Statement of Corporate Intent

thelines company

2017 / 2018

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1.0 Overview

This document provides an overview of the business strategy and performance targets for The Lines Company Limited ("TLC" or "the Company"). The information provided is within the scope defined as in Section 39 of the Energy Companies Act 1992.

2.0 Current Position of TLC

2.1 Company Profile

The Lines Company Limited ("TLC" or the "Group") core business is the ownership, maintenance and operation of an electricity distribution business in the Waitomo and King Country region of New Zealand.

TLC is 100% owned by the Waitomo Energy Services Customer Trust ("WESCT"). WESCT is governed by six trustees. Three trustees are elected by customers within a gazetted area (Hangatiki and Whakamaru) who then appoint one further trustee. Major customers within the Hangatiki and Whakamaru area also elect two trustees. TLC is committed to growing the value of the Group, for the long term benefit of WESCT, while at the same time distributing profits through dividends – a total of $47 million since 2008.

TLC's Head Office is located in Te Kuiti with operational depots in Taumarunui, Turangi, Ohakune and Mangakino. The Group has four distinct business units – Network, Metering, Generation and Contracting, with only the Network business being constrained to the Waitomo and King Country region.

2.2 Network

TLC's Network business provides an electricity distribution service to some 24,300 connected customers – successfully delivering approximately 369 GWh of electricity per year. The distribution area covers 13,700 km^2 and is one of the largest network areas in New Zealand that has no major urban centre (see Figure 1). TLC specialises in providing electrical capacity to rural and sparsely populated areas, including to the highest points in the North Island of New Zealand (the Turoa and Whakapapa ski fields on Mount Ruapehu). TLC's network has a regulated asset value (RAB) of $179.5million.

