

FY2016/17–2018/19 Statement of Corporate Intent

Meteorological Service of New Zealand Ltd

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Introduction

This Statement of Corporate Intent is submitted by Meteorological Service of New Zealand Limited (MetService) and outlines the direction of the Company for the three years ending 30 June 2019.

Background

Nature and Scope of Activities

MetService provides New Zealand’s National Meteorological Service through a contract with the Ministry of Transport (MoT). This includes the provision of public-safety weather warning and forecasting services, as specified by the MoT and agreed to by MetService, to:

- the general public;
- Government agencies and emergency managers at national, regional and local levels;
- maritime interests across the South Pacific; and
- other countries within the South Pacific region.

MetService provides safety-critical aviation forecasting services to the New Zealand domestic aviation sector and the RNZAF. It also provides services to the international aviation community under contract to the New Zealand Civil Aviation Authority (CAA), subject to the requirements of the UN International Civil Aviation Organization (ICAO), including:

- forecasts and warnings of hazardous en-route weather within the CAA-defined “Auckland Oceanic Flight Information Region”;
- specialised forecasts for New Zealand’s international airports; and
- operation of the Wellington ICAO Volcanic Ash Advisory Centre, with responsibility for advisories of air-borne volcanic ash in the South Pacific.

In addition to its core safety services as described above, MetService provides a diverse range of weather forecasts, weather analytics and weather presentation services, both in New Zealand and international markets, including:

- online weather information across multiple channels, and the sale of associated advertising, content and mobile applications;
- specialised weather products and services to key industries whose business economics are affected by weather-related impacts and risks, such as transportation (aviation, marine and road), energy, oil and gas, retailing, construction, agriculture, and mining;
- media weather graphics products and data; and
- weather and related services to Government agencies and emergency managers at national, regional and local levels.

To support the effective delivery of these services, the company engages in the following, subject to appropriate professional and operational standards:

- collection of basic weather information, through the operation of its observing network in New Zealand and through arrangements with overseas agencies and other third-party data providers;
- analysis, forecasting, dissemination and communication of weather information;
- development of software-based tools for the presentation and interpretation of weather and other information;
- provision of meteorological consultancy services; and
- training of professional meteorologists to World Meteorological Organization (WMO) standards.

Strategic Context

In its role as New Zealand's National Meteorological Service, MetService is responsible for delivering a range of weather services that directly support the safety of life and property, including forecasts and warnings of adverse weather tailored to the needs of the general public, the maritime community and the aviation sector. The safety-critical nature of these services imposes an obligation on MetService to deliver them to a very high standard in terms of professional practice, clarity of message and reliability of delivery. These services are also provided in highly-regulated environments and require MetService to actively engage with the international community as a representative of the New Zealand Government.

As a State-Owned Enterprise, MetService was also established to provide its services in a wholly commercial context to drive the company based on business disciplines of continuous improvement and efficiency, as well as to provide opportunities for additional income from new customers that would benefit from MetService's capabilities. From its inception in 1992, all activities that the company has engaged in have been driven by this dual focus on safety and commercial orientation, operating in environments that range from those that are highly regulated to those that are entirely driven by the free market.

MetService's dual responsibilities for public safety and commercial success are complementary, and together they support a unique position globally amongst other National Meteorological Services and commercial weather companies. The professional capability and service reliability that are demanded by its safety obligations provide a foundation for its commercial business that is substantially stronger than would otherwise be possible. At the same time, its commercial character ensures that MetService's safety services are underpinned by sound business practices, allowing it to provide New Zealand with a National Meteorological Service that is innovative and highly efficient.

With respect to its core safety services, the company's focus during the planning period will be to continue to strengthen its resilience to natural disaster or other threats to service delivery through a programme of investment in IT infrastructure and forecasting capability. MetService is also accelerating its growth initiatives in key international markets to drive greater returns in its other commercial activities. The success of these strategies will enable MetService to significantly enhance its value, and ultimately increase returns to its shareholders, while at the same time allowing it to continue to provide New Zealanders with a world-class National Meteorological Service that contributes effectively to public safety and New Zealand's international commitments through the United Nations.

Export revenue is forecast to grow from \$7.7 million in FY2015/16 to \$13.5 million in FY2018/19, representing an increase as a percentage of total revenue from 15% to 20%. EBITDA is projected to grow from \$11.8 million in FY2015/16 to \$16.3 million in FY2018/19, while NPAT is forecast to increase from \$1.8 million to \$3.2 million. The Board will continue to monitor its investments to ensure the financial health of the business remains strong and the business continuance improvements are achieved.

