Statement of Corporate Intent

Statement of Corporate Intent 2013/2014

1.0 Overview

1. The core of TLC's business is its lines network, and one of its objectives has always been to be the best at managing remote rural networks. Over the past decade it has invested in developing systems and staff to that end.

2. Our systems have meant that we have been able to achieve a regulated asset valuation that reflects the strength of the company.

3. TLC has always seen that its future is dependent upon the homes and businesses connected to its lines; its customers. Its future depends upon its ability to meet the requirements of those customers for access to an electricity network at a price they can afford.

4. TLC's focus on the customer has enabled it to have a pricing system which enables the customer to differentiate between the cost of energy and the cost of lines, with the appropriate cost signals.

5. By being close to the customer TLC has been able to complete a successful customer consultation programme that will enable it to increase planned outages in return for keeping future prices at reasonable levels, subject to Commerce Commission clearance. This is a departure from all other industry consultations which seek increased prices in exchange for asset investment.

6. The core drivers of growth within the local network are:

   a. *Holiday home expansion*

      Development is beginning to recommence in Ohakune, with sporadic development elsewhere.

   b. Seasonal accommodation and other businesses servicing the ski industry

      The progression of summer time activities, especially the Ruapehu bike trails, is leading to an increase in annual occupancy for these businesses, and the opportunity for smaller businesses to develop specifically to service these off peak customers. The increase of energy consumption in the off season by these businesses is one of the reasons why energy consumption across our network is currently increasing at a faster rate than load.

   c. Dairy conversions

      Investment is continuing in conversions. This in conjunction with the associated irrigation is providing growth in the Whakamaru region.

d. *Industrial*

Growth continues in the major local industries; effort is being made to ensure that companies seeking to grow do not have to move outside our network to obtain the capacity and quality that they require.

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.

Growth within this area is depressed at the moment due to falling electricity wholesale prices caused by some significant decreases in consumption by major electricity users. This however is also leading major generators to shelve, or abandon, some large projects. The wholesale price may take up to five years to recover.

7. 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. Initial rural broadband plans indicate that the areas within TLC that currently receive only a dial up service will continue to receive only a dial up service.

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

9. The regulatory regime that TLC is operating under for its lines network has been made more certain. The Commerce Commission has determined that in order to earn a fair price over the current 2010 to 2015 regulatory period a price increase of 10% plus cpi in April 2013, followed by a further 10% plus cpi in April 2014 would be justified. The regulatory price is expected to decline in April 2015 to a level suitable for the whole of the 2015 to 2020 regulatory period.

10. As the regulatory regime is nearing certainty 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. As noted above, TLC has developed a recognised expertise in managing the requirements of remote rural networks. A significant acquisition of similar rural assets would enable the Company to capture economies of scale, although this appears unlikely to happen.

11. The growth in peak load has declined from 6% pa in the years 2006 to 2008 to a decrease of 0.9 % pa over subsequent years. Energy consumption, which was growing at a rate of 2.0% pa over the 2006 to 2008 years has however continued

to grow, but at the lower rate of 1.4%. This increase in load factor i.e. a greater volume of energy sold relative to peak load is evidence that our peak load charging regime is proving successful, by encouraging customers to focus on lowering their peak load rather than just controlling consumption.

12. 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.

13. Recent necessary increase in prices has had two effects:

    a. There is resistance from some customers, mainly those who have a high peak load to annual electricity consumption ratio, to pay appropriately both for the peak load that they require, and a fair price for access to the network.

    b. There is also an increase in service expectations from many of our customers. In 2012 our customer engagement, customer service and public relations were strengthened by restructuring into one team.

14. We have aimed to incentivise active customers, who work with us to control our costs and so the customers share in the benefits from this.

    a. The amendment from load being calculated on the highest three hour period when load controlling to the average of six two hour periods was introduced with little reaction from customers. This has however taken away the fear of a load level being set by a single peak.

    b. Over 50% of the commercial accommodation establishments on the new temporary accommodation profile worked with TLC to manage their loads and thus avoid the full impact of the new profile.

    c. Customers who have a TOU (Time of Use) meter installed were given the option of having their load calculated by the relevant profile or the installed meter. This option, subject to a small number of conditions, is available to all customers apart from a small number of customers with high capacity requirements where an applicable profile for their specific use does not exist. All such customers have a TOU meter. This ensures equity between similar customers irrespective of whether they have a TOU meter or have a load on a profile. It is acknowledged that the best way to charge is to base such charges on Time of Use meters rather than profiles.

d. TLC commits to not introducing any new profiles until 1 April 2015, to allow a suitable period for the new load meters to have commenced being rolled out in significant numbers, and then only after consultation with those affected by the introduction of any new profile.

