



HALF YEARLY REPORT 2003



Hydro Tasmania
the renewable energy business



CHAIRMAN'S REPORT

As Chairman of Hydro Tasmania it is my very great pleasure to present the organisation's half-yearly report for the business period from 1 July to 31 December 2002.

In doing so, I would like to point out that, as with the Annual Meeting which we have conducted every year since 1990, there is no legislative requirement to produce a half-yearly report of the organisation's activities.

However, we are firmly of the view that all opportunities should be taken to enable our stakeholders, the people of Tasmania, to scrutinise our performance and accordingly have confidence in that performance and in our business plans for the future.

This, our seventh half-yearly report, covers a number of major milestones in the progress of Hydro Tasmania as a growing business. These milestones include:

- achievement of all jurisdictional approvals for the Basslink power cable interconnector project, following unequivocal support for Basslink from the Commonwealth, Tasmanian and Victorian Governments
- completion of all commercial negotiations for Basslink and the signing and issue of a Notice to Proceed to enable Basslink Pty Ltd and the Siemens-Pirelli consortium to build the link



- official opening of the Woolnorth Wind Farm Stage 1, with massive support and interest shown by the local community for the development during public open days
- awarding of contracts for the construction of Woolnorth Stage 2, to be completed in 2003
- commencement of site work for Woolnorth Stage 2
- commencement of negotiations for a 60 – 80 megawatt wind farm at Cathedral Rocks in South Australia
- development approval sought for Heemskirk wind farm on the West Coast
- recognition of Hydro Tasmania as a renewable energy leader in important national and international energy and water forums
- wind turbine manufacturer Vestas to set up plant in Tasmania to meet Hydro Tasmania's requirements
- agreement with the Tasmanian Farmers and Graziers Association on the contentious issues of water allocation and water trading
- alliance partnership with ALSTOM to upgrade Trevallyn power station, as a major plank in a \$200 million, 10-year asset refurbishment program.

The jurisdictional approvals for Basslink, and the successful negotiations with the consortium which will build it, have been of fundamental importance to Hydro Tasmania and its future.

This cannot be overstated.

Basslink will allow us to compete in the National Electricity Market, underscoring and building on our position as Australia's major renewable energy producer.

It will enable us to fully pursue our growth plans, which are predicated on our move into the national market, and allow us to employ the natural advantage that Tasmania's renewable wind and water resources provide.

Tasmania has a unique mix of these renewable resources. Harnessing them, indeed unleashing them, through our growth plans will bring an exciting new era to both Hydro Tasmania and the State.



These growth plans involve development of major wind farms, refurbishment of existing hydro assets for greater productivity and new, small hydro plant – all driven by the opportunity that Basslink presents to us.

Construction of the Basslink cable has commenced in Italy, and we expect our clean, renewable electricity will be flowing into the national market in 2005 when we will be supplying our valuable product into that marketplace in periods of peak demand.

Not only will Basslink enable Hydro Tasmania to help relieve the peak electricity demands of the national market, it will also introduce competition in the Tasmanian energy market, with electricity flowing both ways across Bass Strait.

With access to a new marketplace, drought mitigation for the State, and the impetus to further develop our renewable energy, we believe our faith is well placed in the Basslink project.

On 18 October 2002, Hydro Tasmania officially opened Stage 1 of its Woolnorth Wind Farm on the northern tip of Tasmania's West Coast. The output of Stage 1, which actually began flowing into the State's electricity grid in August, has been above expectations and a forerunner of what we can expect from the other sites being developed.

In the period covered by this report, we have commenced site work for Woolnorth Stage 2, a 54 megawatt development, and have undertaken all the work necessary to prepare the Development Application and Environmental Management Plan for a 160 megawatt wind farm at Heemskirk, also on the West Coast but further south from Woolnorth.

This Development Application and all supporting documentation was lodged with West Coast Council on 20 January this year and we are confident of all approvals by mid year.

