

LEGISLATIVE COUNCIL
GOVERNMENT BUSINESSES SCRUTINY COMMITTEE 'A'

MINUTES OF MEETING

Tuesday, 25th July 2006

The Committee met at 8.47 o'clock a.m. in the Ante Chamber, Parliament House, Hobart.

Members Present:

Ms Forrest

Mr Harriss

Mr Martin

Mrs Rattray-Wagner

Mr Wilkinson (Chair)

Preamble:

Preliminary to the scrutiny of the following Government Business Enterprises the Members of this Committee met with the Auditor-General. The Committee also met with a number of persons and/or organisations that claimed stakeholder interests in these GBEs. These meetings enabled the Committee to be better prepared for the task of scrutiny.

The Committee adjourned to the Long Room.

HYDRO TASMANIA

The Committee resumed at 9.00 o'clock am

The following witnesses appeared before the Committee –

Hon David Llewellyn, Minister for Energy

Dr David Crean, Chairman

Mr Geoffrey Willis, Chief Executive Officer

Mr Lance Balcombe, Chief Finance Officer

Overview

At the commencement of the hearing both the Minister and Chairman were anxious to put to rest the suggestion that there was a financial crisis within the Hydro.

They argued that, prior to disaggregation, Hydro-Electric Corporation (as a single entity) had zero net profit, the net profit of the Hydro (after disaggregation) now is \$40 to \$50 million. Predictions are that this will further increase over the next five years.

It was further indicated that \$2 billion of private sector investment in energy infrastructure has been developed in Tasmania.

In 2005-06 Hydro's cash position has been "tight" for two reasons:

- (1) A \$50 million security deposit paid in relation to Basslink as a result of the negotiated agreement with National Grid.
- (2) Unbudgeted expenditure of \$50 million on the acquisition and installation of three 35 megawatt gas turbines at Bell Bay.

Hydro contends that to compete in the national electricity market it is desirable to have a debt to equity ratio of 40:60. The current ratio is 50:50. The desired ratio is to account for revenue/expenditure volatility and unforeseen circumstances of operating in the national market. Hydro has requested from the Government a \$300 million equity injection in order to strengthen the company's balance sheet.

Hydro contends an important financial measure, is 'interest cover'. That is, how many times cash flow covers interest payments. Currently cash flow covers interest payments by a factor of 3. Should interest rates increase by 1%, \$10 million would be added to the cash flow commitments which would produce a less comfortable interest cover ratio. Hydro has adopted the cautionary position of accepting fixed interest rates over the next few years.

Hydro further contends that its financial position is reasonable but if the balance sheet was strengthened (with less debt) the company would be in a 'more comfortable' operating position.

Hydro is preparing the 2006-07 budget on the basis of carrying a \$1 billion debt. Continuing profitability is anticipated as well as the capacity to meet capital expenditure requirements and unforeseen operating expenses.

The level of capital expenditure targeted for 2006-07 is \$61 million with \$10 million of this allocated to a long term dam safety program. Other projects planned are the refurbishment of the Gordon No. 1 turbine and initial work on Tungatinah power station together with work at Poatina being brought forward.

Hydro has a debt reduction target of \$80 million over the next five years which is less than desired. Forward estimates for 2006-07 (the first full year of operation of Basslink) indicate a \$30-\$40 million profit after tax.

The recurrent operating costs of Bell Bay Power Station will be reduced by about \$15 million following conversion to gas.

Basslink

The Basslink connection introduced a new phase in Hydro's operation. It is the largest infrastructure project in the State's history, and Hydro believes it will be significant in drought-proofing the electricity network. Consequently, operating risks will now be in the more manageable market-based environment.

By moving from the previous regulated monopoly market to the national energy market, revenue volatility will impact on the business.

Hydro considers there is no imperative to be debt free. The company is benchmarking itself against other electricity entities, none of which are debt free.

The Government believes that Basslink will be profitable over the 25 year life of the contractual agreement with National Grid.