15. TLC's pricing systems are designed to align prices to where costs originate to minimise cross subsidy. This is seen as important to ensure that our commercial customers can compete in international markets with their products. This strategy drives an asset management approach that is very revenue and cost focused.

16. On all networks there is a material amount of network capacity that is taken up by reactive power flows that are not captured by kWh charges. TLC's load charging with load meters can capture this and pass on the associated cost. As the sophistication of electronic equipment increases limiting this reactive power flow through appropriate pricing will mean that TLC's charging will not only encourage ideal network utilisation but also the minimisation of electricity losses. Minimising peak loading also reduces energy losses. These reductions will lower the overall costs to our customers.

17. In 2012 TLC breached the first year of the two year quality threshold. This has been impacted by tree damage arising from some forestry owners who have not cleared trees from the lines. In 2013, TLC was in compliance with the quality threshold targets.

18. TLC has invested substantially in renewing its network. An expenditure of $116m over the next 15 years however is still required to bring the network back to standard and minimise hazards.

19. Forward network renewal expenditure is generally aligned to depreciation and is funded by network generated cash flow.

20. 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 corporate separation is necessary. It also permits retailing of electricity to customers to a level of 75GWh in sales on the local network and without a cap on other networks.

21. Clearwater Hydro has developed expertise in small hydro development.

22. Wholesale electricity prices, on average, have fallen due to a reduction in national electricity consumption, and due to the delay in the implementation of the emissions trading scheme. Any increase in wholesale price is likely to be moderate while national GDP growth continues to be slight.

23. The new Electricity Authority regime provides financial disincentives to retailers to request 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.

24. Most private generation owners are not interested in selling their plants, although the decline in wholesale price may have put some struggling schemes under greater stress.

25. 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.

26. 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.

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

28. Requirements for meter owners introduced by the Electricity Authority are coming into force. This may cause smaller meter owners to exit the business rather than meet the standards required for compliance.

29. The contracting business has improved its efficiency and productivity. Local private work is stable but not likely to increase other than in dairying areas. Local competition has stabilised.

30. JDE has won a substantial tender for a New Zealand Steel Mining project; should this extend to all site work JDE will service all major industrial plants in the area.

31. Oil prices are trending back to their 2008 levels, increasing the potential return from Scope Oil, from its oil recycling business.

32. Over the last 10 years TLC has had a strong focus on hazard and risk control. This work has been key in positioning TLC well to achieve such things as early accreditation of its Safety Management Systems and ensuring that the network is sustainable for the future, from a hazard control and risk management perspective.

2.0 Strategy

The wider King Country lines network is the Company's major asset. It is a long network in rugged rural terrain servicing a comparatively small number of customers. The Company is dedicated to ensuring that its asset management programme keeps the network in a condition where it reliably services the needs of its customers. The Company however also recognises that the cost of the network must remain at an affordable level. To ensure this the Company is engaging with its customers through load pricing and consultation on outage and service levels to clearly establish the network capacity and the service quality that its customers are willing to pay for.

The network business is regulated by the Commerce Commission. Price thresholds are reset on a five yearly basis to ensure that the Company does not earn more than the regulated rate of return from the network in the medium term. Savings from lowering capital requirements or operational efficiencies are passed on to customers. In the long run the Company will therefore earn its cost of capital, but no more, from the network business.

The Commerce Commission provides clear rules around the allocation of costs between business units to ensure that the network is neither subsidising nor subsidised by other business units. We are audited against these rules. Returns earned by other business units do not therefore affect lines prices, except to the extent that the Company's overheads are spread across a wider base.

Given that internal network growth is limited, then to grow shareholder value the Company needs to either expand by network asset acquisition or diversify.

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 larger opportunities have been investigated over this time, but not proceeded with as the Board was seeking a greater return than what the opportunities were likely to produce.

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. As TLC's owners are customer trusts it is important that the dividends that are paid to them are stable over time and at a minimum reflect the earning capacity of the network.

