Leading Energy

October 2012

pwc

Introduction

Welcome to your update on the key issues and challenges for New Zealand's electricity generation and retail companies in FY12.

We take a look at how the sector dealt with record low hydrological conditions in the South Island, and stagnant demand conditions across the economy.

For the first time, you'll be able to read results from a Du Pont analysis on the financial performance of the generation companies, which provides additional insights into their financial returns.

Electricity is a key driver of the New Zealand economy. Given our high reliance on it, the sector remains subject to high levels of scrutiny and interest.

Issues and challenges

Last year we highlighted a number of the measures from the Ministerial Review of the Electricity Market Performance (the Review) that had been implemented, such as the sale of Meridian Energy's Tekapo hydro generation stations to Genesis Energy (June 2011) and the signing of virtual asset swaps by the three State Owned Enterprise (SOE) generators.

Other measures have been or are in the process of being implemented such as: transmission pricing review; the stress testing regime for certain electricity market participants; managing locational price risk; initiatives to improve demand-side market participation; standardising lines company tariff structures and use of system agreements; and improving hedge market liquidity.

We also highlighted that the Government had kick-started its extension of the mixed ownership model (MOM). This process has generated a significant amount of publicity, and the initial public offering of Mighty River Power, originally scheduled for later this year has now been deferred until early 2013.

This year has also been one of the driest on record, with the South Island catchments experiencing some of their lowest recorded hydro inflows. This has impacted on each of the generators in different ways as our analysis highlights – higher prices and a changing generation mix have been major drivers of the performance of these businesses in FY12.

Demand has remained static in a sluggish economy coping with the continued fallout from the global financial crisis. In addition, future demand remains vulnerable to the actions of major consumers, particularly those subject to tightening global demand and pricing for their products.

With demand growth stalling, many generation development options are being delayed or put on hold. Limited domestic growth options have provided the impetus to leverage existing expertise and knowledge internationally. Meridian Energy and TrustPower continue with their Macarthur and Snowtown Australian wind farm developments respectively, while Mighty River Power's international ventures have culminated in the commissioning of a geothermal plant in California.

Read on to find out more about these issues.

The Ministerial Review continues to drive changes in the electricity market.

Generation

A significant driver of the wholesale market this year has been the lowest hydro inflows in the South Island on record (covering 81 years of data) - yet lake levels were managed at reasonable levels. This has not necessarily been the result in previous dry years such as 2008. Meanwhile, inflows in the Waikato catchment were above average for most of FY12, before reducing to below average inflows later in the year.

The overall impact of these hydrological conditions was a reduction in hydro generation, which was covered by higher variable cost generation (thermal gas and coal). Any perceived capacity headroom, was brought to market to meet the hydro shortfall.

From a demand perspective, we highlighted in last year's publication '...that sluggish economic growth, the Canterbury earthquakes and a relatively mild winter resulted in total FY11 generation increasing by only 0.5% over FY10 levels'. Little has changed in FY12. Overall volume growth has been negligible.

Future demand growth is somewhat exposed to global market conditions. Recent announcements by Rio Tinto (the majority shareholder of New Zealand Aluminium Smelter) and Norske Skog (the owner of the Tasman Pulp and Paper Mill) highlight the extent to which the global market for locally produced products has the potential to impact on our electricity demand. With world aluminium prices having slumped, falling demand for newsprint, and the strength of the New Zealand dollar, these businesses have signalled cost cutting programmes, and in the case of Norske Skog, a planned halving of its newsprint output. The Tiwai Point smelter currently consumes approximately 15% of New Zealand's electricity production.

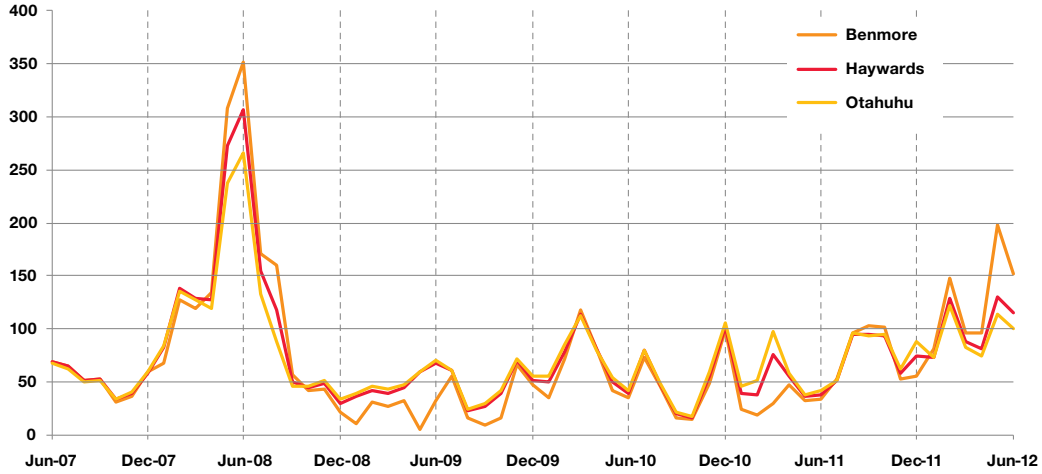
Record low hydro inflows in the South Island reduced hydro generation and drove prices higher.

Demand remains sluggish... with negligible volume growth.

Wholesale pricing

Despite the stagnant demand conditions, the combination of tight hydrological conditions and higher priced thermal stations resulted in higher wholesale electricity prices in FY12 than in FY11.

Mean price in dollars per MWh



Source: Electricity Authority

The average wholesale electricity price in FY12 of approximately $94 per MWh was nearly double the $49 per MWh in FY11.

While this is a substantial increase over the prior year, the market didn't experience the same level of price spikes as in 2008. This was driven by several factors, including replacement of some of the thermal generation that was required in 2008 with renewable generation. This has allowed the displaced existing thermal plant to better respond to generation shortfalls, and underpin lower priced hedge contracts. In addition, while South Island hydro inflows were the worst on record, it seems there was a more conservative approach to managing water storage levels than in 2008.

Other interesting observations from this graph, include the significant disconnect between Benmore prices (South Island) and Otahuhu and Haywards' prices (North Island) in the latter part of FY12. This disconnect was driven by the record low South Island hydrology, and the southward restrictions on the HVDC inter-island link due to the pricing of reserve offers in the South Island.

The current upgrading of the HVDC link is likely to reduce reserve market pressures and lower the price disconnect between the North and South islands. Pole 1 has now been fully decommissioned and pole 3 is due for commissioning in 2013.

As highlighted, stagnant demand has led to a number of generation projects being put on hold, or delayed until demand shows signs of improving.

While we continue to expect upward pressure on wholesale electricity prices in the longer term, in the short to medium term, prices are likely to remain constrained due to uncertainty in relation to electricity demand and recent additions to the generation fleet.

