Keeping the energy flowing

STATEMENT OF CORPORATE INTENT

2011/12

TRANSPOWER

Transpower New Zealand Ltd The National Grid

Statement of Corporate Intent

2011/12

TRANSPOWER STATEMENT OF CORPORATE INTENT ("SCI") FOR 1 JULY 2011 TO 30 JUNE 2014

Introduction

This SCI is submitted by the Board of Directors of Transpower New Zealand Limited, in accordance with Section 14 of the State-Owned Enterprises Act 1986 ("The Act"). It sets out the Board's overall intentions and objectives for Transpower New Zealand Limited and its subsidiary companies (the Transpower Group)[1] for the year commencing 1 July 2011 and the following two financial years.

Transpower New Zealand Limited and its subsidiary companies are referred to as "Transpower" throughout this SCI.

Business scope

Transpower is the owner and operator of the National Grid. Transpower is also contracted by the Electricity Authority (EA) to provide System Operator services to the electricity industry. System operation involves the real-time co-ordination of electricity generation, transmission and demand, and the real-time management of the electricity market in New Zealand.

Role of the National Grid

The National Grid is fundamental to New Zealand's economy. New Zealand needs a reliable supply of electricity, delivered to areas of demand, in order to:

- enable economic growth and development;
- sustain commercial confidence; and
- maintain and enhance the living standards of all New Zealanders.

The National Grid is undergoing major upgrading and asset replacement. In addition, growth in demand for electricity and development of renewable generation has increased the transmission capacity required.

Transpower is committed to playing its part by discharging its responsibilities fully in this regard.

[1] The companies that comprise the Transpower Group are listed in Appendix 3

Regulatory framework for transmission services

Transpower is subject to economic regulation by the Commerce Commission and the Electricity Authority, as follows:

- the Commerce Commission has responsibility for oversight of:
  - transmission investment undertaken by Transpower;
  - the quantum of Transpower's revenues to ensure that transmission services are provided efficiently and in a manner that avoids excessive (i.e. monopoly) profits; and
  - the quality with which these services are provided to ensure that they appropriately reflect customers' needs.
- the Electricity Authority has oversight of:
  - the allocation of charges to recover the costs of transmission services, including new investment costs, between National Grid users (i.e. the transmission pricing methodology); and
  - the establishment of reliability standards for the transmission system.

The regulatory regime governing the environmental impacts of transmission, and the related issues of property rights and access, also have a fundamental influence on Transpower's ability to meet its SCI objectives. Reforms to the Resource Management Act, including the introduction of National Environmental Standards (NES), have improved the regime for obtaining approvals for upgrading existing transmission lines and for managing under-build. Nonetheless, property and land access rights issues remain.

Corporate Social Responsibility

Transpower's prime corporate social responsibility is to provide a reliable transmission service while working in partnership with communities to plan, deliver, and operate infrastructure in a manner which seeks to mitigate the social and environmental impacts of Transpower's activities.

A cornerstone of Transpower's approach to corporate social responsibility is engaging with communities, landowners, customers, employees, and shareholders to identify how to meet relevant needs and improve our performance.

Transpower has established performance targets and reporting frameworks to demonstrate how these responsibilities are reflected in Transpower's functions and actions (set out in Section E).

Context for the 2011/12 SCI

Transpower's continuing priorities over the next three years are to deliver key projects necessary to reinforce the National Grid, and invest in technological solutions to increase utilisation of the grid assets. There is the need for investment in both new capacity and in asset refurbishment and replacement to address the legacy of a sustained period of low investment and optimise asset life and reliability.

- Capital investment is planned to peak in 2011/12 and 2012/13 with expenditure of ca. $850million in each year. This is driven principally by the coincidence of expenditure on three major upgrade projects (the North Island Grid Upgrade between Whakamaru and South Auckland; a new High Voltage Direct Current Pole (Pole 3) to replace the existing Pole 1; and the North Auckland and Northland Project reinforcing supply through Auckland CBD to the north).
- Other capital investment, together with enhanced asset management strategies, is focused on ensuring that Transpower's asset management regime is robust and fit for purpose, in accordance with good electricity industry practice.

