The Lines Company Limited

Statement of Corporate Intent

2011/2012

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Environment

1. The core of TLC's business is its lines network. The core drivers of growth within the local network are:

   a. Holiday home expansion.

      This has quietened considerably since 2008 and is not expected to increase until New Zealand's GDP commences significant growth.

   b. Seasonal accommodation and other businesses servicing the ski industry.

      This too is unlikely to grow until New Zealand's GDP commences significant growth.

   c. Dairy conversions.

      These have been quiet but if the dairy payout is maintained at its current level then conversions are likely to recommence.

   d. Industrial.

      Growth is likely in those sectors that are part of the international demand for resources.

   e. Connected generators.

      This is mainly small hydro, although wind is becoming more of a probability. Extra revenue from these is limited by legislation to the marginal cost they impose on us.

2. The rural area that TLC covers makes expansion into areas such as broadband difficult. The towns within the area have been neither big enough to become part of the urban broadband programme nor small enough to become part of the rural subsidy programme. Whilst TLC may be able to assist a larger operator it is unlikely to earn a significant surplus from so doing.

3. The area, running as it does from the mountains to the sea, does contain a considerable resource for small to medium hydro development.

4. The regulatory regime that TLC is operating under for its lines network has been made more certain. Network prices will increase at the rate of movement in the CPI for the next four years. This is subject to a price adjustment if the current return on assets differs from the regulatory rate of return as mandated by the Commerce Commission.

5. The methodology for determining the regulatory rate of return is currently being appealed by both the major network companies and the major users. TLC is not part of this appeal. Significant changes are considered unlikely.

6. As the regulatory regime is now certain we expect lines company assets to trade at, or close to, their regulatory value. Opportunities for expansion by acquisition are therefore likely to be limited to those areas where either the network is pricing at less than its permitted price path, or the acquirer can bring considerable synergies, for example by the combination of networks. The Company has developed an expertise in managing the requirements of remote rural networks.

7. TLC has increased its prices by 18% over the past two years. The rural sector has borne a disproportionate share of that increase.

8. At the same time the incumbent retailer has also significantly increased its charges, causing it to lose customers.

9. Attention within the community, especially in the Ruapehu and Turangi areas has focused on the increase in the lines charge.

10. Electricity consumption patterns have, for many consumers in recent years, been drifting away from traditional patterns e.g. having 40% of domestic consumption controllable by us and thus be able to be switched off at peak times. Applying traditional assumptions to basic meter data in order to ascertain how much the load of a particular customer, or group of customers, costs, is increasingly proving to be a difficult exercise. This is being exacerbated by a trend towards increasing loads at peak times.

11. In order to maintain line charges at a rate that can be afforded by the average domestic customer in the region, we have broadened our charge base to include all who benefit from our network, and require a service from the network. This has included in the past years full recovery from holiday homes and vacant properties. This ensures that all who benefit contribute.

12. The increase in prices has had two affects:

    a. There is resistance from some customers, mainly those who have a high peak load to annual electricity consumption ratio, to pay for the peak load that they require. A group of such customers, fronted by holiday home owners and including a number of landlords, is running a campaign to discredit the Company in general in an attempt to get the Company to amend its charging structure basis to energy usage rather than peak load.

    b. There is an increase in service expectations from other customers, and a resultant lowering of customer satisfaction with existing TLC service levels.

13. TLC is likely to breach the first year of the two year quality threshold. Unless we increase the amount of work undertaken live line, the increase in our renewal programme will increase our planned outages, which will leave us exposed to

breaching the Commission's quality path. Increasing live line work will however significantly increase the cost of doing that work, which in turn will increase lines prices. Our current belief is that completing our renewal programme at a cost that can be afforded by our local community is the highest priority and therefore the risk of a quality path breach should be accepted. Discussions with customers in some areas however suggest that some customers are willing to pay more in return for a lower level of outages, planned or otherwise.

14. TLC expects its return on its network to be close to 5.1% or 7.1% inclusive of the CPI indexed asset value adjustment. This is expected to be still $1.5 million below the maximum regulatory return. This deficit is in the Ruapehu region.

15. The King Country network acquired by TLC in 1999 had suffered from years of neglect. TLC has invested substantially in renewing its network, to the extent that it can no longer claim to have the oldest network in New Zealand. An expenditure of $...... over the next 15 years however is still required to bring the network back to standard and remove hazards.

