Infratil

Interim Report
2014


Snowtown II wind farm
South Australia

Highlights

for the six months ended 30 September 2014

Net surplus was $399 million compared with $230 million last year (71 cents per share, up from 39 cents).

Consolidated EBITDAF including discontinued operations[1] was $285 million, up 2% compared with last year's $279 million:

- $20 million increase in Trustpower EBITDAF. $18 million decline in Z Energy contribution.
- Satisfactory performances were provided by Infratil's other businesses.

Full year EBITDAF guidance is maintained (adjusted for asset sales)[2]:

- FY2015 EBITDAF guidance is $475 million to $500 million (assuming no further asset sales and Z equity earnings reported on a replacement cost basis).

$196 million of capital was invested over the period, including:

- Trustpower's acquisition of Green State Power hydro and wind assets from the NSW Government for A$72 million.
- Completion of the A$424 million Snowtown II wind farm in South Australia.
- A$15 million incremental investment in Australia Social Infrastructure Partners (ASIP).

The sale of Lumo/Infratil Energy Australia and interests in PayGlobal and property raised $694 million and provided a gain on book value of $343 million.

Net debt of Infratil and wholly owned subsidiaries fell to $349 million from $1,062 million at the start of the period (under 20% of total capitalisation from 46%).

$120 million of capital management initiatives for the second half of FY2015:

- $84 million (15 cents per share) fully-imputed special dividend to be paid in conjunction with the ordinary interim dividend.
- A $36 million on-market share buy-back targeted for the fourth quarter of FY2015.

Additional capital management initiatives will be considered in 2015 pending development of Infratil's investment plans.

The interim dividend increased to 4.50 cents per share from 3.75 cents last year, which is to be paid on 15 December 2014 to shareholders of record on 28 November 2014.

1. EBITDAF is a non-GAAP measure which shows management's view of underlying business performance. It shows operating earnings before deducting interest, tax, depreciation and amortisation and before making any adjustments for fair value movements, realisations and impairments.
2. When assets are sold their financial contributions are separated out from those of continuing operations. While actual consolidated EBITDAF for the half year period was $285 million against $279 million last year, if this is adjusted for the contribution from discontinued businesses the amounts would be $243 million and $231 million respectively. The full year guidance EBITDAF excludes the earnings of discontinued businesses.

Chairman and Chief Executive Report

Infratil's results reflect operational performance, valuation changes and capital allocation decisions. Over the first half of FY2015 capital decisions have overshadowed business performance, but ultimately earnings and projected returns drive value and future capital choices.

Measured by EBITDAF, the period was satisfactory. Operating outcomes were largely consistent with targets and the full year guidance has been maintained (other than to adjust for the impact of asset sales). Naturally each business had its own developments and these are summarised below.

Trustpower had good growth in its retailing operations while experiencing trying wind/hydrology conditions, which are part and parcel of renewable generation. The election result reduced regulatory risk in New Zealand, and the Snowtown II wind farm was completed and commissioned. Australian generation is now a material contributor and the main reason why Trustpower's EBITDAF rose to $173 million from $153 million in the prior period.

Wellington Airport traffic growth was below its five year trend due to airline fleet and route changes, none of which are likely to alter the medium term outlook. A new Jetstar service with Coolangatta was the key airline event of the period. Work is about to start on a major reconstruction of the terminal and the runway extension programme was also progressed. EBITDAF was $40 million, down from $42 million mainly due to lower aeronautical charges.

NZ Bus experienced patronage growth of 5% in Auckland and 1% in Wellington/Hutt. EBITDAF was however down $2 million to $20 million because of lower average fares in Auckland and up-front costs associated with implementing efficiency initiatives. The new contracting model being developed for public transport moved a step closer and the contract structure is now subject to consultation between the industry and Auckland Transport.

Z Energy provided a $4 million equity accounted earnings contribution to Infratil. It was a difficult period with low refining margins and volatile currencies and oil prices, but Z Energy's guidance for the full year replacement cost EBITDAF was maintained, indicating that a strong improvement in the second half of FY2015 is anticipated.

