meridian

# Statement of Corporate Intent

## Meridian Energy Limited

*Year commencing 1 July 2012*

This Statement of Corporate Intent (SCI) is submitted by the Board of Directors of Meridian Energy 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 Meridian Energy (and any subsidiary companies) for the year commencing 1 July 2012 and the succeeding two financial years.

ISSN 2253-4695 (ONLINE)

## Nature and Scope of Activities

Meridian Energy's nature and scope of activities is the generation of electricity (including the ownership and operation of related assets), the management of water related infrastructure, and the marketing, trading and retailing of energy and wider complementary and adjacent products, solutions and services, primarily within New Zealand.

Consistent with these principal activities, Meridian will pursue activities designed to ensure:

- the safe and effective utilisation of its assets and human resources
- the prudent management of its business risks across markets and geographies.

All activities will be carried out with the objective of protecting and growing shareholder value.

Activities outside Meridian's business plan and outside those areas described above will not be undertaken without prior consultation with shareholding Ministers.

## Objectives

Meridian's principal objective, as set out in Part I of the Act, is to operate as a successful business and to be:

- as profitable and efficient as comparable businesses not owned by the Crown
- a good employer
- 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 those interests when able to do so.

In setting and reviewing this SCI, and in particular the performance measures and dividend policy, the Board and shareholding Ministers have agreed that taking a long-term view of performance and capital structure is essential. This reflects the very long-lived nature of generation assets and development projects, the revenue volatility of the Group and New Zealand's need for sustainable and timely investment in new generation and efficiency projects.

To achieve these objectives, Meridian will maximise long-term shareholder value by:

- seeking sustainable competitive advantage from excellence in generating electricity at optimal value through to meeting customer needs for energy and wider complementary and adjacent products and solutions
- actively developing and participating in competitive energy markets to provide customer demanded products and services and to enable Meridian to optimise its risk position
- undertaking new investments that during their lives are:
  - aimed at yielding a positive risk related net present value
  - managed in a manner that will maximise the commercial value of the business
- undertaking prudent risk management in relation to its business activities
- minimising operating costs
- acting with a sense of social responsibility and reporting on its actions
- providing healthy and safe places of work for its people
- building and maintaining relationships through partnering with Maori
- building and maintaining relationships with communities in which it operates
- pursuing its commitment to the environment and the sustainable management and development of the natural, physical and human resources utilised in the business
- taking such other strategic and operational measures as Meridian considers appropriate to best protect and grow the value of the Crown's investment in Meridian.

## Performance Measures

Meridian will be operating in a dynamic and competitive external environment during this planning period in which:

- Meridian assumes rational behaviour by all wholesale participants based on sustainable commercial and economic drivers
- recent growth in demand for electricity has been soft but we expect a return to historical growth rates in the medium term
- Meridian's core markets are regulated at all levels (e.g. transmission investment and pricing, customer dispute resolution) and there is ongoing potential for significant regulatory change
- there is strong competition for the development of new renewable generation projects
- intense competition in the retail electricity market is expected to continue
- its renewables-led operations and growth strategies are dependent on our ongoing access to the "public" resources of water, wind, space and transmission. This makes the following key matters fundamental to Meridian's ability to protect and increase its value:
  - resource regulation;
  - planning and consenting practices and outcomes;
  - transmission policy and regulation.

  During the planning period all of these matters are expected to be subject to regulatory change
- transmission constraints, in particular the restricted operation of the HVDC link, are expected to continue to impact on price levels and price volatility for generators and retailers of electricity.

The financial performance targets below are based on Meridian's current business and its current expectations as to the future. Meridian may revise these financial targets through the year if the context changes or Meridian reasonably determines that revised targets are more appropriate. The tables below include Meridian's targets and should not be taken as estimates or forecasts of actual future results.

The financial performance targets are provided as required under section 14(2) of the Act.

The process of developing Meridian's business plan and financial performance targets included benchmarking our performance to ensure Meridian is as profitable and efficient as our competitors.

Note that from 1 July 2011 Meridian changed its Customer Satisfaction metric to an Index of Customer Experience, which not only measures customer satisfaction, but also measures "intent to remain a customer", "likelihood to recommend" and "pride in being a customer".

**SCI Performance Measures**

| Financial Performance Measures | 2013 TARGET | 2014 TARGET | 2015 TARGET |
|---|---|---|---|
| Equity to Total Assets | 56% | 56% | 56% |
| Net Debt/(Net Debt+Equity) Gearing | <30% | <30% | <30% |
| FFO Interest Cover (# of Times) | 5 | 5 | 5 |
| EBITDAF/MWh Generation | in top 2 of NZ's major gentailers in the medium term | | |

| Non-Financial Performance Measures | 2013 TARGET | 2014 TARGET | 2015 TARGET |
|---|---|---|---|
| Average Index of Customer Experience | 6.6 | 6.8 | 6.9 |
| Hydro Forced Outage Factor | 0.34% | 0.34% | 0.34% |
| Number of Lost Time Injuries | 0 | 0 | 0 |

## Capital Expenditure

Meridian operates an Investment Portfolio process to ensure that the most valuable employment of capital is made in line with the Company's strategic direction. As part of this process Meridian regularly reviews future investment options and can potentially reprioritise capital expenditure. Funding availability, fit with strategic direction, electricity demand growth and commercial viability are considerations in capital expenditure decisions that may change with time.

