The Lines Company Ltd

Statement of Corporate Intent

2007 / 2008

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Corporate Strategy

Philosophy – Company

We are currently running a business philosophy of maximising profits, provided that our cost of capital is met and investments are made on a prudent basis.

This financial objective is balanced both by the five year goal set in 2003 to aggressively lower outages, and by our target of having a higher ratio of satisfied network customers than the industry average.

The Board believes that it should continue with this total philosophy, but pursue it more aggressively in order to significantly increase returns to shareholders.

Returns

Over the past year the yield on 5-year government stock has risen to 6.21%. Based on this yield then our cost of capital model suggests that to meet our weighted average cost of capital (wacc) we need to be earning 7.65% on assets and 8.10% on equity.

Corporate Environment

The bulk of the company's investment is currently in the network business. It is exposed to the following environment:

- Regulatory price thresholds aimed at lowering returns to a real return of between 5% and 6% on ODV. With inflation at over 2% it is questionable whether this will meet our rate of return.
- An x factor of 2%. This will mean that returns are likely to fall below our required rate of return until the review of the regulatory regime is completed.
- Regulatory structure aimed at limiting network asset sales to close to ODV.
- Regulatory returns assume that returns can be generated from the assets for at least 45 years.
- The low fixed charge regime.
- Efficiency campaigns focussed on limiting consumption.
- Possible energy shortages limiting consumption.
- Costs increasing faster than inflation due to increases in resource costs.
- Distributed generation being encouraged to connect to networks, but with obligation to contribute no more than the marginal cost of the connection to the network revenue.
- Total delivered electricity costs climbing rapidly due to energy price increases.
- Re-investment in remote lines is probable, post 2013.

Combined, these factors mean that:

- We have fixed costs but variable network income exposing us to the risk of diminishing revenue

- Substitutes to the use of our lines network will be enhanced by both the escalating price of delivered energy, and the ability to avoid line charges while they are kWh based.

It will be increasingly difficult for the company to meet its cost of capital if it remains almost totally as a network business.

Financial structure

The company currently has a strong, but under leveraged balance sheet comprising:

- Fixed Assets plus net working capital of $114 million
- Debt (other than subordinated debentures of $3 million) of $11 million

The model adopted by the Commerce Commission has an optimum financial structure when 40% of total assets is financed by debt , i.e. debt in the Commission's view can reach this figure without a significant increase in equity return. The regulatory return is based on this premise. If we continue to remain below this figure we will therefore deliver sub optimum returns to our shareholders.

In addition:

- We are currently paying little tax due to discount levels
- The Commission is limiting discretionary discount returns
- If the company is to maintain its level of discretionary returns it might have to start paying dividends, which will increase tax leakage
- If the company lowers discretionary returns, then its borrowing capacity will be lowered.

Corporate strategy

In response, the company intends to use its underleveraged balance sheet to double its business size. This will involve:

- Diversifying out of the network business, where returns are substantially constrained.
- Increasing debt as a % of assets, to a maximum of 50%.

The company recognises that one of its main missions is to deliver a strong sustainable network to the greater King Country area, as covered by its two trust shareholders. It is therefore willing to invest in network expansion within this geographic area at a minimum of wacc, in order not to limit community growth.

Other investments will however be guided by the following rules:

- They must deliver superior sustainable financial performance. This includes investments in other networks, either by purchase or merger.
- Expected returns must exceed the company's wacc.
- At a minimum, a premium of 2.5% over the regulated network wacc will be sought.

- Non network businesses must be sustainable enough to afford their own resource. Network management is not to be diverted from network performance.

To achieve the company must:
- Expand through the purchase of further network assets at or just above ODV where there is significant short term growth, otherwise at below ODV and/or,
- Diversify into non regulated businesses.

The company's preference is to invest in external businesses where:
- There are relatively low competitive forces in the industry
- The company can enter the industry at a relatively low cost, due to synergy or other reasons
- The company has a defined entry strategy with a fully costed plan.
- There is a defined exit strategy

Individual investments will be weighted according to their risk profile.

Businesses

The company is currently investigating a range of businesses that fit the above criteria.

Target

All figures are in $'000s.

Combined	2006 Actual	2007 Forecast	2008 Projected	2009 Projected	2010 Projected	2011 Projected
After tax surplus	5869	6865	6903	5956	7630	8919
Return on equity	8.2%	9.5%	8.8%	7.0%	8.7%	9.7%
Cash	340	200	0	0	0-	0-
Other Current Assets	3420	5500	6400	8300	11100	14000
Fixed Assets	113770	115900	134200	141000	152500	162800
Total Assets	117530	121600	140600	149300	163600	176800
Current liabilities	6840	9500	9200	9600	11400	13400
Deferred tax	23830	24600	28100	28700	29300	30000
Loans (including short term)	15800	14500	20800	25000	32600	38900
Equity	71060	73000	82500	86000	90300	94600
	117530	121600	140600	149300	163600	176800

Notes
It is expected that initially all investments will at least cover the incremental cost of borrowing, with returns then increasing to and beyond the targeted return over time. Any investment will exceed its cost of capital over its lifetime.