16. As forward renewal expenditure will be higher than depreciation the network asset value will continue to climb over the life of the renewal programme. This increase in asset value is likely to see the regulatory price path increasing in the medium term at a rate higher than the inflation rate.

17. The renewal programme until the 2010 year was partly funded by debt ($10 million) and external activities, due to low cash flow from the network. The decrease in external activities has seen a decrease in dividend payments to TLC shareholders. The increase in cashflow from the network due to the increase in network revenue has enabled network renewals to be funded from cashflow and network debt to be lowered.

18. Included in the Company's debt is $8 million raised to finance a special dividend, used by our shareholders to ensure that the ownership of our local retailer was retained within our region.

19. The Electricity Industry Act permits us to invest, including acquisition, in unlimited generation schemes outside our network and up to 50MW on our system before ownership separation is necessary. It also permits us to compete for, but not purchase retail customers.

20. Many of the small generation schemes privately constructed in the 1990's and early 2000's are striking difficulties; the owners of these schemes are consequently looking at quitting them. Enthusiasm for private investment in small generation schemes has dwindled. Clearwater Hydro has developed expertise in small hydro development.

21. Wholesale electricity prices are currently stable, with a significant increase predicted in the next three years, due to the introduction of the emissions trading scheme. The increase may be moderated if GDP growth continues to be slight.

22. The new Electricity Authority regime provides financial disincentives on retailers for requesting customers to conserve in dry years. This is likely to result in wholesale prices being more volatile to ensure demand matches future supply, and hydro storage is maintained.

23. There is a growing drive for advanced meters for the purposes of allowing consumers appliances and smart equipment to interact with the network to ensure the network is not overloaded.

24. Retailers appear committed to advanced meter rollouts for the purposes of increasing customer information and pricing options and reducing retailer costs. To make these affordable retailers are expecting a part of their cost to be absorbed by networks in return for network management benefits.

25. Because of the cost of integrating each retailer's information and billing systems with each data management system, to ensure customers can easily switch retailers, there are unlikely to be more than three data managers New Zealand wide.

26. TLC owned meters will need to communicate with at least one of these data managers.

27. As a result of its restructuring, the contracting business has improved its efficiency and productivity. Local private work is stable but not likely to increase. This includes JDE. Local competition has stabilised.

28. Oil prices are trending back to their 2008 levels, increasing the return from Scope Oil.

Current Strategy

The Board adopted a strategy of diversification in 2006. Since then the Company has invested in developing a generation portfolio of 3 schemes, and has invested in an oil refurbishment business, and a local contracting business concentrating on industrial customers.

A number of other opportunities have been investigated over this time, but not proceeded with as the Board considered that they would not produce a sufficient increase in value for the Company.

The Board believes that, if the Company is to earn more than its cost of capital in the long run, it needs to continue to diversify into businesses other than the network business. However, in order to guarantee success, such diversification should leverage off the proficiencies the Company has developed, and the Company needs to extract as much value as it can from its existing businesses.

In order to maintain an acceptable cost of debt the Company needs to maintain its earnings before interest and tax at a ratio of at least 2.5 times its interest costs. Generation schemes fully funded from debt do not initially meet this ratio, but do over time as electricity prices rise. Therefore in the short term the Company will need to carefully balance its dividend level and its funding of non-core businesses to ensure this ratio is maintained. As the generation portfolio develops and the cash flow from generation is sufficient to fund the succeeding schemes this restriction will ease and dividends will increasingly benefit from the extra cash produced from the generation schemes.

Philosophy – Company

We intend to have a sustainable business. This will be achieved by ensuring:

- Our cost of capital is met, by both controlling costs and setting realistic prices. This includes pricing lines charges up to the threshold set by the Commerce Commission.

- We meet the requirements of the Electricity, Electricity Industry and Commerce Acts.

- Outages do not exceed a level considered satisfactory by our customers.

- The ratio of satisfied network customers is increased.

- Investments are made on a prudent basis.

- We remain safely within our debt covenants.

Returns

Recent work on cost of capital would suggest that we should be earning a return of approximately 7.6% on our network assets and 9.6% on other assets.