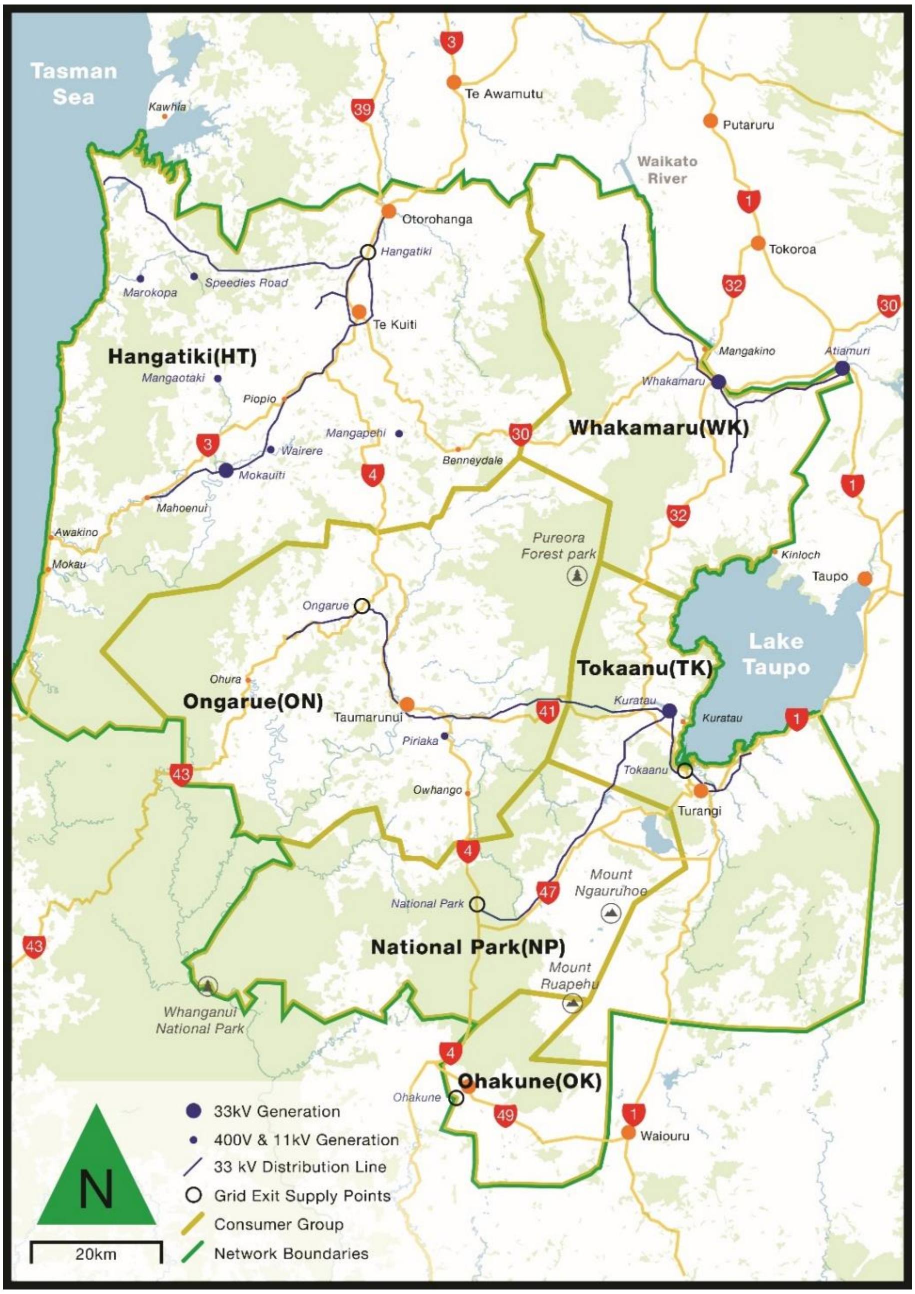


Figure 1: Geographical area within which network assets are located and key physical attributes.

The key metrics of the network business are listed below – note that all figures are from Information Disclosure year 31 March 2016:

Line and Cable length (All voltages):	4,369km
Asset Regulatory Value:	$179,554,000
Distribution Transformer capacity:	240 MVA
Connected customers:	23,595 (Ave. for disclosure year)
Growth in connected numbers over the last year:	43
Any time Max Demand:	72 MW
Energy transported (Energy Delivered)	369 GWh

Table 2: TLC Information Disclosure Key Statistics – 31 March 2016

2.3 Metering

Financial Corporation Limited (FCL) is a wholly owned subsidiary of TLC and represents the Group's metering interests. FCL owns both on-network meters (meters on the TLC Network) and off-meter networks (which exist on non TLC networks) where FCL derive income from electricity retailers and some industrial sites throughout New Zealand. FCL also own 36% in Embrium Holdings Ltd – an "early stage" meter analytics business based in Wellington.

2.4 Generation

TLC operates and maintains three hydro generation sites – these are either wholly owned, or owned in partnership with landowners. Two generation sites (Speedys Road and Mangapehi) are in TLC's network area while one site is located at Matawai near Gisborne.

The key metrics of the generation business are listed in Table 2.

	Mangapehi	**Speedys**	**Matawai**
Annual expected Output	5.2Gwh	8.6Gwh	7.0Gwh
Head	106m	42m	153m
Capacity	1.6MW	2.0 MW	2.0MW
Distance from Te Kuiti	27km	52km	358km
Catchment area	53.9km^2	120.7km^2	43.3km^2
Ownership	100% TLC	75% TLC 25% Landowner	100% TLC

Table 2: Key Hydro Generation Business Metrics – 31 March 2016

These generation sites are run of the river (i.e. no hydraulic storage) hydroelectric plants. The output is dependent on rainfall in the catchments that supply the Intake Rivers. Ongoing improvements continue to be made on plant and equipment in order to optimise generation output and ensure reliability of supply.

