Statement of Corporate Intent

2014 / 2015

Statement of Corporate Intent 2014/2015

1.0 Overview

The objective of this document is to comply with legislative requirements and overview the strategic and tactical business plans and performance.

Strategically The Lines Company Limited (TLC) is focused on ensuring that its assets are performing and producing the necessary returns for stakeholders. The network business returns are below that allowed by legislation and as such the proposals included in this document advance bridging this gap. The generation business is also underperforming and research is underway to establish strategies to resolve this situation.

Hazard control requirements are also continuing to become more stringent and a number of initiatives are underway to ensure that TLC aligns with legislative and industry best practice. TLC introduced an alternative method of charging customers in 2007 that aligns better with the pricing principles and the competition coming from distributed generation technologies than legacy type volumetric charging. TLC intends to continue down this path. This strategy has to be supported by metering, related data/communication systems and other initiatives in this document that are designed to progress the development of the appropriate technology. Efficiency gains whilst providing customer service are important for TLC and a key enabler of these has been identified as IT related. TLC intends to invest in improved IT systems over the next period and planning is underway to achieve this. Integrated with this process is a review of business continuity risks.

Based on customer feedback the reliability and quality performance of the network continues to align with what customers are prepared to pay for. There are no strategies, tactics or plans to alter the present approaches to these although further refinements to the pricing methodology are being considered to improve customer acceptance of charges.

2.0 Group Objectives

The high level long term objective is:

To own and manage a network that provides the level of reliability, capacity, quality, service, and community involvement that customers want at a price they accept while generating returns for investors just below the maximum allowable regulated levels.

Key Objectives to meet the Challenges of the environment we are operating in:

- Organisational culture of excellence
- Well documented and managed systems

Health and Safety

- Focus on the core network
- Focus on the existing non regulated businesses that have the most potential

Consolidate

- Automate where possible
- Knowledge in systems rather than individuals

Cost Control

- Service that customers are prepared to pay for
- Balance between quality, reliability, price and customer choice

Network aligned to Customer needs

- Education
- Tools (In Home Display, Smart phones, load control notification)

Customer Choice

- Com Com , Electricity Act and Regs, H and S, Electricity Authority Codes .