Metlifecare provided an $8 million equity accounted earnings contribution to Infratil. In its full year announcement Metlifecare indicated satisfactory performance measured by earnings, occupancy and unit demand and a marked step up in construction activity with over 200 new units per year to be delivered from 2015, against an average of approximately 60 units in each of the last five years.

Perth Energy EBITDAF was $5 million, up from $4 million last year as it benefitted from a lower obligation to purchase renewable energy certificates.

Snapper, achieved a notable success with its technology being taken up by the Dublin public transport agency in Ireland. Snapper had originally developed the technology for Wellington City Council's cable car.

Investment Environment & Opportunities

In Australia and New Zealand the growing need for private sector involvement in infrastructure is largely being matched by increased investor appetite for assets with stable earnings. Rising supply and rising demand creates both opportunities and challenges. The opportunity is reflected by the high valuations available for mature, well-managed businesses such as Z Energy and Infratil Energy Australia. The challenge is in finding new investments that do not attract a premium entry price.

We believe that the group's investment and divestment activities over the last five years show that both the opportunities and challenges are being well managed. Over that period the Infratil group has realised $1,489 million from divestments and committed $2,067 million to new investment. Over the same period EBITDAF has risen from $363 million to this year's forecast range of $475-$500 million.

It should be noted that while turning over a portion of the group's assets can make good commercial sense, it is not Infratil's core business or purpose. The current period should be seen as a generational refresh of the portfolio rather than a change in strategy or goals. Infratil's over-riding objective is to build good infrastructure businesses providing above average opportunities and returns over the long-term.

While projecting returns from future investment can be difficult, we know that demand for infrastructure is increasing and that investors with operating capability can earn a premium. Infratil's pipeline of growth infrastructure and development opportunities remains very strong and management are actively engaged on a number of opportunities.

Given this perspective, retaining access to capital is important.

Capital and Shareholder Returns

Maintaining an optimal capital structure is difficult at any time, but is particularly challenging when buying or selling large investments. As an example the sale of Infratil Energy Australia has provided the group with a significant short-term cash position and significant access to capital. On 30 September 2014 the $349 million net debt of the Infratil wholly owned group made up less than 20% of total capitalisation (net debt + market value of equity) against a more normal level of about 40%.

Given our long-term return goals and confidence around future opportunities, a staged process has been selected as the best way to deliver capital efficiency while also allowing pursuit of good long-term investments.

Consequently, $120 million of capital management initiatives are targeted for the second half of FY2015 including:

- A special dividend of $84 million or 15 cents per share, fully imputed, to be paid in conjunction with the ordinary interim dividend on 15 December to all shareholders of record on 28 November.
- A $36 million on-market buy-back to repurchase Infratil shares in the fourth quarter of FY2015.

Additional capital management initiatives will be considered in 2015 pending development of Infratil's investment plans.

The future will show whether current investment and capital decisions will deliver above-average returns. Fortunately, Infratil's track record should give its shareholders confidence. As at 30 September 2014 Infratil had provided a compound after tax return since listing in March 1994 of 17.8% per annum. An investor who had invested $1,000 in the listing and reinvested all subsequent distributions would have had a holding valued at $28,827 as at 30 September 2014.

Taking a more recent time frame, over the last three years Infratil's sharemarket return was 21.6% per annum compared with the NZX50 return over that period of 17.1% per annum.

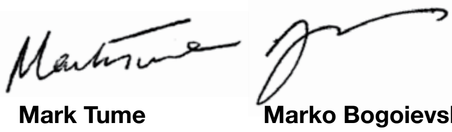
Dividends

In addition to the 15 cents special dividend noted above, Infratil has also declared a regular interim dividend for the first half of FY2015 of 4.5 cents per share fully imputed (3.75 cents last year).

This continues the strategy of converting strong earnings growth into steady increases in shareholder dividends.