2.5 Contracting

TLC has a wholly owned power systems contracting unit. Contracting supports the network as well as provides connection and technical services to customers. The business unit employs approximately 65 staff who provide fault response, connection services, asset construction and maintenance support for both the Network and select industrial sites. This unit is focused as a specialist support unit to the network. In addition to in-house teams, Contracting also engage two key service providers for vegetation management (arborist services) and major construction projects.

3.0 Current and Emerging Challenges

The electrical industry in New Zealand is posed for significant change in the upcoming years driven by factors such as the uptake of Distributed Energy Resources (e.g. photovoltaics, battery storage etc), projected growth of electric vehicles and the potential for legislated industry consolidation – to list a few.

TLC also faces more specific challenges associated with a disparate, aging network financially supported by a relatively small population base. A summary of the current and emerging challenges is listed below:

Customer and community engagement	TLC is the only electricity distribution company in New Zealand to direct bill, employing a pricing methodology that is unique within the industry. The pricing structure has caused significant debate amongst customers and is currently being reviewed in consultation with the community.
Safety Leadership	The Health and Safety at Work Act (2015), sets an expectation that businesses move from a compliance to a proactive safety culture.
Business diversification	TLC has a relatively narrow business portfolio with approximately 80% of our income derived from Network activities.
Cost effective Network service delivery	TLC has an aging asset base that is spread across a wide geographical area. TLC is focused on maintaining network reliability at the least possible life cycle cost which remains challenging with an aging asset and a low population base.
Major customer uncertainty	TLC has 12 major customers (high demand, industrial sites) within the Network - the future of some key customers remain uncertain. In addition, there is the possibility of significant changes to expected loads which could require additional capital expenditure.
Emerging technologies	The emergence of new technology such as photovoltaics, battery storage, smart in home devices, electric vehicles and digital trading platforms, to name a few, has the potential to significantly change the industry and TLC's business activities.
Changing legislative landscape	Because of our shareholding structure, TLC must adhere to strict legislative requirements. The legislative landscape is subject to regular change – more recently, the prospect of consolidating smaller electricity networks has been raised for consideration by Parliament.

Effectively leverage subsidiaries	TLC has invested in complementary subsidiaries, however the full synergist value of these subsidiaries has yet to be fully realised. Investments in technology entities, such as the FCL metering business, that operate in a competitive and dynamic market present both a risk and opportunity to TLC.
Investment in systems and processes	TLC's systems and processes require updating and investment in order to meet the requirements of an evolving business.

4.0 TLC's positioning

TLC remains one of the most complex and challenging electricity networks in New Zealand with many kilometres of network (12th largest from 29th electricity distribution companies[1]) but with some of the lowest number of customers (ranked 20th overall). Over the last 15 years TLC has engaged in a focused renewal program to manage key asset risk while improving network resilience – consequently many network hazards have been addressed and network reliability is at a good and constant level.

In 2013 TLC launched a meter renewal program to update all metering stock with the objective of improved data accuracy and flexibility. By the end of the 2016 all installations had been visited and 84% of the existing meters had been changed. Those meters that haven't been changed are a result of either technical issues (e.g. lack of physical space on the switchboard, the quality of the wiring etc) or the owners refusing TLC access to the site. TLC is still working toward the goal of having all on-network meters updated.

TLC's hydroelectric generation assets continue to operate with high reliability and generate a solid revenue stream – with two of the hydro power stations embedded within the TLC network.

In early 2017, TLC began an external review of the customer pricing methodology. The brief was to review the current structure in terms of equity, simplicity and transparency for customers on TLCs network. The review, and implementation of any recommendations, will continue into 2017/18.

TLC's prices and quality are regulated by the Commerce Commission to provide consumer protection and a fair rate of return. The revenue that TLC is entitled to secure must be in line with TLC's investment in the network and the funding needs of the business. To date, TLC's actual rate of return is lower than our target regulated return.