Compliance with Legislation

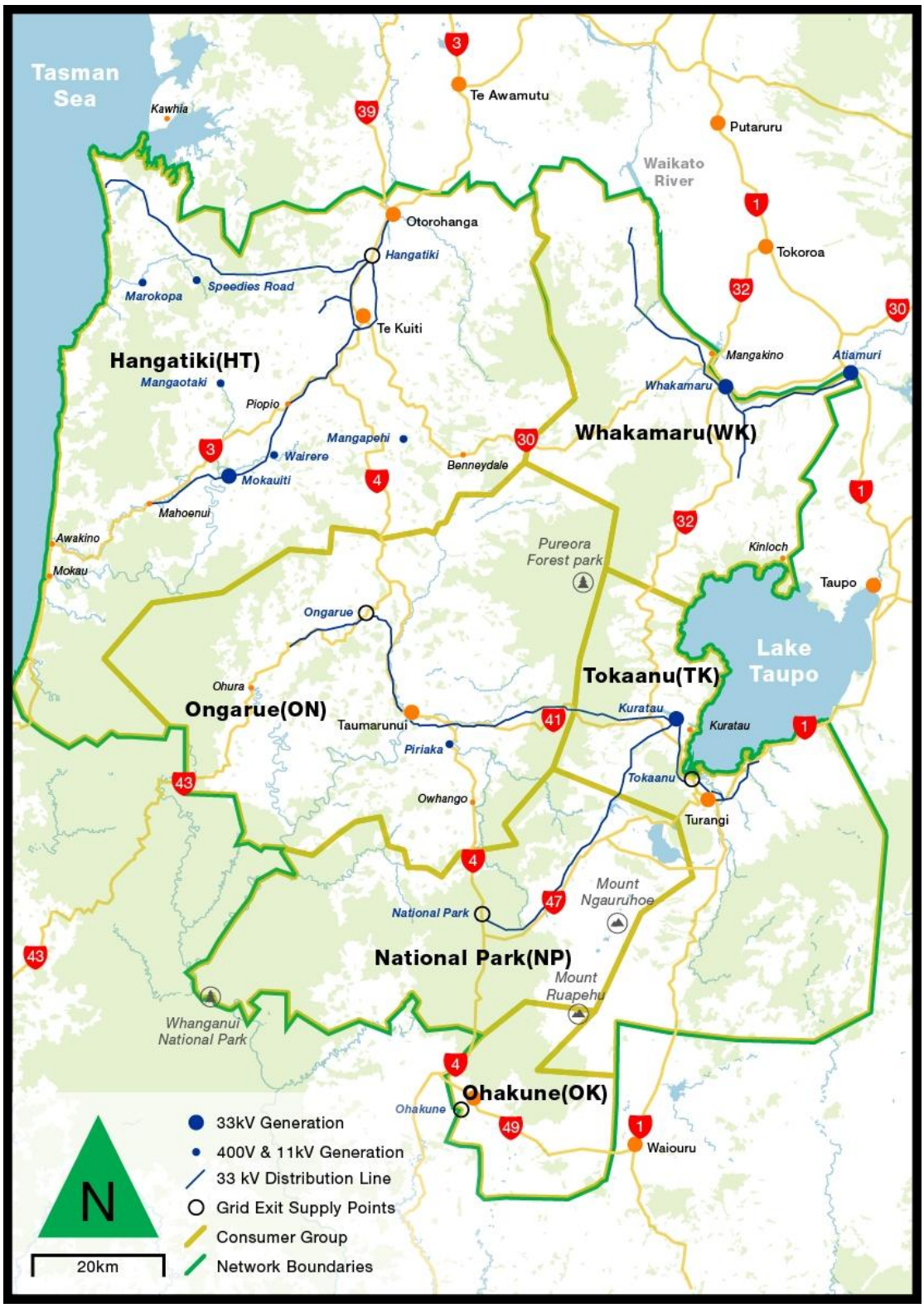
3.0 Nature and Scope of Activities

The Lines Company's core business is owning and operating an electricity distribution business in the 'King Country' region of New Zealand's North Island. As well as keeping power flowing to homes and businesses in the region we also provide a full electrical contracting service, metering and distributed generation business.

The Lines Company is owned by a community trust elected by the people and major users of the northern regions. This trust is called the Waitomo Energy Services Customer Trust.
Our head office is in Te Kuiti, but we also have a physical presence in Taumarunui, Turangi, Ohakune and Mangakino.

3.1 Network Business

The network business sells electrical transport capacity to customers. The distribution area covers 13,700 km2 and is one of the largest network areas in New Zealand with no major urban centre. This aligns with the need to specialise in providing electrical capacity to rural and sparsely populated areas, including to the highest points in the North Island of New Zealand (the Turoa and Whakapapa skifields on Mount Ruapehu).



The major challenges facing the TLC network are maintaining supply quality, reliability and customer service to an area in which the principle business is farming. In recent times the face of the region has changed as farms have rationalised up from typically the 300 acre farms returned servicemen were allocated when they returned home from the wars. Now to be viable in the King Country one has to have a dry stock farm that typically supports 4000 to 5000 stock units. This aligns roughly with a 1000 acre farm. This means that the rural areas have depopulated down. Further the rural towns have seen a similar effect of depopulation partly due to less rural people to support, partly due to rationalisation of many of the services that were present such as post offices, railway depots etc, and partly due to the urban drift.

When the area was developed many of the power lines were constructed on government subsidy. This subsidy is no longer available and many of the assets continue to need renewal funding.

In addition to the depopulation the supply requirements of the people left in the King Country today are far more onerous than the population of 50 years ago. Today the majority of appliances and equipment have some form of data processor or complex electronics within their core functions. This means the supply quality and reliability has to be much higher.

There are other issues also having an impact, for example todays environmental requirements make farmers fence rivers and streams, meaning stock can no longer drink water out of these directly. Farmers have to pump water to their stock; which means they need reasonably sized and reliable pumps that often need to be capable of getting 100,000 litres per day to their stock. The reality is that it is not practical to do this with alternative power supplies. Stock need this water 7 by 24 and if the sun does not shine then technologies like solar alternatives do not work.

Solar technology is becoming more economic as manufacture prices fall. Its effect is to reduce units consumed which means that if any network company escalates its delivered price too high it is faced with the risk of a death spiral in terms of revenue. As more and more solar installations come on stream volumes go down and therefore prices have to go up to provide money for renewal of rotten poles and the like.

