

The Treasury

Solid Energy Information Release

March 2013

Release Document

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- [1] 9(2)(a) - to protect the privacy of natural persons, including deceased people
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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Date: 14 August 2012

To: Minister of Finance (Hon Bill English)
Associate Minister of Finance (Hon Steven Joyce)
Minister for State Owned Enterprises (Hon Tony Ryall)



Aide Memoire: Solid Energy: next steps

Following our aide-memoire of 9 August, and our report of 5 June, you requested advice on the next steps that Ministers should take in response to the deteriorating financial situation for Solid Energy.

Context

The issues facing Solid Energy are industry-wide and international. According to research by UBS, over the last 12 months, an index of Australian listed coal companies is down 42% (in \$AU terms), relative to a 10% drop in the ASX 200. Since January 2011, an index of United States coal companies is down 68%, with some companies within this index down 80-90%. In comparison the S&P500 was up 0.5% over the same period.

These movements are driven by the same market conditions also affecting Solid Energy: weakening Chinese and Indian demand and the Eurozone crisis. In the United States, cheap natural gas prices are also a significant factor. This has resulted in US based coal producers increasing exports of thermal coal, further weakening international prices.

However, within this broader industry context, Solid Energy is facing particular difficulty because of the concerns identified in last year's UBS scoping study and in previous Treasury advice, namely:

- Solid Energy's high cost structure, including corporate overheads
- the Spring Creek mine, which is uneconomic at current market prices and has significant negative cashflow because of capex requirements
- the cash that Solid Energy has invested in its renewables and new development businesses, all of which are cashflow negative, [2],[4],[5]
- Solid Energy's debt position, which is high relative to comparable companies.

In our view, Solid Energy has made poor use of the funds it generated when coal prices were high. We have had concerns for some time that Solid Energy's strategy was unlikely to pay off to the extent that Solid Energy believed it would (given that, amongst other things, they were effectively taking a very large bet against the market). However, the concern now is that the strategy has put Solid Energy in a position of significant vulnerability given that coal prices are low, and are forecast to remain low for an extended period.

Next steps

We think the next steps are:

1. Appoint a new Chair for Solid Energy as soon as possible
2. Treasury engagement with the board
3. The board and Treasury to jointly appoint an “investigating accountant”

We think the most important step is to accelerate the process (already underway) to identify and appoint a new Chair for Solid Energy. Given the difficult situation that the company now faces, we believe having a new Chair appointed and in place as soon as possible is important in the context of driving change and providing assurance to Ministers that Solid Energy’s current plans are achievable. The new Chair also needs to be in place to help the Board make the difficult decisions that are necessary.

[5]

[4],[5]

We also propose a direct engagement by Treasury with the Board, to reinforce how seriously the Crown as shareholder is viewing this situation. We plan to do this on Monday next week, which is the Board’s next scheduled meeting.

Following that, we will work with the Board to jointly appoint an “investigating accountant” who can provide the Board and shareholders with an independent stream of advice. We have begun work on a terms of reference for this role.

Further options

[5],[6]

[5],[6]

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