[1] "Electricity Line Business 2016 Information Disclosure Compendium" – October 2016, PwC

5.0 Strategy

5.1 Strategic Imperative

The Company will concentrate on improving the value and resilience of the business over the next three years with a focus on customer and community value, technology innovation and business efficiency. The Company's goals will be delivered through a revised pricing structure, greater community engagement, close collaboration with industry partners, integrating smart metering technology, supporting local generation and market opportunities and the deployment of new network related technologies. Health and safety has been the priority driver of many business decisions in the past and as such will continue to be the cornerstone of the organisation's core values.

5.2 Community Engagement and the Service Based Pricing Review

As a result of customer feedback, the Company instigated a Service Based Pricing Review – a project to review the current pricing methodology and principles. The mandate defined by the Board was to engage with the community and develop a pricing methodology that is simple, transparent, equitable and easily understood by all. The project began late 2016 and to date has included over 50 hours of dialogue with different community groups and leaders. A pricing structure based upon a 'time-of-use' methodology is being developed, modelled and then trialled with a sample of customers. The Company's systems, 'smart' meters and processes will also require significant modification to accommodate any change in the pricing methodology. A final proposal to proceed will be presented to the Board in October of this year and if approved, the revised pricing methodology will be implemented in April 2018.

5.3 Strategic Objectives

To ensure that the Company maximises and sustains shareholder value, the following high level objectives have been defined and summarised in Table 3.

HEALTH AND SAFETY
• Develop a safety culture, with supporting processes and systems, that will enable TLC to become a zero harm workplace.

CUSTOMER AND COMMUNITY
• Review the pricing methodology and principles and implement any changes.
• Engage more with the community – strengthen TLC's brand as a good community citizen.
• Identify new ways to add value to our all customers through greater customer understanding and the delivery of great service.

NETWORK
• Maintain consistent reliability and quality of supply.
• Drive an innovative approach to Network management with a focus on completing the required amount of renewal to maintain reliability at the lowest possible cost.
• Revenue in line with the Commerce Commission price path, with a pricing strategy aligned with network cost drivers.
• Achieve the regulated ROI on a “right sized” and economic Regulatory Asset Base (RAB).
• Effectively monitor and measure compliance with statutory and regulatory requirements.
• Employ new, emerging technology where there is a clear business case.

CONTRACTING
• Provide a safe and efficient service to customers, while meeting the required ROI.
• Develop a skill base that supports core network operations while preparing for future business needs.

METERING
• Deploy and support metering stock both on TLC’s network and third party networks.
• Provide meter related information services customers.
• Expand the scope of services via innovative technology and partnerships.