Further, today's society is demanding less socialisation of costs. Technology has provided tools to allow the analysis and breakdown of cost drivers. People want to pay as close as possible to the real cost and not pay a proportion of someone else's costs.

These trends were acknowledged by TLC some time ago and as a consequence it had to introduce a way of securing revenue that was different to the status quo. This revenue is needed for renewal of assets and day to day operations. In response, it developed a charging mechanism to take it into the future based on three principle components: dedicated assets, capacity requirements at any time and during constraint times.

This change aligned TLC for the future but did result in customer resistance that put the organisation under strain for a number of years. It is now working through this and a key component is the deployment of advanced meters that accurately measure the components of capacity and make this information available to customers so that they can form an

understanding of how their usage impacts on the network. The ultimate objective of this move is to provide customers with the lowest possible combined lines and energy charges.

The ownership and maintenance of electricity distribution is a natural monopoly and as a consequence the industry is regulated by various pieces of legislation that are overseen by a number of government bodies.

The Lines Company's prices and quality are regulated by the Commerce Commission to provide consumer protection and a fair rate of return that is in line with the investment in the network and the funding needs of the business.

The key Matrices of the business are:

Line and Cable length (All voltages):	4,339km
Asset Regulatory Value:	$175,076,341
Distribution Transformer capacity:	238.08 MVA
Connected customers:	23508 (Ave. for disclosure year)
Growth in connected numbers over the last year:	102 to 31 March 2014
Any time Max Demand:	65 MW
Energy transported (Energy Delivered)	315,336 MWh (ID year 2013)

3.2 Generation Business

The Company owns either wholly or in partnership with landowners three generation sites.

Figure 1: Aerial Shot of Speedys Road Hydro

Two generation sites are in TLC's network area and one is located about 358km to the east.

The key matrices of this business are:

	Mangapehi	Speedys	Matawai
Annual expected Output	5.2Gwh	8.6Gwh	7.0Gwh
Head	106m	42m	153m
Capacity	1.6MW	2.0 MW	2.0MW
Distance from Te Kuiti	27km	52km	358km
Ownership	100% TLC	75% TLC 25% Landowner	100% TLC

3.3 Metering Business

The metering business operates via TLC's subsidiary Financial Corporation Limited (FCL) and rental sites are made up of a combination of On and Off Network metering installations. Rental is charged directly to the customer of On Network installations and retailers for Off Network sites. Advanced meters are currently being installed On Network principally for compliance reasons, but also to have the ability for meters to capture TLC's capacity based charges.

The Off Network metering sites have come about due to opportunities that have been available since the separation of retail and network businesses. At present TLC is replacing many of these soon to be non-compliant assets with advanced meters. The Company is also an audited Metering Equipment Provider under the Electricity Authority participation codes.

In parallel with both of these activities TLC is in the process of investing in an advanced meter management head end and also has available for rental or sale, various in home display devices which give customers more information on their energy use, control periods and demand. Development of various other customer empowering devices is also underway.

3.4 Electrical Contracting Business

TLC owns and operates an electrical wiring contracting business, John Deere Electrical Limited (JDE). This business employs about 14 electricians and carries out commercial and industrial wiring work in the local area.

4.0 Business Plan

4.1 Strategy

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

The key identified elements of the business environment that TLC will need to operate within over the next five years include:

Technological	•More solar, air conditioning, wood burning systems, Hybrid vehicles. •More innovation in communication technologies. •More efficient energy usage devices.
Environmental	•Natural disasters - affecting NZ landuse. •Climate changes - effect on land use, home heating. •More legislation on environmental issues. •Increased political influence in the industry.
Competitors	•Reduced revenues from volumetric charging. •Need for improved customer service and interaction. •Provision of more diverse services.
Demographic	•Declining rural agribusiness population. •Possible increased satelite population. •TLC required to maintain rural lines and expand dairy. •Higher customer reliability expectations.
Legislative	•Increasing analysis by Regulators: rationalisation pressure. •H&S more rigorous. •Additional legislation for network resilience, risk, and disclosure.
Social/Culture	•Increasing use of social media. •More reliance on communication and energy. •Increased retirement age and work/life balance expectations.

Key elements of business strategy are tabled below.

