



# STATEMENT OF CORPORATE INTENT

2005/2006

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**1. OBJECTIVES OF THE CORPORATION**

Macquarie Generation is focused on the continuing security of electricity supply in New South Wales and the National Electricity Market, the delivery of a predictable and consistent dividend payment stream and increased Shareholder value.

Macquarie Generation will deliver on these objectives by:

- Continuing to be the lowest cost electricity generator in New South Wales and one of the lowest cost electricity generators in the National Electricity Market,
- Pursuing focused production, trading and business development initiatives,
- Fostering strong customer relationships,
- Providing highly reliable and safe production, and
- Ongoing and timely Shareholder communication.

By meeting these objectives the Corporation will strive to provide:

- The State of New South Wales with industry highest profitability and the creation of wealth,
- Its employees with meaningful and rewarding jobs demonstrating industry best levels of productivity and participation,
- Industry leading safe workplaces,
- The creation of mutually advantageous business alliances with industry suppliers,
- Pro active improvement in environmental performance, and
- Good corporate citizenship.

In order to meet the needs of the Shareholders and to meet the operating objectives of the Corporation, the following major risks will have to be actively managed:

- Strategic risk including the need for new generation, requirements for capital for investment, security of supply and Shareholder requirements.
- Supply risk including coal and water
- Skills risk due to the Corporation's aging workforce and specialist labour training requirements.

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- Production risk including plant failure, industrial relations, asset security and environmental compliance.
- Profit risk including revenue volatility, transmission interruption, counterparty credit and the Tomago Aluminium key customer.
- Compliance risk including legal, regulatory and OH&S compliance.

### **2. NATURE AND SCOPE OF OPERATIONS**

Macquarie Generation has as its core business the production, marketing and sales of electricity into the wholesale segment of the National Electricity Market.

The National Electricity Market provides the mechanism for electricity sales and marketing in Queensland, New South Wales, Victoria, the Australian Capital Territory, South Australia. The entry of Tasmania to the National Electricity Market is planned for the 2005/2006 financial year.

Macquarie Generation owns and operates the Bayswater and Liddell Power Stations, which are located in the Hunter Valley of New South Wales, between the towns of Singleton and Muswellbrook. The location of the power stations provides access to large quantities of coal from local and remote mines, which will be capable of supplying coal for at least the remaining useful lives of the Corporation's power stations. The Corporation also owns and operates two 25 MW oil fired gas turbines and in 2002 installed a 0.85 MW mini hydro generator on the internal cooling water supply system.

The power stations' combined generating capacity is 4,690 MW, which provided approximately 15% of the National Electricity Market demand for electricity in 2004/2005.

A small Corporate office, providing executive management, finance, information technology, commercial, human resources, fuel and environment, and marketing and trading services, is located in the Newcastle suburb of Lambton.

Macquarie Generation recognises that in the longer term, the useful economic lives of the existing power generation plant at Bayswater and Liddell will be impacted by emerging environmental regulation and new requirements for less carbon intensive generation technologies. With this in mind, the Corporation is continuing to review opportunities to optimise the useful economic lives of Bayswater and Liddell and to participate in new generation technologies using gas, biomass, wind, water and solar fuels.

The useful lives of the power stations have been extended by continuing predictive maintenance programs, capacity improvement programs and the improvement of thermal efficiency to reduce costs and greenhouse intensity.

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At Liddell Power Station, Distributed Control Systems have replaced original analogue systems and a program to replace the Low Pressure turbines with better technology has been recently completed. A contract was let in 2004/2005 for the replacement of existing High Pressure and Intermediate Pressure turbines commencing in October 2005.

At Bayswater Power Station peak output is being increased from 660 MW per unit to greater than 700 MW per unit under favourable operating conditions but the feasibility of achieving higher output on a continuous basis is under investigation.

In total, these upgrades have the potential to increase Macquarie Generation's generation capacity by up to 260 MW and will provide additional revenue and value to the Corporation as demand continues to grow in the National Electricity Market.

The Corporation has also been successful in obtaining Development Approval for the construction and operation of gas fired generator at Tomago near Newcastle. In April the Corporation's Board approved in principle the commencement of the construction of the first 100MW of 500MW of the project and a formal submission was made to the Corporation's Shareholders in May 2005 for approval of the project.