- Projected total capital expenditure including all upgrade and asset renewal works is set out in Section C, below.
- In the short term, before the current reinforcement programme takes effect, unplanned systems interruptions are likely to remain at an increased level. This is reflected in the operational performance measures set out in Section E.
- Transpower puts safety first. Our objective is to be an injury-free workplace for our employees and contractors. Our safety performance is improving steadily but is not yet at a level we deem acceptable. The targets and measures set for our safety performance in Section E, below reflect the long-term journey on which we have embarked toward making Transpower a leader in safety.
- The relatively improved conditions in international credit markets following the global financial crisis (GFC) mean that Transpower is unlikely to face any restrictions in its access to the capital necessary to fund its investment programme. Nonetheless, to ensure continued access to capital and minimise the cost of funds, preservation of a sound credit rating is a priority. We have completed a review during 2011 of capital structure and dividend policy, including an assessment of how credit ratings impacted market access and funding costs through the worst of the GFC. This review indicates that dividends can be recommenced in 2011/12 (a year earlier than previously forecast), while still maintaining a prudent capital structure and interest coverage. The revised dividend policy is described in Section F.
- The nature of the regulatory regime for transmission (described above) is a crucial influence on Transpower's overall performance, particularly the return on regulated assets allowed by the Commerce Commission. The Commission's final decisions in December 2010 and March 2011 set the rate of return at 7.19% (post-tax, nominal). In Transpower's view, this figure is materially below Transpower's weighted average cost of capital (WACC). As a consequence, Transpower has instigated an appeal of the Commission's decision under the process set out in the Commerce Act 1986. The financial performance measures (Section E) and other forecasts set out below reflect the 7.19% set by the Commerce Commission[2].
- In recent years, Transpower's financial results and economic performance have been impacted by the significantly increased costs of instantaneous reserves allocated to the HVDC link. The economic exposure will largely end at 30 June 2011, from which time the majority of HVDC reserves costs will be recoverable from industry participants.
- Transpower's financial results are currently impacted by movements in the estimated market value of land held for re-sale on the route of the North Island Grid Upgrade. This may create volatility in Transpower's earnings until the properties have been sold. The disposal process is expected to take up to three years to complete. The purchase of a substantial number of freehold properties to acquire easements was necessary for the particular circumstances of the North Island Grid Upgrade. In general, Transpower's approach is to acquire easements directly and thus avoid significant exposure to the property market.
- Transpower is not exploring opportunities for developing further its non-core, unregulated activities. This is to allow the focus of the Board and management to be directed fully on the significant challenges in the core business.
- Opportunities for Transpower to add economic value (i.e. achieve returns in excess of its cost of capital) are very restricted. The regulatory framework within which Transpower operates will, over time, limit Transpower's return on capital invested from regulated assets to no more than Transpower's estimated cost of capital and risks to economic value are weighted currently toward the downside. Economic returns measured on an annual basis will also be affected by material inter-temporal adjustments.

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[2] Transmission charges for the 12 month period from 1 April 2011 are based on a regulated return of 7.06%. This figure was the Commerce Commission's draft position in November 2010 when charges were notified to transmission customers.

A TRANSPOWER'S OBJECTIVES

Transpower's principal objective, as set out in Section 4 of the Act, is to operate as a successful business and to be:

a) as profitable and efficient as comparable businesses that are not owned by the Crown;

b) a good employer; and

c) an organisation that exhibits a sense of social responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so.

To achieve its principal objective, Transpower will:

a) be as profitable and efficient as comparable businesses:

- within regulatory requirements, deliver and operate a National Grid that meets the needs of users now and into the future and comply with the statutory requirements of the regulatory regimes under which it operates;
- work with regulatory agencies to agree investment plans that address risks to power system reliability or that relieve persistent congestion affecting market efficiency;
- provide transmission services at the standard of quality and security agreed with National Grid users or required by regulatory agencies;
- provide System Operator services in accordance with service agreements negotiated with users of those services or required by regulatory agencies;
- promote efficient investment in the National Grid to provide the platform for a competitive wholesale market thus enabling options for investment in generation and demand-side management;
- seek to efficiently recover the full costs of its services;
- improve the efficiency of its services, whilst optimising asset reliability and availability; and
- pursue business opportunities based on the capabilities and expertise developed through its core business activities.

b) be a good employer:

- maintain well qualified and motivated staff and adopt human resource policies that treat employees fairly and properly in all aspects of recruitment, retention and employment; and
- promote a high level of safety throughout the organisation, taking all practicable steps to provide its employees and the employees of its contractors with safe working conditions.

c) act in a socially responsible manner:

- build effective relationships with landowners, occupiers and other community representatives and interest groups affected by Transpower's activities;
- build effective relationships with Maori;

- improve environmental reporting and performance, taking all reasonable steps to reduce the risk of adverse effects on the environment that may be caused by aspects of Transpower's activities;
- incorporate sustainability into Transpower's business activities and work with key stakeholders to promote sustainable outcomes for the electricity sector; and
- sponsor educational and training activities that support the future requirements of the electricity industry in New Zealand.