NETWORK: The key elements are:
• A health and safety culture including well documented and managed systems.
• An innovative approach to Network management with focus on rural distribution and enhanced environmental performance
• Engineering support services and systems: including effective field services operation, control room and engineering Capex and Opex delivery
• Service quality standards met or exceeded
• Documentation and management services agreements for Private Lines
• Load control policy which is aligned with customer expectations (both reliability and cost)
• Strong presence on industry working groups and influential on relevant important matters
• Effectively monitored and measured compliance with statutory and regulatory requirements
• Recognized community partner and supporter
• Achieving the regulated ROI on a “right sized” and economic Regulatory Asset Base (RAB)
• Revenues in line with the Commerce Commission price path
• Effective disaster recovery and business continuity processes
• A cost effective business built around integrated IT and shared services
• A pricing strategy aligned with pricing signals (user pays) that are accepted by customers

GENERATION: The key elements are:
• Best value creation through expansion & operation or divestment (sale or merger)
• Deliver or exceed benchmark IRR over asset life.
• Detailed AMP capex and opex projects ensuring maximum plant availability, compliance and alignment with insured risk.
• Plant suits the environment it is in.

METERING: The key elements are:

ON NETWORK

- Deliver or exceed benchmark IRR over asset life
- Grow the Technology in a unique way with a focus on customer service, choice, control and price.
- Compliance with rules
- Integrated with the network and supporting TLC's tariff structure
- Low cost meter reading service heavily reliant on effective Coms systems.

OFF NETWORK

- Deliver or exceed benchmark IRR over asset life
- Have flexible business strategies and a commercial focus with deal making capability to maintain and grow the business.
- Have a meter replacement program tailored to retain business and avoid displacement
- Innovative future products and services ahead of the market.
- Leverage off industry and business relationships

JDE: The key elements are:

- Return on investment and revenue
- Maintain/grow workload for staff through the ability to complete a wide range of work.
- Appropriate vehicles equipment and facilities
- Have IT that enables efficiency gains.
- Adequate H and S systems, documentation, processes and behaviours.

The specific business plans for the next year are focused on advancing the strategic objectives within the operating environment. The significant tactics are:

Network:

Hazard Control	• Progress NZ AS 4801 certification
Revenue	• Narrow gap towards Regulated Returns
Private Lines	• Update documentation and systems
Customer Service	• Terms and Conditions of Supply
Innovation	• Load Control notification to customers
Business Continuity & IT	• IT and Business Continuity plans
Pricing Signals	• Adjust to increase perceived fairness

Generation:

Hazard Control	• Valve isolation at each site
Value Creation	• Review strategy and develop options
Revenue	• Maximise outputs

Metering:

On Network	• Data handling processes
Off Network	• Deployment of advanced metering

JDE:

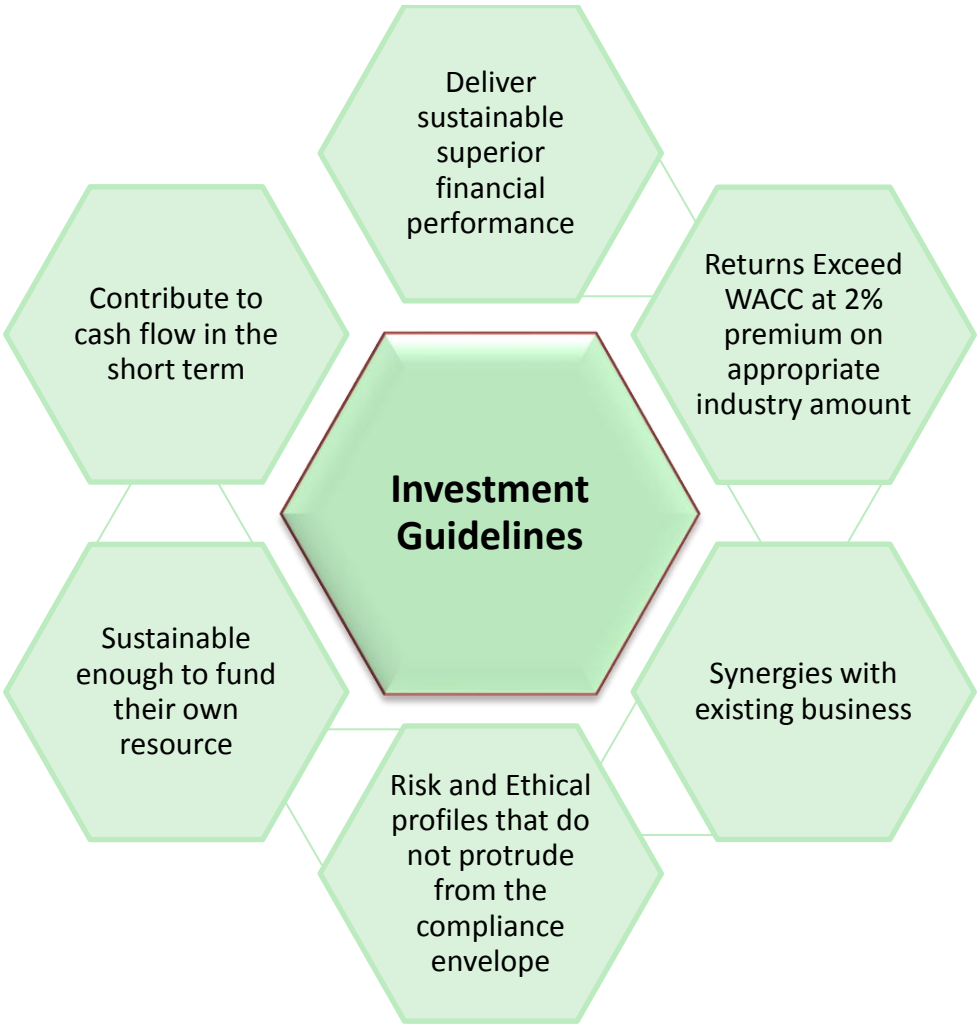
Sustainability	• Focus on growth and aligned opportunities

