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Mr John Horgan  
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31<sup>st</sup> July 2015

### Shareholder's Expectation for Bord na Móna for financial year ending 30 March 2016

Dear John

In a letter dated 11 April 2014 addressed to you by the then Minister for Energy, Communications and Natural Resources (on his own behalf and on behalf of the Minister for Public Expenditure and Reform) (the "April 2014 Letter"), it was indicated that the intention is that a letter would issue to Bord na Móna ("BnM") annually for the purpose of providing guidance to the Board with respect to Government's current objectives for BnM and the primary considerations which will be taken account of by the Minister for Public Expenditure and Reform and myself (and other relevant Government Ministers) in respect of certain matters for which Ministerial consent is required under the Turf Development Acts 1946 to 1998 and the Code of Practice for the Governance of State Bodies (the "Code"). This letter is intended to provide guidance for the purposes of the financial year ending 30 March 2016. The Minister for Public Expenditure and Reform and I believe this will be helpful to the Board particularly in its corporate and strategic planning processes.

At the outset, I would like to acknowledge the level of work that is being undertaken by BnM in progressing the partial merger with Coillte, in conjunction with managing its own core businesses.

I also wish to stress the importance of maintaining a good working environment within these core businesses while further changes are implemented. It is clearly crucial for BnM to have the support of its employees in delivering on its new strategy. I would encourage the use of appropriate external mechanisms where they can assist ongoing discussions between management and the Group of Unions in order to reach an agreeable solution for all parties. The Government's overall current policy objectives for BnM remain that:

- BnM should continue to deliver on its corporate strategy, including contributing to regional economic development in the Midlands and West, providing sustainable, quality employment in these regions and contributing to the development of the renewable energies of wind, solar and biomass.
- BnM should remain as a profitable company with financial policies and a capital structure that is consistent with same.

*Fáiltítear roimh comhfhreagras i nGaeilge*

The specific objectives outlined in this letter should be considered in the context of these overall policy objectives.

### **1. Energy Policy Objectives**

In addition to the specific policy objectives listed above, I wish to ensure that BnM continues to actively work to support delivery of key Government policy objectives in terms of safeguarding security of energy supply, development of a sustainable energy future, and competitive, efficient and properly regulated energy markets, while also working to support important new national policy initiatives, subject to commercial considerations.

Regarding the ongoing work on the joint venture with Coillte in the areas of wind energy, biomass, recreation/tourism and support services, I am pleased to note the extent of progress that has been made on support services and tourism/recreation. There has been some positive progress in recent months on wind, particularly in respect of the Sliabh Bawn windfarm and I understand that the both companies are involved in a feasibility study of integrating additional projects in Q2 2015.

In relation to biomass, progress has been less satisfactory. The importance of establishing BioEnergy Ireland as a means of developing and expanding the biomass market should not be understated. While I recognise the complexities of establishing a viable economic model, it is imperative that progress is made on this workstream in 2015. I note with interest the recent vision that BnM has developed for this entity and look forward to receiving a business plan in the coming months.

The successful implementation of the joint venture is a key Government priority and one that I look forward to being fully completed, not least because it has the potential to really drive and mobilise the market for biomass.

I am also aware of the ongoing interaction between BnM and Irish Water in relation to the proposed Water Supply Project Eastern and Midlands Region, and that BnM has a potentially critical role to play in its successful delivery. I am fully supportive of the company's involvement in this project, again subject to the selection by Irish Water of the preferred option for the project and commercial considerations.

I endorse the work of the Board and management team in implementing the diversification strategy in recent years. In light of environmental pressures on the use of peat in power generation and horticulture, and the expiry of the peat PSO from late 2015 onwards, it is very clear that BnM must pursue an alternative to its reliance on the declining peat market.

I acknowledge that the above will require an appropriate level of ongoing investment by BnM. In developing and implementing any new projects, care must be taken by BnM to prioritise core areas of activity.

### **2. Financial Targets**

Appendices I and II set out a number of financial performance measures (these measures were also set out in the April 2014 letter). Consistent with its statutory functions to provide financial and commercial advisory services to relevant Ministers in relation to designated bodies (including BnM) under the National Treasury Management Agency ("NTMA")

Amendment Act 2014, NewERA will monitor these financial performance measures and provide advice to us in accordance with the NTMA Amendment Act 2014.

Following discussions with NewERA, I now wish targets to be set for two of these measures. The targets include:

- (i) a capital structure target (gearing ratio), reflecting the underlying business mix; and
- (ii) a profitability target (return on capital employed) reflecting the risk profile of the expected business mix.

Ordinarily I would expect that a dividend target also be included but given that a revised dividend policy is being considered by the company this is not required at this time. I look forward to discussing the new dividend policy with you when it is available.

I consider that relevant financial targets should be used to assist in balancing value creation and maintenance of financial risks at a reasonable level, without incentivising increased business risk. The aim should be to formulate high-quality targets that are ambitious while remaining realistic, and that are well defined and thus capable of being monitored on an ongoing basis.