B NATURE AND SCOPE OF COMMERCIAL ACTIVITIES

Transpower's principal commercial activities are:

- the transmission of electricity from generators to distributors and direct supply users;
- the operation, maintenance and development of such assets as are required to ensure this is achieved on a long term basis;
- as System Operator, the short term matching of demand and supply of electricity;
- the co-ordination of the provision of ancillary services, including voltage control and frequency control; and
- the gathering, management and provision of information to the electricity industry.

Any significant departure from Transpower's principal business activities and/or any proposal that Transpower should enter into significant new business activities will be discussed in advance with the Shareholding Ministers. Approval will normally be sought through the Shareholding Ministers' consideration of updated Statements of Corporate Intent.

C CAPITAL STRUCTURE AND INVESTMENT

The estimated capital structure at 2010/11 year-end, and forecast for the next three financial years is set out below:

Capital Structure and Investment[3]	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
Debt ($ million)	2,023	2,535	3,289	3,690
Equity ($ million)	1,575	1,624	1,470	1,498
Ratio of Debt to Debt plus Equity	56%	61%	69%	71%
Capital Investment ($ million)	689	873	868	736

Transpower's intent is that investment related expenditures can be fully recovered from transmission customers in a timely manner. However, cost recovery is subject to regulatory decisions by the Commerce Commission and Electricity Authority.

Transpower will aim to optimise its capital structure. Optimisation depends on a number of factors, including long-run expectations for: the economic environment; Transpower's weighted-average cost of capital; the security of Transpower's revenue stream; and required spending on National

[3] The figures in this table are expressed on the basis of New Zealand International Financial Reporting Standards (IFRS) in accordance with Transpower's Accounting policy. Refer to Appendix 1 for definitions of capital structure and investment measures.

Grid assets. The level of capital investment peaks in 2011/12 and then continues at a lower level through 2013/14 and beyond.

Transpower will seek to manage its future capital requirements without recourse to equity injection by the shareholder. It is, therefore, vital to maintain access to a wide range of debt capital markets to ensure our investment requirements can be funded efficiently. This requires a strong credit rating to be maintained.

Following a review of capital structure and dividend policy during 2011, Directors have concluded that an appropriate credit rating can be maintained while also bringing forward, by one year (to 2011/12), the date from which dividend payments recommence (refer Section F, below).

Prudent liquidity management policies, consistent with Transpower's credit rating, are in place to ensure that sufficient funding is secured ahead of need, and to provide protection against any unexpected deterioration in credit markets.

D ACCOUNTING POLICIES

Transpower's financial statements are prepared in accordance with the Financial Reporting Act 1993. The Financial Reporting Act 1993 requires compliance with generally accepted accounting practice (GAAP) in New Zealand. The financial statements comply with New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS) and other applicable Financial Reporting Standards. The financial statements also comply with International Financial Reporting Standards (IFRS). Transpower is not a public benefit entity for the purposes of NZ IAS 1 Presentation of Financial Statements.

The detailed accounting policies applied in the preparation of the financial statements are consistent with the accounting policies disclosed in the 2009/10 annual report. Transpower's Annual Reports containing its detailed accounting policies can be viewed at:
http://www.transpower.co.nz/n4143.html

E PERFORMANCE TARGETS AND MEASURES

The performance of Transpower in relation to its objectives (contingent on no unexpected or materially adverse decisions resulting from the regulatory framework) will be assessed by reference to a range of operational, financial and non-financial performance targets, grouped by principal objective. These targets are set out below[4].

For reference, a comparison of the performance targets and measures for the 2011/12 year set in the 2010/11 SCI with those set in the 2011/12 SCI is contained in Appendix 2. Where possible, Transpower's operational performance is benchmarked with comparable international organisations.

A summary of standardised financial performance measures is included in Appendix 4 for comparison purposes with the rest of the SOE portfolio.