Corporate:

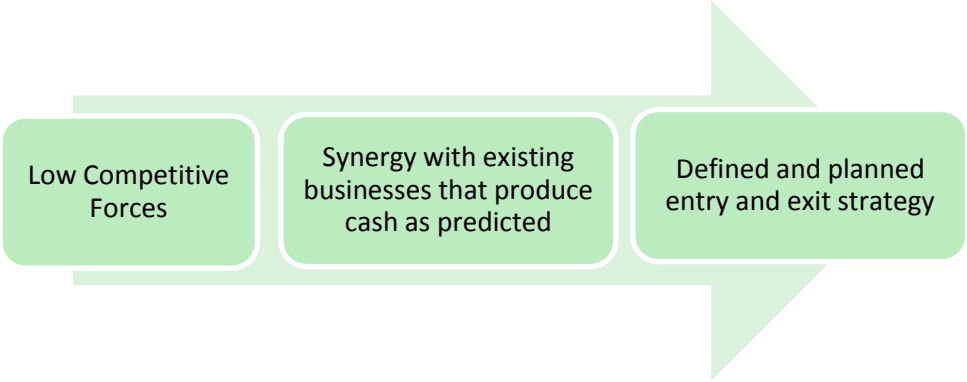
Sustainability	• Ensuring portfolio performance
Strategy	• Strategic, Tactical and Business Plans

Investments

The Company recognises that its main mission is to deliver a strong sustainable network to the greater King Country area. 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 however not willing to invest in network expansion if the projected returns do not exceed Company WACC guidelines. The minimum requirement is a 2% premium on the appropriate industry WACC. Non-regulated business investments will in general terms be subjected to the following assessment elements:



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



Individual investments will be weighted and prioritised according to their risk profile.

New investment for the 2014/15 year will be focused around:

- Metering opportunities.
- Generation other than run of the river Hydro.

4.2 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 the Shareholder, 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	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Projected	Projected	Projected
EBITDA	22,333	22,249	23,434	25,200	26,900	28,900
EBIT	12,168	11,613	12,646	14,000	15,600	18,500
Interest, net	3,200	3,400	3,078	3,200	3,700	3,900
Profit after tax	6,733	5,840	7,315	7,800	8,600	10,500
Return on avg assets	4.0%	3.7%	3.9%	4.3%	4.8%	5.5%
Return- average equity	30.8%	4.1%	5.1%	5.8%	6.3%	7.5%