Projected capital expenditure across the three year period is $1.0 billion, principally in new renewable generation projects. Capital investment is expected to be made in wind and hydro generation capacity in New Zealand and Australia, upgrading existing assets and investing in core systems across Meridian's retail and other operations. The actual investment made in the future will depend on individual projects being approved by Meridian's Investment Portfolio process.

Supporting definitions are included in Appendix III.

## Dividend Policy

Meridian will distribute all funds surplus to its investment and operating requirements, subject to meeting the solvency requirements of the Companies Act 1993. The actual dividend payments are subject to an annual review by the Directors of Meridian Energy. In determining the level of surplus funds, the Directors will take into consideration:

- Meridian's maintenance of a sustainable financial structure, having regard to the risks from predicted short and medium term economic, market and hydrological conditions and projected financial performance and position
- appropriate financial policy settings in order to maintain a sufficiently strong credit rating
- working capital requirements, the asset investment programme and the targeted credit rating.

Subject to the above considerations, Meridian aims to pay two dividends each year, with the interim dividend payment made no later than the last business day of April and the final dividend payment made no later than the last business day of October. The payment ratio on a long-run basis is targeted to be a minimum of 75% of Net Profit after Tax having excluded the post-tax impact of movements in the fair value of derivatives under International Financial Reporting Standards (IFRS) and impairments.

## Information to be Supplied to Ministers

Meridian will provide any information required by shareholding Ministers pursuant to section 18 of the Act, including any information that would normally be supplied to a controlling private shareholder, to enable shareholding Ministers to assess the value of their investment in Meridian. The Company will consult shareholding Ministers on proposed investments in excess of $50 million consistent with shareholding Ministers' expectations.

In addition, the following information will be submitted to shareholding Ministers:

- an annual report in accordance with section 15 of the Act
- a half-yearly report in accordance with section 16 of the Act. This report will include statements of financial performance, financial position and cash flows, and such details as are necessary to allow an informed assessment of Meridian's performance during that reporting period
- quarterly reports comprising summarised financial statements together with a brief commentary on key events for the previous quarter and prospective highlights for the succeeding quarter
- a draft SCI, in accordance with section 14 of the Act, together with a summary of Meridian's business plan for discussion prior to the start of the financial year to which they relate.

# Other Business Management Objectives

## Responsibility for Dam Safety

Meridian is conscious of its obligations as the owner and operator of many of New Zealand's largest dams. Meridian is committed to public safety and asset protection and will implement dam safety assurance programmes consistent with international best practice through its own operational practices and through its subsidiary Damwatch Services Limited.

## Asset Management

Meridian will maintain and operate its assets in a manner and to a level that optimises the value that can be obtained from those assets.

## Procedures for Share Acquisitions

Meridian will consult with shareholding Ministers before it or any member of its Group:

- acquires, by way of one or more related transactions, shares or an equity interest or otherwise makes a significant investment in a business that is outside the nature and scope of business activities outlined in this SCI
- acquires, by way of one or more related transactions, shares or an equity interest or otherwise makes a significant investment in a business (either onshore or offshore) that is material in the context of the Group.

The procedure for the establishment and management of subsidiary companies and disposal of shares and assets is set out in Appendix I.

## Activities involving Crown Compensation

If the Government wishes or requires Meridian to provide goods or services or assume obligations in a manner which constrains the Company from acting in a normal, businesslike manner or which will or could result in a reduction in Company value, Meridian will seek compensation from the Crown in accordance with section 7 of the Act.

Meridian does not currently seek compensation from the Crown for any non-commercial activities.

## Other Matters Agreed by Shareholding Ministers and the Board

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

## Commercial Value of the Crown's Investment

The value of the Crown's investment in Meridian as at 30 June 2012 (as required under section 14(3) of the Act) is estimated to be $6,579 million. This has increased slightly on the valuation at 30 June 2011 of $6,500 million in Meridian's 2011 SCI. The range of valuations for the Crown's investment in Meridian is $6,429 million to $6,729 million.

The valuation was completed by independent valuation expert, PricewaterhouseCoopers. The approach used, where both discounted cashflow (DCF) and capitalisation of earnings (as adjusted by their view of an appropriate control premium) are compared, is consistent with that used in prior years and Company policy, and with key assumptions updated to reflect the 2013 - 2015 business plan.