The initial stage of the project will cost in the order of \$75 million and will require high voltage transmission and gas connection as well as the engineering, procurement and construction of the gas turbine and ancillary equipment.

The project has a positive business case and will also improve black start capability for New South Wales and the National Electricity Market. It is expected that the first generating unit of the project will be substantially complete by mid 2007 subject to the timing of Shareholder approval.

### **3. STRATEGIC DIRECTION**

In the past Macquarie Generation has adopted a policy of actively responding to the supply and demand balance in the National Electricity Market. The Corporation has done this by adopting a program that matched output with system demand while maintaining standby capacity and allowing a cyclical maintenance program for the Corporation's eight generation units.

As a result of this strategy the Corporation has generally only operated six of its eight generation units at any one time and as a result has experienced a reduction in its generation share of the National Electricity Market from a high of 17% five years ago to a low of 13.5% in 2002/2003.

In the past two years the Corporation has moved to maximise the economic benefits of improvements in marginal costs of production and the efficiency of production by progressively increasing output and hence, National Electricity Market share has now lifted to around 15%.

The Corporation plans to continue to increase its share of the National Electricity Market in the 2005/2006 period commensurate with its ability to provide efficient low cost generation into the market on a baseload basis and in order to meet ever increasing electricity demand in New South Wales.

The Corporation has the capacity to implement the objectives outlined in this Statement of Corporate Intent and to meet the financial and performance targets set out in the Business Plan.

#### 4. NEW SOUTH WALES GOVERNMENT, ENERGY DIRECTIONS GREEN PAPER

Macquarie Generation has welcomed the release of the New South Wales Government, Energy Directions Green Paper and has provided a public response to the issues raised in the paper.

The Corporation focused its response on the following issues:

- New South Wales requires a series of power station projects in the planning pipeline to ensure ongoing supply reliability.

As already stated, the Corporation is playing its part in providing real new generation options for New South Wales and has Development Approval for an open cycle gas turbine project currently subject to Shareholder approval.

- There is a need for a clear process and criteria for the Development Approval process for new generation projects.

The planning process should not prescribe emission standards for each new generation technology but instead allow new generation projects to progress if the project relies on the best commercially viable technology.

The Corporation is also of the view that the planning approvals and regulatory environment should not retrospectively apply tighter standards to existing generation plant.

- There is a need for the Government to establish clear processes and criteria for considering joint ventures with the private sector to develop new generation capacity.
- Any emissions trading or abatement schemes should be nationally based and uniform across Australia.

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### 5. PERFORMANCE TARGETS

\$A Millions

Performance Target	2004/2005 AGAAP Forecast	2004/2005 AEIFRS	2005/2006 SCI	2006/2007 Forecast	2007/2008 Forecast
Earnings before Interest and Tax	244.5	244.5	264.2	286.2	241.3
Operating Profit before Tax	166.8	166.8	190.8	217.3	177.7
Target Dividend	105.0	105.0	130.0	140.0	110.0
Return on Assets (%)	8.5	8.5	8.9	9.6	8.5
Return on Equity (%)	16.9	16.9	19.9	22.4	18.1

The reduction in forecasts for the 2007/2008 financial year is due to the impact of the introduction of the Kogan Creek Power Station to the National Electricity Market.

This 700 MW generator is currently under construction and when operational will increase supply and negatively impact electricity prices across the National Electricity Market and in particular in New South Wales. This impact will be similar to the impact of the Millmerran Power Station when introduced to the National Electricity Market.

### 6. CAPITAL WORKS PROGRAM

As with previous years' capital works programs, the Corporation continues to focus on efficiency and capacity upgrades of existing plant, and other infrastructure developments for coal supply and water supply.

The emphasis is currently on efficiency and capacity improvements in response to ever growing demand in the National Electricity Market.

Notable projects to be finally evaluated and implemented in the next year include:

- Water treatment and desalination plant to allow management of salt levels in the Corporation's major water storage at Lake Liddell. Improved salt management will manage environmental obligations while ensuring improved power station operations by avoiding scaling of water systems, pipework and condensers. This project could have a total cost of up to \$50 million depending on final options and capacity specified.

