

MainPowerTrust

2018 Capital Distribution Review Summary Review Report

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MainPowerTrust

Capital Distribution Review Summary Report

Under the terms of the Deed of Trust of the MainPower Trust, (the “Deed”, the “Trust”), Trustees are required every six years to prepare a Review Report reviewing whether or not it is in the best interest of Beneficiaries for the capital of the Trust Fund to continue to be held in whole or in part in the Trust or to distribute all or some of this capital to the Trust’s Beneficiaries. Previous reviews have not resulted in any capital distribution.

Approximately 97% of the capital of the Trust Fund is represented by the Trust’s 100% ownership of MainPower New Zealand Limited, (the “Company”). This is also the Trust’s only significant investment. The Company owns and operates the electricity distribution network throughout the North Canterbury and Kaikoura regions. In addition, the Company has a 100% interest in a relatively small meter-servicing subsidiary company, VirCom Energy Management Services Limited.

The Trust’s remaining capital is represented by a balanced portfolio of other smaller investments. These total approximately 3% of the Trust Fund and include New Zealand, Australian and other international equities, fixed interest deposits and cash. This portfolio is managed by Forsyth Barr Investment Management Limited of Christchurch.

On 20 March 2018 Trustees resolved unanimously that it is in the best interests of Beneficiaries for the MainPower Trust to continue to hold 100% of the distributable capital of the Trust.

In coming to this conclusion Trustees have reviewed and have considered the technological challenges facing the Company going forward, the opportunities that these challenges present and the financial and operational performance of the Company and its subsidiary.

The Trustees have also considered the advantages and disadvantages to Beneficiaries of Trust ownership of the Trust’s 100% shareholding in the

Company and other investments making up the Trust Fund, as compared to a distribution to Beneficiaries of all or part of these investments or their value.

During the Review Trustees took into account the financial and the relevant electricity related advice provided by the commercial consulting firm, PricewaterhouseCoopers, (“PwC”). A copy of PwC’s summary report is attached as **appendix 1**.

PwC concludes at page 4 of the report as follows – *“Given current performance and the current absence of significant drivers for change (such as new investment opportunities unable to be financed from borrowings or an erosion of core business prospects), we consider that the Trust ownership model represents value for Beneficiaries (both present and future) and should, therefore, be continued.”*

A copy of the more detailed public version of PwC’s Full Report, although not forming part of this Summary Report, is available for inspection on the Trust’s website www.mainpowertrust.org.nz/

Detail relating to the advantages and disadvantages to Beneficiaries of Trust ownership of the Trust Fund as compared to a distribution of the Trust Fund is provided at Section 5, “Ownership Options”, pages 30-42 of PwC’s Full Report.

PwC at pages 33-34 of their Report outline the outlook for the Company and the unprecedented changes facing the Company and the electricity sector generally. A detailed analysis of the performance of the Company is available at pages 13-29 of their Report.

PwC concludes at page 43 as follows:

The Company has demonstrated sound performance through utilisation of the Trust model. Notable achievements over the period evaluated since the last review in 2012 include:

- *an increase in operating revenue from \$25.9m to \$85.5m in the 2017 financial year,*
- *an increase in equity from \$191.5m to \$221.4m in the 2017 financial year,*
- *\$53m in Rebates to consumers,*
- *reliability of supply and restoration times which outperform other networks in the Company's peer group, i.e. like companies,*
- *a gearing ratio of 13% (low for an infrastructure company).*

The Company can be expected to continue to perform by the Trust:

- *setting clear direction for the Company,*
- *encouraging the Company to seek opportunities for operational excellence, including access to economies of scale through collaboration,*
- *establishing a culture of innovation,*
- *encouraging the Company to seek out new business ventures which maximise the opportunities, and hence value, which are expected to arise as the industry embraces new technology.*

Consultation: The Trustees must consult the Trust's Beneficiaries on the Capital Distribution Review Proposal that they have approved.

Beneficiaries include "Qualifying Customers", who are the customers of the Company whose premises are connected to the Company's electricity distribution network and who take line services from the Company, with one main exception. Customers whose premises are located in that part of Kaiapoi that was previously the Kaiapoi Borough are not Beneficiaries of the Trust.

Submissions: Qualifying Customers can make submissions to the Trustees on the Trustees' Capital Distribution Review Proposal. Qualifying Customers who wish their submissions to be heard in person will be provided the opportunity to do so at a meeting open to the public to be held on 14 August 2018. Submissions must be received no later than 27

July 2018. Submissions should be posted, faxed or emailed to the Secretary, MainPower Trust, P O Box 370, Rangiora; Fax: 03 313 4509; Email: MPT@kollerhassall.co.nz. Copies of all written submissions will be available to the public; however, your personal information will be withheld at your request.

If any Qualifying Customers would like further information to assist them with deciding whether to make a submission, please contact the Trust Secretary's office using the contact details above.