Annual Meeting

Infratil's 2014 annual meeting was held on 12 August. All resolutions were passed, including the resolution to appoint Alison Gerry as a director. The meeting presentation is available on the website and minutes of the meeting are available on request. The meeting was well attended by shareholders, bondholders and Infratil's management team. As always, there were some interesting questions posed to the board and management.



Mark Tume
Chairman

Marko Bogoievski
Chief Executive

Financial Performance

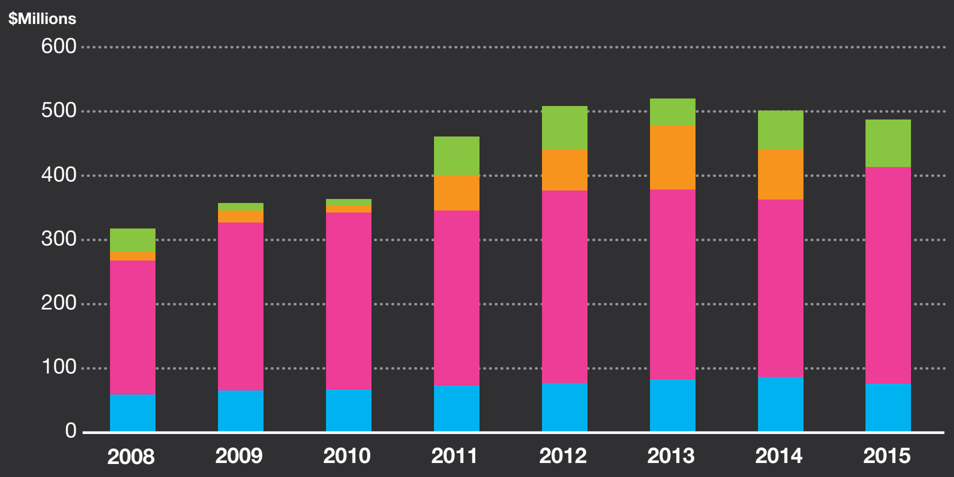
Key EBITDAF, cash flow, dividend, asset and capital trends are shown in the graphs. (Years ended 31 March except where noted)

EBITDAF

In FY2008 Infratil's EBITDAF was $316 million, this year it is expected to be between $475 million and $500 million. EBITDAF has not risen since 2012 because of the partial sale of Z Energy and divestment of IEA. While EBITDAF hasn't risen, the net debt of Infratil and 100% subsidiaries is now $797 million less than it was as at 31 March 2008.

The 2015 column in the graph shows the mid-point guidance for the full year.

