

# **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.

## **Treasury Report: Further Update and Actions on Solid Energy Limited**

<b>Date:</b>	31 October 2012	<b>Report No:</b>	T2012/2804
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### **Action Sought**

	<b>Action Sought</b>	<b>Deadline</b>
Minister of Finance (Hon Bill English)	<b>Note</b> the contents of this report <b>Agree</b> to appoint an investigating accountant and Crown observer to Solid Energy	Friday 2 November 2012
Associate Minister of Finance (Hon Steven Joyce)	<b>Note</b> the contents of this report	Friday 2 November 2012
Minister for State Owned Enterprises (Hon Tony Ryall)	<b>Note</b> the contents of this report <b>Agree</b> to appoint an investigating accountant and Crown observer to Solid Energy	Friday 2 November 2012

### **Contact for Telephone Discussion (if required)**

<b>Name</b>	<b>Position</b>	<b>Telephone</b>	<b>1st Contact</b>
[4]	Analyst, Commercial Transactions Group	[1]	✓
Chris White	Manager, Commercial Transactions Group	[1]	

### **Actions for the Minister's Office Staff (if required)**

None.
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**Enclosure: No**

## **Treasury Report: Further Update and Actions on Solid Energy Limited**

### **Introduction**

1. This report updates you on the most recent information received from Solid Energy on its financial position. The news is not good – coal prices continue to weaken and the company's current forecasts are below their most recent downside scenario submitted in their revised business plan in August with Treasury (which was already a revised downside from their initial business plan forecast).
2. The revised forecasts paint a significantly worse picture [2] lower NPAT over the next 2 years) than those submitted to Treasury as part of the October baseline update (which we briefed you on in T2012/2730 and were based on the August budget). The Fiscal Reporting team is aware of this situation and are working through the potential implications on the half year accounts and forecasts.
3. [2],[5],[6]
4. [2],[5],[6]

Solid Energy currently has \$400 million in debt outstanding to the banks [2],[5],[6]  
The Crown currently has just under \$400 million of equity invested in Solid Energy.

5. We also propose a set of immediate actions to support the Crown's position. These actions are speeding up the process of board renewal, appointing an investigating accountant, developing a strategy to engage with the banks and appointing a Crown observer for Solid Energy.

## What has changed?

6. Coal markets have continued to weaken and are now tracking below analyst forecasts. At current prices Solid Energy is not profitable. The graph below charts Solid Energy's current estimate of realised average price over the next 2 years. This shows that Solid Energy is expecting prices to bottom out [2] in Q3 FY13 and only growing to [2] Q4 FY14. At these prices we understand that Solid Energy will only just cover its costs of extraction. In addition to these low US dollar prices, Solid Energy is not expecting any relief on the exchange rate, which is forecast to remain at its current levels.

[2]

## What does this mean?

7. It will be extremely difficult for Solid Energy to survive a sustained period with prices at the levels indicated in the graph above, given the debt burden that the company has taken on. Solid Energy has a high level of debt for a coal company (around \$400 million; as previously advised, a more normal level of debt would be zero) and requires ongoing profitability to service this debt. [2],[5],[6]

8.

[2],[6]

9. [2],[5],[6]

10. [2],[5],[6]

11. As you know it has been a long-standing policy that borrowing by SOEs in their own name is not in any way guaranteed by the Crown. All SOE loan documents need to include an explicit statement to this effect.

#### **Actions to Address the Situation**

12. There are a number of steps we recommend Ministers take to respond to Solid Energy's current position. These are as follows.

13. **Board Renewal:** Following the appointment of Mark Ford, a renewal process for the Solid Energy board was intended. [4],[5],[6]

Due to the current financial circumstances, it is likely that indemnities will need to be [4],[5],[6]. The COMU appointments and governance team will report to you on this issue separately.

14. [5],[6]

15. **Appoint an Investigating Accountant (IA):** Appointing an IA will provide more insight into the company and a separate stream of financial advice from management. It will also give an independent view on the company's strategy and business plans and report if there are better options than those put forward by management. As mentioned above, we expect that the banks will also seek to appoint an IA, so there is benefit in ensuring that the Crown does not end up at an information disadvantage in any subsequent negotiation with the banks. We suggest that an appointment of an IA is made in conjunction with the board as this will provide support for the new Solid Energy chair on financial issues and could assist the Crown in its engagement with the banks by allowing us to use the company as a filter. Depending on who is appointed as IA, it may also be helpful to make a secondary appointment to get expertise on the mining and coal sector, as the forecast coal price is the major driver of Solid Energy's financial performance.

16. [5],[6]

17. **Appoint a Crown Observer:** Having a Crown observer for the Board, along the lines of the role Treasury played successfully in last year's Crown Support Agreement with AMI Insurance Limited, would allow Ministers to have a greater insight into what was going on at board level. The Crown observer would attend each meeting of the board and of any board committee, and would receive all board notices and papers. In addition to providing in depth information about the progress of the company, the presence of the Crown observer has an important signalling effect, continually reminding the company that its focus should be on moving to a sustainable position, and minimising risks to the Crown. A Crown observer is not a director and has none of the powers or duties of a director, other than to receive information and attend meetings.

## Next Steps

18. [5],[6]

19. If you agree we will also approach the chair of Solid Energy to appoint an IA.

## Recommended Action

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We recommend that you:

a [5],[6]

b **agree** to appoint an investigating accountant to Solid Energy in conjunction with the board.

*Agree/disagree.*  
Minister of Finance

*Agree/disagree.*  
Minister for State Owned Enterprises

c **agree** to appoint a Crown observer to the Solid Energy Board

*Agree/disagree.*  
Minister of Finance

*Agree/disagree.*  
Minister for State Owned Enterprises

d **note** Treasury will continue to work on potential scenarios and options for Ministers regarding Solid Energy.

Chris White  
**Manager, Commercial Transactions Group**

Hon Bill English  
**Minister of Finance**

Hon Steven Joyce  
**Associate Minister of Finance**

Hon Tony Ryall  
**Minister for State Owned Enterprises**