At the time of the hearing, water storages were at 31% compared to the previous year when they were just above 20%. If Basslink was not operational it is likely that levels would be as low as last year. In the first three months of operation, Basslink has been a net importer of energy thus retaining manageable water storage levels.

Hydro's advantage in the national market is that it can sell energy to the mainland during summer at optimum prices and purchase energy during the winter months at a very competitive rate. In the first two months of operation,

Basslink energy trading was ahead of budget. Two particular incidents highlight the volatility of trading in a competitive market: the first was in the evening of 24 July 2006 when 500 megawatts were sold into Victoria at a peak price of \$600 per megawatt.

The other was on 23 May 2006 when Hydro reportedly lost \$400 000. This loss is under investigation by NEMCO, National Grid and Hydro Tasmania. There will be full public disclosure of what happened, why it happened, and exactly how much the financial implications will be for Hydro Tasmania.

However, trading in the national electricity market has seen the Tasmanian hydro system run harder than ever before. This will need careful monitoring because of the advanced age of most of the generating system.

Roaring 40s – CLP Power Asia

Hydro Tasmania's former subsidiary, Roaring 40s Renewable Energy Pty Ltd has been the development vehicle for securing an equal partner to pursue renewable energy developments in Australia and overseas. CLP Power Asia is investing \$110 million in equity in return for a 50 per cent shareholding in Roaring 40s. The value of Roaring 40s is expected to grow to over \$1 billion by 2010.

The renewable energy development program of Hydro was challenged because the Federal Government refused to extend the Mandatory Renewable Energy Target scheme, resulting in a decline in prices for Renewable Energy Certificates. Hence the pursuit of an equity partner in order to continue the development of the renewables business, most likely outside Australia.

Significant business opportunities are emerging in China where that government is aiming for 30,000 megawatts of new renewable energy by 2020. Roaring 40s is involved 'at the ground floor' with the first phase of a 100-megawatt project.

CONCLUSIONS

1. The question is how aggressively will Hydro Tasmania be able to continue its development program if it does not have a stronger balance sheet?
2. The Hydro is entering an exciting phase of business with the introduction of Bass Link and the joint venture between Roaring 40s and CLP Power Asia.
3. Even though Hydro Tasmania's debt to equity ratio of 50:50 is reasonable, a ratio of 40:60 is a much better business position as operating in the national electricity market continues.

4. The Committee requests that details be provided to Parliament of the report into the events of the 23 May 2006 where Hydro reportedly lost \$400,000 in national market trading.

The meeting was suspended at 12.07 o'clock p.m.

SOUTHERN REGIONAL CEMETERY TRUST

The Committee resumed at 12.11o'clock pm.

The following witnesses appeared before the Committee –

Hon. Paul Lennon, Premier, Minister for Local Government and Community Development

Mr Glenn Appleyard, Chairman

Mr Malcolm Tucker, Chief Executive Officer

Overview

The Southern Regional Cemetery Trust has a total equity of \$6 million. Turnover is \$1.8 million per annum.

The Cemetery Trust's core business is to serve the southern Tasmanian community in terms of burials and cremations.

The Cemetery Trust operates in a very competitive market. They face competition not only in relation to cremations but also in relation to burials from both municipal cemeteries and church cemeteries.

In 1980-81 the Cemetery Trust were conducting in excess of 400 burials but that has now been reduced to just over 200.

There was a steady growth from 1980-81 until 1999-2000 in relation to cremations, however when the introduction of competition from Millingtons commenced there was a significant impact in terms of the number of cremations and therefore revenue. Another impact on revenue was the increasing trend for direct committals.

The Cemetery Trust's business is not a profitable business. The Government, as a consequence, has agreed to not take a dividend for the current corporate plan cycle which runs to 2008.

The Cemetery Trust's annual report for 2004-05 reported a loss of \$62 901. The Trust's annual report for 2005-06, however stated the loss for the previous financial year was \$262 361. This variation in reported loss arose from a requirement under the Australian Accounting Standards that the accounts for the year ended 30 June 2005 be restated following a re-assessment of the Trust's defined benefits superannuation liability.