[4] Refer to Appendix 1 for definitions of the performance measures.

a) To be as profitable and efficient as comparable businesses

Operational Performance Targets	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
High Voltage Alternating Current (HVAC) circuit availability (%)	98.4	98.5	98.5	98.5
High Voltage Direct Current (HVDC) (pole 2 only) availability (%)	85.3	82.5	82.5	N/A[5]
Number of loss of supply events greater than 0.05 System Minutes	19	21	21	21
Number of loss of supply events greater than one System Minute	3	3	3	3

Financial Performance Targets	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
EBITDAIF[6] margin	61.6%	63.2%	65.6%	71.3%
Free Funds from Operation Interest coverage	3.2	2.8	2.7	2.8
Return on capital employed	6.7%	7.3%	7.2%	7.4%
Return on equity	8.9%	9.9%	11.7%	13.9%
Average total transmission costs (c/kWh)	1.67	1.75	2.07	2.31
Estimated economic value added ($million)	(38)	(13)	(1)	14

Non-Financial Performance Targets	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
Material Breaches of System Operator Performance Obligations reported to the Electricity Commission	0	<4	<4	<4

b) To be a good employer

[5] HVDC Pole 3 is forecast to be commissioned in 2012/13. A revised target for Pole 3 and Pole 2 will be set in the following years

[6] Earnings before interest, tax, depreciation, amortisation impairments and net fair value adjustments

Non-Financial Performance Targets	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
ACC Workplace Safety Audit Status	Tertiary	Tertiary	Tertiary	Tertiary
Number of fatalities or injuries causing permanent disability	0	0	0	0
Number of medical treatment injuries	26	10% < 2010/11 out-turn (adjusted for forecast 2011/12 man hours)	10% < 2011/12 out-turn (adjusted for forecast 2012/13 man hours)	10% < 2012/13 out-turn (adjusted for forecast 2013/14 man hours)

(c) To be an organisation that exhibits a sense of social responsibility

Corporate Social Responsibility		
	Target	**2011/12 Proposed Actions**
Environmental care	Improve environmental performance and ensure full compliance with environmental authorisations.	Implement environmental approvals monitoring process. Rollout environmental “KPI triangle” with contractors and monitor performance towards environmental outcomes.
Public safety	Avoid encroachments within transmission corridors and develop action plans to address issues identified.	Seek buffer distances through application of the National Policy Statement. Undertake programme of line surveying to identify and rectify non-compliant structures and other encroachment. Advocate for corridor management policy objectives to be integrated into private subdivision and development proposals.
Climate change	Report total direct and indirect green house gas emissions against management and mitigation targets set out in Transpower’s GHG management programme.	Publish 2010/11 emissions report on Transpower’s website. Raise internal awareness of carbon footprint programme (and wider sustainability issues).

F DIVIDEND POLICY AND ESTIMATES

Funds attributable to the shareholder and surplus to Transpower's financing and operating requirements will be distributed annually to Transpower's shareholders. The level of surplus funds will be determined by having regard to: a sustainable financial structure, with a focus on FFO/interest coverage; Group capital expenditure and working capital requirements; economic regulation; and forecast macroeconomic conditions.

Subject to the above considerations, target distribution over time is expected to average between 65% and 75% of free cash flow, after deduction of maintenance capital expenditure.

Year	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
Estimated amount to be distributed by dividend ($m)	nil	315	229	151

Dividend payments will normally be divided into an interim dividend paid in April and a final dividend paid in October. The interim payment will be based on forecast performance in the current financial year and would typically represent ca. 40% of the estimated full-year distribution.

In recommending the dividends to be paid to shareholders, Transpower will follow procedures generally adopted by Directors of publicly listed companies, and comply with the requirements of section 15 of the Act and any notice given by the Shareholding Ministers under section 13 of the Act.

G INFORMATION TO BE REPORTED

To enable the Shareholding Ministers to assess the value of their investment in Transpower, any information that would normally be supplied to a controlling private shareholder will be made available.

An annual report for each financial year, including audited financial statements, will be submitted in accordance with section 15 of the Act. The annual report will:

- contain sufficient information to enable an informed assessment to be made of Transpower's operations, including a comparison with the SCI; and
- state the dividend payable to the Crown for the relevant financial year.

Transpower will also submit to the Shareholding Ministers:

- half-yearly reports, in accordance with section 16 of the Act, and quarterly reports which will include unaudited profit and loss, balance sheet and cash flow statements together with such details as are necessary to permit an informed assessment of the company's performance during that reporting period; and
- a draft of Transpower's Business Plan and a draft SCI, which will be made available to Shareholding Ministers for discussion prior to the commencement of the financial year to which the plan and the SCI relates.

Transpower will, in addition, provide other information relating to the affairs of the company requested by the Shareholding Ministers pursuant to section 18 of the Act and in accordance with the State-Owned Enterprises' Continuous Disclosure Rules.