Generation projects

During FY12 there were no significant generation plants commissioned.

This compares to approximately 300MW in FY11, although this included a significant amount of non-baseload plant, including 200MW of peaking plant and 100MW of wind generation. There are however a number of projects currently under construction or planned for development. Imminent projects are summarised in the table below.

Name	Organisation	Fuel Source	Capacity	Status
Ngatamariki	Mighty River Power	Geothermal	82MW	Construction
Te Mihi	Contact Energy	Geothermal	166MW	Construction
Mill Creek	Meridian Energy	Wind	60MW	Construction
McKee peakers	Todd Energy	Gas	100MW	Construction

This list has been subject to change since FY11.

Contact Energy's Tauhara II (250MW geothermal) which appeared on the list last year, has been placed on hold given market conditions. Contact Energy has indicated that the completion of Te Mihi will signal the end of its current investment programme.

Similarly, Meridian Energy's Central Wind (120MW) has been put on hold (maintaining its 'investor ready' status) while it has exited both its Hayes and Mokihinui projects due to economic and consenting risks and uncertainties.

TrustPower has put its Arnold hydro development on hold, instead focusing on incremental investment on its current generation stations.

Similarly, Mighty River Power following completion of its Ngatamariki development, will progress options in readiness for more favourable market conditions, and will consider contributing further capital to international geothermal opportunities.

Genesis Energy's generation projects also provide future options, but only if they are more economically viable than buying electricity from the wholesale market. They have also signalled the long term storage of two of the four 250MW Huntly units, with one due to be decommissioned later this year and the other in December 2014.

Todd Energy's peaker station provides flexibility to capture peak pricing events and volatility in market prices, and is expected to be commissioned later this year.

Other market developments

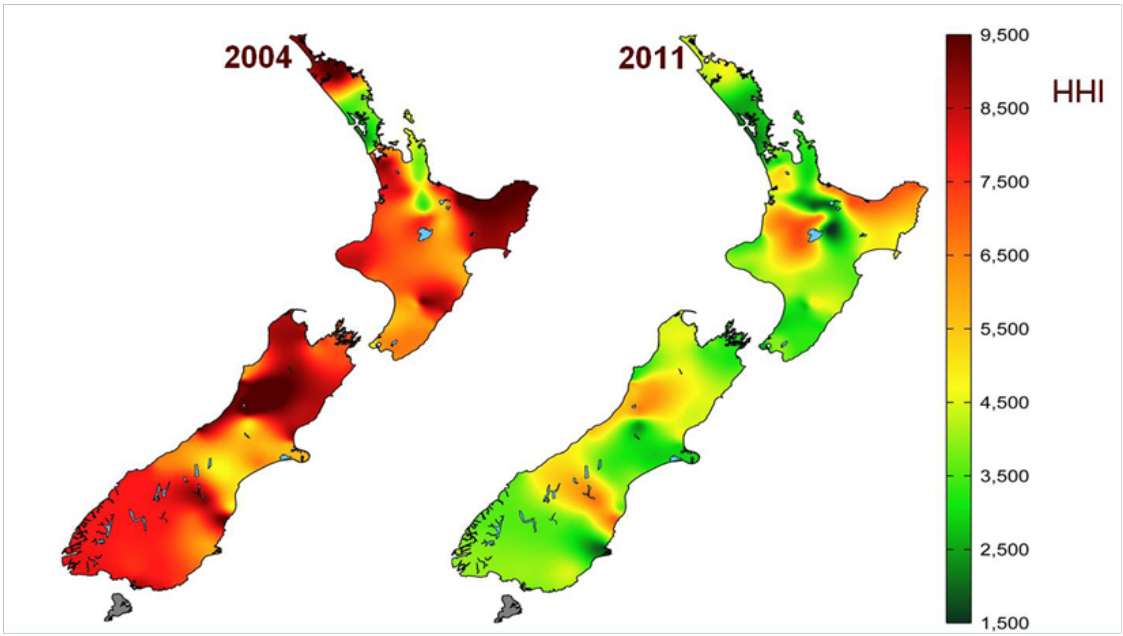
The ASX electricity futures market has continued to develop. Future trading has grown significantly and according to the Electricity Authority (EA), now accounts for more than half of the electricity hedge contracts. The EA had also set expectations on uncovered open interest of 3,000GWh, which is now being achieved (primarily as a result of the inclusion of the virtual asset swaps).

The EA has also announced the introduction of financial transmission rights (FTRs). FTRs are a type of hedge contract that allow parties to cover price risk between two nodes on the national grid, providing a protection mechanism from variations in prices in one location versus another (locational price risk or basis risk). Locational price risk has the potential to discourage retail competition as generators look to maintain retail customers close to their generation (thereby avoiding the potential for locational prices to impact on them). Initially, FTRs will be traded in relation to a North Island node (Otahuhu) and a South Island node (Benmore). The first trades are expected to occur by May 2013. Consideration is also being given to options to address intra-island basis risk.

Retail

Levels of churn in the retail market, while still high, have recently flattened out.

The EA released the output of one of a series of measures of market structure that it used for the New Zealand market, being the Herfindahl-Hirschman Index (HHI). The HHI places a high weighting on market dominance. In general, an HHI of 3,500 is considered to indicate a reasonably competitive market structure.



Source: Electricity Authority

HHIs for the retail electricity market are presented above. The HHI for each region is based on each retailer's percentage share of installation control points (ICPs). This roughly translates to each retailer's percentage share of customers.

The two maps highlight the level of reduction in seller concentration in the retail market. The weighted-average HHI has declined every year since 2004, from a high of nearly 6,500 to the current level of just above 3,500.

The HHI is only one high level indicator of the degree of competition in a market. The EA is intending to publish a suite of competition statistics on an annual basis to accompany its annual market performance reviews, to be released in February each year.

We cover the retail sector in more detail later in this publication.

Smart metering

There have been a number of developments in the last year in relation to smart metering.

Smart metering means different things to different people. Smart meters are able to provide electricity usage data remotely, which assists in ensuring up to date metering data for billing, and provides remote connection and disconnection functionality. This is of benefit to the electricity retailers, reducing the cost of meter reading, and to customers through more accurate meter reads. It may also provide the opportunity for retailers to offer different tariff structures, depending on market conditions for example.

Electricity lines companies can also benefit from the installation of smart meters. The information provided by the meters can be used to better identify network and equipment faults, as well as provide functionality to manage network peaks, for example through load control, deferring upgrades to their networks assets.

The number of smart meters deployed across New Zealand is estimated to be around 800,000, with AMS (Vector's metering subsidiary) having installed nearly 400,000 meters. Many of these are for Genesis Energy, which has installed close to 300,000 meters and is currently trialling multi rate tariffs.