Material external factors that are relevant to the determination of this valuation and that form a risk that can impact on the valuation include but are not limited to:

- competitive wholesale and retail markets for electricity
- the volatility of spot electricity prices and generation volumes
- factors such as future carbon prices and the possibility of new economical gas discoveries
- uncertain hydrological inflows and transmission constraints in the South Island
- uncertain quantum and timing of future major capital expenditure
- transmission availability and capacity, in particular the HVDC link
- any future changes to industry structure or regulation such as water reform, transmission pricing and scarcity pricing
- reliance on a Water Management Agreement with Genesis Energy to manage water into Lake Pukaki (approximately 40% of Meridian's fuel).

## Comparison with targets from last year's Statement of Corporate Intent

| SCI Performance Measures | 2012 SCI | | | 2011 SCI | | | |
|---|---|---|---|---|---|---|---|
| **Financial Performance Measures** | 2013 TARGET | 2014 TARGET | 2015 TARGET | 2012 TARGET | 2013 TARGET | 2014 TARGET | NOTES |
| Equity to Total Assets | 56% | 56% | 56% | 58% | 58% | 57% | |
| Net Debt/(Net Debt+Equity) Gearing | <30% | <30% | <30% | 26% | 26% | 28% | |
| FFO Interest Cover (# of Times) | 5 | 5 | 5 | 5 | 5 | 5 | |
| EBITDAF/MWh Generation ($/MWh) | In top 2 of NZ's major gentailers in the medium term | | | 46.56 | 52.13 | 63.01 | |

| Non-Financial Performance Measures | 2013 TARGET | 2014 TARGET | 2015 TARGET | 2012 TARGET | 2013 TARGET | 2014 TARGET | NOTES |
|---|---|---|---|---|---|---|---|
| Average Index of Customer Experience | 6.6 | 6.8 | 6.9 | 6.6 | n/a | n/a | 1 |
| Hydro Forced Outage Factor | 0.34% | 0.34% | 0.34% | 0.34% | 0.34% | 0.34% | |
| Number of Lost-Time Injuries | 0 | 0 | 0 | 0 | 0 | 0 | |

### Notes:

1. From 1 July 2011 Meridian changed its Customer Satisfaction metric to an Index of Customer Experience, which not only measures customer satisfaction, but also measures "intent to remain a customer", "likelihood to recommend" and "pride in being a customer".

Supporting definitions are included in Appendix III.

# Appendix I – Subsidiaries and Associate Companies

The terms “share”, “shareholding Minister”, and “subsidiary” have the same meanings as in section 2 of the Act.

## Subsidiaries

Meridian will ensure that the control of the affairs of any subsidiary of Meridian is exercised by a majority of the directors of that subsidiary.

Without the prior consent of shareholding Ministers, neither Meridian nor any of its subsidiaries shall sell or otherwise dispose of, whether by a single transaction or any series of transactions, and whether by a sale of assets or shares, the whole or any substantial part of the business or undertaking of the Company and its subsidiaries (taken as a whole).

## Associates

Where Meridian or its subsidiaries hold 35% or more of the shares in any company or other body corporate (not being a subsidiary of Meridian), it will not sell or otherwise dispose of any shares in that company without first giving written notice to shareholding Ministers of the disposition.

# Appendix II – Statement of Significant Accounting Policies

## Reporting Entity and Statement of Compliance

Meridian Energy Limited (the Company) is a profit-oriented entity domiciled in New Zealand, registered under the Companies Act 1993 and an issuer for the purposes of the Financial Reporting Act 1993. The shares in Meridian Energy Limited are held in equal numbers by the Minister for State Owned Enterprises and the Minister of Finance, on behalf of Her Majesty the Queen in Right of New Zealand (the Crown) under the State-Owned Enterprises Act 1986. The liabilities of Meridian Energy Limited are not guaranteed in any way by the Crown.

Meridian’s core business is the generation of electricity (including the management of related assets) and the trading and retailing of electricity and wider complementary products and solutions.

The consolidated financial statements comprise those of Meridian Energy Limited (the “Parent” or the “Company”) and its subsidiaries (together referred to as “Meridian” or the “Group”).

Financial statements are prepared in accordance with Generally Accepted Accounting Practice in New Zealand. They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) as well as other applicable Financial Reporting Standards, as appropriate for a profit-oriented entity and are prepared in accordance with the requirements of the Financial Reporting Act 1993.

The consolidated financial statements comply with International Financial Reporting Standards (IFRS) as do those of the Parent entity.

## Basis of Preparation

The financial statements are prepared on the basis of historical cost modified by the revaluation of certain assets and liabilities as identified in the following accounting policies.

The financial statements are presented in New Zealand dollars rounded to the nearest thousand.

The accrual basis of accounting is used unless otherwise stated.