- NZ Bus and Other
- Infratil Energy Australia
- Trustpower
- Wellington Airport



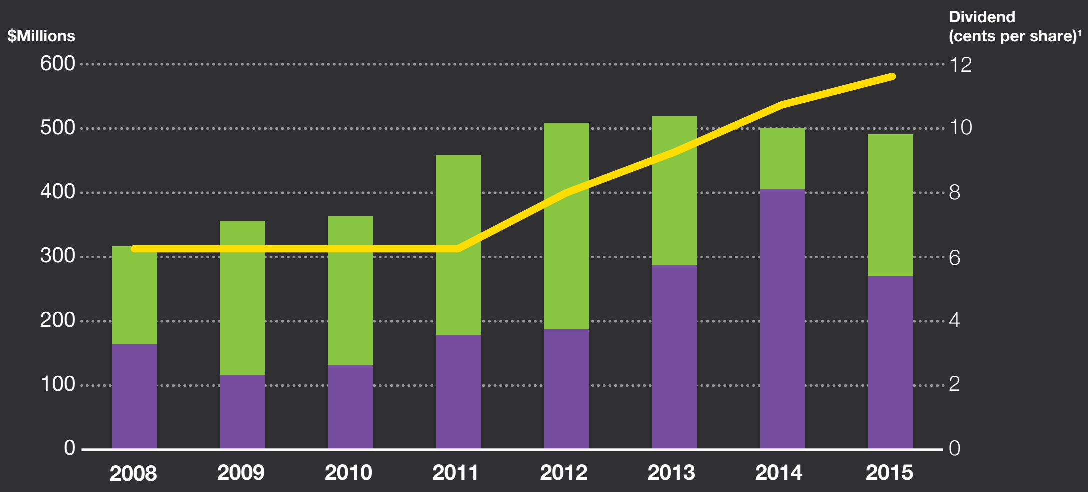
Cash Flows & Dividends

Deriving operating cash flows starts with EBITDAF and deducts interest, tax payments, and adjust for working capital changes. FY2015 operating cash flows are expected to be lower than those of FY2014 which saw $107 million of distributions from Z Energy and $38 million gained from closing foreign exchange hedge contracts.

Since 2011 dividends have risen from 6.25 to 11.5 cents per share; a compound rate of +16% per annum.

The 2015 column in the graph shows the mid-point guidance for the full year.

- Dividend (rhs)
- Interest, tax, working capital
- Operating Cash Flow



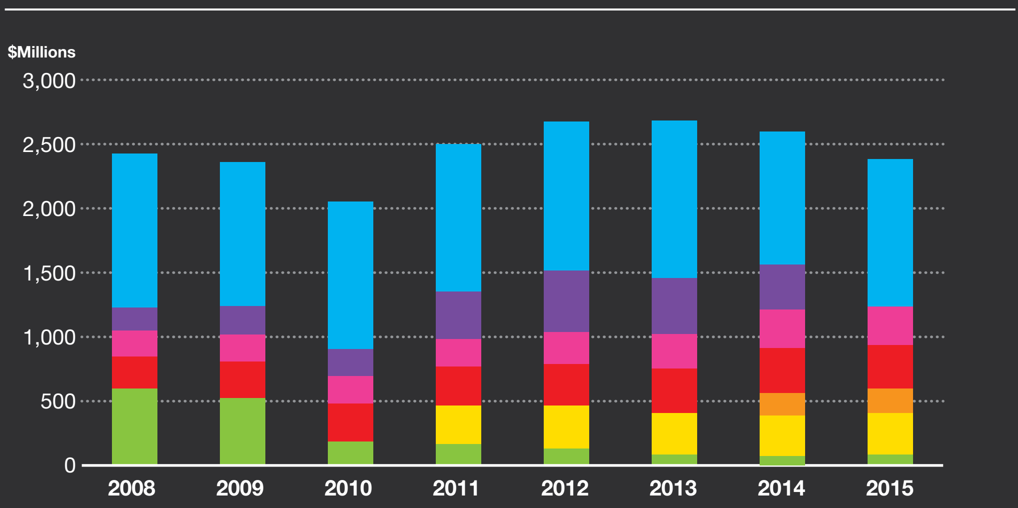
1. Excludes the 15 cent special dividend

Infratil's Assets

The sale of IEA continues Infratil's gradual change in asset mix and profile.

The 2015 column in the graph shows the position as per 30 September 2014.

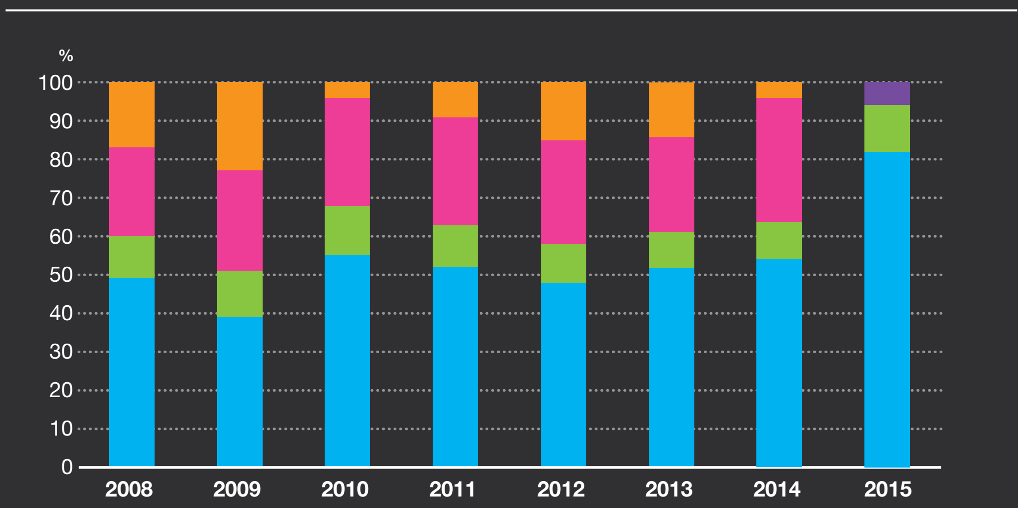
- Trustpower
- Infratil Energy Australia
- NZ Bus
- Wellington Airport
- Metlifecare
- Z Energy
- Other