Mighty River Power (via its metering subsidiary Metrix) has installed over 300,000 meters and Contact Energy and Meridian Energy are also at various stages in smart meter rollouts. WEL Networks is rolling out smart meters as part of a 'smart network' build, in Hamilton. SmartCo (a consortium of lines companies) has signalled its desire to aggregate the requirements of its line company owners, share infrastructure, and roll out smart meters across the country during the next three years.

However the rollout of smart meters is not without teething issues. The piecemeal rollout of these meters is providing challenges to sector participants, and may negate the full realisation of the benefits of smart metering. Different technology solutions, lack of commonality of standards, and data access and ownership issues, inhibit full benefit realisation. A more collaborative approach by sector participants is critical to maximising the value of smart meters, and ultimately more broadly smart grids.

Smart meter deployment continues but the piecemeal nature of the rollout is providing challenges.

Asset management

As previously highlighted, limited demand growth has led to a number of generation projects being placed on hold. Financial pressures are mounting, customers are becoming more demanding and regulators are becoming more sophisticated and diverse in their processes and approach to regulation.

Well-managed assets help to optimise financial performance for organisations. The strategic management of assets can support energy generation, transmission and distribution companies to meet financial objectives, customer demands and regulatory requirements.

Strategic asset management meets these diverse requirements by looking at complex networks of assets and providing a whole of life management approach for all types of physical assets. Importantly, it aligns an organisation's strategic objectives with asset management by creating a link between the strategy and the day-to-day asset operational realities. This helps the organisation to effectively balance short and long cycle operating, investment, regulatory and risk management pressures.

In the past asset management approaches were diverse, and with little sharing of what might be described as best practices. Asset management frameworks are now coming to the fore as a means of maintaining consistency, streamlining communications and establishing best practice around asset management internationally.

PAS 55 is a framework for establishing consistency in the strategic asset management approach, sharing best practices, understanding the impacts of asset management techniques on risk and financial performance, and creating a common language around strategic asset management. PAS 55 requires organisations to establish an asset management system; including an asset management strategy, asset management policy, asset management objectives and asset management plans.

PAS 55 links an organisation's strategic goals with the management of a portfolio(s) of assets, and within those portfolios, systems of assets, all the way through to individual asset life cycles. It is scalable to an organisation's size, complexity and operating environment.

PAS 55 also provides a standard terminology to communicate critical concepts around risk, system performance (level of service) and regulatory requirements (business continuity / network resilience). This common language allows organisations to effectively communicate with regulators and other stakeholders enabling clear cases to be made for example for pricing changes or allowances for new and replacement capital expenditure.

Importantly, the PAS 55 framework also enables organisations to benchmark themselves objectively by comparing performance across industry sectors, between regulated and non-regulated, or public/private environments. Even using PAS 55 as a checklist of requirements can provide valuable insights that can lead to significant performance improvements.

PAS 55 is an effective tool for turning improvement ideas and opportunities into objective, prioritised and coordinated implementation plans that the whole organisation can understand and commit to.

Through the application of PAS 55 organisations have a solid framework to help them come to terms with a diverse portfolio of asset systems and understand how they can be used to meet financial, customer and regulatory requirements.

The implementation of PAS 55 requires a multi-disciplinary approach to ensure that the all risks, stakeholders and obligations are managed effectively, and that the benefits of the framework are fully realised.

What is PAS55

As the international benchmark for asset management, PAS55 defines the principles of industry leading practice for effective physical asset management. Power utilities globally have been among the early adopters, recognising the benefit that the approach provides to all stakeholders, particularly regulators.

Sector performance

In this section we provide an overview of the recent financial performance of the five largest electricity generation companies[1]. While this analysis is high level, it provides a sufficient level of detail to allow some key observations on the sector to be made.

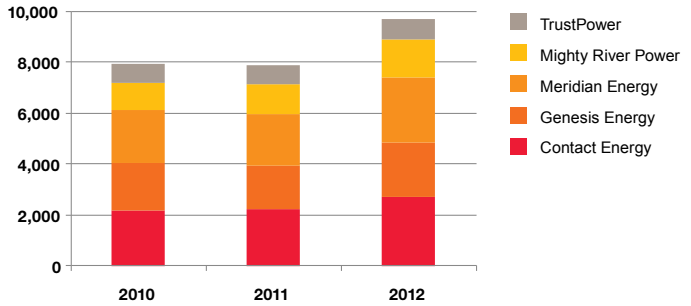
[1] *Results for the year ended 30 June 2012 (or 31 March 2012 in the case of TrustPower)*

Revenues

The chart below summarises the total revenues[2] for the five companies comprising our analysis.

Total electricity sector revenues have increased by nearly 23% in FY12. Previous years' favourable hydrology have not been repeated in FY12, resulting in a significant increase in wholesale electricity prices, translating into higher sector revenues.

Sector Revenue ($m)



Source: Companies' annual results announcements and reports

Other than TrustPower, all of the companies experienced double digit revenue growth. While as a headline this is impressive, this revenue growth has not translated into earnings growth, with overall electricity earnings dropping from FY11.

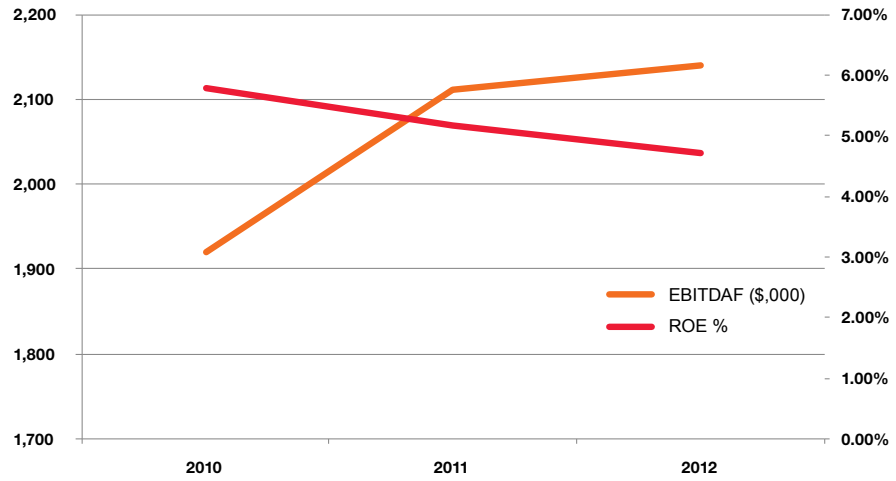
Significant revenue growth has not flowed through directly into earnings growth.