Balance Sheet	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Projected	Projected	Projected
Cash	650	1,500	3,500	1,500	500	500
Other current assets	4,750	5,000	3,450	3,900	4,100	4,200
Non current assets	227,800	226,700	229,350	234,400	244,200	251,800
Loan to related entity	-	-	13,500	-	-	-
Total assets	**233,200**	**233,250**	**249,800**	**239,800**	**248,800**	**256,500**
Current liabilities	7,000	7.800	6,900	7,250	7,750	8,250
Deferred tax	44,800	43,200	44,100	43,600	43,600	43,600
Bank loans	40,900	40,950	51,950	52,800	57,700	59,400
Minority Interest loans	-	-	1,250	1,250	1,250	1,250
Shareholder Funds	140,500	141,300	145,600	134,900	138,500	144,000
	233,200	**233,250**	**249,800**	**239,800**	**248,800**	**256,500**

Cash Flows	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Projected	Projected	Projected
Operating Cash Flows	15,200	15,550	20,100	19,400	20,000	21,100
Capital Expenditure	(11,250)	(9,800)	(12,800)	(17,200)	(20,900)	(17,800)
Debt Movements, net	(550)	50	11,000	800	4,900	1,700
Dividends	(3,550)	(4,950)	(4,950)	(5,000)	(5,000)	(5,000)
Loan to related entity	-	-	(13,500)	-	-	-
Sale of investments	-	-	2,150	-	-	-
Net Cash Movement	(150)	850	2,000	(2,000)	(1,000)	-

5.1 Performance Targets

1. Return on Average Assets

	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Projected	Projected	Projected
Return	**4.0%**	**3.7%**	3.9%	4.3%	4.8%	5.5%

2. Return on Average Equity (including revaluation gains)

	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Projected	Projected	Projected
Return, excluding revaluations	7.0%	4.1%	5.1%	5.8%	6.3%	7.5%
Asset Revaluation	23.8%	-	-	-	-	-
Return, including revaluations	30.8%	4.1%	5.1%	5.8%	6.3%	7.5%

3. Debt

	2012	2013	2014	2015	2016	2017
	Actual	Actual	Actual	Projected	Projected	Projected
Subordinated debentures	3,000	3,000	3,000	3,000	3,000	3,000
Minority Interest loans	-	-	1,250	1,250	1,250	1,250
Bank loans	40,900	40,950	51,950	52,800	57,700	59,400
Total	**43,900**	**43,950**	**56,200**	**57,050**	**61,950**	**63,650**

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

5. Average urban domestic prices to be ranked lower than 10th on MBIE survey.
   Note that 1 is the most expensive of lines companies in the rankings.

	2012	2013	2014	2015	2016	2017
	Actual	Actual	Projected	Projected	Projected	Projected
Taumarunui	14	20	16	15	15	15
Otorohanga	19	23	22	18	18	18

6. Dividends

	2012	2013	2014	2015	2016	2017
	Actual	Actual	Projected	Projected	Projected	Projected
Dividends	3,560	4,932	4,950	5,000	5,000	5,000

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.

8. Regulated Revenues

To have a Notional Revenue to Allowable Notional Revenue ratio as set out in the Default Price Path Annual Compliance Statement of not less than 80%.

9. Funding of Community Projects

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 shareholder's 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 their carrying value, less deferred tax assets.

Accounting Policies

The Company's accounting policies will comply with the legal requirements of the Companies Act 2013 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 2013, which comply with the International Financial Reporting Standards (IFRS).

6.0 Other Matters

6.1 Information to be provided to Shareholder

1. Updates will be provided on key issues.

2. Half yearly reports will be delivered to the Company's shareholder 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 shareholder 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 changes in equity.
- 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 shareholder 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 Shareholder 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 Shareholder 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 Shareholder one month to make comments on the proposed modification.

The Shareholder may also resolve at a general meeting of the Company to require the Directors to modify the statement. The Shareholder 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 Shareholder must consult the Directors.

Glossary of Terms

EBITDA	Earnings before interest, tax, depreciation and amortisation.
EBIT	Earnings before interest and tax.
Assets	Total assets, less deferred tax assets.
Net Assets	Total assets, less current liabilities.
Equity Ratio	Shareholders Funds / Assets
Return on Average 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 for the year) divided by ((Opening Shareholder's Funds plus closing Shareholder's Funds) divided by 2).
Renewals	Replacement of existing property, plant and equipment either undertaken or committed to in the financial year.
Shareholders' Funds	Shareholder's equity plus subordinated debentures.
Surplus Funds	Net cash from operating activities less any increase in net cash due to temporary changes in working capital.