Infratil's Capital Structure

The 2015 column in the graph shows the position as per 30 September 2014.

- Bank
- Dated Bond
- Perpetual Bond
- Equity (market value)
- For 2015 net bank debt and dated bonds are combined



The following tables summarise Infratil's reported results and reconcile reported earnings and surplus with operational cash flows.

Infratil's Consolidated Results

The following table reconciles EBITDAF to net surplus

$ Millions	6 months to 30 September 2014	6 months to 30 September 2013	12 months to 31 March 2014
EBITDAF (continuing)	**$243**	**$231**	**$437**
Depreciation & amortisation	($72)	($60)	($126)
Net interest	($92)	($91)	($180)
Tax expense	($22)	($32)	($59)
Net gain on Z IPO	-	$183	$183
Revaluations[1]	$25	$69	$110
Discontinued operations	$367	($21)	($91)
Net profit after tax	$448	$277	$275
Minorities	($50)	($47)	($76)
Net surplus	**$399**	**$230**	**$199**

1. Revaluation of energy, interest rate and FX derivatives, and net investment realisations/(impairments).

As at 30 September 2014 Infratil had 561.6 million shares on issue which was unchanged from 31 March 2014. As at 30 September 2013 586.2 million shares were on issue (all figures exclude shares held by Infratil as treasury stock).

EBITDAF

Indicating the sources of Infratil's consolidated EBITDAF by business unit

$ Millions	6 months to 30 September 2014	6 months to 30 September 2013	12 months to 31 March 2014
Trustpower	$173	$153	$277
Wellington Airport	$40	$42	$86
NZ Bus	$20	$22	$40
Perth Energy	$5	$4	$17
Z Energy	$4	$22	$33
Metlifecare	$8	-	$5
Parent/Other	($9)	($11)	($21)
EBITDAF (continuing)	**$243**	**$231**	**$437**
Discontinued operations	$42	$48	$54
Total EBITDAF	$285	$279	$491

EBITDAF from continuing operations for the full year is expected to be between $475-$500 million (assuming no further asset sales and Z equity earnings reported on a replacement cost basis).

The two main changes over the period were Trustpower's $20 million increase which reflected increased contributions from Australian operations, and the lower contribution from Z Energy. The Z decline was due in part to Infratil's sale of 60% of its holding in August 2013 and lower reported EBITDAF on an historic cost basis.

Consolidated Operating Cash Flow

Reconciling EBITDAF to reported net operating cash flows

$ Millions	6 months to 30 September 2014	6 months to 30 September 2013	12 months to 31 March 2014
EBITDAF (continuing)	**$243**	**$231**	**$437**
Net interest	($87)	($84)	($168)
Tax paid	($40)	($30)	($43)
Working capital /other	($7)	$132	$112
Discontinued operations	$14	$25	$68
Operating cash flow	**$122**	**$275**	**$407**

Full year operating cash flow is expected to be between $250-$280 million.

Last year's $132 million working capital movement included $101 million of distributions received from Z Energy and $38 million gained from closing foreign exchange hedge contracts.

