Alliant Energy New Zealand

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Alliant Energy in New Zealand

Alliant Energy New Zealand Ltd

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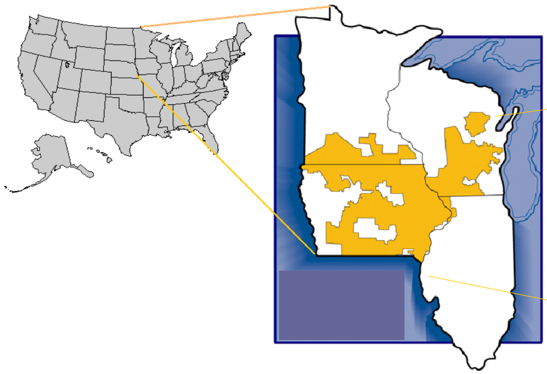

Market Value of Approx $500m

Infratil

TrustPower

- New Zealand investment primarily in TrustPower, a public company
- 35 hydro-generation facilities, 2 wind-farms & 200,000+ retail customers
- Small investment in partner, Infratil
- Helps realise value through stable governance
- Seeks to add value through technology transfer opportunities
- Interest declared: Director of TrustPower Ltd

The original report

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New Zealand

INVESTMENT IN THE NEW ZEALAND ELECTRICITY INDUSTRY:

- An examination of comparative financial performance, pricing, and new entry conditions; and a discussion of the principles of new investment,
- by Auckland Uniservices Limited

Note: Please contact info@alliantenergy.co.nz to get a copy of this report

- Examined the financial statements of the five largest companies in the electricity industry 1999-2004
- Three state-owned enterprises and two private companies

The original report

THE NEW ZEALAND ELECTRICITY INDUSTRY : A GOOD CASE STUDY

- A transparent competitive market
- SOEs go head to head with private investors
- six years of robust data and can show clear trends across time

- Focused on book vs market valuations, and return expectations of public vs private ownership
- Found significant differences existed

We're on for you.

The update to June 2005

Total Market Year Ended June 2005	$m
Operating revenue	5,559
Line revenues	1,474
Electricity revenues	**4,085**
Operating earnings before tax	1,043
Tax	370
NPAT	**673**

Total Market Year Ended June 2005	$m
Asset values incl revaluations	14,656
Current liabilities	1,447
Longer term liabilities	3,429
Total liabilities	4,875
Equity = net assets	**9,781**

The industry value chain and balance sheets in 2005

- operating earnings of $673 million
- total equity of $9.8 billion

The findings

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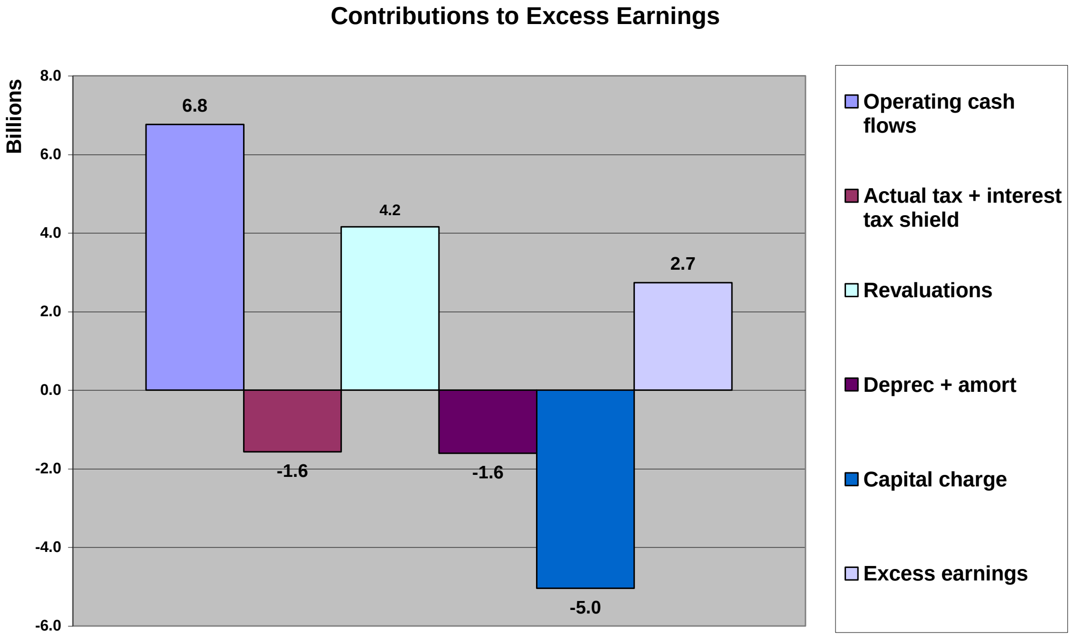
Description	Estimate	Source
Risk free rate	5.75%	10 year govt stock
Aggregate tax rate for investors on debt	33%	
Asset Beta	0.650	Mid range from UoA study
Equity Beta	0.848	
TAMRP	7.50%	Commerce Commision decisions and PWC website
Cost of equity	**10.22%**	
Cost of debt		
Debt margin	1.25%	Mid range from UoA study
Cost of debt pre tax	**7.00%**	
Corporate tax rate	33%	
WACC		
Debt to Value ratio	23%	Industry books
Equity to Value ratio	77%	
WACC (nominal)	**8.9%**	