The 7.6% return on network assets is a combination of asset revaluations and immediate return. With inflation around 2.0% this reduces the immediate return to 5.6% from our network.

Generation is a business with accelerated cashflows over time. Operational costs are relatively small, compared with revenue. With depreciation being fixed, returns from generation grow over time. We therefore should not expect an immediate return of more than 3% from generation, whilst the weighting of our portfolio is dominated by new schemes.

With 78% of our assets tied up in the network and 7% in generation this gives us a target level of 6.3% across the total asset base.

Corporate Strategy

The Company intends to concentrate on improving the value of its existing businesses in the next three years, i.e. lines, network, generation, contracting and metering, and leveraging off those businesses where there are clear synergies.

This will involve:

- Identifying opportunities arising from the nationwide advanced meter installation programme.

- Delaying for one year generation construction for the purposes of:
  - Ensuring certainty of forward energy price projections
  - Completion of teething operational expenditure on existing schemes
  - Ensuring that the best project is adopted for construction.
  - Strengthening the Clearwater management model.

- Identifying opportunities for contracting expansion – but only in areas of competency and reasonable margins. This is likely to exclude working for lines companies other than our own.

The Company recognises that its main mission is to deliver a strong sustainable network to the greater King Country area, as covered by its two trust shareholders. It is therefore willing to invest in network expansion within this geographic area at a minimum of our cost of capital, where revenue is assured, in order not to limit community growth. It is not however willing to invest in network expansion if the projected revenue increase is less than our cost of capital

Acquisitions will be guided by the following rules:

- They must deliver sustainable financial performance. This includes investments in other networks, either by purchase or merger.

- Expected returns must exceed the Company's wacc. At a minimum, a premium of 2.0% over the regulated network wacc will be sought.

- Non-network businesses must be sustainable enough to afford their own resource. Network management is not to be diverted from network performance.

- They must be in an area of core competency, and utilise synergies and expertise from our existing businesses.

The Company's preference is to invest in external businesses where:

- There are relatively low competitive forces in the industry.

- The Company can enter the industry at relatively low cost, due to synergy or other reasons.

- The Company has a defined entry strategy with a fully costed plan.
- There is a defined exit strategy.
- Their business produces a positive cash contribution from time of investment.
- The business is profitable from the time of investment.

Individual investments will be weighted according to their risk profile.

Businesses

Over the next two years the Company will be focused on:

- Other electricity networks if opportunities arise as the final outcomes from Commerce Commission regulation become clear.
- Distributed generation, both within and external of the network.
- Entering energy retailing if necessary to maximise generation returns.
- Expansion of our contracting business.
- Metering.
- Rural broadband fibre.
- Remote management control systems.

Network Pricing

Existing subsidies between regions will be eased out over the next five years.

Existing subsidies between customer groups, unless required by the Electricity Authority, will be eased out over the next five years.

Customer Service

The assumption that retailers would, in order to deliver a competitive service, assist customers in understanding network prices and help them in managing their electricity usage to best balance their needs with as low as possible network charges has failed locally.

It is now incumbent upon TLC to provide this service to customers. It is consequently intended that TLC will increase its investment in assisting customers to manage their load and energy use. Targets have been increased on satisfaction levels on contact with TLC's service team and operations overall.

Dividend Policy

Surplus funds from the operation of the business shall be applied to:

1. Renewal of existing assets.

2. Repayment of debt at 8% of opening debt levels.

3. Of the balance 25% shall be retained and applied to growth of the Company and the remaining 75% distributed to shareholders, subject always to:

   - The solvency requirements of the Companies Act 1993;
   - Any banking or other funding covenants by which the Company is bound from time to time and;
   - The investment and operating requirements referred to in this policy.

Target

All figures are in $'000s.