The Company has a statutory obligation to act as a successful business. This will be achieved by the Company:

- Meeting customer needs.
- Maximising shareholder returns.
- Achieving long term growth.
- Providing long term network sustainability and reliability at an affordable cost.
- Expansion based on existing core competencies.

In particular the Company needs to ensure that:

- Outages do not exceed a level considered satisfactory by customers.
- The ratio of satisfied network customers is increased. This involves increasing levels of customer service and providing cost/benefit trade-offs for customers.
- Its customers perceive that it values its customers.
- Its cost of capital is met, by both controlling costs, including new network investments and setting realistic prices based on the necessary level of investment in the network.
- The requirements of the Electricity, Electricity Industry and Commerce Acts are met.
- Investments are made on a prudent basis.
- It remains safely within its debt covenants.

3.0 Returns

The Commerce Commission resets network prices on a 5 year cycle. The current 2010 to 2015 cycle is based on a return of 8.7%. TLC's current returns are below that level.

In the interim years the Commission publishes an updated rate for those who want customised price paths. The current 5 year network cost of capital announced by the Commerce Commission translates into a post tax return of 6.9% on our network assets. With a 2% risk premium, this equates to 8.9% for generation assets. To ensure stability of pricing, whilst prices remain below the threshold, the target should be the lower of the two.

The 6.9% return on network assets is a combination of asset revaluations and immediate return.

Generation is a business with accelerated cash flows 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 2% from generation whilst the weighting of our portfolio is dominated by the recently developed schemes.

4.0 Business Plan

4.1 Initiatives

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:

- IT systems investments, including a replacement of the core billing system, to improve customer service and reduce related operating costs.
- Evaluate organisational structure to ensure the company is adequately resourced to deliver change and improve the quality of services and information to all stakeholders.
- Identify appropriate staff training and development opportunities to improve core skills sets, widen institutional knowledge, and strengthen staff retention and continuity.
- A project to transfer the transactional banking relationship to Westpac and consequential negotiation for the reduction in lending margins. This will result in lower debt costs associated with financing new opportunities.
- Identifying opportunities arising from the nationwide advanced meter installation programme.
- Consolidating Clearwater Hydro including:
  - Ensuring that existing opportunities can be developed further when wholesale prices increase.
  - Explore acquisition, or joint ventures, where investments can be made at realistic prices and the schemes developed further.
  - Evaluate strategic options linked to structured exit programme.
- Continue with the development of hydraulic oil cleansing.
- Explore the development of off network retailing, including working in conjunction with other generation partners.
- Keep abreast of the development of battery and other technologies to aid the storage of electricity to smooth load at peak times.
- Dependent upon the above, reinvestigate solar opportunities.

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 new revenue is assured, in order not to limit community growth. It is not however willing to invest in network expansion if the projected return is less than our cost of capital.

Acquisitions will be guided by the following guidelines:

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

- They must contribute to cash flow in the short term rather than requiring capital injections with a long development period.
- Expected returns must exceed the Company's WACC. At a minimum, a premium of 2.0% over the appropriate industry 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.
- 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.

4.2 Opportunities

Over the next two years the Company will be mainly looking for opportunities from:

- Other network electricity asset investments
- Off network retail
- Gas distribution
- Distributed generation, both within and external of the network
- Metering, especially in embedded networks
- Structural insulated panels
- Rural broadband
- Metering Data Management

4.3 Network Pricing

While the prices permitted by the Commerce Commission for the next two years will be well above those currently charged, the reduction in interest rates since 2009 would mean that if interest rates were to remain low, permitted prices would decline again in April 2015. The company is currently evaluating its forward price path to ensure that over time it achieves the prices necessary to sustain the business and operate successfully.

4.4 Customer Engagement

The company will be expanding further its customer engagement and public relations program over the next three years. Targets have again been increased on satisfaction levels on contact with TLC's service team and operations overall.

4.5 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. Net debt level changes will be the difference between this debt repayment and new debt used to fund capital projects.

3. Of the balance 20% shall be retained and applied to growth of the Company and the remaining 80% distributed to shareholders, subject always to:
   - Directors' discretion.
   - 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.

5.0 Financial Performance

TLC Group - All figures are in $'000s.