SCI return on average equity targets	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Meridian	5.29%	5.70%	7.60%	8.90%	5.30%	7.40%
MRP		6.80%	8.30%	8.30%	8.60%	10.90%
Genesis	4.9%	4.0%	4.0%	4.70%	4.70%	6.60%

Looked at WACC and SCIs

- The return on equity targets set in the Statements of Corporate Intent for the State Owned Enterprises suggests the required average rate of return on assets for SOEs is lower than would be acceptable to private investors – through lower return on equity targets.

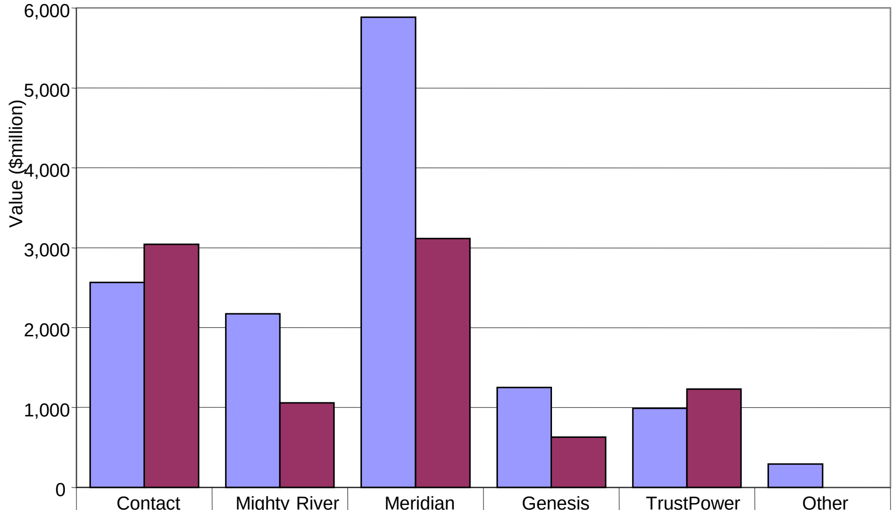
The findings



Looked at earnings composition

- The returns on the capital invested in the New Zealand electricity industry have come mostly through revaluations rather than through operating earnings which alone, have not covered the industry’s cost of capital.

The findings



	Contact	Mighty River	Meridian	Genesis	TrustPower	Other
Calculated	2,565	2,171	5,885	1,251	989	290
Book Value	3,041	1,056	3,114	626	1,230	