Combined	2008	2009	2010	2011	2012	2013
	Amended	Actual	Actual	Projected	Projected	Projected
Ebit	10,100	8,507	10,617	14,001	12,931	14,203
Surplus after tax	4,951	4,014	6,060	6,888	6,808	7.616
Return on assets	5.4%	4.0%	4.5%	5.7%	4.6%	4.7%
Return on equity	6.4%	4.9%	6.4%	7.5%	7.1%	6.9%
Cash	400	1,100	1,000	900	900	600
Other current assets	4,900	7,900	5,000	3,100	3,200	4,100
Fixed assets	129,800	164,700	171,400	174,000	205,600	218,900
Total assets	136,100	172,700	177,400	178,000	209,700	223,600
Current liabilities	4,900	7,900	5,600	5,200	6,500	6,500
Deferred tax	22,300	29,600	31,300	29,600	37,100	37,100
Loans	31,400	42,300	44,500	41,500	41,800	51,700
Equity	77,500	92,900	96,000	101,700	124,300	128,300
	136,100	172,700	177,400	178,000	209,700	223,600

Performance Targets

1. Return on Average Net Assets :

	2009	2010	2011	2012	2013
	Actual	Actual	Projected	Projected	Projected
Return	4.0%	4.4%	5.7%	5.0%	4.9%

2. Return on Average Equity (including revaluation gains):

	2009	2010	2011	2012	2013
	Actual	Actual	Projected	Projected	Projected
Return	4.9%	6.5%	7.0%	6.0%	6.0%
Asset Revaluation	27.6%	0.00%	0.0%	17.1%	0.0%
Gross return	32.3%	6.5%	7.0%	23.1%	6.0%

3. Debt

All figures are in $’000s.

	2009	2010	2011	2012	2013
	Actual	Actual	Projected	Projected	Projected
Subordinated (equity)	3,000	3,000	3,000	3,000	3,000
Normal	42,300	44,500	41,500	41,800	51,700
Total	45,300	47,500	44,500	44,800	54,700

4. Equity to Asset ratio: will not be less than 40%.

5. Average urban domestic prices to be ranked no higher than 10th on MED survey.

	2009	2010	2011	2012	2013
	Actual	Actual	Projected	Projected	Projected
Taumarunui	12	13	13	13	13
Te Kuiti / Otorohanga	14	16	16	16	16

6. Dividends

All figures are in $’000s.

	2009	2010	2011	2012	2013
	Actual	Actual	Projected	Projected	Projected
Dividend	4,020	3,000	3,500	3,620	3,760

7. Reliability

	2009	2010	2011	2012	2013
	Actual	Actual	Projected	Projected	Projected
Average minutes off per customer					
Planned	58	80	110	110	110
Unplanned	211	160	190	190	190
Total	269	240	300	300	300
Supply interruptions per customer					
Planned	0.9	0.9	1.20	1.20	1.20
Unplanned	3.70	3.00	3.70	3.70	3.70
Total	4.60	3.90	4.90	4.90	4.90

Extreme events, which are exempt from consideration under Commerce Commission ‘***decision 685,’*** are not counted.

8. No more than 10 proven long term voltage complaints.

9. No more than 80 logged voltage “surge” complaints.

10. Completion of 2011/12 line renewal and voltage remedial programme.

Customer Satisfaction

11. To have at least 80% of customers, who have an opinion, believe that in general The Lines Company does a good job in servicing its customers.

12. To have at least 90% of customers, who have an opinion, who have contacted The Lines Customer service centre satisfied with how they were served.

13. To increase customer understanding of lines charges and load pricing to at least 60% of those who want to know.

14. Average time to settle complaints less than 20 days.

15. Unsettled complaints taking longer than 3 months to settle – no more than 6.

16. Number of focus group meetings – at least 5.

17. Number of customer clinics – at least 12.

18. Increase in understanding of demand charges.

Phone Calls

19. Non answer (including referral to answer message) rate below 5%.

Staff Safety and Health

19. Average annual man hours lost through accident occurring during the year - less than 2.5.

20. To complete the follow through actions from the October 2010 safety culture survey, and re-survey.

21. Staff turnover - < 15%.

22. Days lost per employee for sick periods of 2 or less days - < 5.

Development

23. To have at least 3 electrical or lines trainees.

Funding of Community Projects

24. To expend $60,000 in supporting community projects.

Generation

25. That plant is available for at least 90% of time.

26. To receive no notices of non-conformance with safety or resource management requirements.

Metering

27. To adopt a programme for on network meter changes to advanced meters.

28. To commence rollout in Ohakune – completion by winter 2012.

Other Required Measures

Capital Ratio

This ratio is defined as total consolidated shareholder funds as a percentage of total assets where:

- Consolidated shareholders' funds comprise the total issued capital, the balance of undistributed profits and all revenue and capital reserves including revaluations, less any minority interests, plus subordinated debentures.

