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Snowy Hydro's Cash Drain

Gas Plant Expansions Likely To Be Fuelled With Taxpayer Funds

Executive Summary

Snowy Hydro, the Australian federal government owned hydro-electric power scheme, has announced bold ambitions to expand its fossil gas-fired power generation facilities. The announcement of these grandiose plans came following the company's hubris in announcing it had delivered a 'strong financial performance' in the 2019-2020 fiscal year.[1]

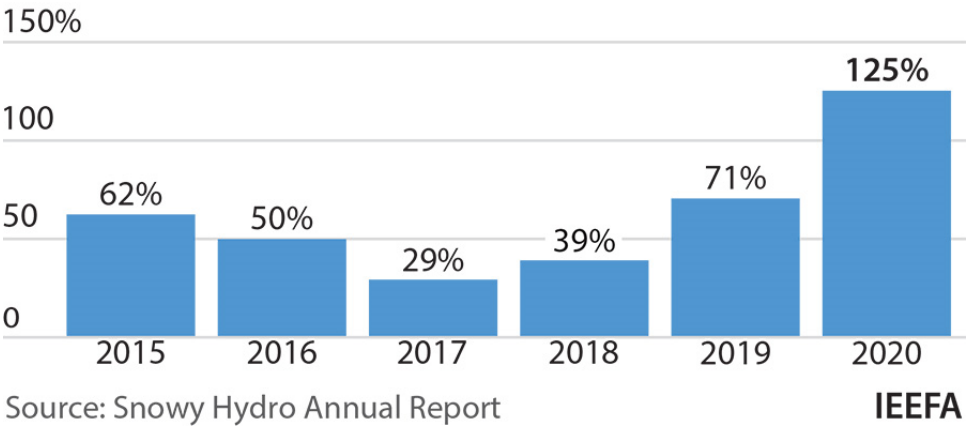
A closer look at the financial statements however reveal a starker picture, with the company producing its worst ever financial performance.

Promoted as a project to help Australia transition to a low carbon future at the lowest possible cost, initial estimates suggested that the Snowy 2.0 pumped hydro scheme would cost A$2 billion.

Today, with construction, financing and transmission costs for the flagship project spiralling and expected to reach A$10 billion, it is unlikely Snowy 2.0 will ever pay a commercial return. Rather, taxpayers are likely to bear the costs of this financially unfeasible project, as well as the environmental burden.

Snowy Hydro Debt on the Rise

The company saw a long-term debt-to-equity increase of 125 percent as of June 2020.



[1] Snowy Hydro. Annual Report, 2019-2020. Page 3.

From the outset, the Australian Federal government touted Snowy 2.0 as a 'Nation Building Project', paying the New South Wales and Victorian state governments a total of A$6.2bn to buy out their equity interests.

In June of this year, final approvals were received to commence the project. By this time, the total estimated cost had blown out to A$5.7 - $6.2bn[2], taking the total estimated government exposure up to $10bn, and more when including the $6.2bn already spent in buying out the state government interests. All of this has occurred prior to the project barely starting.

Following a tough year marred by catastrophic bushfires and COVID-19, the CEO painted an optimistic view of Snowy Hydro's 2020 results in its latest annual report, describing the financial year as a 'strong performance' with 'solid outcomes'.[3] The report focusses on gross revenues for FY2020 at A$2.7bn, only a $151m fall from the prior year.[4] Prima facie, a seemingly strong result in a year disrupted by a number of uncontrollable adversities.

Overall, the annual report is perhaps aptly described as a bleak picture of deteriorating financials.

A further review of the annual report reveals however that the slight drop in gross revenues was accompanied by an unseemly collapse in statutory profit after tax to A$81 million – down over 75% from the prior year (A$322m for FY19)[3]. Accounting for the drop in energy prices, Snowy also wrote down its energy hedging contracts, resulting in the company's first ever comprehensive loss of A$59m.[5] Overall, the annual report is perhaps more aptly described as a bleak picture of deteriorating financials, rather than a story of strong results.

Despite declining revenues, Snowy's annual report stresses the achievement of maintaining a credit rating of BBB+ or above.[6] As of 30 June 2020, Snowy Hydro retained a Standard & Poor's rating of A-. However, a number of the company's key solvency ratios had alarmingly weakened, demonstrating the company could be a future credit risk concern.

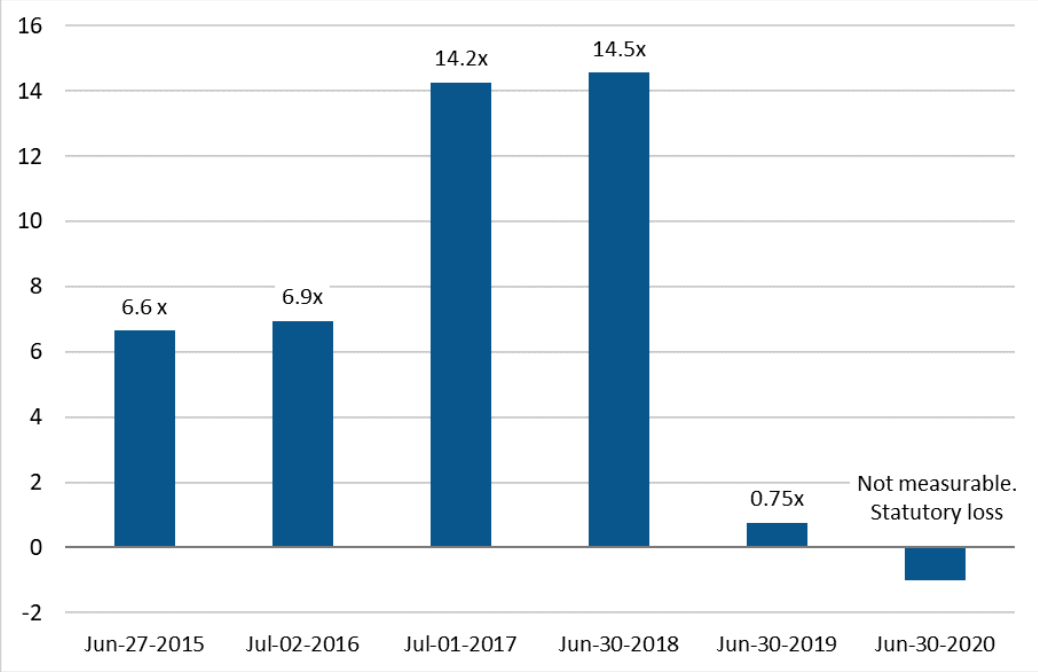
Over the financial year, interest bearing liabilities for the company ballooned over 40% to $1,887m as of 30 June 2020.[7] Current liabilities exceeded current assets by A$25m highlighting potential short-term liquidity concerns. Perhaps more