## Adoption Status of Relevant Financial Reporting Standards

The additional new standards adopted since the preparation of the Group's financial statements for the year ended 30 June 2011 and that apply for the financial statements for the year ended 30 June 2012 are as follows:

- Improvements to New Zealand Equivalents to International Financial Reporting Standards 2010 - Improvements to NZ IFRS 3, NZ IFRS 7, NZ IAS 1, NZ IAS 27, NZ IAS 34 and NZ IFRIC 13
- Amendments to NZ IFRIC 14 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction
- Amendments to NZ IFRS 7 Financial Instruments: Disclosures
- Amendments to New Zealand Equivalents to International Financial Reporting Standards to harmonise with International Financial Reporting Standards and Australian Accounting Standards
  - FRS 44 New Zealand Additional Disclosures
  - Amendments to FRS 44 NZ Additional Disclosures.

## Judgements and Estimations

The preparation of financial statements in conformity with NZ IFRS requires judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in relation to forecast earnings and multiples used to value the generation structures and plant assets and future price estimates, including electricity, aluminium and estimates for inflation and discount rates, which have been used to fair value the energy derivatives. In addition, accounting judgements are made in respect of the hedge designation of certain financial instruments, assessment of hedge effectiveness, determination of useful lives of Property, Plant and Equipment and the impact of tax rate changes on deferred tax balances.

# Significant Accounting Policies

The following significant accounting policies have been adopted in the preparation and presentation of the financial report:

## Basis of Consolidation

### Subsidiaries

Subsidiaries are those entities controlled directly or indirectly by the Company. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activity.

The acquisition method is used to account for the purchase of subsidiaries by the Company. The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group. All material intra-Group transactions, balances, income and expenses are eliminated on consolidation.

Non-controlling interests in the net assets of consolidated subsidiaries are presented in the equity section of the consolidated statement of financial position, separately from the equity of the owners of the parent.

## Common Control Amalgamation Transactions

Under a business combination where entities under common control are amalgamated, the carrying values of the assets and liabilities of the entities are combined, with any gain or loss on amalgamation recognised in equity.

## Operating Segments

Operating segments are reported in a manner consistent with internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive.

## Joint Ventures

### Jointly Controlled Entities

Joint venture arrangements that involves the establishment of a separate entity in which each venturer has an interest where it has entitlement to a share of the outcome (profit/loss) of the activities of the joint venture and that is subject to joint control (unanimous decision-making) by the venturers is referred to as a jointly controlled entities. Meridian reports its interest in jointly controlled entities using the equity method of accounting.

Under the equity method, investments in joint ventures are carried in the consolidated Statement of Financial Position at cost as adjusted for post-acquisition changes in the Company's share of the net assets of the joint venture, less any impairment in the value of individual investments. Losses of a joint venture in excess of the Company's interest in that joint venture (which includes any long-term interests that, in substance, form part of the Company's net investment in the joint venture) are not recognised unless there is a legal or constructive obligation incurred by Meridian on behalf of the joint venture.

### Jointly Controlled Assets

Where Meridian has an interest in a jointly controlled asset, Meridian recognises its share using the proportionate consolidation method. Under this method Meridian recognises its share of the jointly controlled asset according to the nature of the asset, any liabilities incurred in respect of the joint venture and any income or expenses from its share of the joint venture or incurred in respect of the joint venture.

## Foreign Currency

Transactions denominated in a foreign currency are converted at the exchange rates at the date of the transactions. Foreign currency monetary assets and liabilities at reporting date are translated at the exchange rate prevailing at reporting date.

Assets and liabilities of overseas entities, whose functional currencies are other than NZD, are translated at the closing rate at the balance date. The revenues and expenses of these entities are translated at rates approximating the exchange rates at the dates of the transactions. Exchange differences arising on the translation of the financial statements of these entities are recorded in the foreign currency translation reserve. Such translation differences are recognised in the income statement in the period in which the foreign operation are disposed of.

## Property, Plant and Equipment

Meridian's generation structures and plant assets (including land and buildings) are stated in the Statement of Financial Position at their revalued amounts, being the fair values at the date of revaluation, less any subsequent accumulated depreciation and impairment losses. Revaluations are performed by an independent valuer with sufficient regularity to ensure that the carrying amounts do not differ materially from those that would be determined using fair values at the balance date.

The fair value of generation assets was determined using an income approach. In using the income approach, consideration was given to the application of either the net present value of expected future cash flows or capitalisation of earnings approach, whichever was more appropriate.

Any revaluation increase arising from a revaluation is credited to the revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in the income statement, in which case the increase is credited to the income statement to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation is charged to the income statement to the extent that it exceeds the balance, if any, held in the revaluation reserve relating to a previous revaluation of that asset.

Accumulated depreciation at revaluation date is eliminated against the gross carrying amount so that the carrying amount after revaluation equals the revalued amount.

Subsequent additions to generation structures and plant assets are recorded at cost, which is considered fair value, including costs directly attributable to bringing the asset to the location and condition necessary for its intended service. The cost of assets constructed includes all expenditure directly related to specific contracts including financing costs where appropriate.