[2] *For the purposes of this analysis we have excluded Genesis Energy's Kupe revenues and TrustPower's and Meridian Energy's Australian generation activities.*

Sector returns

In considering the financial returns of these companies, we have focussed on three key indicators. The first of these is earnings before interest, tax, depreciation, amortisation and fair value adjustments (EBITDAF)[3] which is commonly used as a surrogate for the cash earnings of a company. Return on equity (ROE)[4] is used to compare the underlying earnings of each business to the amount of equity invested in the business. EBITDAF/MWh provides an indication of the cash earnings generated for each MWh of electricity produced.

Sector Returns



Source: Companies' annual results announcements and reports

Group EBITDAF for the five companies has continued to grow, albeit at a reduced rate in FY12. This can be contrasted with a reduction in ROE, primarily driven by lower overall underlying earnings of the businesses.

In the remainder of this publication, we focus primarily on the electricity segment of these companies' operations.

[3] *EBITDAF for the consolidated business rather than just the electricity business has been used in this analysis to ensure comparability with the company-wide ROE figures.*

[4] *We note that ROE is impacted by the revaluation policies of these businesses*

EBITDAF

The combined EBITDAF[5] for the five companies increased only slightly from $1,990m in FY11 to $2,009m in FY12 (1.0 percent increase).

The changing hydrological conditions during the year had contrasting impacts on the relative EBITDAF performances.

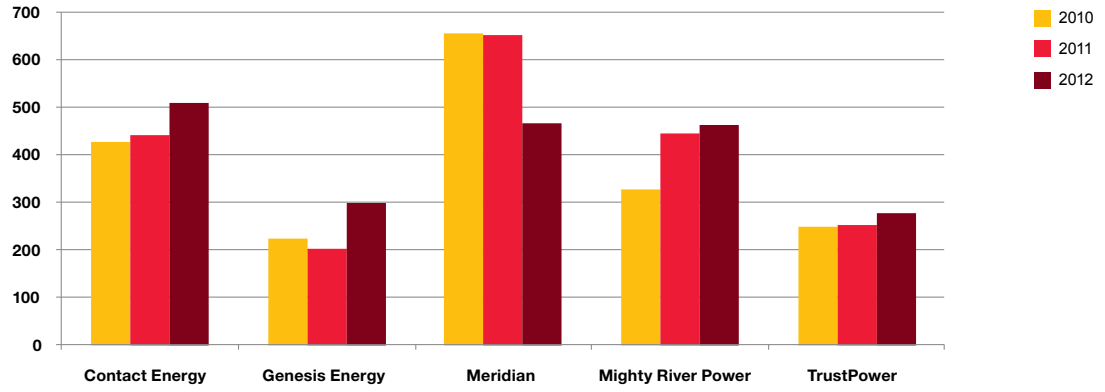
Contact Energy has continued to grow its electricity EBITDAF, on the back of increased generation plant flexibility (higher thermal generation volumes), as well as tighter operational discipline. Similarly, Genesis Energy has also benefited from flexibility in its generation portfolio, with higher thermal generation volumes and a full year of Tekapo A & B generation.

The EBITDAF of Meridian Energy was significantly impacted by the record low hydro inflows in the South Island catchments, reducing generation, exacerbated further by the sale of the Tekapo A & B stations in June 2011.

Mighty River Power's EBITDAF has increased on the back of a small uplift in generation volumes (as a result of higher utilisation of its flexible thermal generation) and the higher wholesale electricity prices.

TrustPower continues on its long term historical incremental EBITDAF growth trajectory, with this year's growth a function of increased generation volumes (across its North and South Island hydro generation and wind generation assets) and higher wholesale electricity prices.

EBITDAF ($m)

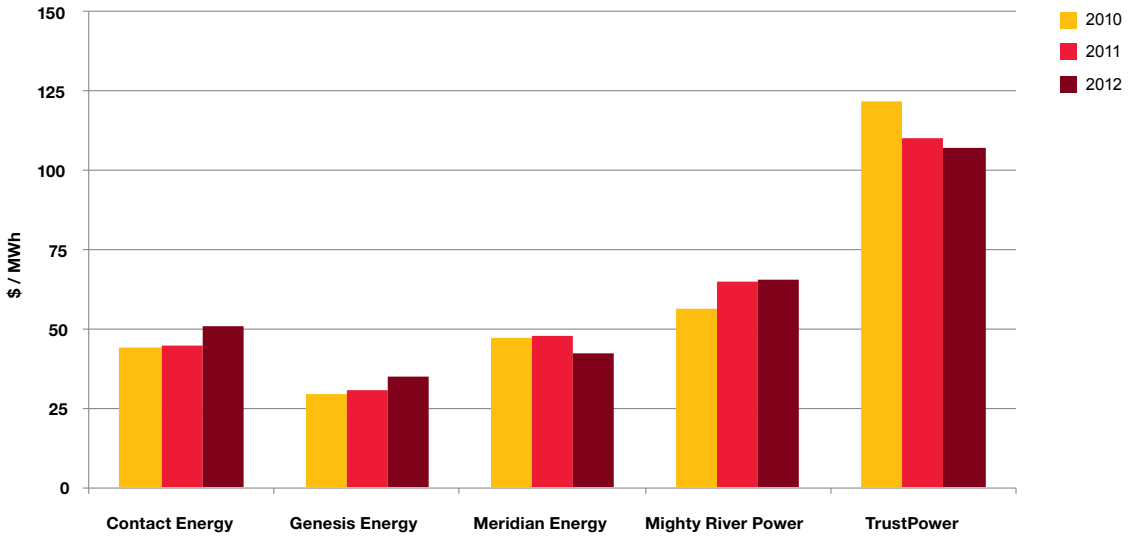


Source: Companies' annual results announcements and reports

[5] *For comparability, we have excluded EBITDAF attributed to Genesis Energy's Kupe and TrustPower's and Meridian Energy's Australian generation activities.*

EBITDAF/MWh

EBITDAF per MWh



Source: Companies' annual results announcements and reports

This chart demonstrates each business' ability to earn 'cash' from its generation activities. It effectively represents a measure of the profitability of each business' electricity generation activities. Factors that influence returns include the nature of the generation assets (ie the extent to which generation revenues are offset by an associated 'fuel' cost) and the relationship between the scale of a company's retail load compared to its generation portfolio.

TrustPower continues to be the standout performer on this measure, albeit with a gradual recent decline. Its relatively high performance on this criterion is driven by several factors including its low level of generation production relative to its retail load and its largely renewable generation portfolio (ie direct operating costs such as fuel are limited). As highlighted in last year's publication, it is also recognised across the sector that TrustPower's average cost to serve its retail customer base is lower than most of its competitors, while it continues to be able to charge some of those customers premium prices (in part due to benefits arising from its partial trust ownership structure).

Interestingly, while TrustPower's EBITDAF continues to show year-on-year growth, this is at a slower rate than its generation volumes, leading to a declining trend on the EBITDAF/MWh measure.