The Cemetery Trust is at all times examining ways of containing costs. It has moved into contract mowing for some of the broad acre areas which have reduced costs and also freed up some of their labour force.

The Cemetery Trust has contracted out its grave digging at Cornelian Bay and the St Margaret's cemetery site. The Trust employees still dig graves at their Kingston site. High level information technology and accounting have also been contracted out.

There are a number of groups within the community who assist on a voluntary basis. There are students from TAFE, inmates from the Her Majesty's prison, and a small group known as the Friends of the Cemetery who freely give their time helping with maintenance and general activities around the cemetery.

In previous years the payment of accounts had extended to 108 days. This was unacceptable and has now been reduced to 72 days. There was a concern in relation to slow payment of accounts by funeral directors – this is now not a concern.

The Australian Valuation Office is undertaking valuations on the Trust's properties.

Cornelian Bay

Cornelian Bay was established in the 1870s. It is expected that there is land available at the site for approximately a further twenty years. There are about 2000 sites that are now available to be purchased. Families can choose to purchase a double depth grave site. Beyond the twenty-year time span there is a considerable usage for the cemetery for second burials and an interment of cremated remains.

There is a growing interest in families continuing the usage of a site by choosing cremation, and then having the cremated remains placed in the family grave.

In Tasmania there has been a relatively high proportion of memorialisation - approximately 60-70%. Whilst at Cornelian Bay there may not be the vast number of burial sites as previously there are still a number of sites available for the placement of roses, the placing of plaques alongside relatives or other artifact sites for commemoration.

Kingston

Kingston has considerable capacity for sites into the future. It has also developed bush land burials, a new concept in terms of environmentally friendly burials as opposed to the traditional lawn cemetery burials.

St Margaret's Cemetery

Further operations at the old St Margaret's Cemetery have commenced and business is expanding at that site. The Cemetery Trust has made improvements in terms of maintenance and presentation of the site. There is a number of years site availability at St Margaret's Cemetery.

CONCLUSIONS

- (1) The Southern Regional Cemetery Trust is satisfactorily managed.
- (2) The Trust is continuing to endeavour to contain its costs in a competitive market.
- (3) The Trust is continuing to devise marketing strategies to compete with other competitors.

The meeting was suspended at 12.54 o'clock pm.

FORESTRY TASMANIA

The Committee resumed at 2.04 o'clock pm.

The following witnesses appeared before the Committee.

Hon. Paul Lennon, Acting Minister for Economic Development and Resources

Mr Lawrence Wilson, Chairman

Mr Evan Rolley, Managing Director

Ms Penny Egan, Chief Financial Officer

OVERVIEW

Forestry Tasmania has experienced a difficult trading year in terms of wood product sales. Approximately half a million tonnes of reduced volume sales has impacted in the order of \$18 million. There has therefore been an extensive effort within Forestry Tasmania as well as by its contractors to manage those difficulties in order to maintain profitability. The Committee was assured that Forestry Tasmania has traded profitably and will meet corporate plan commitments in relation to dividend, payroll and other tax equivalent payments.

The major reason for sales downturn has been due to reduced demand for hardwood pulpwood. This reduced demand is mainly due to:

- (1) The exchange rate – the Australian dollar having traded for a majority of the year at an average of 75 cents against the US dollar.
- (2) Freight cost impacts.
- (3) Campaigns to boycott Tasmanian wood products in a number of overseas markets, particularly Europe, Japan and China.

Particularly against the backdrop of (3) above it is significant that the Federal and State Governments have recently negotiated (through the Tasmanian Community Forest Agreement) protection of over one million hectares of old growth forests, phasing out clear felling and eliminating the use of 1080 poison.

As a result of the misinformation campaign overseas one company has cancelled all its contracts where Tasmanian products are concerned and two others have suspended wood product purchases from Tasmania.

To further highlight the impact of the misinformation campaign, Forestry Tasmania indicated that, within 24 hours of the announcement by Malaysian company Ta Ann to invest \$60 million in two new capital projects in Tasmania, both reliant only on re-growth and hardwood plantations, a campaign of misinformation was commenced in Europe to deter potential customers from dealing with Ta Ann.