Work continues on assessing the potential of both the Musselroe wind farm site, in Tasmania's North-East, and at Cathedral Rocks in South Australia.

These are the major wind developments Hydro Tasmania has pursued in the period of the first half of the 2002-2003 financial year.

Associated with them is the high probability of securing for Tasmania the establishment of a wind component manufacturing capability which would meet the wind turbine requirements of Australasia and the Pacific region.

These projects, together with a major 10-year hydro asset refurbishment program which is underway, really do give us a sense of excitement and great opportunity for the future of Tasmania as a growth centre.

All of these opportunities reflect the Triple Bottom Line approach with which Hydro Tasmania underpins its business. An equal focus on People, Planet and Profit is a responsible, sustainable way forward.

We trust all our stakeholders will share our enthusiasm for a growth agenda which is preparing Hydro Tasmania for its role as an important competitor in the Australian electricity scene.





CEO'S REPORT ON THE HALF YEAR

Our performance over the years since disaggregation has set a solid financial and organisational foundation on which to continue the process of growing the business.

Our performance in both financial and operational terms in the six months to December 2002 confirms this.

I am pleased to report that Hydro Tasmania has produced a most satisfactory result when compared to the same period last year:

- a consolidated profit before income tax expense of \$55.3 million compared to \$33.8 million at December 2001. This represents a 63% increase over the previous period.

Energy sales have increased by \$15.9 million to \$171.6 million over the comparative period. This represents strong demand from both the major industrial customers and the retail sector.

Sales of Renewable Energy Certificates (RECs) have begun to make a significant contribution to the overall result, providing a source of funds which are being reinvested into our renewable energy developments. Our Consulting business continues to develop and is capturing a growing number of external customers.



Operating costs have been contained at \$57 million, which is well below our budget projections. This figure represents a 9% increase over the same period last year and reflects our increased activities and preparations for joining the National Electricity Market.

Borrowing costs for the six months remained stable at \$45.5 million. Our management of the debt portfolio has seen the benefit of the favourable interest rate environment.

Our trading pattern is seasonal and is favourably weighted in the first six months. This result cannot be interpreted to represent a full year's trading.

Our cashflow is dependent on the rainfall patterns. A dry 2003 autumn may necessitate the operation of both gas and oil units at Bell Bay. This would impact on the result for the full twelve months and means all our costs and activities will need to be tightly controlled to ensure we achieve our full year goals.

This financial result reveals the effort put into:

- responsible asset management including a heightened awareness on security
- the continued refinement of risk management strategies
- a strong focus on budgets which has left us in an excellent position to continue growing the business.

During the six months Hydro Tasmania has continued its 10-year program of upgrading and refurbishing existing hydro plant. This program is underpinned by the incentives of the current Mandatory Renewable Energy Target. The target was designed to encourage such redevelopment as well as foster new projects and the incentives are provided by Renewable Energy Certificates (RECs). A certificate is created for each megawatt hour of additional renewable energy produced.

The income earned from RECs is re-invested into the business for further renewable energy development, including the upgrade and refurbishment program. Over the next ten years \$208 million will be injected into this program from within the business.



While our financial achievements are important to growing the business, we measure our progress by the sustainability of our operations.

The Basslink project has now received all approvals from the Tasmanian, Victorian and Federal governments. We signed the Notice to Proceed on 29 November 2002, which means the work has now started on building the cable in Pirelli's factory in Italy.

This project is immensely important for our business and for the State. Basslink will allow us to compete in the National Electricity Market and Basslink will also unleash Tasmania's renewable energy. We intend to harness the remarkable synergy of wind and water.

The Financial Close of Basslink was finalised at the end of November 2002. This has allowed Hydro Tasmania to finalise the terms of a structured derivative instrument (Basslink Facility Fee Swap), which eliminates all currency and interest rate exposure during the construction phase and interest rate risk over the 25 years of the project. This allowed Hydro Tasmania to secure rates at historical lows.