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- Liddell Power Station High Pressure and Low Pressure turbines will be progressively replaced under a contract with Alstom. This project will improve plant efficiency and capacity and will be completed progressively over the next four years in line with planned maintenance outages. This project will have a cost of \$38 million.
- In preparation for delivery of coal supplies from the low cost Wilpinjong mine and the Anvil Hill mine, the Corporation is in the process of developing a new rail coal unloader at Antiene on land owned by Macquarie Generation. This project will involve additional train sidings and unloading capacity totalling up to \$75 million.
- The Corporation is also conducting a research and development project at Liddell Power Station to ascertain the efficiency gains from using solar heating, collected from a solar array, to heat boiler feedwater in the steam cycle. Following the success of these trials it is now proposed to integrate the solar plant with the Liddell generating plant.

In this stage, the solar energy will be used to produce steam which in turn will be used to heat feedwater returning to the boiler of one of Liddell's generating units. Extra steam would therefore be made available to pass through the turbine cycle hence increasing generating efficiency and unit output.

The cost is estimated at \$5.5 million, consisting of \$3.1 million for additional mirrors and \$2.4 million for the generating plant interface equipment consisting mainly of a heat exchanger and pipework. This phase is expected to be completed in 2006 and will produce up to 6,000 MWh per annum of Renewable Energy Certificates.

- Following a review of coal supply logistics at Liddell Power Station, it has been decided to construct a dry storage facility. This dry storage facility will overcome fuel supply issues into the power station in times of extended wet weather and will be constructed at a cost of around \$2 million commencing in 2005/2006.

Funding for these projects and a number of minor projects will be sourced from internal cash flows. The total capital budget for the 2005/2006 Plan is in the order of \$125 million.

### 7. ACCOUNTING POLICIES

The Corporation has a policy of striving for best practice in relation to all operations including accounting and finance.

In adopting such practice the Corporation complies with relevant Australian Accounting Standards and Treasury of New South Wales Circulars and Mandates on accounting policy.



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From the 1st July 2004 the Corporation was required to ensure that it has processes in place to allow the reporting of comparative accounts for a range of Australian Equivalent of International Accounting Standards (AEIFRS) noting that the standards and the Australian equivalents will not become operational and effective until the first full year reporting period after the 1st January 2005. This means that the Corporation's accounts for the year commencing from the 1st July 2005 will be prepared on the basis of AEIFRS.

The Corporation has been preparing accounts on the basis of existing Australian Standards and AEIFRS since the 1st July 2004 and will meet all reporting requirements.

### **8. SOCIAL PROGRAMS AND NON-COMMERCIAL ACTIVITIES**

Macquarie Generation will continue its role in the Hunter Valley as a leading corporate citizen with a total of \$200,000 budgeted in 2005/2006 for social programs and non-commercial activities.

The largest single contribution of \$50,000 has been allocated for the Upper Hunter River Rehabilitation Initiative (UHRRI) – a joint project by local industries, governments and research agencies with the objective to restore an eight kilometre section of the river to its condition prior to European settlement. UHRRI was a finalist at the 2005 Banksia Environmental Awards.

Macquarie Generation has budgeted \$150,000 in 2005/2006 for corporate and community sponsorship. Strategic oversight of the Corporation's Community Support Program is vested in an employee advisory panel, which has identified five priority categories for assistance: Recreation, Community Services, Education, Health and Environment.

Major projects under the Community Support Program include the funding of short term crisis accommodation at Singleton, support for local theatre and the arts and association funding for youth, adult and veterans sport.

Major commitments under the Corporate Sponsorship Program include the State wide Keep Australia Beautiful school based Waste Watchers' Program, Hunter Medical Research Institute, Hunter Valley Research Foundation and Westpac Rescue Helicopter Service.

### **9. FINANCIAL ASSET AND LIABILITY MANAGEMENT**

The Corporation has contracted the management of the Corporation's debt portfolio and cash reserves as they exist from time to time, to the Treasury Corporation of New South Wales.

The Treasury Corporation of New South Wales won the contract as part of a competitive tender in 1996 and based on recent assessments of alternative treasury management providers, the Board of the Corporation has elected to continue contracting with Treasury Corporation of New South Wales for the next two years.