H PROCEDURES FOR SHARE SUBSCRIPTIONS OR PURCHASES

Subscriptions for shares in any company or interests in any other organisation will, where material, be subject to consultation with Shareholding Ministers. The procedures for the establishment of subsidiary companies and the sale of substantial assets in Transpower or any of its subsidiaries are set out in Appendix 3.

I ACTIVITIES FOR WHICH COMPENSATION IS SOUGHT

Transpower will, in accordance with section 7 of the Act, seek compensation sufficient to allow Transpower's position to be restored if the Government wishes Transpower to undertake activities or assume obligations that in Transpower's view will:

- result in a reduction of Transpower's profit or net worth; or
- modify the National Grid in ways which lower its ongoing security and reliability.

There are currently no activities in relation to which Transpower is seeking, or has sought, compensation from the Crown.

J OTHER MATTERS AGREED BY THE SHAREHOLDING MINISTERS AND THE BOARD

No other matters have been agreed by the Shareholding Ministers and the Board for inclusion in this statement pursuant to section 14(2) (j) of the Act.

K COMMERCIAL VALUE OF THE CROWN'S INVESTMENT

As at 30 June 2011, the principal physical assets of Transpower primarily comprise:

- 182 sub/switching stations;
- more than 11,800 route kilometres of HVAC and HVDC transmission lines;
- the HVDC link between the North and South Islands;
- two national control centres;
- three regional operating centres;
- a communications network;
- a supervisory control and data acquisition network;
- 81 freehold properties acquired on the proposed route for the North Island Grid Upgrade.

In addition the company has significant intellectual capital in staff, company processes and procedures.

The Board's estimate of the current commercial value of the Crown's investment in Transpower is $1.6 billion[7]. The current commercial value, often referred to as the equity value, was calculated by taking the enterprise value of $3.9 billion and deducting net debt and deferred tax liabilities of $2.3 billion.

This estimate is a "sum of the parts" valuation based on a combination of two alternative valuation methodologies: (a) discounted cash flow (DCF) estimates based on the forecast future cash flows set out in Transpower's 10 year business plan; and (b) book value.

For the estimate of current commercial value, book value was used for: regulated transmission activities, including new investment agreements; and for freehold property. The book value is a particularly relevant valuation methodology for the regulated transmission asset base. The book value is consistent with the regulatory asset value established under the framework within which Transpower operates. This framework provides for a regulated rate of return on capital employed for the regulated asset base with the allowed return based on an assessment of Transpower's weighted-average cost of capital (WACC). Book value is also more appropriate for freehold property which is subject to periodic revaluation to reflect current market value. Other activities were valued on a DCF basis.

For comparison purposes, the valuation of the Crown's investment using DCF for all of the Group's business activities is $2.0 billion.

Given the regulated nature of Transpower's business and the sensitivity of DCF valuation to modelling assumptions, more reliance is placed on the sum of the parts valuation.

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[7] The disclosure of Commercial Valuation follows closely the Model Disclosure Statement for use in Statements of Corporate Intent provided by COMU.

Key points about the manner in which these valuations were assessed include:

- The valuations were calculated as at 30 June 2011;
- The discounted cash flow (DCF) valuations are on an after-tax basis based on the nominal (i.e. not inflation-adjusted) future cash flows set out in Transpower's 10 year business plan;
- For the DCF valuation of the regulated transmission assets the terminal value was based on the book value at end of the 10 year timeframe, discounted back to June 2011;
- Discount rates of 7.8% and 8.1% were assumed for regulated and un-regulated activities respectively;
- The valuations were prepared internally and subject to peer review externally prior to approval by the Board.

The commercial valuation at 30 June 2011 of $1.6billion compares with $1.6 billion at 30 June 2010. The nil net change in commercial value reflects offsetting movements: i.e. an increase in retained earnings for 2010/11, offset by an adjustment to the book value of the regulated transmission assets based on the lower allowed regulated rate of return for the period to 2014/15.