Breakdown of Consolidated Results Before Revaluations: Six Months Ended 30 September 2014

Detailing the consolidated results by key line items

$ Millions	EBITDAF	D&A	Interest	Tax	Total	Ownership
Trustpower	$173	($46)	($38)	($21)	$69	51%
Wellington Airport	$40	($8)	($8)	($3)	$20	66%
NZ Bus	$20	($13)	-	-	$6	100%
Perth Energy	$5	($3)	($2)	-	-	80%
Z Energy	$4	-	-	-	$4	20%
Metlifecare	$8	-	-	-	$8	20%
Parent/Other	($9)	($2)	($43)	$2	($51)	-
Total	**$243**	**($72)**	**($92)**	**($22)**	**$57**	
IEA	$41	($9)	-	($10)	$21	100%
Pay Global	$1	-	-	-	$1	54%
	$285	($81)	($92)	($32)	$79	

Breakdown of Consolidated Results Before Revaluations: Six Months Ended 30 September 2013

Detailing the consolidated results by key line items

$ Millions	EBITDAF	D&A	Interest	Tax	Total	Ownership
Trustpower	$153	($34)	($30)	($22)	$67	51%
Wellington Airport	$42	($8)	($10)	($4)	$21	66%
NZ Bus	$20	($13)	-	($1)	$8	100%
Perth Energy	$4	($3)	($3)	$1	($2)	80%
Z Energy	$22	-	-	-	$22	50%
Metlifecare	-	-	-	-	-	-
Parent/Other	($11)	($2)	($48)	-	($61)	-
Total	**$231**	**($60)**	**($91)**	**($26)**	**$54**	
IEA	$54	($13)	-	($10)	$30	100%
Pay Global	-	-	-	-	-	54%
European Airports	($6)	($2)	-	-	($8)	100%
	$279	($75)	($91)	($36)	$76	

Infratil's Assets

$Millions	30 September 2014	31 March 2014
Trustpower	$1,168	$1,037
Wellington Airport	$330	$352
NZ Bus	$301	$303
Perth Energy	$77	$77
Z Energy	$317	$312
Metlifecare	$193	$171
Infratil Energy Australia	-	$272
Other	$73	$79
Total	$2,459	$2,601

Values exclude 100% subsidiaries' cash balances and deferred tax where CGT does not apply.

Over the period, IEA was sold for a net $670 million and assets previously held under "Other" with a 31 March value of $19 million were sold for $28 million; $26 million after tax. These assets included a property in New Lynn which had been developed in partnership with the Auckland Council and a shareholding in PayGlobal.

Changes to the values of Trustpower and Z Energy are due to changes in listed share prices, Metlifecare changes also includes reinvestment of dividends. Changes in the value of Wellington Airport and NZ Bus reflect the difference between the companies' net surplus over the period and payments to shareholders.

"Other" now includes iSite, Snapper, Infratil Infrastructure Property and ASIP.

For 30 September a NZ$/A$ exchange rate of 0.8910 was used (March 0.9364).

Liabilities and Risk Management

$ Millions	30 September 2014	31 March 2014
Net bank debt/(cash) 100% subsidiaries	($640)	$73
Dated bonds	$754	$754
Perpetual bonds	$235	$235
Market value equity	$1,589	$1,269
Total capital	**$1,938**	**$2,331**
Dated debt / capital	6%	36%
Debt / capital	18%	46%

Over the period, a net $694 million was raised by Infratil from the sale of subsidiaries and assets. Net debt of the Infratil wholly owned group was reduced by $713 million.

As at 30 September 2014 Infratil and 100% subsidiaries had $503 million of committed bank funding of which $392 million was undrawn. Over the half year committed bank facilities were reduced from $784 million to save costs.