Financing costs for qualifying assets are capitalised at the average cost of borrowing. Costs cease to be capitalised as soon as the assets are ready for use.

All other property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sales proceeds and the carrying amount of the asset and is recognised in the income statement. Any balance attributable to the disposed asset in the asset revaluation reserve is transferred to retained earnings.

The depreciation of property, plant and equipment assets, other than freehold land, is calculated on a straight-line basis to allocate the costs or fair value amounts of the assets, less any residual value, over their estimated remaining useful lives. Meridian used judgement to determine the depreciation and amortisation rates that best approximate the estimated remaining useful lives. The following depreciation and amortisation rates have been applied:

| | |
|---|---|
| Generation Structures and Plant | Up to 80 years |
| Freehold Buildings | Up to 67 years |
| Other Plant and Equipment | Up to 20 years |
| Resource Consents | Up to 50 years |

The residual values and the useful lives of assets are reviewed, and if appropriate adjusted, at each balance date.

## Assets Classified as Held for Sale

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than continuing use are classified as held for sale.

Immediately before being classified as held for sale, the assets (or disposal group) are re-measured in accordance with Meridian's accounting policies. Thereafter the assets (or disposal group) are measured at the lower of their carrying amounts or fair values less costs to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on re-measurement are recognised in the income statement. Gains are not recognised in excess of any cumulative impairment loss.

## Finance Lease

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership to the lessee. Meridian recognises assets held under finance lease arrangements as receivable or payable at amounts equal to the present value of the minimum lease payments. Finance lease receipts are apportioned between principal repayments, relating to the lease receivables, and interest revenue. The interest revenue reflects a constant periodic rate of return on Meridian's net investment over the term of the leases. Finance leases are classified as loans and receivables.

## Intangible Assets

### Customer Acquisition Costs

Customer acquisition costs are finite life intangibles and represent the capitalisation of costs incurred to acquire retail customers. Amortisation is calculated using the straight-line method to allocate the cost over its useful life.

### Computer Software

Acquired computer software licences, which are not considered an integral part of related hardware, are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised over their useful lives on a straight-line basis.

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs directly associated with the production of identifiable and unique software products that will generate economic benefits beyond one year are recognised as intangible assets and amortised over their estimated useful lives on a straight-line basis.

### Patents and Trademarks

Patents and Trademarks are finite life intangibles and are recorded at cost less accumulated amortisation and impairment. Amortisation is charged on a straight-line basis over their estimated useful lives.

### Licence Agreement

The value of a Licence Agreement has been recognised on the acquisition of controlled entities. Each Agreement is a finite life intangible and is recorded at fair value less accumulated amortisation and impairment. Amortisation is charged on a straight-line basis over a period of ten years.

Other licences are also amortised on a straight-line basis over their useful lives.

### Research and Development Costs

An intangible asset arising from Meridian's development activity is recognised only if all of the following conditions are met: an asset is created that can be used or sold; it is probable that the asset created will generate future economic benefits; and the cost can be measured reliably.

Development costs that meet these criteria are amortised on a straight-line basis over their estimated useful lives. Capitalised development expenditure is stated at cost less accumulated amortisation and impairment losses. Development costs incurred that cannot be separately identified from a physical asset are included in the item of property, plant and equipment being developed and depreciated over the useful life of the asset.

If the recognition criteria are not met or the expenditure is on research activities (undertaken with the prospect of gaining new scientific or technical knowledge and understanding), expenditure is recognised as an expense as incurred.

## Impairment of Non-Financial Assets Other than Goodwill

At each balance date, or when events/circumstances indicate, Meridian reviews the recoverability of the carrying amounts of its tangible and intangible assets to determine whether they have suffered an impairment loss. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Value in use is the present value of the future cash flows expected to be derived from the asset. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units). An impairment loss is recognised immediately in the income statement for the amount by which the asset's carrying amount exceeds its recoverable amount, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Non-financial assets that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date. A reversal of an impairment loss is recognised immediately in the income statement, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

### Goodwill

Goodwill, representing the excess of the cost of acquisition over the fair values of the identifiable assets, liabilities and contingent liabilities acquired, is recognised as an asset and not amortised, but tested for impairment annually and whenever there is an indication that the goodwill may be impaired. Any impairment is recognised in the income statement and is not subsequently reversed. For the purpose of assessing impairment goodwill is allocated to cash generating units.

### Non Derivative Financial Instruments

Financial assets and financial liabilities are recognised in Meridian's Statement of Financial Position when the Parent or Group becomes a party to the contractual provisions of the instrument (trade date).

### Non Derivative Financial Assets

Meridian classifies its financial assets as either loans and receivables, or assets available for sale. The classifications depend on the purposes for which the financial assets were acquired. Meridian determines the classifications of its financial assets at initial recognition.