APPENDIX 1 DEFINITIONS OF CAPITAL STRUCTURE, INVESTMENT AND PERFORMANCE MEASURES

Capital Structure and Investment	
Debt	“Debt” equals current and non current debt and finance leases
Equity	“Equity” equals share capital, reserves and accumulated retained earnings.
Total Funds Employed	“Total Funds Employed” equals current liabilities, non current liabilities and equity.
Ratio of Debt to Debt plus Equity	Self-explanatory
Capital Investment	Capital investment equals total capital expenditure, excluding net property acquisitions/disposals

Operational Performance Targets	
High Voltage Alternating Current (HVAC) circuit availability (%)	Number of hours per year that HVAC electricity network or part thereof is in service expressed as a percentage
High Voltage Direct Current (HVDC) (pole 2 only) availability (%)	Number of hours per year that HVDC electricity network or part thereof is in service expressed as a percentage
Number of loss of supply events	Number of loss of supply events that originate from the non-performance of Transpower’s assets. All events are counted, including events caused by the actions of Transpower’s customers and other third-parties. Events are categorised according to the number of system minutes (SM) lost: (i) events greater than 0.05 SMs but less than 1 SM; and events greater than 1 SM. A system minute is a standardised unit for measuring interruptions to the electricity supply from the National Grid. One system minute is equivalent to the loss of total national electricity supply for one minute. System minutes are calculated by dividing the total amount of energy not supplied to customers because of unplanned outages by the system maximum peak demand.

Financial Performance Targets[8]	
EDITDAIF to Revenue (%)	Earnings before interest, tax, depreciation, amortisation, impairment and changes in the fair value of financial instruments (EBITDAIF) divided by total revenue.
Free Funds from Operations to Interest coverage (times)	Cash Flow from Operations adjusted for changes in working capital plus implied depreciation on operating leases, plus interest costs divided by interest costs
Return on capital employed (%)	Earnings before interest, tax and changes in the fair value of financial instruments (EBITF) less tax expense (adjusted for interest tax shield), divided by average capital employed. Capital employed is made up of current assets (excluding derivatives) plus fixed assets (excluding works under construction), less current liabilities (excluding current debt, derivatives, interest payable and income in advance).
Return on equity (%)	Profit After Tax (excluding changes in the fair value of financial instruments) divided by average equity (excluding cumulative changes in the fair value of financial instruments).
Average total transmission costs (c/kWh)	Total transmission revenue divided by energy supplied from the national grid.
Estimated economic value added ($million)	Measures the net profit earned in excess of that required to deliver a return equal to the estimated weighted average cost of capital for Transpower's business activities. The capital base on used in the calculation includes adjustments for two items to reflect the regulatory value on which the revenue is based: • Inclusion of historical revaluations that were required to bring the asset value in line with the Optimised Depreciated Valuation at 30/06/2006; • Capitalisation of operating leases

Non-Financial Performance Targets	
Material Breaches of System Operator Performance Obligations reported to the Electricity Commission	Material means breaches that have a market impact exceeding $20,000
ACC Workplace Safety Audit Status	Result of ACC Workplace Safety Audit
Number of fatalities or injuries causing permanent disability	Self-explanatory
Number of medical treatment injuries	Self-explanatory

[8] Based on Transpower's NZ IFRS financial statements.

APPENDIX 2 REVIEW OF PERFORMANCE TARGETS AND MEASURES FOR 2011/12

The following tables compare the performance targets and measures for the 2011/12 year set in the 2010/11 SCI with those set in the 2011/12 SCI. Commentary is provided to explain the variances.

2011/12 Operational Performance Targets	Previous SCI	Current SCI
High Voltage Alternating Current (HVAC) circuit availability (%)	98.8	98.5
High Voltage Direct Current (HVDC) (pole 2 only) availability (%)	n/a	82.5
Number of loss of supply events of greater than 0.05 System Minutes	21	21
Number of loss of supply events of greater than one System Minute	3	3

Operational performance targets are largely unchanged. The estimated availability of Pole 2 reflects the impacts of preparations for the installation of Pole 3.

2011/12 Capital Structure and Investment	Previous SCI	Current SCI
Debt ($ million)	2,428	2,535
Equity ($ million)	1,851	1,624
Ratio of Debt to Debt plus Equity	57%	61%
Capital Investment ($ million)	996	873

The lower equity reflects the earlier resumption of dividends which are now forecast to recommence from 2011/12 (compared with 2012/13 in last year's SCI). The earlier resumption of dividends similarly increases forecast debt and gearing. Lower capital investment reflects, primarily, delay in the commissioning of Pole 3 and the North Island Grid Upgrade.

2011/12 Financial Performance Targets	Previous SCI	Current SCI
EBITDAIF margin	63.3%	63.2%
Interest coverage	3.2	2.8
Return on capital employed	7.6%	7.3%
Return on equity	10.9%	9.9%
Average total transmission costs (c/kWh)	1.87	1.75
Estimated economic value added ($ million)	3	(13)

Interest coverage is reduced with the change in dividend policy and capital structure. Financial returns are lower with lower forecast earnings due to a lower regulated rate of return allowed by the Commerce Commission and delay to capital expenditure (including Pole 3) reducing operating revenue.