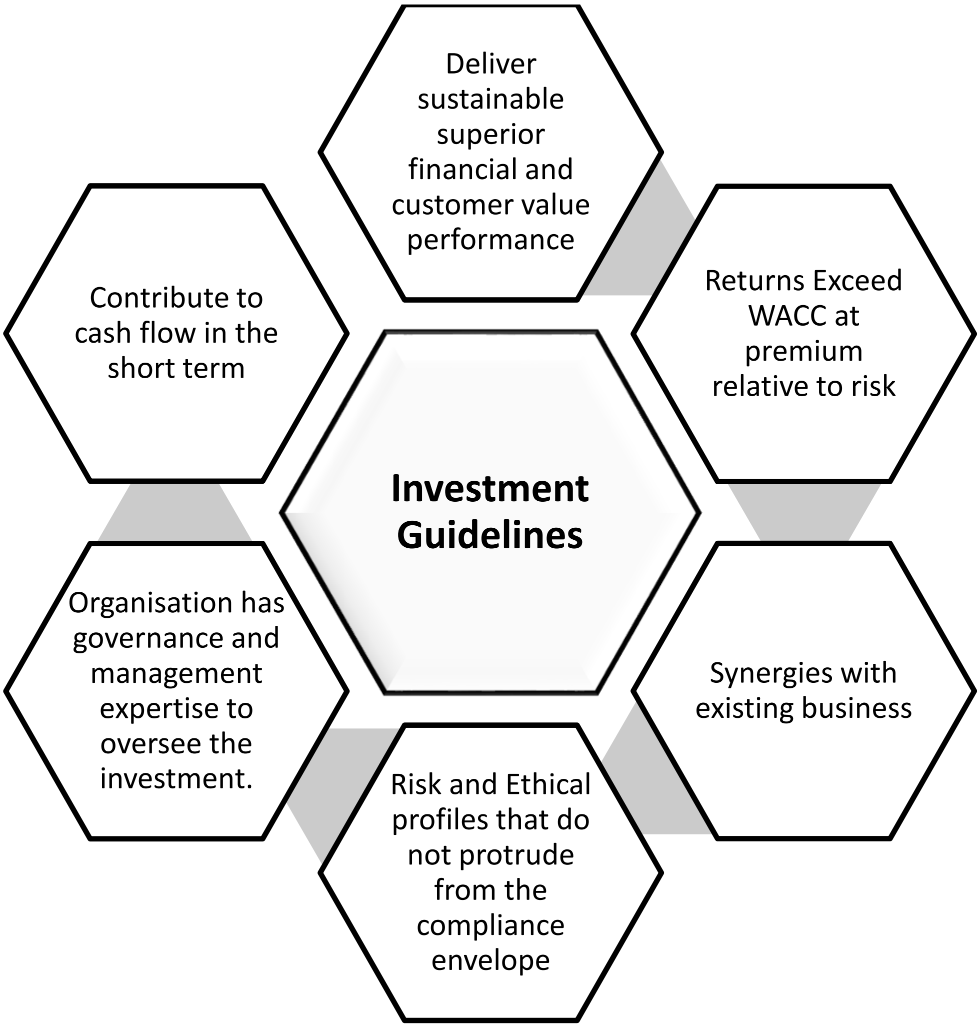
GENERATION
• Maintain and positioning the investment so that the value is maximised.
• Ensure the hydroelectric sites are hazard controlled and compliant.
• Identify opportunities that are able to produce energy at low cost when demand and prices are high and adding these to the portfolio when the risk and returns are acceptable.

CORPORATE
• Actively engage with industry partners and seek opportunities for strong collaboration.
• Investigate opportunities to further diversify TLC in a way that leverages the current business and complements the evolution of the electricity industry.
• Review current processes and system to ensure that they are efficient and support both current and future needs of TLC and our customers.
• Enhance the leadership qualities and skills of our people.
• Monitor the regulatory landscape and emerging legislation and proactively manage change.
• Provide governance, and shared corporate support services systems, in an effective and efficient manner.

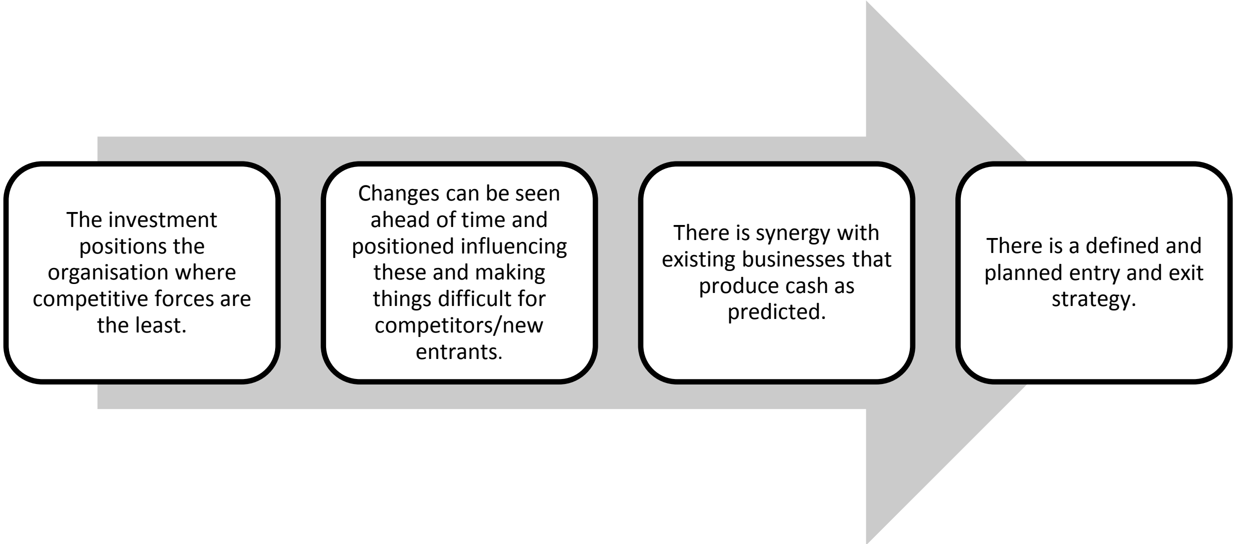
Table 3: Key Strategic Business Objectives for TLC