In response to the sales losses, operating costs of Forestry Tasmania have been reduced through reduction of staff levels by 50. This has been achieved through a mixture of redundancy and voluntary separation programs negotiated jointly with unions and employees.

Value Adding

After lengthy negotiations with overseas companies, a new dimension has been introduced to downstream processing of Tasmania's forestry resource.

The State's first rotary peeled veneer facility is now under construction at the Southwood site in the Huon. This is the first stage of a very significant investment by the Malaysian company, Ta Ann, with a further plant proposed for Smithton. The two plants will process only regrowth and plantation hardwood residues which would otherwise have been produced as export woodchips.

Forestry Tourism

Forestry Tasmania is responding to the demand of tourists seeking more than a passive visitor experience.

New attractions have been developed in regional areas to form a network of international standard tourism venues which provide investment and jobs.

Forestry Tasmania has, arguably, the State's second largest investment in tourism infrastructure. The popular Tahune Airwalk celebrated its 5th anniversary in July and more than 600 000 visitors have contributed to the local and state economy. The Airwalk ranks in the top 10 attractions in Tasmania.

The Dismal Swamp Maze and Visitor Centre near Smithton was also opened during the year.

Wood Supply – Proposed Pulp mill

In April 2004 Forestry Tasmania signed a Heads of Agreement with Gunns Ltd to form the basis of a twenty year commercial wood supply for Gunns' proposed pulp mill at Bell Bay.

The supply of approximately 2 million tonnes of wood product from state forests has been identified in the Heads of Agreement.

The agreement ensures no increase in the harvesting levels of native forests but simply continues the long-term evergreen licence agreements between Forestry Tasmania and Gunns whereby product will be processed through the pulp mill rather than converted to export woodchips. Export opportunities will thus be significantly diversified from the historically predominant reliance on

Japanese markets with consequential economic and environmental benefits to Tasmania.

Wood supply prices will most likely reflect fluctuations in the international pulp and paper market and be CPI indexed in a similar manner to the supply agreements currently existing with companies like Norske Skog at Boyer.

OTHER PROJECTS/ISSUES

Auspine/Rayonier dispute

Under the softwood joint venture between Forestry Tasmania and GMO Renewable Resources Ltd, Rayonier manages negotiations on behalf of the joint venture partners. Rayonier is thus involved in product supply negotiations with Auspine.

There is a current supply agreement between Auspine and the joint venture partners which expires on 31 December 2006. Negotiations as to wood supply price beyond 31 December have developed tension between the parties.

Two independent reports indicate the joint venture can justifiably expect a price increase for the supply of its softwood to Auspine upon the expiry of the current agreement.

Because the current supply price is sub-economic no new planting of radiata pine is being undertaken by the joint venture. New planting will only be triggered when the return on investment is economically sound. Similarly, Auspine must be able to trade profitably and these two competing elements need to be brought together.

The simplistic notion that the Government should intervene ignores the fact that GMO owns half of the relevant softwood resource and such a private company cannot be directed by Government. GMO employs more than 250 people in Tasmania and has invested many millions of dollars in the joint venture and their investment should reasonably deliver commercial returns.

Huon Southwood Project

The regrowth sawmill has now been operating for over a year. The wood supply agreement applicable to the mill has realised base stumpage prices 10% more than those previously achieved by Forestry Tasmania for regrowth wood supply.

The sawmill operator has the necessary security under the supply agreement to pursue further capital investment at the site and they are considering the installation of a \$1 million rotary stacker.

Following the successful negotiation of a 150,000 green metric tonne wood supply agreement, Malaysian company Ta Ann is developing a rotary peeling

vener mill at the Southwood site. The products from the mill will be sold into the world market, with particular emphasis on Europe and Japan. Forestry Tasmania has a small equity share in the project.

The new projects at the site have produced a much higher electricity demand and a new transmission line is being installed to deliver the necessary power to the site.

In addition to the external supply of power to the site, there is an opportunity to generate on-site power by the development of a wood fired station. This station could generate 35 megawatts of electricity to service some site needs and also feed into the southern Tasmanian grid.

