

**Summary of audit report *TEŠ Power-plant block 6 investment***

Electric power supply infrastructure in Slovenia has been for the most part built in the 70's and 80's of the last century. The power-plants and distribution networks have been built at the level of technological development at the time and the period of their economic utility is coming to an end. By the end of this and in the next decade the period of their technical utility will also expire.

Company TEŠ (Termoelektrarna Šoštanj; Šoštanj thermal power-plant) is the largest thermal power-plant in the HSE group ( Holding Slovenske Elektrarne). In 1956 the first two blocks of the power-plant begun to operate, with three additional blocks being built in the next 20 years. In 2008 blocks 4 and 5 underwent some modernisation while the oldest two blocks have been shut down in 2008 and 2010 respectively. The company TEŠ has at the time decided to invest in building of a new coal power-plant for production of electricity and building of a new block, block 6. As such large and relevant project it was included by the Government in the Resolution on national development projects for the period 2007-2023. The block 6 investment is the largest investment in the energy sector in Slovenia, for which the company TEŠ has taken on a long-term loan of 440 million euros, underwritten by the Republic of Slovenia. The consequence of such guarantee is a certain level of exposure of the State to the success of the investment, even more so because the State is at the same time the sole owner of the company HSE, a 100% owner of the investor, company TEŠ.

The Court of Audit of the Republic of Slovenia ( hereafter: the Court) conducted an audit with the aim of this audit was to issue an opinion on the efficiency of planning and management of financing resources of the HSE group for the block 6 investment in the period from 1.1.2012 to 31.12.2014.

Until 2013 the company HSE has not developed any scenarios to plan for a positive cash-flow regarding the planned investment in block 6 at all. Only then did it begin with the financial evaluations of the measures envisaged to be undertaken to this end and were completed by July 2014. Also in 2014 the company HSE and the HSE group underwent a process of rationalisation and optimisation but it is not possible to assess how much of the expected 45,4 million euros of savings have actually been achieved and thereby available for financing of investments. It has been established that the company HSE has not had an efficient and transparent management plan for other companies in the grouping in the years 2012 -2014. This became evident when the information necessary for planning of the block 6 investment later proved to be unreliable and therefore not adequate for sound investment decisions to be made at the time.

By the end of 2014 the company HSE secured 414,777 million euros for the block 6 investment by additional capitalisation of the TEŠ company and by contracting a debt, which is 13,275 million euros more than envisaged in the Novel Investment Programme, 6th revision. Having had established good flow of financial information within the HSE group the company HSE was able to manage its liquidity risks nevertheless. In order to timely secure own financing resources for the block 6 investment the HSE company has taken up a loan and sold an equity share in one of the companies in total amount of 218,711 million. These additional resources of financing were not reflected in its business plan and due to no control over the risks of poor planning and the actual cash-flow of the block 6 investment the HSE company as well as the HSE group were forced to postpone other planned investments of an estimated value of 838,338 million euros.

A positive financial result of the company TEŠ after the completion of the investment has not been accounted for as one of the vital elements for sound management of the block 6 investment. This fact would later have a detrimental effect on the potential for the achievement of the planned financial results of the investment and on securing sufficient cash-flow of the HSE group. As it has been established that the final sale price of the electricity and purchase prices of coal as planned in the Novel Investment Programme, 6th revision are not realistic, the planned business results of company TEŠ are not attainable and the risk that TEŠ will not be able to secure own assets to repay the outstanding debt remains. This in fact means that the necessary additional financing will have to be provided by the company HSE and HSE group.

With the difference of 125,965 million euro in the estimated value of the investment between the 5th and the 6th revision of the Novel Investment Programme the total investment amounts to 1, 428 billion euros and exceeds the ceiling determined in the Act on the guaranty of the Republic of Slovenia for the long-term loan of TEŠ. The State has namely agreed to step in as a guarantor for the 440 million long-term loan company TEŠ would contract to with the European Investment Bank under the condition that the total value of the investment does not exceed 1,302 billion euros. Such changes in the management of the investment led to the conclusion that the company HSE failed to meet the criteria on the maximum value of the investment in spite some activities to lower the price of the main technological equipment and its installation.

After analysing the different estimates of the purchase price of coal it can be concluded that company HSE as majority owner of the Coalmine Velenje did not use its supervisory powers to provide that planned estimated price of coal is met. As this is a vital parameter for the calculation of the financial result of the operating of block 6, it amounts to the second criteria from the Act on the guaranty not being met by the investor.

From comparing the different estimates of the future prices of electricity it can be concluded that the risk of not achieving the prices used in calculations of the final result of the operation of block 6 remains out of control of the HSE. There is also a risk that additional planned income from the lease of capacity for provision of systemic services in the electricity supply chain will not be generated in the operational period in the amount envisaged.

Slovenian Sovereign Holding (SSH), a central manager of the state-owned companies and asset-portfolio, has by adopting a code (Corporate Governance Code for Companies with Capital Assets of the State) and recommendations (SSH Recommendations and Expectations) provided a framework for adequate information on business operations of the company and the group HSE to be made available and thereby enabled a certain level of monitoring over the company's decision-making. However, no such request has been made to the HSE company in 2012 and 2013 which would allow for proper analysis of the availability of sufficient financial recourses of the HSE group for the block 6 investment and of the kind of measures the HSE group would be in a position to undertake to guarantee better efficiency and transparency in the management of the companies within the HSE group. Similarly, no future plan for further development of the HSE group was requested. In was only in January 2014 that SSH issued a formal request to company HSE to take action which would provide SSH with adequate information on the business operation more timely.

In the Strategy of State assets management for the period 2011-2015 there was no analysis and financial assessment of the advantages and disadvantages of the existence of two separate energy pillars in the energy sector in Slovenia. For the period 2012-2014 there was no scenario on the side of the SSH incorporating measures to be used in case it was estimated that the block 6 investment would cause a negative cash-flow for the HSE group.

The Court has requested response reports from the HSE company and the Slovenian Sovereign Holding over corrective measures required with regard to preparation of action plans for the financial and business restructuring of the Coalmine Velenje company and company TEŠ, for better internal coordination of the HSE group, for establishment of clear relations, rights and obligations between Republic of Slovenia and the creditors regarding the conditions set in the Act on the guaranty of the Republic of Slovenia for the long-term loan of TEŠ and actions to establish the responsibility of managerial and supervisory bodies of the companies HSE and TEŠ. Of the SSH it has also been required to present a development plan for the HSE group. The Court has also issued some recommendation to the HSE company and SSH as to the activities of the HSE group in order to guarantee a positive cash-flow of the group in the future.

15 September 2015