The final decision of the Trustees on the proposal, the "Review Decision" will be made at a Trustee meeting to be held on 21 August 2018 that will be open to the public. Notice of the Trustees' Review Decision will be given by:

- Making the Notice available for inspection during normal business hours at the Council service centres and libraries referred to above, the offices of the Trust Secretary, and the office of the Company, Fernside Road, Rangiora; and
- By way of a public notice in newspapers circulating in the region: and
- On the Trust's website www.mainpowertrust.org.nz.

Qualifying Customers Poll: Qualifying Customers who were on the Roll of Qualifying Customers at midnight on 9 June 2018 are provided with the opportunity, if they disagree with the Trustees' Review Decision, to ask Trustees to reconsider their Review Decision by way of a Reconsideration Poll. The Trustees' Reconsideration Decision is final.

Qualifying Customers who would like Trustees to reconsider their decision must give formal notice to the Secretary of the Trust by 11 September 2018. A valid notice will contain:

- A statement that each of the Qualifying Customers signing the notice required the Trustees to reconsider their Review Decision;
- The full name and address of each such Qualifying Customer;
- The ICP number of each such Qualifying Customer as recorded on the Qualifying Customer's power account; and
- The signature of each such Qualifying Customer.

- For the avoidance of doubt, the formal notice requiring a Poll may include more than one Qualifying Customer as long as each Qualifying Customer provides the above information.

Where the number of Qualifying Customers who give such notices totals at least 5% of all the Qualifying Customers, then a Reconsideration Poll will be held in accordance with the provisions of the Trust Deed.

If a Poll is requisitioned the Trustees would immediately appoint a Returning Officer who would conduct the Poll.

The Reconsideration Poll will take place during October 2018 and will close on 29 October 2018. The Returning Officer would declare the result of the Poll on 3 November 2018.

K W Brookfield

Chair

MainPower Trust,

On behalf of Trustees.

9 June 2018

MainPowerTrust

Appendix One:

PwC Summary Report

MainPower Trust

Ownership review

Summary report

Final

February 2018

Catherine McMillan
Chair
MainPower Trust
PO Box 370
RANGIORA 7440

9 February 2018

MainPower Trust Ownership Review – Summary Report

Dear Catherine,

We are pleased to provide our summary report which considers the performance of the MainPower Group (comprising MainPower New Zealand Limited (MainPower) and VirCom Energy Management Services Limited (VirCom)), and a review of the ownership options in respect of MainPower. This summary report has been developed for inclusion in a MainPower Trust public notice regarding the ownership review. Accompanying this summary report is a full report containing our detailed analysis and findings, the public version of which will be published on the MainPower Trust website.

This report is provided in accordance with the terms of our engagement letter dated 17 October 2017, and is subject to the restrictions set out in Appendix A. This report supersedes any previous drafts.

Yours sincerely,



Craig Rice
Partner
craigrice@nz.pwc.com
09 355 8641



Lynne Taylor
Executive Director
lynnnetaylor@nz.pwc.com
09 355 8573



MainPower Trust Ownership Review - Summary

Introduction

This summary report has been prepared for the MainPower Trust to support the review of its ownership of MainPower New Zealand Limited. This report summarises the performance and outlook for MainPower. It also summarises the advantages and disadvantages to beneficiaries of the Trust of ownership of MainPower's shares and other significant investments compared to a distribution of those assets (or their value).

Company overview

MainPower owns and operates the electricity distribution network which provides electricity services in the North Canterbury and Kaikoura regions. MainPower also owns VirCom, which provides qualified and registered field services capability throughout New Zealand.

MainPower Group performance

The Group's performance has been sound having increased operating revenue over the FY12 to FY17 period and distributed \$53m of rebates to consumers over the review period. Furthermore, the group has continued to invest in the Mt Cass wind farm development and increased their ownership in Vircom from 77.4% to 100%.

MainPower has undertaken a number of projects to expand network capacity, strengthen security of supply and improve the resilience and reliability of the network. Line charge revenue has increased, resulting in an increase in EBITDA of \$6m over the review period. MainPower increased its rebate to over \$9m in FY17, after absorbing Transpower's

price increase in the year.

VirCom's financial performance has also improved with gross margin increasing. Revenue has increased since FY12 as a result of increased smart meter volumes and a price renegotiation in FY15.

Comparative performance

Benchmarked against a peer group of like EDBs and industry averages, MainPower's electricity lines business has performed well during the 2013-2017 period. In particular:

- Network opex is in line with its peer group first quartile, and below the industry average. Non-network opex is similar to the peer group third quartile and industry average.
- Total opex per connection has remained relatively flat over the review period and although it exceeds the peer group third quartile, it remains below the industry average.
- Network capex was above the peer group and industry averages between 2013 and 2016, and reduced to below the averages in 2017.
- Power outages occur less often and restoration times are shorter on MainPower's network relative to the others in the peer group.
- The regulatory return on investment was in line with the peer group third quartile and above the industry average from 2013 to 2016. A reduction in RY17 reflected the absorption of Transpower's increased charges.
- Average unit prices (after rebates) fall between the first quartile and peer group and industry averages.

