Presentation

Dennis Barnes
Chief Executive Officer

Well, good morning, everyone, and welcome to the half-year results presentation of Contact Energy. I've got a slide pack here which I'll take you through to guide our conversation. There is more detail available on the website, so please feel free to access that or come back with any additional questions. I also have my colleague Mark Elliot, Chief Financial Officer; and our Investor Relations guy, Fraser Gardiner with me; in addition to our Communications and Partnerships team with Janet Carson and Nick Robinson in the room. So of course, feel free to come to any of us and if you want more time then please ask Janet.

So quickly into the numbers. Contact's business at that EBITDAF level grew by $5 million in the half compared to the prior half, with a number of features which drive that outcome. On the positive, we had no take-or-pay costs from our gas contracts, as we did in the prior period. Our sales volumes increased and growth in customer numbers began to take hold at the end of the period after suffering losses at the first part of the period. This was offset by lower hydro generation. So inflows into Clutha are at 14-, 15-year lows and some slight cost increases as we refresh our systems that we operate on, and also, all businesses will have been impacted by the increase in insurance costs post-Christchurch.

On the operational progress front, the Stratford peakers and Ahuroa storage, a $430 million investment by Contact, were fully operational for all of the period. Our next generation development in Te Mihi is achieving its key milestones and our Enterprise Transformation System, or SAP, completed in our finance and generation business, is now on track to be delivered for our retail business.

In the period, we purchased the Whirinaki Power Station from the Crown. Contact built that and have operated it for many years. So it feels great for it to be part of the real family, and just after the end of the period, we divested a non-core hold in a power station in Australia.

In terms of future growth of our generation portfolio, Tauhara, the next most competitive generation source of scale for New Zealand, the pre-FID is progressing well. So this is the information you need to collect to know how much it would cost to develop. Having said that, the market signals are probably not there right now for us to rush in to spend a lot of money on that.

In terms of capital management, during the period we raised $305 million from the debt and hybrid markets, reducing our gearing level and keeping our balance sheet strong.

In terms of how does that break down into the 2 ways we think about our business, the 2 ways being the Electricity business and inventively titled Other. The Electricity business performed 4%, up about $8 million, largely as a result of no take-or-pay costs. Price increases in the wholesale spot market, which allowed us to generate more of those prices, but a reduction in Retail. Essentially, the cost increases in the Retail business around network and market charges were not offset by the price rises. So we weren't able to pass through all of the cost associated with operating in the market and paying the network companies.

Other is a segment where we have Wholesale and Retail Gas, the LPG business and our Metering business, and the big story there is, in fact, the wholesale gas segment was down because we had a large legacy contract roll-off period-to-period. But pleasingly, in that segment, first time we've been able to say this for a number of years, LPG volumes stabilized. So LPG has been an industry in decline in volume terms and actually stabilized in the period.

So this is the accounting stuff to get you to the statutory and underlying figures. So underlying earnings were down $2 million, which is largely as a result of increased depreciation because we have the new assets and interest expense because we weren't capitalizing interest on assets in construction to the same degree. We'll pay a dividend of $0.11, as we did at this time last year. But we'll be paying that dividend to 15% more shares than we did last year because during the year we issued share equity.

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I've covered this but it gives you some indication of the detail of the numbers that sit behind the result. So in generation, spot prices were up. Costs were down because we didn't have take-or-pay cost because of the flexibility our portfolio now has. This was largely offset by hydro inflows. So yellow is good, gray is bad, and you can see that they largely offset.

In Retail, very simply, market -- our network cost went up $14 million in the period and our price rises didn't keep pace. So you can look at that chart and actually add together the $21 million of price increase with the $10 million of increased discount for the Online OnTime product, and that's the net $11 million and our costs went up $14 million. So that's really the story in Retail. The current market conditions mean that price raises are not keeping pace with third-party costs.

So, into some of the things that drive the numbers. No disrespect to my CFO, but there are more interesting things for me. We have continued to change the composition of our Retail base. We've long been on a strategy of moving our customer base further north, as we develop more generation in the north and reduce our risk of dry sequences in the south, and at the same time, growing our time-of-use market. So that's what the left-hand chart essentially says. Big feature of the year and a big success for Contact, in hindsight, was that we were able to reverse the declining customer numbers which were triggered in part by the What's My Number campaign earlier in the period. We did this with the introduction of an increased discount, and I think for the last 3 months of the period, our customer numbers increased by about 5,000. Fully expect that to keep going.

Our large capital projects in generation and systems for our customers continue to hit their time frames. Te Mihi has a number of dimensions to it, the power station being one of them. But the steam field works that were required for the first phase were completed last year. The turbines, which are being manufactured in Japan, arrive in the next few weeks and go into a building which is just about looking like a building, so all of the timetable has been hit. Enterprise Transformation, so the implementation of SAP, is now in and complete in finance and generation and now in its really complex phase for the Retail business, and will be implemented towards the end of this year.

You'll note I said towards the end of this year, retail billing and call center solutions are hugely complex and in no way will we jeopardize our service levels. So we will implement that and go live with it when we're confident that it's delivering the improved service and billing that we expect from it, and not before.