Infratil Energy Australia Divestment

		$ Millions	Per Infratil Share
31 March 2014	Book value	$272	$0.48
30 September 2014	Net sale proceeds	$670	$1.19
	Net gain	$398	$0.71
May 2014	Average broker value	$474	
	Proceeds vs. valuation	$196	$0.35

The $670 million net sale proceeds can be compared against either the book value or the $474 million average broker valuation of Infratil's IEA shareholding in May 2014 (after the FY2014 results announcement).

Investment Plans

Internal capital expenditure accompanied by periodic acquisitions is a feature of the Infratil model. Current levels of investment should be seen as a precursor of higher future earnings.

$ Millions	6 months to 30 September 2014	Full year outlook to 31 March 2015	12 months to 31 March 2014
Trustpower	$144	$155-175	$350
Wellington Airport	$7	$40-45	$20
NZ Bus	$10	$15-25	$68
Perth Energy	-	$1-2	-
Metlifecare	$1	$1-2	$148
IEA	$16	$16	$22
ASIP	$16	$25-35	-
Other	$2	$2-3	$6
Total	**$196**	**$255-303**	**$616**

Infratil's investment is either through subsidiaries, such as Trustpower building the Snowtown wind farm, or by direct acquisition, such as the 2013 purchase of the Metlifecare shareholding.

Business Reports

Z Energy

Z Energy performed well during an extremely difficult period with low refining margins and volatile currencies and oil prices.

Strength in fuel marketing margins continues to support the business and market share performance has been satisfactory across key product lines.

Reported results were impacted by significant unrealised foreign exchange losses, although Z's guidance for full year replacement cost EBITDAF has been maintained, indicating that a strong improvement in the second half of FY2015 is anticipated.

Metlifecare

Metlifecare earnings, occupancy and unit demand all progressed satisfactorily.

The Company has announced a major increase in construction development. Over the last five years it has developed on average 60 units a year, and from next year that is expected to rise threefold to 200 units per year. Adding 200 units would result in Metlifecare's total units increasing by approximately 5% per annum.

Perth Energy

Perth Energy is Infratil's sole investment on the west coast of Australia where it operates an energy retailing and generation business.

The Western Australian electricity industry operates to its own state rules, which are less market orientated than those of the eastern states. In the most recent period, generation and retail were relatively stable, but Perth Energy benefited from a reduction in the State specified obligation to buy renewable energy certificates which lifted EBITDAF earnings about $1 million to $5 million.

Snapper

Snapper continued to develop and enhance its small-value payment technology.

Snapper received a boost when it was chosen to provide technology to the public transport agency of Dublin in Ireland.

This particular application had been developed by Snapper and Wellington City Council's cable car company and is an excellent illustration of the benefit to New Zealand of such partnerships.

Infratil Infrastructure Property

Working with Auckland Council IIP completed stage one of the New Lynn Merchant Quarter development and undertook its partial sell down.

Work is now underway on a number of other property opportunities for the Infratil group.

Trustpower

Trustpower is progressing three distinct avenues to grow earnings. The multi-product retail strategy is beginning to differentiate Trustpower's offering in the market and is developing good momentum. In Australia Trustpower continues to grow its generation capacity, while in Canterbury work is continuing on irrigation options.

Total electricity volume sold in New Zealand was 2,051GWh, compared with 1,831GWh in the prior period, an increase of 12%. Total energy accounts increased to 255,000, including 21,000 gas accounts. Good progress was made in acquiring new customers in North Island metro markets and in having customers take more than one service. While the retail energy market remained highly competitive throughout the period, Trustpower continued to experience lower levels of customer churn than the market overall.

Reflecting the winter weather, Trustpower's New Zealand generation production of 1,225GWh was 8% below the expected long-term average.

Australian expansion continued with completion of the Snowtown Stage II Wind Farm at a cost of A$424 million. Trustpower has now invested A$644 million in its two wind farms near Adelaide.

Trustpower also acquired hydro and wind assets from the NSW Government for A$72 million. These smaller scale generation assets are expected to produce 270 GWh in a year of average wind/rain. The investment gave rise to a revaluation gain of $25 million which represented the difference between the purchase price and fair value, as assessed by an independent valuation at period end. In part this gain reflects the relatively low level of competition for small scale wind and hydro generation assets in developed markets.