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Macquarie Generation has a policy of maintaining sufficient cash reserves to meet working capital requirements. Cash reserves surplus to these requirements have traditionally been used to retire debt especially where accounting losses on the repaid debt can be avoided. However, with the existing large future capital expenditure program, including the Tomago gas turbine, the Corporation's debt will average around \$960 million for the next three or four years.

The Treasury Corporation of New South Wales manages the Corporation's debt and cash in accordance with the Macquarie Generation Treasury Risk Management Policy, which is the subject of at least annual review and amendment as necessary by the Board of Directors. The current Policy was approved on the 16th April 2004 and is currently under review.

The Policy imposes specific limits on Treasury Corporation of New South Wales and during the past year no breaches of Policy were notified. The Policy also imposes specific limits which are monitored and reported monthly to the Corporation.

The Policy has been developed in accordance with the Treasury of New South Wales guidelines for treasury management by State Owned Corporations.

### **10. HALF YEARLY REPORT**

The *State Owned Corporations Act 1989* requires the Board of Directors to deliver to the voting Shareholders, one month after the end of December, a report of the operations of the Corporation and any subsidiaries during that half year.

The half yearly report will include a special purpose set of financial statements based on accounting standards applicable at the time of publication. The Half Yearly report will be prefaced by a statement by the Chairman and the Managing Director on the financial performance of the business for the half year and will also include an outlook for the full financial year.

### **11. RISK OVERVIEW AND IMPACTS**

Each year Macquarie Generation completes a comprehensive review of the risks facing the Corporation as it participates in the National Electricity Market.

The review is facilitated by external risk professionals and is conducted by the Corporation's executive management and senior management staff in a workshop session which is also attended by the Board of Directors.

Arising from the review is an Executive Risk Profile which provides an analysis of the Corporation's critical risks, ranked in order of importance and detailing the ownership of the risk management task, the treatment of the risk and how risk management is to be measured.

**12. REPRESENTATION AND COMMITMENT STATEMENT**

The Board and Management of Macquarie Generation confirm the following:

- The performance targets within the Statement of Corporate Intent are based on and supported by the Corporation's Business Plan.
- Relevant pre-planning requirements for capital and maintenance will be undertaken in accordance with the New South Wales Government's *Total Asset Management Manual* for i) Projects which require an Environmental Impact Statement; and ii) Projects of State Significance proposed to commence in 2005/2006.
- Projects of State Significance have been identified in accordance with the criteria set down in New South Wales Treasury's *Guidelines on the Assessment of Projects of State Significance*. In principle approval from Budget Committee and final approval from Voting Shareholders for Projects of State Significance planned to commence in 2005/2006 will be obtained.
- The Corporation's Strategic Asset Management Plan is as far as practical consistent with the principles of the Property Disposal Reforms and the TAM Manual.
- The requirements of New South Wales Treasury's *Financial Appraisal Guidelines* have been complied with for capital expenditure projects proposed to commence in 2005/2006.
- To the best of our knowledge, all the known 'key risks' and the 'major emerging contingent liabilities', which could materially impact the current and future results of our organisation, for the forthcoming year, have been disclosed.
- The requirements of New South Wales Treasury's *Treasury Management Policy* have been complied with and related party interests which may represent a possible conflict of interest for Macquarie Generation Directors have been disclosed.
- The Corporation's Chief Executive has an employment contract and performance agreement. The Chief Executive's performance is appraised annually in August. The employment contract is appraised annually around September and the current contract expires on the 1st September 2005.
- The Corporation's Board agrees to provide the Voting Shareholders with financial and other information on a quarterly basis to assess the performance against commitments in this Statement of Corporate Intent and to assess the value of the Shareholders' investment in the Corporation.

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- The Corporation will comply with the Treasury Circulars on accounting policy matters as detailed in Attachment 1 of New South Wales Treasury's *Guidelines for the Development of the 2005-06 Statement of Corporate Intent*. However further consideration of the impact of the introduction of International Accounting Standards from the 1st July 2005 may impact the Corporation in such a manner that specific consultation with the Treasury of New South Wales might be required.