### Available for Sale Investments

Certain shares held by Meridian are classified as being available for sale and stated at fair value. Gains and losses arising from changes in fair value are recognised directly in the available-for-sale revaluation reserve, until the investments are disposed of or are determined to be impaired, at which time the cumulative gain or loss previously recognised in the available-for-sale revaluation reserve is included in the income statement for the period. Dividend income is recognised separately from other changes in fair value.

Investments in shares that do not have a quoted market price in an active market and whose fair value cannot be reliably measured are carried at cost, less any impairment loss to reflect irrecoverable amounts.

### Investments in Subsidiaries and Joint Ventures

In the financial statements of the Parent, the cost method is used to account for investments in subsidiaries and joint ventures.

### Trade Receivables

Trade receivables are measured on initial recognition at fair value, and are subsequently carried at amortised cost. Appropriate allowances for estimated unrecoverable amounts are recognised in the income statement when there is objective evidence that the asset is impaired. The allowance recognised is measured as the difference between the assets' carrying amount and the present value of estimated future cash flows.

### Construction Work in Progress

Construction work in progress is stated at cost plus profit recognised to date, less progress billings and any provision for foreseeable losses. Cost includes all expenditure directly related to specific projects and an allocation of fixed and variable overheads incurred in the Company's contract activities based on normal operating capacity.

### Cash and Cash Equivalents

Cash and cash equivalents comprise cash on hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

### Non Derivative Financial Liabilities

Meridian classifies its financial liabilities as either borrowings and payables, or liabilities held for sale. Financial liabilities are classified as held for sale if the sale of the asset or disposal group to which they relate is highly probable and is available for immediate sale in its present condition subject only to normal sale terms. The classification of other financial liabilities depends on the purpose for which the financial liabilities were acquired. Meridian determines the classification of its financial liabilities at initial recognition.

### Borrowings

Borrowings are recognised initially at fair value, net of transaction costs. Borrowings not designated as hedged items are subsequently stated at amortised cost and any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings designated as hedged items are subject to measurement under hedge accounting requirements.

### Trade Payables and Accruals

Trade and other accounts payable are recognised when Meridian becomes obligated to make future payments resulting from the purchase of goods and services, and are subsequently carried at amortised cost which approximates fair value.

### Deferred Income on Emission Rights

Meridian receives tradable emission rights from specific energy production levels of certain renewable generation facilities. The future revenue arising from the sale of these emission rights is a key matter in deciding whether to proceed with the construction of the generation facility and is considered to be part of the value of the generation assets recorded in the Statement of Financial Position. Proceeds received on the sale of emission rights are recorded as deferred income in the Statement of Financial Position until the committed energy production level pertaining to the emission rights sold have been generated.

### Derivative Financial Instruments and Hedge Accounting

Derivatives include cross currency interest rate swaps (CCIRSs), interest rate swaps (IRSs) (including forward rate agreements and interest rate options), foreign exchange contracts (including currency options (FECs)) and electricity contracts for differences (CfDs).

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured on a periodic basis at their fair values. The method of recognising a resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Meridian designates certain derivatives as either:

- hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge); or
- hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge).

For derivatives designated in a hedge relationship, Meridian documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedge transactions. Meridian also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Some derivatives (within risk management policy) are not in designated hedging relationships.

## Fair Value Hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement in Net Change in Fair Value of Financial Instruments within other finance related expenses in respect of CCIRSs, together with any changes in the fair value of the hedged assets or liabilities that are attributable to the hedged risks. Interest expense on the loans designated as hedged items in fair value hedges is recognised in finance costs.

If a hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of the hedged item is amortised to the income statement over the period to maturity.

## Cash Flow Hedge

The effective portion of changes in the fair values of derivatives that are designated and qualify as cash flow hedges are recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement in Net Change in Fair Value of Financial Instruments within operating profit in respect of FECs and Net Change in Fair Value of Financial Instruments within other finance related expenses in respect of CCIRSs and certain IRSs. Cash settlements on derivatives in cash flow hedge relationships are recognised in the income statement as adjustments to the selling prices (or costs) of the hedged items.

Amounts accumulated in other comprehensive income are recycled in the income statement in the periods when a hedged items affects profit or loss (for instance when the forecast transaction that is hedged takes place). The realised gains or losses relating to the effective portion of derivatives are recognised in the income statement.

When a forecast transaction that is hedged results in the recognition of a non-financial asset or a non-financial liability, the gains and losses previously deferred in other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability as a “basis adjustment”.

However, if Meridian expects that all or a portion of a loss previously deferred in equity will not be recovered in one or more future periods, the amount that is not expected to be recovered is reclassified into profit or loss immediately.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

## Derivatives not Designated as Hedges

Derivative instruments that do not qualify for hedge accounting or for which hedge accounting is not actively sought are at fair value through profit or loss and classified as being held for trading stock. Changes in their fair value, therefore, are recognised immediately in the income statement within operating profit in respect of CfDs and FECs and within finance costs in respect of IRSs. Cash settlements on such derivatives will adjust the price of the underlying item to which they relate. The cost of certain electricity options is recognised within “Net Change in Fair Value of Financial Instruments (Operational)”.