5.4 Investment Criteria Guidelines

The Company recognises that its main mission is to deliver a strong sustainable network to the greater King Country area. It is therefore willing to invest in network expansion within this geographic area at a minimum of our cost of capital, where new revenue is assured, in order not to limit community growth. Non-regulated business investments will in general terms be subjected to the following assessment elements including a premium on the appropriate industry WACC.



5.5 External Investment Tests



The Company has to apply commercial and risk management principles to its investment portfolio. This includes a constant review of the activities TLC is involved in, seeking profitable growth, seeking to make activities/products more difficult for competitors to copy, using the business/activity for strategic positioning of the group, or exit.

Individual investments will be weighted and prioritised according to their risk profile.

New investment for the 2017/18 year will be focused around:

- Providing metering and related services.
- Products that will deliver customers better service at a lower price.
- Customer growth related expansion including the upgrade of Hangatiki substation and specific work relating to the Taharoa Ironsands mine.
- Network renewal.

5.6 Dividend Policy

Surplus funds from the operation of the business shall be applied to:

1. Renewal of existing assets.

2. The prudent management of debt.
   The prudent management of debt includes consideration of debt repayment related to asset lives, dividend maintenance, and having regard to the Company's equity ratio.

3. Of the balance 20% shall be retained and applied to growth of the Company and the remaining 80% distributed to the Shareholder, subject always to:
   - Directors' discretion.
   - The solvency requirements of the Companies Act 1993.
   - Any banking or other funding covenants by which the Company is bound from time to time and,
   - The investment and operating requirements referred to in this policy.

6.0 Financial Performance

TLC Group - All figures are in $'000s.

Earnings	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
	Actual	**Actual**	**Forecast**	**Projected**	**Projected**	**Projected**
EBITDA	24,635	24,811	25,744	27,110	28,299	30,942
EBIT	13,465	13,383	15,103	16,294	16,821	18,894
Interest, net	2,923	2,658	2,807	2,986	3,124	3,359
Profit after tax	7,341	7,427	8,572	9,065	9,819	11,727
Return on average assets	4.0%	3.9%	4.5%	4.7%	4.6%	5.0%
Return - average equity	5.2%	5.4%	6.0%	6.2%	6.6%	7.6%

The 2016 result included the writing off of JDE goodwill of $860,000.

Balance Sheet	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
	Actual	**Actual**	**Forecast**	**Projected**	**Projected**	**Projected**
Cash	837	447	667	515	397	351
Other Current Assets	5,071	5,351	4,727	4,890	5,282	5,489
Non-current Assets	239,345	244,991	251,202	260,187	272,311	277,939
Other Financial Assets	0	0	98	98	98	98
Total Assets	**245,253**	**250,789**	**256,694**	**265,690**	**278,088**	**283,877**
Current Liabilities	9,498	12,060	10,782	9,449	9,091	9,464
Deferred Tax	47,910	48,380	48,252	49,331	49,770	49,923
Bank Loans	47,950	49,100	52,239	57,900	66,500	66,700
Sunordinated debentures and Minority Interest Loans	4,000	3,950	4,150	4,150	4,100	4,100
Shareholder Funds	135,895	137,299	141,272	144,860	148,628	153,690
Total Equity + Liabilities	**245,253**	**250,789**	**256,695**	**265,690**	**278,088**	**283,877**