Pleasingly, we continued our journey to an aspiration of 0 harm. Our total recordable injuries are a measure of that, only one measure, and they improved by 20% on the period. Continued vigilance, as we continue to construct in high-risk activities on safety. It's great that we're harming less people. Our target is to harm no one.

So onto some of the market dynamics now. This is a chart we often show, of hydrology levels in the bluish lines and prices in the yellow and red lines, and hydrology has taken a few phases in the last 6 months, to be honest. It was wet at first, then it dried and then it got wet again, and more recently, it's gone quite dry. And prices did respond to that to be, on average, $25 higher in the period. $25 to take it to $79, on average, is still not enough for Contact to achieve significant exposed earnings, but it does cover our cost of running the thermal plant, but only just.

Part of the dynamic in the market is that in the last 4 or 5 years the level of new supply has far outstripped the level of new demand. So on the left, you see that approaching 6,000 gigawatt hours of new generation has been produced or built to be produced in a 40,000-gigawatt-hour market, and at the same time, demand has only gone up to just a little over 1,000 gigawatt hours. And these generation sources are not like the bulk of Contact's development in recent times. Like the peakers, which don't have to run, these are effectively must-run generation sources. So wind runs when it's blowing, geothermal has a need to continue to run in base load. And the big blue block at the top is the expansion at Huntly for gas-fired production, which essentially is must-run because it relies on Kupe gas in Taranaki and that runs to produce liquids and oil. So all of that generation effectively goes into the market no matter what the price, which crowds out thermal generation that both Contact and Genesis have. So that's the dynamic that has dampened price, to some degree, in the half.

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There are services a bit of flavor above the market, so what does that mean for Contact going forward? Well 2 things, really. The first one is we will continue to lower our average cost of generation and increase the flexibility in our portfolio. Te Mihi, big example of that. Peakers, Whirinaki at 350-megawatt hours of flexibility. Gas storage provides the reservoir with which we can trade gas and move gas between seasons and days. And there's a contract we have which, on a relative basis, is expensive and that ends this year the Huntly swaption.

What we've yet to do in that mix is determine how much gas and what shape that gas will have in the future. Our gas contracts are up for renewal in 2014, and then that will determine how we operate Otahuhu and Taranaki combined cycles. So a lot of ticks there and things to do this year, which are materially important to that first strategic priority.

Second strategic priority is, when the time is right, i.e. when the market recognizes the value of capacity and supply demand tightens such that a return can be had, then we're well-placed with Tauhara and a whole range of development options to invest new capital. But that won't come until the signals are there.

So just a little bit more detail on why this year is important in future delivery of that strategy. Number one, we've long foreshadowed that in the next few months we'll get a reserves update from our largest gas supplier in Taranaki. That will then determine how we think about maintaining Otahuhu and it will then determine what levels of gas we think about from 2014 onwards. So quite an important year in terms of portfolio and asset investment. That's not to say a whole heap of other stuff isn't going on. Retail systems will go live. I've noted, the investment in the transmission system will be complete this year, hopefully, which will change the way we think about moving power around the country. Smart meters are getting deployed to 1/3 of our customer base. No doubt this year we will announce that, that will be rolled out to all customers, and a continued drive to complete Te Mihi and get Tauhara ready for when the time is right.

So just a little bit more detail on Te Mihi. It's a hot topic, given it's only now 15 months away from completion. If you say that quickly, it doesn't sound like a long time. But the picture to the right gives you a scale of the activity there. That's the Te Mihi construction site and to left is a carpark, and you might be able to spot the cars and that gives you a sense of scale. The cranes in the middle are where the turbines will go, and there's a bit more developed today and we'll start to see turbines arriving in the next few weeks. The picture to the left is the bioreactor and that's beside Wairakei power station in the Waikato, and that's a project where we are investing $35 million to reduce the impact of our discharges into the Waikato. So all of that is happening in the same region at the same time and all on track, with some pretty good partners: Hawkins, the people behind the joint venture at the power station, Downers and Century. Pretty happy to be having good partners along the ride -- with the ride, for us.

So in summary, trying to bring all of that together into a single message. First half, clearly measurable benefits from the portfolio investment, offset by low hydro volumes; and the Retail market competition, which frankly, just didn't allow us to fully recover our costs; progress made on take-or-pay, i.e. we didn't pay any take-or-pay costs; 4 months of Retail customer gains; the addition of, effectively, 155 megawatts to the portfolio with hardly any cash outlay because the Oakey divestment gives us a gain of $28 million at the full year. Whirinaki cost us $33 million. Projects on track, the balance sheet in a strong position.
In terms of outlook, I'll split it into 3 time horizons. The first one being the next 5 months to take us to the full year with low hydro levels, giving an indication to me that there could be positive for Contact in exposed earnings in the back end of this financial year. The next 2 to 3 years, structural changes in our portfolio, which will continue to increase the flexibility. And then the third horizon, when the time is right and the market signals, a diverse range of development options.
So that's all I was going to say this morning. I'd like to say there's more detail on the website.

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