MetService's people are the foundation on which it will grow its business, and the company will continue to invest in the development of its staff to improve long-term company performance. It will also continue to invest in its innovation programmes to support its growth initiatives and enhance its core safety services. While R&D spend varies considerably by market sector and individual company, the majority of companies globally spend less than 5% of revenues annually on R&D. MetService's current ratio of 10% per annum will be sustained through the planning period, focused on core safety services and business growth areas due to their strategic significance to the company.

Commercial Value of the Crown's Investment

As at 30 June 2016, the Board's estimate of the current commercial value of the Crown's investment in MetService is in the range of \$50.0 to \$66.6 million (if a point-value needs to be taken, the mid-point is \$58.3 million). At 30 June 2015, the valuation was \$61.4 million.

The current valuation is based on the following:

- The Discounted Cash Flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire MetService group, including all subsidiaries, on an after-tax basis.
 - The DCF/NPV is based on nominal future cash flows set out in the MetService Group's three-year business plan and an additional seven years, calculating a present value in the terminal year, including a growth assumption to the terminal value of 2.0%.
 - The discount rate ranges from 8.08% (post-tax) in the first three years to a terminal value after year 10 of 8.41% (post-tax).
 - The valuation was prepared internally by MetService's Finance team and the model calculations and the Weighted Average Cost of Capital (WACC) used for the valuation have been reviewed by Deloitte prior to approval by the Board.
 - The range reflects sensitivity around the future growth of MetService in export markets, with the lower end of the range representing limited growth against strategic plans and the upper end of the range depicting successful implementation of the company's Business Plan.
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Organisational Goals

Vision

To be recognised as the global leader in local weather intelligence.

Purpose

To support safety of life and property, and create wealth from weather, for New Zealanders, shareholders and customers.

Mission

Empowering foresight through powerful weather intelligence.

Corporate Objectives

- To support the safety of life and property in New Zealand and, as appropriate, the wider South Pacific region, through the provision of timely and reliable forecasts and warnings of adverse weather and its impacts.
 - To provide customers with innovative, reliable, weather-related services that are highly profitable, enabling MetService to deliver an appropriate return on investment to its shareholders.
 - To operate in a socially responsible manner, with particular regard to MetService employees, the environment, the community and customers.
 - To be the most desirable meteorological company to work for in the world.
 - To enhance MetService's international reputation, through innovation in global markets for commercial weather services, and by contributing to the international community on behalf of New Zealand, through advances in the science and practice of meteorology.
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Ratio of Consolidated Shareholders' Funds to Total Assets

MetService's FY2017-19 Business Plan projects a 54% ratio of consolidated shareholders' funds to total assets (equity ratio) as at 30 June 2019. In this context, consolidated shareholders' funds means the total paid-up capital together with retained surpluses and reserves. Total assets means the sum of all current and fixed assets owned by MetService, to the extent that these have been attributed value in its financial statements.

Capital Structure

The Board annually re-assesses the capital structure of MetService to ensure that it continues to be appropriate for the circumstances, including the need to retain financial flexibility. The Board considers that, in the long term, a gearing ratio lower than 35% would be appropriate.

In the medium term, MetService may create substantial international growth opportunities, based on its expertise and intellectual property, which could require investment funding beyond the level of free cash flow being generated. Should this occur, the Board may seek permission from the Shareholding Ministers to present alternative options.

MetService is committed to reducing debt from \$17 million at 30 June 2016 to \$14.5 million by 30 June 2019 to achieve the Board's targeted gearing ratio range of 30 - 35%.

Dividend Policy

Funds attributable to the shareholder and surplus to MetService's financing and operating requirements will be distributed annually to MetService's shareholders. The level of surplus will be determined by having regard to:

1. a sustainable financial structure with a focus on long-term gearing of between 30% and 35%
2. company medium-term replacement and refurbishment capital expenditure, and working capital requirements; and
3. forecast macroeconomic conditions.

Subject to the above considerations, dividend paid over time will be in the range of 50% to 75% of free cash flow from operations, after the deduction of replacement capital expenditure.

In order to reduce debt and achieve its target gearing ratio, while simultaneously accommodating critical investment in resilience of the company's aviation systems plus its strategic plans to address legacy systems with its Information Services Strategic Plan, MetService's dividend payment will be adjusted to 25% to 50% of free cash flow from operations after deduction of replacement capital expenditure for the three financial years of this Statement of Corporate Intent.

MetService is confident that this adjustment to its dividend payments will only be necessary for FY2016/17 through FY2018/19 to counter the effects of under-investment in the past, and it intends to resume full dividend payments per the Dividend Policy no later than FY2019/20.

Dividend payments will normally be paid as a final dividend in October.

Key Performance Indicators

Financial KPIs

The following KPIs provide a representative view of the projected financial performance of MetService over the planning period. Notes to the Financial KPIs including definitions are found in the Appendix.