Financial Performance

Despite earnings before interest and tax being substantially down, operating expenditure was still at similar levels to previous years. Earnings were reduced primarily because of market contraction in the last quarter of the 2004-05 financial year. A significant impact on operating expenses arose through the requirement of Forestry Tasmania to pay local government rates of approximately \$1.7 million.

The company expects to reduce overheads by about \$5 million during 2005-06.

Borrowing costs increased some \$400 000 on the previous year.

The 'interest cover' (the factor by which cash flow covers interest payments) falls within a factor of 6 to 7, thus enabling BBB credit rating to be maintained.

The net unfunded superannuation liability is \$65.8 million and is likely to increase in the future.

The first tranche of funds from the Federal Government under the Tasmanian Community Forest Agreement amounting to \$12.5 million were received during the year. This enabled expanded activity in the thinning, planting and pruning programs which employ approximately 400 private contractors.

Alternative Silviculture

A number of research programs are continuing, particularly assessing the biodiversity impacts of non-clear-felling. At the Warra site in the southern forests, long term trials are assessing regeneration success, forestry safety, residue removal and bio-diversity impacts.

Non-clear-felling is a more expensive harvesting method and in order to assess the impact, some funding is being allocated to contractors to enable them to harvest trees in selective processes.

Fire Management

Approximately \$500,000 is allocated each year to fire management activities particularly in native and non-production forests. Two to three hundred employees are trained in fire fighting. Fire fighting equipment is leased from the Civil Construction Corporation.

Tasmania has the lowest cost fire management in Australia due to an inter agency protocol adopted about 10 years ago, which has seen an inter-operable equipment sharing arrangement between Tasmania Fire Service, Parks and Wildlife Service and Forestry Tasmania.

State/Federal Agreements

Ninety six million dollars compensation to Tasmania was negotiated under the Tasmanian Community Forest Agreement in the lead up to the Federal election in 2005.

Other State/Federal agreements in the past have delivered compensation to Tasmania in recognition of a higher level of forest conservation.

The package of compensation funds have been tied to, amongst other matters, infrastructure development, intensive forest management, plantation development and reduction of clear-felling of old growth forest on public land.

The forest management plans have also enabled leatherwood stands to be retained for the honey industry. The Denison 10C coupe is a good example. \$2.037 million worth of high quality sawlogs were reduced to \$400,000 to protect the leatherwood stand. Return to the State Government from apiary licence fees for the area foregone was \$26,786.

The witnesses withdrew.

Conclusions

- (1) Despite a difficult year and reduced sales Forestry Tasmania has traded profitably.
- (2) Forestry Tasmania will meet all its corporate plan commitments in relation to dividend and tax payments.
- (3) Borrowings expanded from approximately \$26 million in 2003-04 to \$32 million in the year under review. This attracted an extra cost of \$400 000. The borrowing limit agreed with TasCorp is \$35 million.
- (4) Net unfunded superannuation liability is \$65 .8 million and is expected to continue rising. This matter needs to be reviewed by future Scrutiny committees.

- (5) Tourism continues to be an important operation of Forestry Tasmania. After 5 years the Tahune Airwalk has had over 600,000 visitors placing it in the top 10 visitor attractions in Tasmania.
- (6) Forestry Tasmania has signed a Heads of Agreement with Gunns Ltd which will see logs currently sold for export wood chipping to be diverted to the pulp mill proposed for Northern Tasmania.
- (7) Forestry Tasmania's management of forest resources has resulted in investment of capital for a number of new and proposed projects. These investments deliver employment growth.
- (8) Tasmania's fire management practices are the most cost effective in Australia due mainly to inter-agency co-operation.
- (9) The Committee concludes that Forestry Tasmania has been well managed and provides a benefit for the taxpayers of Tasmania.

The Committee deliberated.

Resolved, That the Chair and Secretary provide a draft Minutes for the Committee to consider.

The Committee adjourned at 5.30 o'clock pm sine die.

CONFIRMED

DATE

CHAIR