Cash Flows	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
	Actual	**Actual**	**Forecast**	**Projected**	**Projected**	**Projected**
Operating Cash flows	19,172	21,026	21,188	20,331	21,286	23,691
Capital Expenditure	(12,856)	(17,516)	(18,757)	(20,344)	(23,654)	(17,136)
Debt Movements, net	(4,000)	1,150	3,139	5,661	8,600	200
Dividends	(5,000)	(5,000)	(5,300)	(5,800)	(6,300)	(6,800)
Loan to related party	-	-	-	-	-	-
Sale (purchase) of Investments	-	(50)	(50)	-	(50)	-
Net Cash Movement	**(2,684)**	**(390)**	**220**	**(152)**	**(118)**	**(45)**

It is important to note that the forecast capital expenditure includes the new building cost and the completion of the roll out of smart meters across the network. These are largely one-off capital expenditure events with forecast capital expenditure expected to reduce to $13.5m per annum from 2022.This reduction in capital expenditure will translate directly to additional free cash flow which indicates that debt will reduce approximately $6.0m per year from 2022.

6.1 Performance Targets

1. Return on Average Assets

	2015	2016	2017	2018	2019	2020
	Actual	Actual	Forecast	Projected	Projected	Projected
Return	4.0%	3.9%	4.5%	4.7%	4.6%	5.0%

2. Return on Average Equity (including revaluation gains)

	2015	2016	2017	2018	2019	2020
	Actual	Actual	Forecast	Projected	Projected	Projected
Return, excluding revaluations	5.2%	5.4%	6.0%	6.2%	6.6%	7.6%
Asset Revaluation	4.1%	-	-	-	-	-
Return, including revaluations	9.3%	5.4%	6.0%	6.2%	6.6%	7.6%

3. Debt

	2015	2016	2017	2018	2019	2020
	Actual	Actual	Forecast	Projected	Projected	Projected
Subordinated debentures	3,000	3,000	3,000	3,000	3,000	3,000
Minority Interest loans	1,250	1,200	1,150	1,150	1,100	1,100
Bank Loans	47,950	49,100	52,239	57,900	66,500	66,700
Total	**52,200**	**53,300**	**56,389**	**62,050**	**70,600**	**70,800**

Bank debt is expected to start reducing from 2020 to $65.0m in 2021, and $58.5m in 2022.

4. Equity to Asset ratio: will not be less than 40%.

5. Dividends

	2015	2016	2017	2018	2019	2020
	Actual	Actual	Forecast	Projected	Projected	Projected
Dividends	5,000	5,000	5,300	5,800	6,300	6,800

6. Reliability

The performance target relating to SAIDI and SAIFI reliability is for TLC not to breach the reliability limits as set out in the Default Price Path Annual Compliance Statement.

7. Regulated Revenues

To have a Notional Revenue to Allowable Notional Revenue ratio as set out in the Default Price Path Annual Compliance Statement of between 80% and 100%.

8. Funding of Community Projects

To expend no more than $100,000 in supporting community projects.

9. Health and Safety

That there are no notifiable incidents that lead to serious harm; there is steady improvement in lost time injuries and that there is continuous improvement in health and safety culture.

6.2 Other Required Measures

Equity Ratio

This ratio is defined as total consolidated shareholder funds as a percentage of total assets where:

- Consolidated shareholder's funds comprise the total issued capital, the balance of undistributed profits and all revenue and capital reserves including revaluations, less any minority interests, plus subordinated debentures.
- Total assets comprise all recorded tangible and intangible assets of the Company valued at their carrying value, less deferred tax assets.