	2015/16 (Forecast ¹)	2016/17 (BP)	2017/18 (BP)	2018/19 (BP)
1. Shareholder Returns				
Total Shareholder return	8.4%	2.0%	1.6%	1.9%
Dividend yield	0.0%	2.0%	1.6%	1.9%
Dividend pay-out	0.0%	19.0%	14.0%	11.6%
Return on equity (ROE)	9.4%	11.6%	12.2%	13.8%
Return on funds employed	10.0%	11.6%	12.3%	13.6%
2. Profitability / Efficiency				
NPAT (\$000)	1,790	2,385	2,661	3,243
EBIT (\$000)	3,620	4,263	4,679	5,347
EBITDA (\$000)	11,771	13,310	14,991	16,266
Asset turnover	1.18	1.29	1.40	1.48
Operating margin (EBITDA)	23.1%	23.5%	23.9%	24.1%
Operating margin (EBIT)	7.1%	7.5%	7.5%	7.9%
3. Leverage / Solvency				
Gearing ratio (net)	39.5%	38.4%	40.9%	34.2%
Interest cover	12.2	14.0	15.3	19.3
Solvency	1.31	1.09	1.28	1.59
Debt coverage ratio	4.70	3.64	3.63	2.71
4. Growth / Investment				
Revenue growth	10.8%	11.2%	10.3%	7.4%
EBITDA growth	23.6%	13.1%	12.6%	8.5%
NPAT growth	88.7%	33.3%	11.6%	21.9%
Capital renewal	0.34	0.63	0.60	0.60

¹ FY2015/16 Forecast results in this Statement of Corporate Intent are provisional and subject to final audit results.

Non-financial KPIs

Non-financial KPIs are the measures that MetService has agreed with stakeholders to assess business performance. Notes to the Non-financial KPIs including definitions are found in the Appendix.

	2014/15 (Actual)	2015/16 (Actual)	2016/17 (BP)	2017/18 (BP)	2018/19 (BP)
1. Warning Performance					
POD ¹ Heavy Rain	94%	93%	> 90%	> 90%	> 90%
POD Severe Gales	93%	94%	> 85%	> 85%	> 85%
POD Heavy Snow	100%	100%	> 85%	> 85%	> 85%
FAR ² Heavy Rain	13%	19%	< 25%	< 25%	< 25%
FAR Severe Gales	12%	15%	< 30%	< 30%	< 30%
FAR Heavy Snow	12%	29%	< 30%	< 30%	< 30%
2. Observing					
Radar % Uptime	99.3%	99.5%	> 97.0%	> 97.0%	> 97.0%
AWS ³ % Uptime	99.5%	99.7%	> 98.0%	> 98.0%	> 98.0%
3. Corporate and Social Responsibility					
Critical Programme Audit Findings	0	0	0	0	0
Accidents or Serious Incidents	0	0	0	0	0
Social Investment (\$000)	205	201	210	220	230
Community Engagement (hours)	216	145	150	185	220
WMO Staff Participation (number of staff)	12	18	10	10	10

¹ Probability of Detection.

² False Alarm Ratio.

³ Automatic Weather Station.

Relationship with Shareholding Ministers

Information to be Provided

To enable Shareholding Ministers to assess the value of their investment in MetService, any information that would normally be supplied to a controlling private sector shareholder will be made available. In particular, this includes the following:

- Annual Reports will be submitted in accordance with Section 15 of the State-Owned Enterprises Act 1986.
- Half-Yearly Reports will be submitted in accordance with Section 16 of the SOE Act, and will include unaudited statements of financial performance, financial position, and cash flows, along with such other details as are necessary to permit an informed assessment of MetService's performance during the period.
- Quarterly reports will be submitted within one month of completion of the quarter, indicating actual performance against key financial and operating performance targets during the period, and reasons for any significant departure from forecasts.
- Shareholding Ministers will be advised of any changes to the Treasury management policies and procedures applied by MetService, including the Board's approved limits for currency, interest rate, and credit exposure.
- A Business Plan for the next three financial years will be made available to Shareholding Ministers for discussion prior to the commencement of each financial year.
- MetService will fully comply with Section 18 of the SOE Act in providing to Shareholding Ministers such additional information as may from time-to-time be requested.

Consultation

MetService undertakes to consult with Shareholding Ministers when specific business opportunities exceed the following thresholds:

- Core Activities: Opportunities where the proposed transaction exceeds \$5 million.
- Related Activities: Opportunities where the proposed transaction exceeds \$3 million.

MetService maintains a “no surprises” communications approach with its Shareholding Ministers and their representatives, such as Treasury, including appropriate communication around major capital and investment business cases.