### Day 1 Adjustment

A Day 1 adjustment arising when an electricity derivative is entered into at a fair value determined to be different to the transaction price and is amortised to profit or loss as electricity volumes contracted in the derivative expire. The carrying value of the derivative is disclosed net of the Day 1 adjustment. Meridian has elected to use the amortisation method in respect of the NZAS Pricing Agreement.

Difference between Fair Value at Initial Recognition and Amount that would be Recognised using a Valuation Technique

Where a valuation technique that incorporates unobservable inputs is used to value electricity derivatives, and this value results in a value at inception that is different from its cost, the valuation model is recalibrated by a fixed percentage to result in a value at inception equal to the transaction price (fair value). This recalibration adjustment is then applied to future valuations over the life of the contract. Meridian applies the recalibration method to the electricity derivative portfolio.

**Fair Value Estimation**

The fair values of financial assets and financial liabilities, including derivative instruments, must be estimated for recognition and measurement, or for disclosure purposes.

The fair value of instruments traded in active markets (such as electricity futures traded on commodity markets) is based on closing market prices at balance date.

The fair value of instruments that are not traded on an active market (IRSs, CCIRSs, FECs, CfDs) are determined using various valuation techniques which include assumptions on both observable data when such data is available (IRSs, CCIRSs, FECs, and some CfDs) and non-observable data (some CfDs) in all other instances. The fair values of IRSs, CCIRSs, FECs and CfDs is based on the discounted value of future cash flows. Assumptions on the determination of future cash flows are based on the publicly available forecast prices where available and internal models when a forecast prices are not available.

In relation to forecast prices used to determine future cash flows for CfDs for non-observable periods, the following significant assumptions are used where relevant:

- forecast of the forward wholesale electricity price for the non-observable period based on a fundamental analysis of expected demand and cost of new supply
- forecast of the aluminium price (based on the London Metal Exchange (LME)) for the non-observable period using a historical trend analysis to form future price expectations
- forecast CPI or proxy for price inflation
- all CfDs run to full term.

Future electricity price estimates are used to determine expected cash flows to be settled on CfDs. The expected cash flows are then discounted to determine the fair values of the CfDs. The discount rates used are based on Government Bond Rates adjusted for additional risks, including credit risk and the remaining terms of the CfDs. In relation to the NZAS Pricing Agreement, the discount rate used is Meridian's weighted average cost of capital.

The fair value of FECs is determined using forward exchange market rates at balance date discounted to present value. The fair value of currency options is determined using appropriate binomial models or the Black-Scholes model.

The fair value of financial liabilities in fair value hedge relationships and for the purpose of disclosure is estimated by discounting the future designated cash flows at current market interest rates applicable to the risks being hedged.

The valuations determined for instruments not traded on an active market, particularly with respect to CfDs can vary significantly based on assumptions in relation to the forecast electricity price and interest rates. In addition, the fair value of the NZAS Pricing Agreement can also vary based on the price of aluminium published on the LME. The sensitivity to changes in assumptions for level 3 financial instruments is quantified in the note in the financial statements on Financial Risk Management.

## Reserves

The revaluation reserve arises on the revaluation of generation structures and plant and from the revaluation of certain intangible assets as part of the step acquisition of Whisper Tech Group on 3 July 2006. Where a revalued generation structures or plant assets are sold, that portion of the asset revaluation reserve that relates to that asset, and is effectively realised, is transferred directly to retained earnings. Where a revalued intangible asset is sold, that portion of the reserve which relates to that intangible asset, and is effectively realised, is transferred directly to retained earnings. Where a revalued intangible asset is impaired, the impairment is recognised in the reserve to the extent of any surplus for that asset otherwise the impairment is recognised in the income statement.

The foreign currency translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

The cash flow hedge reserve comprises the effective portion of the cumulative net change in the fair values of cash flow hedging instruments relating to hedged transactions that have not yet occurred. The cumulative deferred gain or loss on the hedge is recognised in the income statement when the transaction impacts the profit or loss, or is included as a basis adjustment to the non-financial hedged item, consistent with the applicable accounting policy.

The available-for-sale revaluation reserve arises on the revaluation of available-for-sale financial assets. Where a revalued asset is sold that portion of the reserve that relates to that financial asset, and is effectively realised, is recognised in the income statement. Where a revalued financial asset is impaired, the impairment is recognised in the reserve to the extent of any surplus for that asset, otherwise the impairment is recognised in the income statement.

## Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the income statement because it excludes items of income and expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

### Deferred Tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and interests in joint ventures, except where Meridian is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the assets to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited to the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and Meridian intends to settle its current tax assets and liabilities on a net basis.

