



14 August 2009

Weather, transmission and economic conditions impact Contact result

2009 financial year in review

A unique confluence of events negatively impacted Contact Energy's result for the year to 30 June 2009.

During the severe winter drought in the South Island, transmission constraints north of Wellington and across the High Voltage Direct Current link (HVDC) prevented Contact from transmitting thermal generation from the North to the South Island, requiring the company to purchase very high-priced power from the market to meet South Island customer demand.

Yet when the situation reversed in the spring and the southern hydro lakes rapidly filled, transmission constraints in the lower South Island, combined with the loss of demand from the Tiwai Point aluminium smelter, forced Contact to spill more than 400 gigawatt hours of potential generation – almost twice the working volume of Lake Hawea - as the transmission system could not take any additional generation.

At the same time, the anticipated loss of gas supply flexibility also impacted the business. During periods of high hydro inflows and low wholesale prices, gas supply inflexibility constrained the company's ability to reduce higher-priced thermal generation.

The combination of these factors resulted in underlying earnings after tax for the year of \$160.6 million, down from \$232.8 million for the 2008 financial year. Earnings Before Net Interest Expense, Income Taxation, Depreciation, Amortisation, Financial Instruments and Other Significant Items were \$445.3 million, down from \$567.2 million in the previous year.

"It was a challenging year for Contact," said Contact Managing Director David Baldwin today. "The confluence of severe drought in the South Island in the 2008 winter, high hydro inflows in the spring/summer, transmission constraints and the effects of economic recession on energy demand growth, significantly impacted Contact's profit this year."

Distribution to shareholders

Notwithstanding these events, Contact's Board of Directors resolved to hold the 2009 final distribution at the equivalent of 17 cents per share, under the company's Profit Distribution Plan. Commenting on the distribution, Mr Baldwin said that the decision to maintain the distribution level was based on the expectation that the company's financial performance would return to normal trends. Contact's underlying return on shareholders' equity was 5.5 per cent for the year ended 30 June 2009, down from 8.0 per cent in the prior corresponding period.

"Any reoccurrence of extreme hydrology, transmission constraints, adverse government policy changes, or a prolonging of the recession could impact Contact's financial performance in the near-to-medium term," Mr Baldwin said. "To the extent such impacts do occur, the company would be unlikely to maintain distributions at this year's level."

Investing in key energy infrastructure

Mr Baldwin added that the key structural issues that impacted profitability over the last year are systematically being resolved.

“The role of the transmission system is to deliver the most cost effective sources of electricity generation to all consumers, and this year has provided the clearest demonstration yet that the state of New Zealand’s transmission network is currently the biggest barrier to the most efficient operation of the electricity market,” he said.

“Regional transmission constraints in the lower South Island will be alleviated later this year, but the replacement of pole one of the HVDC by April 2012 with pole three remains a critical energy infrastructure project for the country.

“Contact will continue to participate as a member of the HVDC (Pole Three) Procurement Advisory Group and to support Transpower’s efforts to streamline and hasten transmission investment across all parts of the national grid,” said Mr Baldwin.

The other major impact on Contact’s result for the 12 months to 30 June 2009 was a loss of operational flexibility, both through the shift to stringent take-or-pay gas contracts and the removal of the New Plymouth power station from the company’s portfolio.

Historically, under flexible Maui gas contracts, Contact had been able to simply switch off its baseload gas-fired power stations when there was a high level of hydro generation, and use the gas later. Similarly, Contact had the option of using the New Plymouth gas-fired power station to augment its three other gas-fired plants during dry periods (there have been three reasonably dry winters over the last decade).

“We have been impacted this year by the decommissioning of New Plymouth and loss of gas supply flexibility, but our Ahuroa gas storage project and the Stratford gas-fired peaking project will restore some of this flexibility,” said Mr Baldwin.

Both of these projects are on schedule and budget, and will be in operation in mid 2010.

“Gas storage will restore valuable flexibility of gas supply, enabling Contact to turn off its gas-fired power stations and store the gas for use when it is most required. In addition, the new 200 megawatt Stratford peaking plant will respond to increasing levels of volatility, particularly as peak demand continues to grow,” he said.

Mr Baldwin said geothermal expansion continues to be the company’s next significant development priority. The construction of the first phase of the Tauhara geothermal project, a 23 megawatt binary power station, is on schedule and budget for commissioning in mid 2010.

Well positioned for growth

Mr Baldwin said while Contact’s geothermal generation options position the company well in terms of executing the country’s most economic new generation projects, the company is continuing to develop a range of generation options across wind, natural gas and hydro generation for execution when market conditions are suitable.

“Contact holds consents to construct the 220 megawatt Te Mihi geothermal station and is preparing resource consent applications to expand the Tauhara geothermal project by an additional 240 megawatts. The sequencing and timing of the Te Mihi and Tauhara projects is dependent on a number of factors including electricity demand growth, credit

conditions, carbon policies, currency rates and resource consents. However, we currently anticipate both projects will be implemented over time.”

With a gearing of 27 per cent as at 30 June 2009, Contact’s financial strength continues to position the company well in terms of navigating the complexity of the current economic circumstances and executing growth options when economic conditions are conducive.

Over the year, Contact undertook a number of steps to enhance the company’s financial strength, including issuing \$550 million of retail bonds and implementing a Profit Distribution Plan, which will also apply to the 2009 final distribution.

Mr Baldwin said both of these initiatives demonstrated continued and strong shareholder and investor support for Contact’s strategy. The capital raised supports the funding of three of Contact’s growth projects, which are currently under construction: the \$250 million Stratford peaker project, the \$250 million Ahuroa underground gas storage project, and the first phase of the Tauhara geothermal project - an initial investment of \$100 million.

Customers

Mr Baldwin said the loss of retail customers over the course of the year was a disappointment that Contact was working hard to turn around.

“Last year, our customers made it quite clear they perceived a link between price increases and an increase to the fee pool from which directors are paid which was not acceptable to them. The result was a loss of customers, a drop in our favourability ratings and a bruise to our brand,” he said.

“The message was loud and clear and we’ve been intensely focused on rebuilding the trust and confidence of our customers and other stakeholders by providing a range of new offers, in addition to the usual outstanding customer service from our dedicated team across New Zealand.”

Mr Baldwin noted that while there had been no increase in base directors’ fees, the increase in the fee pool had enabled the company to implement a number of changes in the Contact Board.

Outlook

“In respect of the 2010 financial year, we expect the extreme weather events which affected the business in July and August 2008 will not recur given current hydrological conditions,” said Mr Baldwin.

“However, wholesale prices are currently below both the variable costs of operating thermal plant, and the price required to support investment in new generation. In addition, current economic conditions are expected to continue to dampen demand growth and, consequently, tariff movements.

“With the range of market and operating uncertainties, it is not appropriate to provide quantitative guidance for the 2010 full year financial performance at this time.”

Mr Baldwin said despite these uncertainties, there are a number of encouraging indicators emerging. “Electricity load at Tiwai Point continues to recover, transmission issues across the country are being systematically addressed, we are again gaining customers, and we are making good progress building some of the country’s most important energy projects.

“These projects, which are due to be operational in mid-2010, will replace the portfolio flexibility that was recently lost and, together with our prospective geothermal opportunities, provide a platform for the company’s future growth, as well as making a significant contribution to New Zealand’s long term energy security.”

Investor enquiries

Liz Kelly
04 462 1190
021 461 302

Media enquiries

Jonathan Hill
04 462 1285
021 440 090