Genesis Energy and Contact Energy have diversified portfolios that comprise higher percentages of thermal generation sources. As a result the companies' EBITDAF/MWh margins are more significantly impacted by higher operating costs. However, in both cases, the performance of these businesses has been improving year-on-year.

Meridian Energy has a similar (albeit significantly larger) renewable based generation portfolio to TrustPower and is also not encumbered by fuel costs. The EBITDAF/MWh earned by Meridian Energy, is generally expected to be lower than that of TrustPower as a result of the legacy contract that exists between Meridian Energy and New Zealand Aluminium Smelters, believed to be at a price that is below current wholesale market prices.

In addition Meridian Energy, like the other South Island generators, bears the cost associated with transporting electricity over the HVDC link.

The record low South Island hydrology has impacted Meridian Energy's EBITDAF/MWh, which after at least three years of growth has decreased. While generation volumes also decreased, the impact on Meridian Energy's EBITDAF was proportionately higher.

Mighty River Power's portfolio is predominantly renewable but its geothermal activities and its Southdown thermal generation assets incur higher levels of direct operating costs than Meridian Energy and TrustPower's generation assets. Mighty River Power has continued to grow its EBITDAF/MWh, albeit only marginally in FY12.

ROE

For the first time, in this year's publication we have undertaken a high level Du Pont ROE analysis. This analysis provides a deeper insight into the ROE, by deconstructing the ROE measure into three parts:

1. Profitability, defined as Underlying Earnings[6]/Sales
2. Operating efficiency, defined as Sales/Total Assets
3. Financial leverage, defined as Total Assets/Equity

These equations simplify to Underlying Earnings/Equity (or ROE).

This analysis has been undertaken at the group level for each business, given the difficulties associated with determining ROE on a segmental basis, and therefore includes activities other than just electricity operations.

1. Profitability	Contact Energy	Genesis Energy	Meridian Energy	Mighty River Power	TrustPower
FY12	6.5%	4.3%	4.1%	10.7%	16.8%
FY09 - FY11 average	7.0%	4.1%	11.1%	15.2%	15.2%

This measure indicates the extent to which businesses convert revenue into net profits (in this case defined as underlying earnings). Our historical analysis suggests that those businesses with largely renewable generation assets (ie high capital costs but lower operating costs such as fuel) perform better on this measure.

Historically, Meridian Energy, Mighty River Power and TrustPower have outperformed Contact Energy and Genesis Energy, both having a larger proportion of their revenues generated through higher variable cost generation, such as gas and coal.

Contact Energy's and Genesis Energy's current year profitability, is relatively consistent with recent historical trends. While Meridian Energy's revenues increased, this was on the back of lower generation volumes. This meant Meridian Energy needed to acquire more electricity from the higher priced wholesale market to supplement its lower generation volumes, significantly lowering its energy margin, with a commensurate impact on lower underlying earnings.

Mighty River Power's underlying earnings remained consistent with FY11, but with revenue growth of 30% its profitability measure has reduced from its recent historical average, as higher electricity wholesale costs increased its costs of meeting its customer requirements.

TrustPower's growth in earnings was proportionately higher than its growth in revenues, driving an increase in its profitability measure. TrustPower's revenue growth in FY12 of 5%, was significantly lower than the average across the other generation companies of approximately 25%, but underlying earnings increased by around 16%.

[6] *As supplied by each of the companies. Genesis Energy did not report an Underlying Earnings figure. We have estimated this after adjusting for the revaluation of financial instruments.*

2. Operating efficiency	Contact Energy	Genesis Energy	Meridian Energy	Mighty River Power	TrustPower
FY12	0.46	0.62	0.30	0.27	0.30
FY09 - FY11 average	0.43	0.69	0.25	0.24	0.31

This measure provides an indication of operating efficiency, or the extent to which revenues are generated by a business' assets. This measure is sometimes referred to as asset turn.

Again, there is an interesting clustering here of the largely renewable portfolio companies Meridian Energy, Mighty River Power and TrustPower, and the more diversified Contact Energy and Genesis Energy.

On this measure, Contact Energy and Genesis Energy are arguably 'more efficient' in generating revenues from their assets. This is primarily due again to the nature of the fixed assets of these businesses. Renewable generation assets tend to exhibit higher upfront capital costs, and lower operating costs. In contrast, thermal assets have lower capital costs but tend to incur a higher proportion of variable costs, such as fuel. In addition, renewable generation assets (particularly hydro) tend to have longer lives and maintain their value over time, as a result of low levels of depreciation and an environment where these assets are carried in the financial statements at market value.

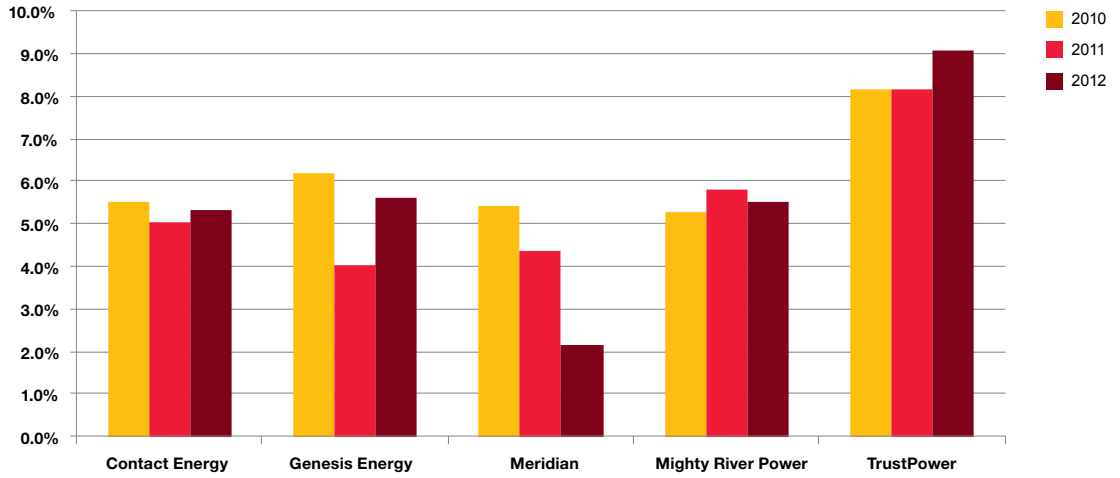
3. Financial leverage	Contact Energy	Genesis Energy	Meridian Energy	Mighty River Power	TrustPower
FY12	1.8	2.1	1.8	1.9	1.8
FY09 - FY11 average	1.8	1.9	1.7	1.8	1.8

The equity multiplier captures the degree of financial leverage in each of the businesses, defined as total assets/equity. The five businesses have relatively similar financial leverage, with Genesis Energy's equity multiplier increasing on the back of the largely debt funded acquisition of Tekapo A & B from Meridian Energy. The similarity in the leverage of the five companies highlights that differing ROE's are being driven by margins and operating efficiency.