## Employee Benefits

Provision is made for benefits accruing to employees in respect of wages and salaries, annual leave, long service leave and employee incentives when it is probable that settlement will be required and they are capable of being measured reliably.

Provisions made in respect of employee benefits are measured using the remuneration rates expected to apply at the time of settlement.

## Goods and Services Tax (GST)

The income and cash flow statements are prepared on a GST-exclusive basis. All items in the Statement of Financial Position are stated net of GST, except for receivables and payables, which include GST.

## Inventories

Inventories are stated at the lower of cost or net realisable value. Cost is determined on a weighted average basis and includes expenditure incurred in acquiring the inventories and bringing them to their existing condition and locations. Net realisable value represents the estimated selling prices less estimated selling expenses.

Emission rights produced are also recognised as inventory but only if the rights have been verified, it is probable that expected future economic benefits will flow to Meridian, and the rights can be reliably measured. In this case the inventory is measured at the lower of cost (which is a nominal amount) and net realisable value (current carrying value nil).

## Provisions

Provisions are recognised when Meridian has a present obligation as a result of a past event, and it is probable that Meridian will be required to settle that obligation and the amount has been reliably estimated.

## Warranties

A provision for warranties is recognised as a liability when the underlying products or services are sold.

## Restructuring

Restructuring is a programme planned and controlled by Meridian that materially changes the scope of a business undertaken by Meridian or the manner in which that business is conducted by Meridian. Meridian recognises a provision for restructuring when the Directors have approved a detailed formal plan and restructuring has commenced or a public announcement regarding the restructuring has been made. Costs and expenditures related to ongoing operations are not included in the provision for restructuring.

## Operating Leases

Operating leases are leases where the lessor effectively retains substantially all the risks and benefits of ownership of the leased items.

Operating lease payments are recognised as an expense on a straight-line basis over the term of the lease.

## Government Grants

Government grants received comprises amounts received from the Government. Grants are offset against the cost of the asset to which the grants relate.

## Revenue Recognition

### Sale of Energy and Other Related Services

Revenue comprises amounts received or receivable in the ordinary course of business for the sale of electricity sold into the wholesale electricity market and to retail customers and for energy related goods and services provided.

Revenue from a contract to provide dam related maintenance services is recognised by reference to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed.

### Dividend Income

Dividend income is recognised when the right to receive payment is established.

### Interest Income

Interest income is recognised on a time proportionate basis using the effective interest rate method.

### Energy Related Costs

Energy related costs reported in the income statement include amounts payable for electricity purchased from the wholesale market and energy related services purchased from suppliers.

### Construction contracts

When earnings on construction contracts can be reliably estimated, contract revenue and costs are determined using the percentage-of-completion method at balance date. This is measured as the proportion of contract costs for work performed to date to the total contract costs, except where this would not be representative of the stage of completion. Provision is made for estimated future losses on an entire contract from the date it is first recognised that a contract loss may be incurred.

## Cash Flow Statement

The cash flow statement is prepared exclusive of GST, which is consistent with the method used in the income statement. The GST component of cash flows arising from investing and financing activities, which is recoverable from or payable to, the taxation authority is classified as operating cash flow.

# Appendix III – Supporting Definitions

## Definitions of SCI Performance Measures

| | |
|---|---|
| Equity to Total Assets | Group Equity divided by Total Assets |
| Net Debt / (Net Debt + Equity) Gearing | Net Debt divided by Capital Funding |
| FFO Interest Cover | FFO plus Net Interest divided by Net Interest (12 month rolling average) |
| EBITDAF / MWh Generation | EBITDAF divided by MWh Generation |
| Index of Customer Experience | Six-month rolling average of survey scores across four customer segments and four questions relating to customer satisfaction, intention to remain a customer, likelihood to recommend Meridian and pride in being a Meridian customer |
| Hydro Forced Outage Factor | Percentage of time that hydro assets are unavailable in a period owing to forced, unplanned outages |
| Number of Lost-Time Injuries | Count of the number of times any staff member is absent from work for at least one full shift owing to injury |

## Supporting Financial Definitions

| | |
|---|---|
| Adjusted Equity | Period closing Group Equity less unrealised fair value movements on derivative financial instruments after tax |
| Capital Funding | Net Debt plus Adjusted Equity |
| EBITDAF | Group Earnings before Interest, Tax, Depreciation, Amortisation and Unrealised Fair Value Movements on Derivative Financial Instruments for the period |
| FFO - Funds from Operations | Group EBITDAF less Net Interest less Tax Paid |
| Group Equity | Period closing Group Equity attributable to Shareholders |
| MWh Generation | Megawatts hours of New Zealand generated electricity |
| Net Debt | Face value of borrowings less cash and cash equivalents |
| Net Interest | Interest paid less interest received (excluding capitalised interest) for the period |
| Total Assets | Period closing Group Total Assets |

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MBR0047