- Total assets comprise all recorded tangible and intangible assets of the Company valued at book value, plus net working capital, less deferred tax.

The ratio is expected to reduce to 71% over the next three years.

Accounting Policies

The Company's accounting policies will comply with the legal requirements of the Companies Act 1993 and the Financial Reporting Act 1993.

The accounting policies will be consistent with those adopted by the Company in its Annual Report to 31st March 2010, which comply with the International Financial Reporting Standards (IFRS).

Information to be provided to Shareholders

The following information will be provided:-

(a) Regular newsletters, which will include information on non-financial performance.

(b) Half yearly reports will be delivered to the Company's shareholders within 3 months after the end of the half-year. These reports will comprise:

- a report from the directors covering the operations for a half year; and
- un-audited consolidated financial statements for the half year.

(c) Annual reports will be delivered to the Company's shareholders within 3 months of the end of each financial year and will comprise:

- a report from the directors covering the operations for the year; and
- audited consolidated financial statements for the financial year; and
- auditors' report on the financial statements and the performance targets (together with other measures by which the performance of the Company has been judged in relation to the Company's objectives).

The Company's audited consolidated financial statements will comprise the following:

- Statement of financial position.
- Statement of financial performance.
- Report on performance achieved.
- Statement of cash flows.
- Such other statements as may be necessary or required by the Financial Reporting Act 1993 to fairly reflect the financial position of the Company, the resources available to it and the financial results of the operations.

(d) Draft Statements of Corporate Intent (SCI) are required to be delivered to the Company's shareholders within one month of the beginning of each financial year.

(e) A summary of the annual capital expenditure budget adopted by the Board, including identification of all programmed projects with a budgeted capital expenditure in excess of $200,000.

Procedures for Acquisition of Shares in Other Companies or Organisations

As a general policy, any proposed share investment by the Company will be required to meet the same financial criteria as any significant capital expenditure. In addition, the questions of control and risk will be addressed.

All share investment proposals will be considered by the Company's Board of Directors. If the size of the proposal makes it a Major Transaction as defined in the Constitution, the shareholders' approval to the proposal will be sought. For transactions with a value in excess of $5 million, but below that required for a major transaction, the Company will, at least 10 business days prior to the Company entering into any such transaction, supply to the shareholders a report which, in the opinion of the directors, gives reasonable particulars of:

- The estimated size of the transaction.
- The benefits to the Company.
- The risks to the Company.

- The likely financial impact on the Company.

Transactions with related companies and local authority shareholders

The Energy Companies Act 1992 requires the Company to publish in its Statement of Corporate Intent the details of any transactions that the Company intends to enter into with any related company or any local authority that is a shareholder of the Company.

The Company's subsidiary Clearwater Hydro provides management services to the Company's hydro subsidiaries. The Company's contracting division provides services to Clearwater Hydro and FCL, the Company's metering arm.

Procedure to Modify the Statement of Corporate Intent

The Statement of Corporate Intent may be modified by the directors provided that they have first given the shareholders one month to make comments on the proposed modification.

The shareholders may also resolve at a general meeting of the company to require the directors to modify the statement. The shareholders must have regard:

(a) to the requirement that the principal objective of the Company is to operate as a successful business, and the desirability of ensuring the efficient use of energy;

(b) to the financial accounts and other reports the Company is required to prepare under Section 44 of the Act;

and the shareholders must consult the directors.

Glossary of Terms

Ebitda Earnings before interest, tax, depreciation and amortisation.

Ebit Earnings before interest and tax.

Net Assets Fixed Assets plus net working capital.

Return on Assets (Ebit multiplied by the applicable tax rate) divided by ((opening Net Assets plus closing Net Assets) divided by 2).

Return on Average Equity
(Surplus after Taxation) divided by ((Opening Shareholders' Funds plus closing Shareholders' Funds) divided by 2).

Renewals
Replacement of existing property, plant and equipment either undertaken or committed to in the financial year.

Shareholders' Equity
Shareholders' funds plus subordinated debentures.

Surplus Funds
Net cash from operating activities less any increase in net cash due to temporary changes in working capital.