Network profit has been abnormally lifted in 2007 by capital contributions. Profit is expected to fall in 2008 and 2009 due to this. Price thresholds will be reset in 2010 and this is expected to have a positive effect on our surplus from network operations.

Performance Targets.

1. Return on Equity (including revaluation gains):

	2007	2008	2009	2010
Return	9.5%	8.8%	7.0%	8.7%
Asset Revaluation	0	9.0%	2.0%	1.8%
Gross return	9.5%	17.8%	9.0%	10.5%

The required equity return of 8.1% is met each year.

2. Debt

All figures are in $'000s.

	2007	2008	2009	2010
subordinated	3000	3000	3000	3000
Normal	11500	17800	22000	29600
total	14,500	20,800	25,000	32,600

Note:
The debt levels assume no major network purchases. Should such purchases occur the debt pattern will significantly change.

3. Debt to Asset ratio: will not exceed 50%.

4. Urban domestic prices below the upper quartile in the MED survey

5. Discount level
   All figures are in $'000s.

2007	2008	2009	2010
6200	6200	6000	7000

Note: The discount levels have been capped at 30% of network and local metering income. This is in line with IRD discount approvals received by other companies.

6. Dividends

   All figures are in $'000s.

2007	2008	2009	2010
132	132	171	255

7. Reliability:

	Threshold	2006 Actual	2007 Forecast	2008 Target	2008 Target	2010 Target
Average minutes off per customer						
Planned		98	102	95	93	88
Unplanned		180	240	180	170	155
Total	527	278	340	275	263	243
Supply interruptions per customer						
Planned		0.6	0.6	0.6	0.6	0.6
Unplanned		3.1	2.8	3.0	2.8	2.8
Total	6.3	3.7	3.4	3.6	3.4	3.4

The unplanned targets above are heavily influenced by the weather. They will therefore be automatically adjusted as follows:

	2006 Actual	2007 forecast	2008 Target	2009 Target	2010 Target
Unplanned Base Minutes	135		130	120	110
Plus per storm event			5	5	5
Unplanned Base Occurrences	2.0		1.80	1.80	1.80
Plus per storm event	0.089		0.075	0.07	0.07

A storm event is one where:

- Wind speed is over 75km per hour
- More than 5 lightning strikes occur within a 4 hr period within 1 km of our lines
- More than 25mm of snow falls in below 0^{c} conditions

8. **Customer satisfaction**: To have at least 15% greater customer satisfaction than the national lines company average on the NBR satisfaction question i.e. Do you think The Lines Company generally does a good job of serving its customers?. This survey will be carried out in the 2007 year.

9. **Safety:** average annual man hours lost through accident occurring during the year of less than 2.5 (current target 3.3).

Capital Ratio

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

- Consolidated shareholders' 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 book value, plus net working capital, less deferred tax.

The ratio is expected to reduce to 65% over the next five years.

Accounting Policies

The Company's accounting policies will comply with the legal requirements of the Companies Act 1993 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 2007, which comply with the International Financial Reporting Standards.

Information to be provided to Shareholders

The following information will be provided:-

(a) Bi-monthly newsletters, which will include information on non-financial performance.

(b) Half yearly reports will be delivered to the Company's shareholders within 3 months after the end of the half-year. These reports will comprise:

- a report from the directors covering the operations for a half year; and
- un-audited consolidated financial statements for the half year.

(c) Annual reports will be delivered to the Company's shareholders 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
- auditors' 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).

The Company's audited consolidated financial statements will comprise the following:

- Statement of financial position
- Statement of financial performance
- Report on performance achieved
- Statement of cash flows
- Such other statements as may be necessary or required by the Financial Reporting Act 1993 to fairly reflect the financial position of the Company, the resources available to it and the financial results of the operations.

(d) Draft Statements of Corporate Intent are required to be delivered to the Company's shareholders within one month of the beginning of each financial year. To meet this timetable it is proposed to deliver to shareholders in January the directors draft plan on how they intend to meet the company's key objectives in the following year. This plan will form the basis of the next SCI.

(e) A summary of the annual capital expenditure budget adopted by the Board, including identification of all programmed projects with a budgeted capital expenditure in excess of $200,000.

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 in the Constitution, the shareholders' approval to the proposal will be sought. For transactions with a value in excess of $5 million, 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 shareholders 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.

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 metering assets have been sold to its subsidiary FCL.

Procedure

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

The shareholders may also resolve at a general meeting of the company to require the directors to modify the statement. The shareholders must have regard:

(a) 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;

(b) to the financial accounts and other reports the Company is required to prepare under Section 44 of the Act;

and the shareholders must consult the directors.

Glossary of Terms

Ebitda	Earnings before interest, tax, discretionary discount, depreciation and amortisation.
Ebit	Earnings before discretionary discount, interest and tax.
Total Assets	Fixed Assets plus net working capital
Shareholders' Equity	Shareholders' funds plus subordinated debentures.
Capital Ratio	Shareholders' Equity divided by Total Assets.
Return on Average Equity	(Surplus after Taxation) divided by ((Opening Shareholders' Funds plus closing Shareholders' Funds) divided by 2).
Customer Discount	Total discount paid or committed as per note.
Surplus after Taxation	Surplus after tax, but with the add back of any discretionary discount, less the tax effect of that discount.