2011/12 Non-Financial Performance Targets	Previous SCI	Current SCI
Material Breaches of System Operator Performance Obligations reported to the Electricity Commission	<4	<4

The targets are unchanged from last year.

2011/12 Non-Financial Performance Targets	Previous SCI	Current SCI
ACC Workplace Safety Audit Status	Tertiary	Tertiary
Number of fatalities or injuries causing permanent disability	0	0
Number of medical treatment injuries	10% < 2010/11	10% < 10/11 out-turn (adjusted for forecast 11/12 man hours)

The target for medical treatment injuries is similar in seeking a reduction in the rate of medical treatment injuries but with the target adjusted to reflect the increased level of activity.

APPENDIX 3 SUBSIDIARY COMPANIES

The terms "share", "Shareholding Ministers", and "subsidiary" have the same meanings as in section 2 of the Act.

Transpower will ensure at all times that:

a) control of the affairs of every subsidiary of Transpower is exercised by a majority of the Directors appointed by Transpower; and
b) a majority of the Directors of every subsidiary of Transpower are persons who are also Directors or employees of Transpower, or who have been approved by the Shareholding Ministers for appointment as Directors of the subsidiary.

Transpower's current subsidiaries

The Transpower Group contains the subsidiary companies listed in the table below.

Name	Holding
Halfway Bush Finance Limited	100%
TB and T Limited	100%
Risk Reinsurance Limited	100%
Transpower Finance Limited	100%
Energy Market Services Limited[9]	100%
d-cyphaTrade Limited	100%

Functions of subsidiary companies

Halfway Bush Finance Limited and TB and T Limited were formed during the 2003 cross-border lease transaction. These companies do not undertake trading activities. Their purpose is to hold assets on behalf of the Transpower Group.

Risk Reinsurance Limited is Transpower's captive insurance subsidiary. It is the primary insurer on Transpower's material damage and cables insurance programmes (both electricity and fibre optic). Risk Reinsurance Limited reinsures a portion of this risk with third party insurers. Risk Reinsurance is registered in the Cayman Islands, but is domiciled in New Zealand for taxation.

Transpower Finance Limited is a financing company, arranging Group borrowings and associated interest rate derivatives.

Energy Market Services Limited provides reconciliation and metering services in New Zealand.

d-cyphaTrade Limited markets energy derivative products in association with the Australian Stock Exchange.

Consultation

Transpower will, in relation to any single transaction or series of transactions, consult with the Shareholding Ministers on items outside normal operations and having a material impact on Transpower's financial position not contemplated in the Business Plan, including:

[9] EMS is to be amalgamated into Transpower New Zealand Limited effective 1 July 2011.

1. any substantial capital investment in activities within the scope of core business;
2. any substantial expansion of activities outside the scope of core business;
3. subscription for, or sale of, shares in any company or equity interests in any other organisation which are material, involve significant overseas equity investment or are outside Transpower's core business;
4. the sale or other disposal of the whole or any substantial part of the business undertaking of Transpower; and
5. where Transpower or its subsidiaries hold 20% or more of the shares in any company or other body corporate (not being a subsidiary of Transpower), they will not sell or otherwise dispose of any shares in that company without first giving written notice to the Shareholding Ministers of the intended disposal.

Transpower will also consult on specific items included in the Business Plan as agreed between Transpower and Shareholding Ministers from time to time.

For the purpose of this document, a substantial investment outside core business would be any transaction or series of transactions resulting in a maximum potential cash outflow from Transpower in excess of $20 million or 2% of total consolidated Transpower group equity, whichever is the lesser.

APPENDIX 4 FINANCIAL PERFORMANCE MEASURES FOR THE SOE PORTFOLIO

This Appendix sets out financial performance measures based on standardised reporting and definitions requested by the Shareholder for all SOEs. The accompanying definitions and glossary are set out below.