In this context, and also to assist in assessing financial performance<sup>1</sup>, I ask that BnM would now develop appropriate financial targets<sup>2</sup> for the two measures set out above, in the context of BnM's five year strategic plan to be submitted under the Code. These targets should be agreed with the Minister for Public Expenditure and Reform and me, with the support of NewERA, by 30 September 2015. The Departments and NewERA should be kept informed of progress in the formulation of these targets with NewERA carrying out any detailed financial analysis it requires in order to provide its advice to the Minister for Public Expenditure and Reform and me in relation to the targets.

As regards the profitability target, this should be an ambitious but achievable target to be achieved relative to BnM's expected cost of capital, which will be reviewed by NewERA and the two Departments as part of setting the profitability target, and which should be seen as a minimum requirement for the return. It is considered that establishing a profitability target that exceeds the expected cost of capital will assist in ensuring that shareholder value is created over time. I expect that analyses of BnM's business plan as well as assessments and comparisons based on relevant industry and peer companies will be important components in setting this profitability target (refer to section 4 below on peer companies).

Representatives from both Departments and NewERA will meet you at least once annually to discuss the financial targets, including their outcome and relevance, BnM's work to achieve them and whether any changes need to be made to them.

### **3. Shareholder Returns**

As set out in the April 2014 letter, and in order to assist in measuring value creation (which is a separate matter to the financial targets set out above), my officials will be reviewing total shareholder return (TSR) over a five year period commencing from 1 January 2014, assisted in this process by NewERA. It is acknowledged that returns will vary from year to

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<sup>1</sup>Pursuant to Section 21 of the NTMA (Amendment) Act, NewERA shall "... in respect of each designated body, assess its financial performance and prepare, at least annually, a report on its financial performance", with BnM being one of the designated bodies.

<sup>2</sup> The targets do not necessarily mean a single number of X% but could include a tight range of X% to Y%.

year, sometimes due to temporary or non-controllable factors, but it is a key Government objective that the factors that drive changes in BnM's value are clearly understood.

As regards measuring TSR and value creation, Appendices I and II set out financial performance measures in respect of shareholder return which I propose to apply. As you will see, certain measures necessitate the use of the commercial equity value of the entity. I ask that BnM carry out an equity valuation with a valuation date as at 25 March 2015, to be submitted to the two Departments no later than 30 September 2015. The equity valuation should be undertaken on a basis that is consistent with the previous equity valuation that was carried out during 2014 with a valuation date as at 26 March 2014. This valuation will be reviewed by NewERA and DCENR, in consultation with DPER. I anticipate that a similar exercise will be carried out on an annual basis, with a valuation to be carried out by an independent party at least every three years. However, if you decide to appoint a third party to carry out the valuation that is required by 30 September 2015 then the terms of reference for the valuation should be agreed with the two Departments, who will be supported and advised by NewERA, in advance of appointing a third party.

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

#### **4. Peer Companies**

As noted in Section 2 above, it is proposed that peer companies be reviewed as part of the process of setting suitable financial targets for BnM.

[REDACTED]

[REDACTED]

#### **5. Governance Arrangements:**

##### **5.1 Corporate Plan**

With respect to the rolling five year corporate plan which BnM is required to prepare and submit to me pursuant to the Code, officials from the two Departments, together with NewERA will continue to engage with you in this process in order to provide feedback to you on the plan. I acknowledge the imperative for BnM to continue its move away from reliance on the declining peat market and the work and consultations which BnM has already undertaken this year as part of its root and branch review of strategy.

## 5.2 Reporting

As you know, the Code sets out current requirements in terms of reporting obligations, which supplement BnM's obligations in this regard under the Turf Development Acts 1946 to 1998. I expect BnM to continue with the quarterly meetings that are held with NewERA and the two Departments, and I am very appreciative of the co-operation that BnM have shown to date in this regard. I also anticipate a continuation of the existing policy of regular communication with both Departments and NewERA should any material matters arise.

## 5.3 Board Evaluation

Consistent with the requirement in the Code it is expected that the Board continually reviews its own operation and performance and that of its committees and individual members, undertakes an evaluation of its performance on an annual basis and that the Board considers having such an evaluation facilitated by an independent assessment once every three years. I know that such a review and evaluation process in BnM is led by the Chairman and I expect that it allows each Director to give honest and constructive feedback on performance, both individually and for the Board as a whole.

I would ask that a formal high-level feedback report be provided to my officials, and copied to NewERA, on overall Board performance<sup>3</sup>, key focus areas for continuing development and assurance that the process has been properly implemented. The feedback report should be sent as soon as practicable after the evaluation has been completed by the Chairman for the year ending 25 March 2015.

## 6. Engagement

My expectation is that you will engage with NewERA and our Departments shortly after receiving this letter to discuss in more detail the matters raised. This process will enable BnM to set out its perspectives in relation to the proposed approach, and I would be grateful if you would make the appropriate arrangements for such discussions with NewERA and the Departments.

Yours sincerely



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Alex White T.D.  
Minister for Communications, Energy and Natural Resources

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

Cc Eileen Fitzpatrick  
Director, NewERA

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<sup>3</sup> Note that performance relates to the performance of the Board as a collective and the feedback report is not to contain comments on the performance of individual board members.