The overall ROE from combining these measures is summarised in the following table, with historical three year returns provided in the chart over the page.

ROE	Contact Energy	Genesis Energy	Meridian Energy	Mighty River Power	TrustPower
FY12	5.3%	5.6%	2.2%	5.5%	9.1%

Return on Equity



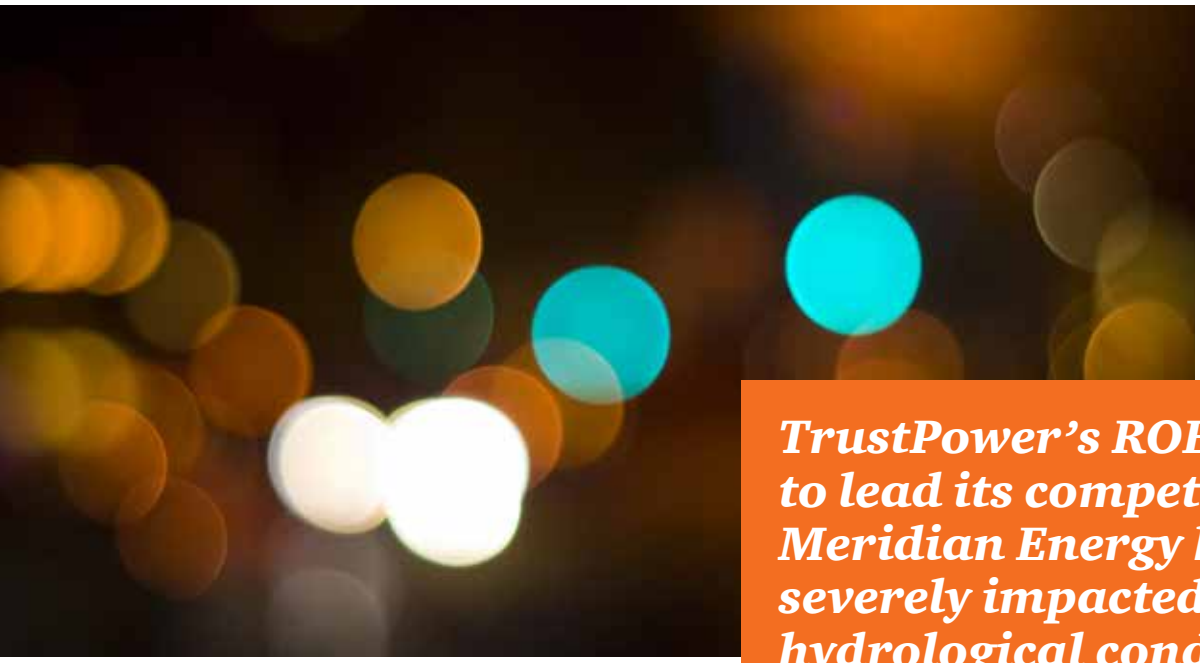
Source: Companies' annual results announcements and PwC analysis

Contact Energy and Genesis Energy's ROE have both improved over FY11 on the back of improved financial performance during the year.

Meridian Energy's overall ROE reflects the lower earnings of the company as a result of the poor hydrological conditions.

Mighty River Power's overall ROE has reduced slightly. Overall earnings remain flat, but average equity has increased compared to FY11.

TrustPower's ROE has increased due to stronger underlying earnings.

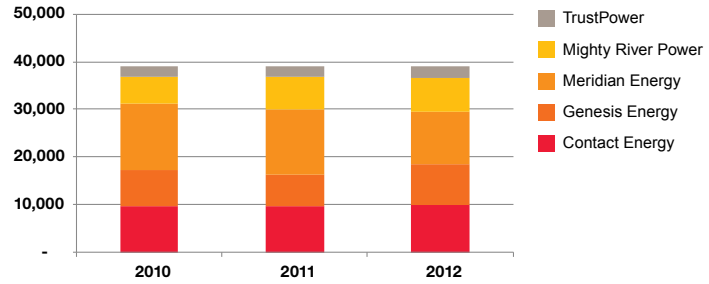


TrustPower's ROE continues to lead its competitors, while Meridian Energy has been severely impacted by poor hydrological conditions.

Generation

As previously highlighted, generation volume growth has been negligible.

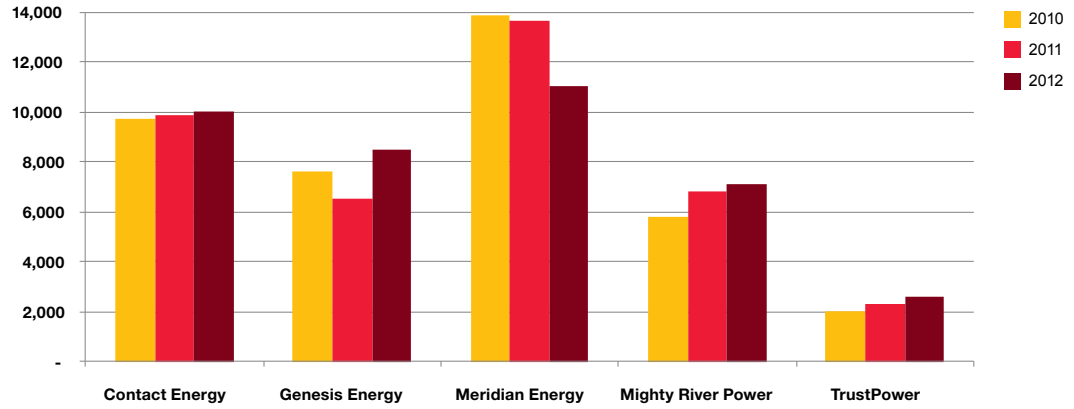
Generation Volume (GWh)



Source: Companies' annual results announcements

While total generation volumes are largely unchanged, the composition of the generation by company, shows some significant movements.

Generation Volume (GWh)



Source: Companies' annual results announcements

Contact Energy's generation volumes have increased slightly, but the makeup of its generation has changed. Given the tight hydrological conditions in the South Island, Contact Energy's hydro assets have been utilised less than in previous years, down 25% compared to FY11. This has been more than offset by a 28% increase in its thermal generation as it responded to meet the hydro shortfall, and its peaking stations were more heavily used during peak pricing periods. Contact Energy's baseload geothermal generation was up by 4%.

Genesis Energy, like Contact Energy, benefited from portfolio diversity and its first full year of generation from Tekapo A & B. Genesis Energy's total generation output increased by 30%, thermal increased by 29% (including substantial increases in coal generation) and its renewable portfolio by 32%.