1. Shareholder Returns

Measure	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
Total shareholder return	(1.0%)	11.1%	12.3%	15.2%
Dividend yield	0%	7.9%	23.0%	13.3%
Dividend payout	0%	76.6%	241.2%	93.0%
Return on equity[10]	7.9%	11.1%	13.0%	15.2%
Return on equity adjusted for IFRS fair value movements and asset revaluations[11]	9.3%	10.4%	12.2%	14.4%

2. Profitability/Efficiency

Measure	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
Return on capital employed[12]	8.3%	8.4%	9.1%	10.2%
Operating margins	61.4%	63.1%	65.5%	71.2%

3. Leverage/Solvency

Measure	2010/11 Forecast	2011/12 Budget	2012/13 Plan	2013/14 Plan
Gearing ratio (net)	56.2%	60.9%	69.1%	71.1%
Interest cover[13]	3.7	3.1	2.9	3.0
Solvency	106.3%	89.3%	103.6%	104.6%

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[10] SOE Portfolio performance ratio does not adjust Fair value movements, Transpower ratio also adjusts the Profit and Loss Statement and equity for fair value

[11] SOE Portfolio performance ratio only adjusts the Profit and Loss Statement for the Fair Value movements, Transpower ratio also adjusts equity for fair value.

[12] Transpower ratio calculation adjusts tax for the effect of interest costs; SOE portfolio ratio excludes tax.

[13] Transpower ratio is based on Cash Flow from Operations;

Description of calculation of Financial Performance Measures for SOE Portfolio

Table 1: Shareholder Returns

Measure	Description	Calculation
Total shareholder return	Performance from an investor perspective – dividends and investment growth.	(Commercial value$_{end}$ *less* Commercial value$_{beg}$ *plus* dividends paid less equity injected)/Commercial value$_{beg.}$
Dividend yield	The cash return to the shareholder.	Dividends paid/Average commercial value.
Dividend payout	Proportion of SOE's net operating cash flows less allowance for capital maintenance paid out as a dividend to the shareholder.	Dividends paid/Net cash flow from operating activities less depreciation expense.
Return on equity	How much profit a company generates with the funds the shareholder has invested in the company.	Net profit after tax/Average equity.
Return on equity adjusted for IFRS fair value movements and asset revaluations	Return on equity after removing the impact of IFRS fair value movements and asset revaluations.	Net profit after tax adjusted for IFRS fair value movements (net of tax)/Average of share capital plus retained earnings.

Table 2: Profitability/Efficiency

Measure	Description	Calculation
Return on capital employed	The efficiency and profitability of a company's capital from both debt and equity sources.	EBIT/ adjusted for IFRS fair value movements/Average capital employed.
Operating margin	The profitability of the company per dollar of revenue.	EBITDAF/Revenue.

Table 3: Leverage/Solvency

Measure	Description	Calculation
Gearing ratio (net)	Measure of financial leverage – the ratio of debt (liabilities on which a company is required to pay interest) less cash, to debt less cash plus equity.	Net debt/Net debt plus equity.
Interest cover	The number of times that earnings can cover interest.	EBITDAF/Interest paid.
Solvency	Ability of the company to pay its debts as they fall due.	Current assets/Current liabilities.

Definitions of Key Terms Used in Calculations of Performance Measures for SOE Portfolios

Term	Definition
Capital employed	Interest-bearing debt plus share capital plus retained earnings.
Capital expenditure	Payments for the purchase of property, plant and equipment items taken from the cash flow statement.
Commercial value	This is the board's estimate of the current commercial value of the Crown's investment in the Group as per the company's Statement of Corporate Intent.
Depreciation expense	Depreciation expense per the profit and loss account.
Dividends paid	Dividends paid to the shareholder during the financial year per the cash flow statement.
EBIT	Earnings before interest and taxation.
EBITDA	Earnings before interest and taxation, depreciation and amortisation
EBITDAF	Earnings before interest and taxation, depreciation and amortisation and fair value adjustments.
Equity	Total shareholders' equity taken from the balance sheet.
Fair value adjustments	Includes unrealised fair value gains/losses on derivatives or all fair value gains/losses on derivatives where the entity does not separately identify unrealised items. Also includes changes in the fair value of biological assets and investment properties.
Interest paid	Interest paid for the financial year on interest-bearing debt per the company's cash flow statement.
Net cash flow from operating activities	Taken directly from the cash flow statement – this is cash flows from operating activities less cash flows to operating activities. Ensure that interest paid is included in operating activities.
Net debt	Interest-bearing debt such as loans, bonds and commercial paper plus interest-bearing finance leases less cash.
Retained earnings	Profits retained in the business (i.e. after dividends to the shareholder).
Revaluation reserve	When an asset is revalued to fair market value for accounting purposes the increase in the value of the asset is reflected in a revaluation reserve within equity.
Revenue	Revenue from the operations of the business. Interest revenue should be excluded.
Share capital	The amount of capital originally invested by the shareholder and any subsequent equity injections.
Tax on fair value adjustments	This is the tax effect relating to the changes in the fair values.

STATEMENT OF CORPORATE INTENT 2011/12

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