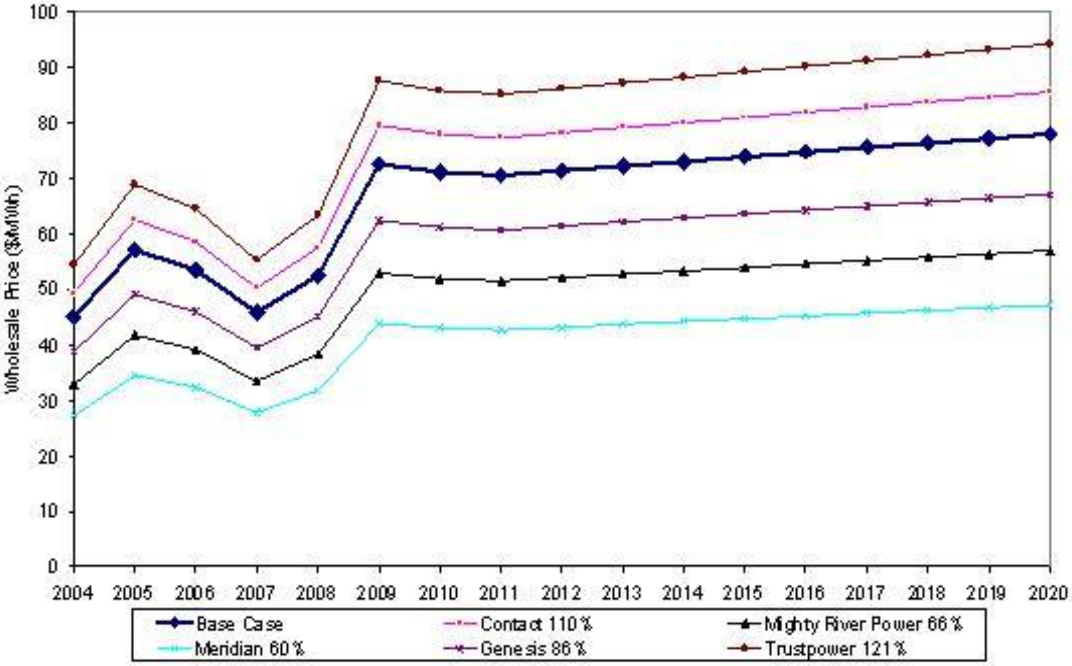
Looked at valuations

- Found that all three SOEs were significantly undervalued in 2004.
- Under-valuations and inadequate return expectations enable companies to accept lower prices in the marketplace.

Note: MRP and Genesis revalued since – now close to 2004 Uniservices estimates

We're on for you.

Why is this important?



Price paths consistent with book values

- The undervaluation of assets, particularly among the SOEs, means reported SCI returns on the existing book value of assets are overstated. This may enable the SOEs to "hide" sub-optimal returns on new investment.

The findings

$millions	2000	2001	2002	2003	2004	2005
Average equity	$5,061	$5,351	$5,901	$6,786	$7,646	$8,933
NPAT	$284	$329	$231	$404	$467	$608
Return on Average Equity From Operating	**5.6%**	**6.2%**	**3.9%**	**5.9%**	**6.1%**	**6.8%**
Revaluations	$326	$34	$843	$600	$972	$1,386
Return on Average Equity Including	**12.1%**	**6.8%**	**18.2%**	**14.8%**	**18.8%**	**22.3%**

Looked at returns on operating earnings

- the return on equity from operating earnings were below the opportunity cost of the capital deployed

Note: For the two gas companies, Contact and Genesis, we reduced opex by the same % as gas revenue to total

SCI setting

The process for setting SOE SCIs is:

- Companies retain responsibility for their business planning.
- Shareholding Ministers have opportunities to convey to company boards the government's ownership expectations.
- CCMAU assists Ministers (and to some degree the companies) to participate fully in the process.
- Ministers retain the right to direct companies to change their SCI/SOI.

A question:

How do policy-makers know that there is no systemic bias from their own companies towards lowering the operational thresholds that a private operator must live within, and thus making private investment, both incumbent and new entry, less attractive.

The State-Owned Enterprises Act 1986:

- ..the principle objective of the state businesses is set out: This is to be a successful business, to operate as a successful business and, to this end, to *be as profitable and efficient as comparable businesses that are not owned by the Crown*

Current settings

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Financial Performance Measures	Year ended 30 June 2006	Year ended 30 June 2007	Year ended 30 June 2008
EBITDA per MWh produced (NZ)	$35.9	$38.5	$39.4
Return on average Equity (%)	9.1	9.5	10.4
Debt to Debt plus Equity (%)	37.4	38.7	37.4
EBITDA Interest Cover	5.2	5.2	5.6

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Return on Average Shareholders Equity (%)	4.0	3.4	3.4
Total Equity/Total Assets (%)	72.8	68.2	64.9
Net Debt/ Net Debt plus Equity (%)	23.0	28.3	31.8
Free Funds from Operations/Interest Expense (x)	5.14	3.71	3.26

Genesis Energy's performance targets for the next five financial years are:

YEAR ENDING 30 JUNE	2006	2007	2008	2009	2010
Financial Performance Targets					
Return on capital (NOPAT/Avg Debt + Equity)	3.9%	3.2%	2.9%	5.0%	7.4%
Return on equity (NPAT/Avg Shareholders' Funds)	4.8%	4.1%	3.1%	5.5%	8.8%
Earnings before interest and tax to average total assets	5.9%	4.9%	4.5%	7.1%	10.0%

Status quo remains

- Low return expectations amidst undervaluation

SOEs – Where to from here?

Some conclusions

- SOE financial drivers can not be separated from the question of market reform.
- Reform of the way expectations of SOE performance are determined is needed; this should focus on the SCIs.
- Additional new entry tests should also be incorporated into SCIs to ensure systemic bias is overcome.
- SCI returns should target equity returns derived from the weighted average cost of capital, and
- The existing assets need to always be fully valued to their market value.

Thank you