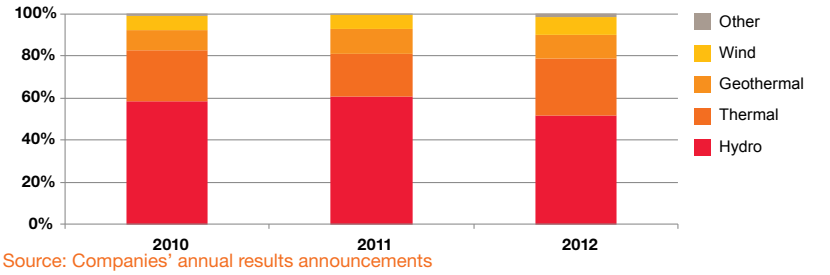
Meridian Energy's generation volumes dropped substantially due to the record low hydrological conditions. Hydro generation decreased by 22% (some of which is attributable to the loss of the Tekapo A & B stations). This was offset to some extent by an increase in wind generation of 18% with Te Uku contributing a full year of generation.

Mighty River Power's hydro and geothermal generation volumes were broadly consistent with FY11. However, output from its thermal activities more than doubled (albeit a relatively small proportion of its overall generation portfolio) taking advantage of the high electricity price environment.

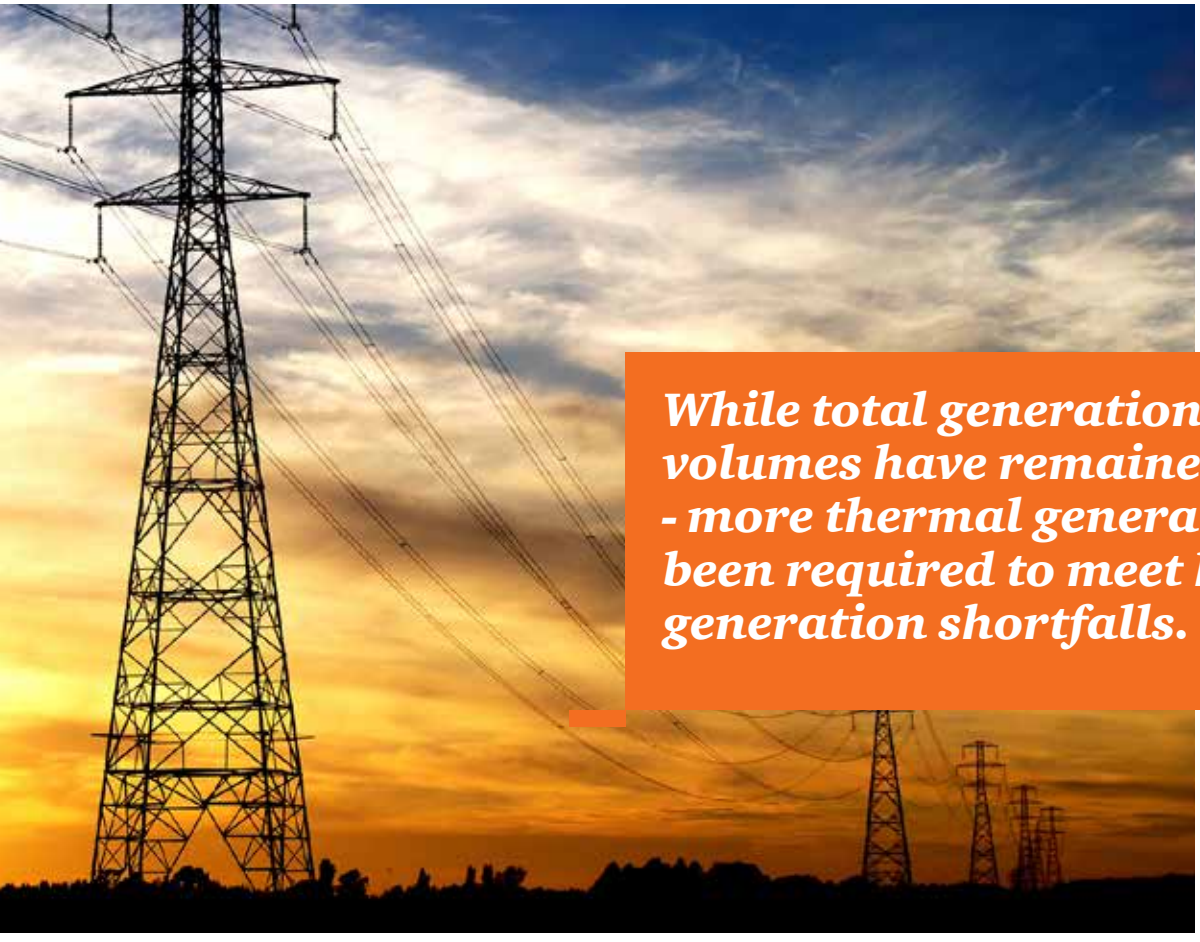
TrustPower's generation volumes increased across its hydro assets (due to above average inflows in its catchment areas) and its wind generation increased by nearly 18%, primarily due to a full year's contribution from the Mahinerangi windfarm.

The following chart highlights the significant impact that hydrological conditions have had on the overall generation mix, as thermal generation sources have been required to meet shortfalls in hydro generation.

Generation type



Source: Companies' annual results announcements



While total generation volumes have remained static - more thermal generation has been required to meet hydro generation shortfalls.

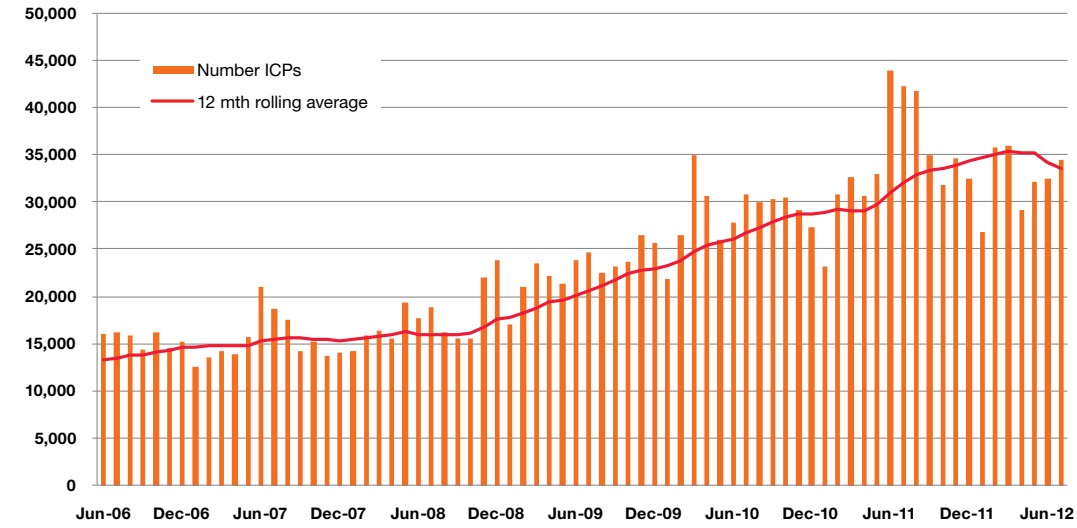
Retail market share

Last year, we undertook an analysis of the retail market, given the high levels of churn being experienced and the retailer portfolio balancing that was taking place. We have updated that analysis below. However, it is useful to note that while the residential market accounts for the majority of connections (as proxied by the number of ICPs), on a volume of electricity consumed basis, residential consumers account for only one third of the volume.