Earnings	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
EBITDA	22,712	22,333	22,249	24,400	25,000	25,800
EBIT	14,100	12,168	11,613	13,800	14,300	15,100
Profit after tax	7,744	6,733	5,840	8,000	8,500	9,200
Return - avg net assets	5.6%	4.0%	3.7%	4.4%	4.3%	4.4%
Return - average equity	8.5%	30.8%	4.1%	5.6%	12.8%	5.8%

Balance Sheet	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
Cash	800	650	1,500	500	500	500
Other current assets	4,100	4,750	5,000	5,000	5,000	5,000
Fixed assets	176,500	227,800	226,700	231,400	248,800	252,050
Total assets	**181,400**	**233,200**	**233,250**	**236,900**	**254,300**	**257,550**
Current liabilities	6,600	7,000	7.800	6,500	6,900	7,100
Deferred tax	31,400	44,800	43,200	45,450	51,050	52,650
Bank loans	41,400	40,900	40,950	40,600	38,200	36,800
Shareholder Funds	102,000	140,500	141,300	144,350	158,150	161,000
	181,400	**233,200**	**233,250**	**236,900**	**254,300**	**257,550**

Cash Flows	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
Operating Cash Flows	19,350	15,200	15,550	19,550	21,000	21,700
Capital Expenditure	(13,300)	(11,250)	(9,800)	(15,250)	(13,100)	(13,950)
Debt Repayments	(3,050)	(550)	50	(350)	(2,400)	(1,400)
Dividends	(3,250)	(3,550)	(4,950)	(4,950)	(5,500)	(6,350)
Net Cash Movement	(250)	(150)	850	(1,000)	-	-

5.1 Performance Targets

1. Return on Average Net Assets

	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
Return	**5.6%**	**4.0%**	**3.7%**	**4.4%**	**4.3%**	**4.4%**

2. Return on Average Equity (including revaluation gains)

	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
Return, excluding revaluations	8.5%	7.0%	4.1%	5.6%	5.6%	5.8%
Asset Revaluation	0.0%	23.8%	0.0%	0.0%	7.2%	0.0%
Gross return, including reval.	8.5%	30.8%	4.1%	5.6%	12.8%	5.8%

3. Debt

	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
Subordinated debentures	3,000	3,000	3,000	3,000	3,000	3,000
Bank loans	41,400	40,900	40,950	40,600	38,200	36,800
Total	**44,400**	**43,900**	**43,950**	**43,600**	**41,200**	**39,800**

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

5. Average urban domestic prices to be ranked lower than 10th on MED survey.

Note that 1 is the most expensive of lines companies in the rankings.

	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
Taumarunui	13	14	20	15	15	15
Te Kuiti / Otorohanga	16	19	23	18	18	18

6. Dividends

	2011	2012	2013	2014	2015	2016
	Actual	Actual	Actual	Projected	Projected	Projected
Dividend	3,250	3,560	4,932	4,950	5,500	6,350

7. Reliability

The performance target relating to SAIDI and SAIFI reliability is for TLC not to breach the reliability limits as set out in the Default Price Path Annual Compliance Statement.

Customer Satisfaction

8. Customers perceive that TLC values its customers; measurement is growth in customer perception of at least 10% on previous survey.

9. To have at least 90% of customers, who have been surveyed and have an opinion, believe that in general The Lines Company does a good job in servicing its customers.

10. Number of customer clinics – at least 12.

Staff Safety and Health

11. Average annual man hours TLC lose (lost time injuries) through accidents occurring during the year - less than 2.5.

12. Staff turnover - < 15%.

Generation

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

Development

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

Funding of Community Projects

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

5.2 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.

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 2012, which comply with the International Financial Reporting Standards (IFRS).

6.0 Other Matters

6.1 Information to be provided to Shareholders

1. Regular newsletters, which will include information on non-financial performance.

2. 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.

3. 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
   - Auditor's 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.

4. 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.

5. 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.

6.2 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 10% of the company's equity, 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.

6.3 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, including John Deere Electrical Ltd, provides services to Clearwater Hydro and FCL, the Company's metering arm.

6.4 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:

1. 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;
2. to the financial accounts and other reports the Company is required to prepare under Section 44 of the Act;
3. 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	Non current assets plus net working capital.
Return on Average Net Assets	(EBIT multiplied by the applicable tax rate) divided by ((opening Net Assets plus closing Net Assets) divided by 2).
Return on Average Equity	(Profit after tax) 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' Funds	Shareholders' equity plus subordinated debentures.
Surplus Funds	Net cash from operating activities less any increase in net cash due to temporary changes in working capital.