The Facility Fee obligations in the Basslink project include an interest rate risk exposure similar to that of a floating interest rate exposure on amortising debt. The Basslink Facility Fee Swap involves Hydro Tasmania paying a fixed amount and receiving a variable amount which offsets the floating interest exposure inherent in the Basslink Facility Fee.

The primary objective of Hydro Tasmania in the use of derivatives for the Basslink project was to eliminate the financial market risks that arise from the Basslink Facility Fee payments including:

- the foreign exchange risk inherent in the Facility Fee payment obligation (this resulted in a hedge gain recorded on statement of financial position as a deferred liability of \$27.7m)
- the construction interest rate risk inherent in the Facility Fee payment obligation (this resulted in a hedge cost recorded on statement of financial position as a deferred asset of \$8.7m)



The interest rate risk inherent in the ongoing Facility Fee payment obligation has been fixed by the Basslink Facility Fee swap. As this is a continuing hedge there is no immediate cash or accounting consequence as it relates to the 25 year period of Basslink.

The inherent interest rate applicable to the Basslink Facility Fee Swap is 7.41%. (The market value of the Basslink Facility Fee Swap at financial close was \$152.1m and will be amortised over the 25 year period of Basslink.)

The commissioning of Stage 1 of the Woolnorth Windfarm on 29 June 2002 has since produced a pleasing contribution in the six months under review. With the first 10.5 megawatts now operational we are now progressing the 54 megawatt Stage 2 at Bluff Point.

When completed, the Woolnorth Windfarm will have a total installed capacity of 130 megawatts.

The conversion of one of the two oil-fired units at Bell Bay is continuing and commissioning will be completed by March 2003. Due to technical issues in the process the commissioning has taken longer than originally budgeted. As a result of this delay, this unit has not produced the quantity of electricity nor incurred the costs of this production.

Low rainfalls during December and the first two weeks of January have storage levels lower than this time last year. This comes after the 2002 autumn being the driest on record.

Managing a system with low water levels and providing a quality power supply continues to be challenging.

Within the period under review a number of significant milestones have been achieved that allow us now to focus on moving forward toward National Energy Market entry. With Basslink now approved, we are moving ahead with our renewables development program both here in Tasmania and interstate. Most importantly, this expansion of our business is based on a very sound financial foundation.

Financial Performance

Statement of Financial Performance for the six months ending 31 December 2002

| | Consolidated | Consolidated | Holding Corp | Holding Corp |
|--|--------------|--------------|--------------|--------------|
| | Six Months | Six Months | Six Months | Six Months |
| | Ending 31st | Ending 31st | Ending 31st | Ending 31st |
| | December | December | December | December |
| | 2002 | 2001 | 2002 | 2001 |
| | \$'000 | \$'000 | \$'000 | \$'000 |
| Revenues from Ordinary Activities | | | | |
| Electricity Sales | 176.0 | 155.7 | 174.0 | 155.7 |
| Other Trading Income | 20.6 | 17.9 | 18.4 | 17.5 |
| | 196.6 | 173.6 | 192.4 | 173.2 |
| Expenses from Ordinary Activities excluding borrowing costs | | | | |
| Expenses | 57.0 | 52.3 | 53.0 | 51.9 |
| Depreciation | 38.8 | 42.0 | 37.7 | 41.9 |
| | 95.8 | 94.3 | 90.7 | 93.8 |
| Borrowing Costs | 45.5 | 45.1 | 45.4 | 45.1 |
| Share of net loss of joint venture accounted for using equity method | - | -0.4 | - | - |
| Profit from Ordinary Activities before income tax equivalent | 55.3 | 33.8 | 56.3 | 34.3 |

Seasonal factors affect the revenue figure in the first six months and it is not appropriate to derive a full year estimate on the basis of the half yearly results.

The above statement of Financial Performance has not been subject to audit.



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