The intensity of retail competition is often measured by the level of customer churn (i.e. the number of customers changing supplier). Following a period of high churn levels over the last three years, churn appears to be reaching a plateau. At current levels of approximately 30,000 to 35,000 per month, this equates to around 20% of all ICPs changing supplier over the course of FY12, up from 17% in FY11 and 14.2% in FY10.

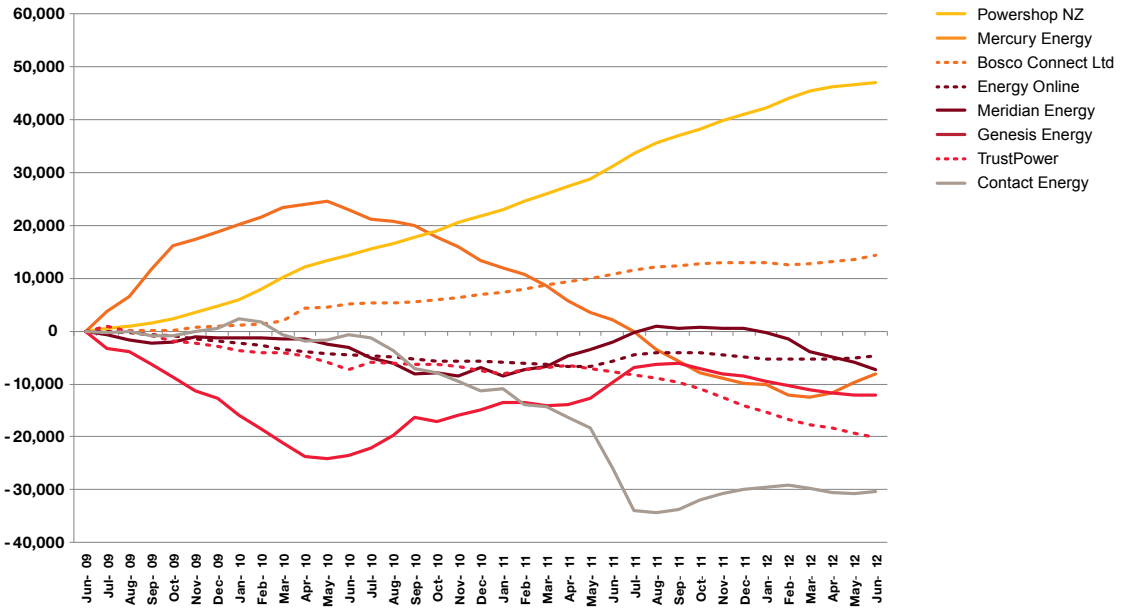
As highlighted last year, increasing levels of churn continue to squeeze tight retail margins. Marketing costs to attract new customers, the retention costs (such as loyalty programmes), attrition costs (administration as customers join/leave) and bad debts have all come under increased pressure.

ICPs changing electricity supplier



Source: Electricity Authority

Cumulative ICP change by retailer (Jun 09 base year)



Source: Electricity Authority

Genesis Energy's South Island customer acquisition campaign has reduced the impact of significant losses incurred during FY10. Net customer growth of over 11,000 ICPs in FY11 and FY12 has clawed back almost half of the net losses from FY10. Energy Online's ICP numbers have reduced over the last three years by approximately 4,800 ICPs.

After a relatively stable FY10, Contact Energy lost almost net 30,000 ICPs across FY11 and FY12, predominantly in the South Island as it targeted North Island growth to better align its generation and retail location. In an increasingly competitive retail environment Contact Energy's pricing remained at a premium to most other suppliers. However, its 'on-line, on-time' campaign has resulted in a stabilisation of customer numbers during FY12.

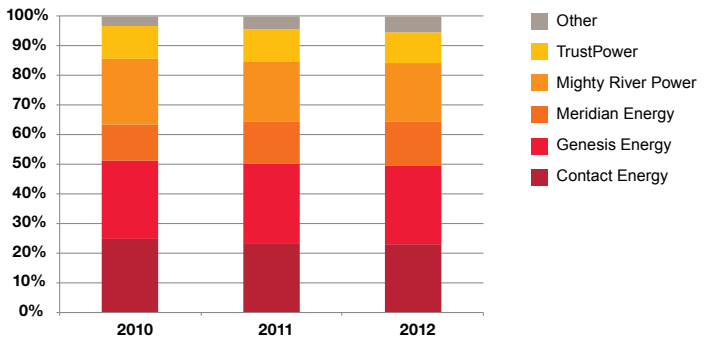
Over the 12 months to 30 June 2012, Meridian Energy's customer base remained reasonably static, decreasing over that time by approximately 5,000 ICPs. Powershop continued its impressive growth since its market entry in April 2009. In FY12 it added a further 16,000 new connections, a further 50% to its customer base in 12 months. While significantly smaller than the 'big five' retailers it has a clearly defined niche market.

Mercury Energy's customer numbers have dropped slightly over the three year period. Following significant growth in customers in FY10, customer numbers dropped as Mercury Energy focused on higher consumption customers south of Auckland. Bosco Connect added a further 14,000 ICPs over the same three year period.

TrustPower lost a further 12,500 (July to June) ICPs in FY12.

The chart opposite illustrates the relative market shares of each of the five major generators. Subsidiary retail companies have been incorporated with their parent for this analysis: Bosco Connect with Mighty River Power, Powershop with Meridian Energy, Energy Online with Genesis Energy and Empower with Contact Energy.

Market share ICPs



Source: Electricity Authority

Genesis Energy's combined market share has remained relatively consistent across FY10-FY12. Contact Energy decreased slightly from nearly 25% in FY10 to 23% in FY12 and Mighty River Power from 22% to 20%. Meridian Energy including Powershop increased from 12% to 15% and TrustPower remained relatively unchanged on 11%.

High customer churn levels remain, although there are signs that churn may have reached a plateau.

Changes in ICPs reflect not only higher customer awareness, but also portfolio rebalancing by the retailers.

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