Ownership options

This report evaluates the advantages and disadvantages of four Trust ownership options; 100% Trust ownership, distribution or sale of 24.9% or 49.9% of shares, distribution of 100% of shares, sale of 100% of shares.

Options were evaluated against criteria reflecting MainPower's company objectives and sector developments and evaluates both the immediate merits of Trust ownership and the medium-long term or intergenerational merits. The criteria are:

- operate as a successful business providing a safe, secure and financially sustainable electricity supply to the North Canterbury and Kaikoura region
- ability to respond to the challenges and opportunities arising from the evolution of the electricity sector.

Options assessment

Operate as a successful business

With **100% Trust ownership**, MainPower has demonstrated it can operate as a successful business, enjoying sustained growth in revenue and continued customer confidence. These outcomes are however dependent on strong leadership and direction, and potentially collaboration, to encourage performance excellence.

Retaining 100% control has minimal administrative costs and enables the Company to avoid heavy-handed price-quality regulation.

With **partial or full distribution or partial sale** of the Trust's shares, MainPower could be encouraged to focus on short-term shareholder returns at the cost of long-term shareholder value for the benefit of both current and future qualifying customers and the broader community. It also raises questions about inter-generational equity, as current qualifying customers would benefit at the expense of future generations of customers. This is offset somewhat by the establishment of the MainPower Foundation which retains some funding to support the local community in the future.

This model adds administrative complexity, cost and regulatory oversight, with the Trust losing its exempt status under Part 4 of the Commerce Act. However this provides some protection for consumers through enforced price and quality standards.

In the event of a **sale of 100% of shares**, the Trust's current beneficiaries crystallise the existing value of MainPower. While the establishment of the MainPower Foundation and increased regulatory oversight would provide some ongoing benefit for the community, future generations will not benefit from the entire shareholding.

Ability to respond

With **100% Trust ownership**, MainPower has adopted a long-term focus appropriate for a large community utility. The Company's programme of network investment funded through borrowing also demonstrates the potential to fund business change through debt.

However, with new technologies, evolving regulatory settings and more widespread and active participation in the sector, strong direction is required from the Trust. The Trust may also consider partnering or investing in new ventures to access capability, introduce innovation into the business, and expand beyond traditional services.

With **partial distribution or sale or full distribution**, implementing change may be harder given the difficulty achieving consensus across a broader shareholder base. There is also the possibility that short-term returns are prioritised over the business evolution required to drive long-term growth.

Under the **100% sale of shares** option, this objective is no longer relevant as the Trust has no direct interest in the sector.

Conclusion

MainPower has demonstrated sound performance through utilisation of the Trust model. The Company can be expected to continue to perform well by the Trust:

- setting clear direction for the Company
- encouraging the Company to seek opportunities for operational excellence, including economies of scale through collaboration
- establishing a culture of innovation

- encouraging the Company to seek out new business ventures which maximise the opportunities, and hence value, which are expected to arise as the industry embraces new technology.

Given current performance and the current absence of significant drivers for change (such as new investment opportunities unable to be financed from borrowing or an erosion of core business prospects), we consider that the Trust ownership model represents value for beneficiaries (both present and future) and should, therefore, be continued.

Appendix A – Important notice

This summary report provides an overview of the analysis and advice provided in the document ‘MainPower Ownership Review – Full Report’ submitted to MainPower Trust alongside this report. Both reports have been prepared for MainPower Trust to support the Trust’s requirements to carry out an ownership review every six years, consistent with its Trust Deed. The reports have been prepared solely for this purpose and should not be relied upon for any other purpose. We accept no liability to any party should it used for any purpose other than that for which it was prepared.

This report can be made available for public inspection in accordance with the requirements of the MainPower Trust Deed. Apart from this noted exception, our report is not intended for general circulation, distribution or publication nor is it to be reproduced or used for any purpose without our written permission in each specific instance.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this report and/or any related information or explanation (together, the “Information”). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of the MainPower Trust or MainPower New Zealand Limited. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this report are based on information available as at the date of the report.

We reserve the right, but will be under no obligation, to review or amend our report, if any additional information, which was in existence on the date of this report, was not brought to our attention, or subsequently comes to light.

We have relied on forecasts and assumptions prepared by MainPower Trust and MainPower New Zealand Limited about future events which, by their nature, are not able to be independently verified. Inevitably, some assumptions may not materialise and unanticipated events and circumstances are likely to occur. Therefore, actual results in the future will vary from the forecasts upon which we have relied. These variations may be material.

This report is issued pursuant to the terms and conditions set out in our engagement letter dated 17 October 2017.