[2] Snowy Hydro continues to assert that the project will cost between $3.8bn-$4.5bn. S&P believes the project will cost at least $5.7bn-$6.2n and various other commentary has estimated it will cost upwards of $10bn.
[3] Snowy Hydro. Annual Report, 2019-2020. Page 4.
[4] Snowy Hydro. Annual Report 2019-2020. Page 46.
[5] Snowy Hydro. Annual Report 2019-2020. Page 47.
[6] Snowy Hydro. Annual Report 2019-2020. Page 3.
[7] Snowy Hydro. Annual Report 2019-2020. Page 49.

worrisome for credit ratings, long-term debt to equity increased from 71% as at 30 June 2019 to 125% (see Table 1).

The increased debt load borne by the company also appeared to be borderline unmanageable, as interest coverage ratio (EBITDA less capex divided by interest expense) moved from 14.5x to negative having reported a full year loss (Table 2).

Table 2: Snowy Hydro (EBITDA-CAPEX) / Interest Expense



Source: IEEFA Calculations. Snowy Hydro Annual Report.

Somewhat predictably, S&P responded by downgrading the credit rating of Snowy Hydro to junk on 29 September 2020. The long-term issuer credit rating of the company was lowered to BBB+ and the standalone credit rating of Snowy 2.0 to bb+. In revising its rating, S&P raised concerns over the long-term economic viability of the project, acknowledging the likely blowout costs and the need for ongoing extraordinary government financial support.

S&P downgraded the stand-alone credit rating of Snowy 2.0 to junk.

As construction ramps up on the project and cash reserves are depleted, the impact of the S&P downgrade is likely to be sorely felt. S&P estimated that the Federal government's proposed but yet to be funded "upfront" equity injection of A$1.38bn would support Snowy for approximately 12 months, after which the pressure on leverage and financial metrics is likely to increase. In the absence of further capital

injections by the Federal government, Snowy would presumably look to secure more public debt.

Prior to the ratings downgrade, Snowy successfully raised A$3.5bn in corporate debt in April, with the CEO boasting the capital raise was oversubscribed by a factor of 2 despite there being no government guarantee attached. With a revised credit rating of bb+ for the Snowy 2.0 project, the eligible pool of investors would be substantially narrowed if future debt raises were required, with many institutional investors unable to hold debt with a credit rating of BB or below. Any future debt raise is also likely to be more expensive to finance and may be out of reach to service as the company already demonstrated in FY20 that it is struggling to meet its interest expense.

After reporting a comprehensive loss, $218m in dividends were paid out of cash reserves.

A key initial selling point of Snowy 2.0 to potential investors and stakeholders was also the possibility for an 8% return on investment. In the company's statement of corporate intent, Snowy committed to a dividend payout ratio of 70% of Net Profit after Tax. For FY20, A$218m in dividends were paid, representing a payout of 268%.[8] After reporting a comprehensive loss for the year however, and completing a corporate debt raise, the dividends were paid out of cash reserves.

Amid escalating capital costs, increased financing risk, lower energy prices, and reduced revenues, an 8% return seems highly unlikely. This spiralling story of deteriorating finances is hardly surprising given that a feasibility study was never pre-emptively performed[9].

Since embarking on the Snowy 2.0 project, numerous independent energy experts have highlighted there are a number of cheaper alternatives available which have fewer environmental concerns. In fact, greenhouse gas emissions from the construction of Snowy 2.0 and during its first decade of operation are expected to reach 50 million tonnes of CO2. While the project is reported to ultimately reduce emissions by storing renewable energy, it is questionable whether the project will be complete by 2025[10]. There is also suspicion that the full facility will not be usable until 2030, which many would argue is too late to impact on 'Australia's low carbon future' and global warming, particularly given its 'crowding out' impact on a number

[8] Snowy Hydro. Annual Report 2019-2020. Page 51.
[9] The Snowy Hydro Project was announced by then Prime Minister Malcolm Turnbull in March 2017 and projected to cost A$2bn. A feasibility study on the project was not released until December 2017 by independent experts and was projected to cost between A$3.8bn and $A4.5bn.
[10] The original estimated completion date was 2021. The timeline has continually blown out.

of smaller, more distributed, faster to build and privately funded energy project proposals.

Acclaimed as a 'Nation Building triumph', the financial and environmental costs are certainly stacking up. Construction on Snowy 2.0 has only recently commenced and without any form of budget, costs may continue to spiral, and it will be increasingly difficult to raise corporate debt.

Despite the foreseen increasing cost blowouts, it seems almost inevitable that Snowy 2.0 will continue to be supported at great cost by the Australian Federal government and its debt ultimately borne by Australian taxpayers with very few or no prospects of a return on investment anything like what has been claimed.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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