## Appendix I: Financial Performance Measures (Standardised)

### Shareholder Return

Measure	Calculation
Total Shareholder Return (TSR)	(Commercial Equity Value (end) <i>less</i> Commercial Equity Value (beg) <i>plus</i> Dividends <i>less</i> Equity injected) / Commercial Equity Value (beg)
Dividend Yield	Dividends Paid / Commercial Equity Value (average)
Dividend Payout	Dividends Paid / Adjusted net profit after tax for dividend purposes (prior year)
Return on Equity	Adjusted Net Profit after Tax / Equity (average)
Earnings Growth	Compound annual growth rate in Adjusted Net Profit after Tax

### Profitability / Efficiency

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

### Leverage / Solvency / Credit Metrics

Measure	Calculation
Gearing Ratio	(i) Net debt / Net debt <i>plus</i> 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	S&P, Moody's & Fitch basis
FFO / Debt	S&P and Moody's basis

### 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 Equity Value	See Section 3 of this letter
Dividends Paid	(i) Dividends paid in respect of the financial year in line with agreed dividend policy (ii) Dividends paid in respect of the financial year in line with agreed dividend policy <i>plus</i> special dividends (if any)

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
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 <i>plus</i> interest bearing finance leases <i>less</i> unrestricted cash balances

## Appendix II: Financial Performance Measures (BnM Specific)

### Shareholder Return

Measure	Calculation
Total Shareholder Return (TSR)	(Commercial Equity Value (end) <i>less</i> Commercial Equity Value (beg) <i>plus</i> Dividends <i>less</i> Equity injected) / Commercial Equity Value (beg)
Dividend Yield	Dividends Paid / Commercial Equity Value (average)
Dividend Payout	Dividends Paid / Adjusted net profit after tax for dividend purposes (prior year)
Return on Equity	Adjusted Net Profit after Tax / Equity (average)
Earnings Growth	Compound annual growth rate in Adjusted Net Profit after Tax

### Profitability / Efficiency

Measure	Calculation
Return on Capital Employed (ROCE)	(iii) Adjusted EBIT / Capital Employed (average) (iv) Adjusted EBIT / Adjusted Capital Employed (average)

### Leverage / Solvency / Credit Metrics

Measure	Calculation
Gearing Ratio	(iii) Net debt / Net debt <i>plus</i> equity (iv) 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	S&P, Moody's & Fitch basis
FFO / Debt	S&P and Moody's basis

### Definitions of key terms used in calculations

Term	Definition
Adjusted EBIT	Earnings before interest and tax adjusted for exceptional or extraordinary items, payment of dividend or other distribution on, or in respect of any share in the capital of the Company or the transfer of any sum to reserves, the proportion of profits or gains which is attributable to minority interests in subsidiaries, any credit shall have been taken for income from associated undertakings which increase the consolidated net profit in that financial period and in no event taking account of any finance costs and income in respect of any pension scheme deficit or surplus or IFRS fair value



	<p>movements.</p> <p>For the avoidance of doubt, land sales in the ordinary course of the business of any member of the Group shall not be deemed extraordinary or exceptional.</p>
Adjusted EBITDA	<p>Earnings before interest, tax, depreciation and amortisation or writing off of goodwill or other intangible assets adjusted for exceptional items writing off of goodwill or other intangible assets or IFRS fair value movements.</p> <p>For the avoidance of doubt, if a Subsidiary has been acquired or disposed of since the date as at which the latest audited consolidated financial statements of the Group were prepared, EBITDA shall be deemed to be adjusted in order to take into account the acquisition or disposal of that Subsidiary and its annualized earnings during the relevant Rolling Twelve Months.</p>
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 Equity Value	See Section 3 of this letter
Dividends Paid	<p>(iii) Dividends paid in respect of the financial year in line with agreed dividend policy</p> <p>(iv) Dividends paid in respect of the financial year in line with agreed dividend policy <i>plus</i> special dividends (if any)</p>
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, pre capex and tax paid and pre-working capital changes)
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	<p>Interest bearing debt (defined below) less cash</p> <p>Debt means: Moneys borrowed; Any amount raised by acceptance under any acceptance credit facility or dematerialised equivalent; Any amount raised pursuant to any note purchase facility or the issue of bonds, notes, debentures, loan stock or any</p>

similar instrument; The amount of any liability in respect of any lease or hire purchase contract which would, in accordance with GAAP, be treated as a finance or capital lease; Receivables sold or discounted (other than any receivables to the extent they are sold on a non-recourse basis); Any amount rained under any other transaction (including any forward sale or purchase agreement) having the commercial effect of a borrowing; Any derivative transaction entered into in connection with protection against or benefit from fluctuation in any rate or price (and, when calculating the value of any derivative transaction, only the net market value shall be taken into account, if any); Any counter-indemnity obligation in respect of a guarantee, indemnity, bond, standby or documentary letter of credit or any other instrument issued by a bank or financial institution; and the amount of any liability in respect of any guarantee of indemnity for any of the items referred to above

Net Debt to EBITDA

As determined on a rolling twelve month basis as at each Accounting half year (to be more than 3.25 to 1.0)