Procedure for Acquisition of Shares

MetService will not invest in the shares of another entity unless the securities acquired are likely to bring added value to MetService. In any instance where MetService intends to subscribe for, or otherwise acquire (whether at the same time or over a period of time), 20% or more of the shares of any company, it will give prior written notice of its intention to Shareholding Ministers.

Activities for Which Compensation is Sought

Where the Government wishes MetService to undertake activities, or assume obligations, that will, or could, result in a reduction in the surplus or net worth of MetService, the MetService Board of Directors will seek sufficient compensation to allow MetService's financial position to be preserved.

MetService does not currently seek compensation for any non-commercial activities under Section 7 of the Act.

Accounting Policies

The MetService Group's accounting policies are contained in its latest Annual Report, as available on www.metservice.com.

Appendix

Notes on the Financial KPIs

Table 1: Shareholder Returns

Measure	Description	Calculation
Total shareholder return	Performance from an investor perspective – dividends and investment growth	$(\text{Commercial value}_{\text{end}} \text{ less Commercial value}_{\text{beg}} \text{ plus dividends paid less equity injected}) / \text{Commercial value}_{\text{beg}}$
Dividend yield	The cash return to the shareholder	Dividends paid / Average commercial value
Dividend payout	Proportion of net operating cash flows less allowance for capital maintenance paid out as a dividend to the shareholder	Dividends paid / Net cash flow from operating activities
Return on equity (ROE)	How much profit a company generates with the funds the shareholder has invested in the company	Net profit after tax / Average equity
Return on funds employed (ROFE)	A measure of profitability and the efficiency with which capital is employed to achieve that profit	Ratio of EBIT to average debt plus equity over the period

Table 2: Profitability, Efficiency

Measure	Description	Calculation
Asset Turnover	The amount of revenue generated for every dollar's worth of assets	Revenue / Assets
Operating margin (EBITDA)	The profitability of the company per dollar of revenue, with profitability measured as earnings before interest, taxation, depreciation and amortisation adjustments	EBITDA / Revenue
Operating margin (EBIT)	The profitability of the company per dollar of revenue, with profitability measured as earnings before interest and taxation adjustments	EBIT / Revenue

Table 3: Leverage, Solvency

Measure	Description	Calculation
Gearing ratio (net)	Measure of financial leverage - the ratio of debt (liabilities on which a company is required to pay interest) less cash, to debt less cash plus equity	Net debt / Net debt plus equity
Interest cover	The number of times that earnings can cover interest	EBITDA / Interest paid
Solvency	Ability of the company to pay its debts as they fall due	Current assets / Current liabilities
Debt coverage ratio	Level of bank debt in relation to earnings	Bank debt / EBIT

Table 4: Growth, Investment

Measure	Description	Calculation
Revenue growth	Measure of whether the company is growing revenue	% change in revenue
EBITDA growth	Measure of whether the company is growing earnings	% change in EBITDA
NPAT growth	Measure of whether the company is growing profits	% change in NPAT
Capital renewal	Measure of the level of capital investment being made by the company	Capital expenditure / Depreciation expense

Notes on the Non-Financial KPIs

Measure	Description /Calculation
Probability of Detection (POD)	<p>The ratio of correctly forecast severe weather events to actual events observed.</p> <p>The POD and FAR for heavy rain events is reported as a 12-month running mean; for heavy snow and high wind events the POD and FAR are reported as a 24-month running mean, reflecting the relative infrequency of these events.</p>
False Alarm Ratio (FAR)	<p>The ratio of forecast severe weather events that did not occur (false alarms) to the number of events forecast.</p> <p>The POD and FAR for heavy rain events is reported as a 12-month running mean; for heavy snow and high wind events the POD and FAR are reported as a 24-month running mean, reflecting the relative infrequency of these events.</p>
Radar % Uptime	The percentage of time that radar data is available within MetService’s Wellington office, averaged over all radar sites.
AWS % Uptime	The percentage of time that Automated Weather Station data is available within MetService’s Wellington office, averaged over all AWS sites.
Critical Programme Audits	Critical programmes that are externally audited, including Civil Aviation Part 174, ISO 9001 Quality Management Systems and Accident Compensation Corporation’s Work Place Safety Management.
Accidents or Serious Incidents	The number of workplace Health and Safety incidents classed as either Accidents or Serious Incidents. An accident is defined as any event causing harm and a serious incident is an event that damages property or equipment but does not cause harm. This term is also used for a near misses that may affect reputation.
Social Investment	The amount of investment over the financial year given to community organisations or charities.
Community Engagement	The number of hours over the financial year that staff engaged directly with schools and community organisations.
WMO Staff Participation	Staff participation with the United Nations World Meteorological Organization in either a working group or a formal meeting over the financial year.

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