewing total shareholder return (TSR) over a 5 year period, assisted in this process by NewERA. We acknowledge that returns will vary from year to year, sometimes due to temporary or non-controllable factors but it is a key Government objective that Coillte delivers shareholder returns over the relevant period that are in excess of its equity cost of capital.

As regards measuring TSR, Appendix I sets out the financial performance measures in respect of profitability and shareholder return which we propose to apply. As you will see one of those measures necessitates the use of the commercial equity value of the entity. We ask that Coillte procure an independent third party to carry out a formal commercial equity valuation of Coillte with a valuation date as at 31 December 2013, to be submitted to my Department by no later than the end of September. The terms of reference for the valuation can be agreed with my Department and NewERA in advance of appointing the third party. This valuation will be reviewed by NewERA and my Department, in consultation with the Department for Public Expenditure and Reform (DPER), and the Board's views in relation to any divergence will form part of the discussion. It is expected that a similar valuation exercise will then be carried out on an annual basis with a valuation to be carried out by an independent party at least every three years.

This proposed approach to developing a perspective on shareholder return will be reviewed on an on-going basis and may be adapted as necessary.

### **3. Policy Objectives**

The purpose of the Forestry Act 1988 is to '*make provision for the development of forestry and to provide for the establishment of a company for that purpose...*', namely Coillte Teoranta. The principal objectives and general duty of the Company continue to be those provided for in the Forestry Act 1988, as amended.

Sustainable forest management will continue to underpin the management of the Coillte estate. In this regard, it is important that Coillte pay attention to the following main economic, environmental and social considerations:

#### **Economic**

- a) Coillte will maintain and enhance the productivity of its underlying forest asset in a way that is consistent with good forest practice and the protection of the environment. It will ensure good stocking and appropriate silvicultural management throughout the rotation, avoid any excess removal of nutrients at harvesting, and apply appropriate species and provenance selection and good stocking levels during the planting and establishment of reforested areas.
- b) Coillte will ensure a sustainable, continuous and predictable level of roundwood and fibre supply from its forests, to underpin its own current and future asset return and to support indigenous industry, added value and employment.
- c) Where appropriate, Coillte will implement recommendations set out in the updated national forest policy, in particular, measures to increase wood mobilisation within both its own estate and the private forest sector, through the sharing of information and knowledge and other means.

#### **Environment**

- d) Coillte will adhere to good environmental practice in all its operations and practices, to protect biodiversity, water and soil, archaeology, landscape, and other aspects of Ireland's natural and cultural heritage.



- e) Where appropriate, Coillte will positively engage with initiatives, measures and partnerships aimed at protecting and enhancing important species and habitats, water, landscape, and other aspects of Ireland's heritage.
- f) Coillte will continue to protect and enhance carbon stores and sinks.

#### **Social**

- g) Coillte will continue to provide on a planned strategic basis for the use of its forest and non-forest lands for appropriate types of outdoor recreation and environmental awareness, in a way that is compatible with the maintenance of the forest resource and protection of the environment.
- h) Coillte will continue the policy objective of delivering recreation benefit.

### **4. Governance Arrangements**

#### **Corporate Plan**

With respect to the rolling 5 year corporate plan which Coillte is required to prepare and submit to us pursuant to the Code, going forward, NewERA will engage with you earlier in this process in order for us to provide feedback to you on the plan in a more timely fashion.

#### **Reporting**

As you know the Code sets out current requirements in terms of reporting obligations, which supplement Coillte's obligations in this regard under the 1988 Forestry Act (as amended). We also expect Coillte to continue with the quarterly meetings that are held with NewERA and our Departments, and we are very appreciative of the co-operation that Coillte have shown to date in this regard. We also anticipate a continuation of the existing policy of regular communication with both Departments and NewERA should any material matters arise.

Please note that Section 7 of the Code deals with the requirements applicable to State bodies in relation to remuneration including in particular the obligation to implement Government pay policy as expressed from time to time. In this context we highlight the increasing drive towards transparency in relation to remuneration and expect that Coillte will make appropriate disclosures in line with the guidelines in this regard as they evolve.