Accounting Policies

The Company's accounting policies will comply with the legal requirements of the Companies Act 2013 and the Financial Reporting Act 1993.

The accounting policies will be consistent with those adopted by the Company in its Annual Report to 31st March 2017, which comply with the International Financial Reporting Standards (IFRS).

7.0 Other Matters

7.1 Information to be provided to Shareholder

1. Updates will be provided on key issues.

2. Quarterly report on the investment in Embrium Holdings

3. Half yearly reports will be delivered to the Company's shareholder within 3 months after the end of the half-year. These reports will comprise:
   - A report from the Directors covering the operations for the half year, and
   - Un-audited consolidated financial statements for the half year.

4. Annual reports will be delivered to the Company's shareholder within 3 months of the end of each financial year and will comprise:
   - A report from the Directors covering the operations for the year; and
   - Audited consolidated financial statements for the financial year; and
   - Auditor’s report on the financial statements and the performance targets (together with other measures by which the performance of the Company has been judged in relation to the Company's objectives).

5. Draft Statement of Corporate Intent (SCI) is required to be delivered to the Company's shareholder not later than one month before the end of each financial year.

6. A summary of the annual capital expenditure budget adopted by the Board, including identification of all programmed network projects with a budgeted capital expenditure in excess of $500,000.

7.2 Procedures for Acquisition of Shares in Other Companies or Organisations

As a general policy, any proposed share investment by the Company will be required to meet the same financial criteria as any significant capital expenditure. In addition, the questions of control and risk will be addressed.

All share investment proposals will be considered by the Company's Board of Directors. If the size of the proposal makes it a Major Transaction as defined by the Companies Act 1993, then Shareholder approval to the proposal will be sought. For transactions with a value in excess of 10% of the Company’s equity, but below that required for a major transaction, the Company will, at least 10 business days prior to the Company entering into any such transaction, supply to the Shareholder a report which, in the opinion of the Directors, gives reasonable particulars of:

- The estimated size of the transaction.
- The benefits to the Company.
- The risks to the Company.
- The likely financial impact on the Company.

7.3 Transactions with related companies and local authority shareholders

The Energy Companies Act 1992 requires the Company to publish in its Statement of Corporate Intent the details of any transactions that the Company intends to enter into with any related company or any local authority that is a shareholder of the Company.

The Company's contracting division provides services to Financial Corporation Limited, the Company's metering arm.

7.4 Procedure to Modify the Statement of Corporate Intent

The Statement of Corporate Intent may be modified by the Directors provided that they have first given the Shareholder one month to make comments on the proposed modification.

The Shareholder may also resolve, at a general meeting of the Company, to require the Directors to modify the statement. The Shareholder must have regard:

- to the requirement that the principal objective of the Company is to operate as a successful business, and the desirability of ensuring the efficient use of energy;
- to the financial accounts and other reports the Company is required to prepare under Section 44 of the Energy Companies Act 1992;
- and the Shareholder must consult the Directors.

Glossary of Terms

EBITDA	Earnings before interest, tax, depreciation and amortisation.
EBIT	Earnings before interest and tax.
Assets	Total assets, less deferred tax assets.
Net Assets	Total assets, less current liabilities.
Equity Ratio	Shareholders Funds / Assets.
Return on Average Assets	(EBIT multiplied by the applicable tax rate) divided by ((opening Net Assets plus closing Net Assets) divided by 2).
Return on Average Equity	(Profit for the year) divided by ((Opening Shareholder's Funds plus closing Shareholder's Funds) divided by 2).
Renewals	Replacement of existing property, plant and equipment either undertaken or committed to in the financial year.
ROI	Return of Investment**.**
Shareholders' Funds	Shareholder's equity plus subordinated debentures.
Surplus Funds	Net cash from operating activities less any increase in net cash due to temporary changes in working capital.
WACC	Weighted Average Cost of Capital.