#### **Board evaluation**

Consistent with the requirement in the Code we expect that the Board constantly reviews its own operation and performance and that of its committees and individual members, that the Board undertakes an evaluation of its performance on an annual basis and that the Board considers having such an evaluation facilitated by an independent assessment every three years. As is normal practise, we are aware that such a review and evaluation process in Coillte is led by you, the Chairman, as it allows each Director to give honest and constructive feedback on performance, both individually and for the Board as a whole.

We request that, following the next evaluation of Board performance, a formal high-level feedback report should be provided to us (copied to NewERA) on overall Board performance, key focus areas for continuing development and assurance that the process has been properly implemented.

### Engagement

Finally, let me conclude by referring to the good engagement that has taken place this year, our expectation is that you will continue engage with NewERA and our Departments in the near term to discuss the matters set out in this letter in more detail and to progress these issues. This process will enable the company to set out its perspectives in relation to the proposed approach, set out in this letter and appendices. I am, like you, anxious that this process be concluded quickly and in this regard, I would be grateful if you would make appropriate arrangements for discussions with NewERA and the Departments to commence as soon as possible.

Best Regards

Yours sincerely

A handwritten signature in black ink, appearing to read 'Simon Coveney', with a stylized, flowing script.

Simon Coveney T.D.  
Minister for Agriculture, Food and the Marine

Cc Brendan Howlin T.D  
Minister for Public Expenditure and Reform

CC Eileen Fitzpatrick  
Director, NewERA

## Appendix I: Financial Performance Measures

### Shareholder Return

Measure	Calculation
Total Shareholder Return (TSR)	(Commercial equity value <sub>(end)</sub> /less Commercial equity value (beg) plus Dividends /less equity injected) / Commercial equity value (beg)
Dividend yield	Dividends paid / Average commercial equity value
Dividend payout	(i) Dividends paid / Adjusted net profit after tax (prior year) (ii) Dividends paid / net cash flow from operating activities
Return on Equity	Adjusted net profit after tax / Average Equity
Earnings Growth	Compound Annual Growth Rate in Adjusted net profit after tax

### Profitability / Efficiency

Measure	Calculation
Return on Capital Employed (ROCE)	(i) Adjusted EBIT / Average Capital Employed (ii) Adjusted EBIT / Adjusted Average Capital Employed

### Leverage / Solvency

Measure	Calculation
Gearing Ratio (net)	(i) Net debt / net debt plus equity (ii) Net debt / Net debt <i>plus</i> pension liabilities <i>plus</i> employee related liabilities <i>plus</i> equity
Interest Cover	Adjusted EBITDA / Interest paid
FFO Interest Coverage	Funds from Operations <i>plus</i> Interest Paid / Interest Paid
FFO / Debt	Funds from Operations / Gross Debt
RCF / Capex	Funds from Operations (FFO) /less Dividends / Capex [Measures ability of cashflow generated to cover Capex]

### Definitions of Key Terms used in calculations

Term	Definition
Adjusted EBIT	Earnings before interest and tax adjusted for exceptional items and IFRS fair value movements
Adjusted EBITDA	Earnings before interest, tax, depreciation and amortisation adjusted for exceptional items and IFRS fair value movements
Adjusted Net Profit after Tax	Net profit after tax adjusted for exceptional items and IFRS fair value movements
Adjusted Capital Employed	Net debt <i>plus</i> equity <i>plus</i> pension liabilities <i>plus</i> employee related liabilities
Capital Employed	Net debt <i>plus</i> equity
Commercial Value	See Section 2 of this letter
Dividends Paid	Dividends paid during the financial year per the cashflow statement (excl. special dividends)
Equity	Total shareholder(s) equity taken from the balance sheet
Fair value adjustments	Includes unrealised fair value gains / losses on derivatives or all fair value gains / losses on derivatives where the entity does not separately identify unrealised items.
Funds from Operations	Net cashflow from operating activities (post interest and tax paid and pre-working capital changes)



Gross Debt	Interest bearing debt such as loans, bonds and commercial paper <i>plus</i> interest bearing finance leases
Interest Paid	Interest paid for the financial year on interest-bearing debt per the company's cashflow statement.
Net cashflow from operating activities	Taken directly from the cashflow statement - ensure interest paid is included
Net Debt	Interest bearing debt such as loans, bonds and commercial paper plus interest bearing finance leases <i>less</i> cash