About a third of Trustpower's total generation will now be produced in Australia.

Trustpower is actively progressing other wind development options in Australia with the aim of developing further projects over the next five years. Development approval applications for close to 1,300MW of wind projects are being progressed on the basis that the Australian regulatory environment will continue to support further renewable investment. While the outcome of the Australian Government review of the Renewal Energy Target remains uncertain, there appears to be growing support for a bipartisan agreement which would allow further investment in renewable energy.

Year ended 31 March **Six months ended 30 September**	**30 September 2014**	**30 September 2013**	**31 March 2014**
NZ output sold	2,051GWh	1,831GWh	3,512GWh
NZ generation	1,225GWh	1,218GWh	2,209GWh
Australian generation	619GWh	193GWh	536GWh
Electricity accounts	234,000	218,000	224,000
Telco & gas accounts	56,000	39,000	45,000
Av. NZ generation spot price	6.3c/kwh	6.8c/kwh	6.7c/kwh
EBITDAF	**$173m**	**$153m**	**$277m**
Investment spend	$144m	$193m	$350m
Infratil cash income	$32m	$32m	$64m
Infratil's holding value[1]	$1,168m	$1,121m	$1,037m

1. NZX market value at period end

Dr Bruce Harker Chairman of Trustpower atop a Wind Turbine at Snowtown South Australia.

Wellington Airport

Operationally Wellington Airport experienced a remarkably event free half year, but several initiatives with long-term consequences were progressed.

After several years of work Jetstar has announced a new service with Coolangatta. This is Wellington's first new international carrier in a decade and is important because it has been consistently shown that it is new entrant airlines which spark long-term growth. The link also sees the Capital connected into Jetstar's Australian-Asian low-cost network. A price conscious traveller in Singapore or Japan can now board a Jetstar service and get to Wellington with only one transfer.

The Airport's other major project is the introduction of direct northern hemisphere services, with the first step being the construction of a 300 metre extension to the runway. This project is explained at length in the September Infratil Update, but in summary, the Airport and Wellington City Council are working together to evaluate the viability of the extension and to then have it consented.

The evaluation has now been concluded and indicates positive benefits with construction likely to cost about $300 million. While a significant sum, it is plausible if local and central government work with the Airport to unlock the regional and national benefits. A decision to progress consenting will be made before Christmas and it is expected that consents could be granted within a year.

Wellington Airport also had to stay abreast of a swathe of regulatory developments involving the Commerce Commission, Ministry of Innovation, Business and Employment and the Ministry of Transport. The only immediate effect over the period was that aeronautical charges were reset with an average reduction of about 40 cents per passenger. It is possible that regulatory decisions could have consequences for the Airport's investment plans, but the main effect now is uncertainty.

Year ended 31 March **Six months ended 30 September**	**30 September 2014**	**30 September 2013**	**31 March 2014**
Passengers Domestic	2,311,527	2,366,838	4,683,931
Passengers International	357,200	349,891	753,355
Aeronautical income	$31m	$32m	$68m
Passenger services income	$17m	$17m	$34m
Property/other	$6m	$6m	$9m
Operating costs	($13m)	($13m)	($25m)
EBITDAF	**$40m**	**$42m**	**$86m**
Investment spending	$7m	$12m	$20m
Infratil cash income	$38m	$35m	$35m
Infratil's holding value[1]	$330m	$337m	$352m

1. Infratil's share of net assets excluding deferred tax at period end


Cyberzone

NZ Bus

NZ Bus experienced strong patronage growth in Auckland and a more modest increase in Wellington/Hutt Valley.

Unfortunately patronage growth wasn't translated into improved earnings. Average fares in Auckland were unexpectedly reduced by the increasing use of HOP cards and the fare structure and discount allocation required by Auckland Transport. Costs were also higher as NZ Bus is part way through a productivity improvement initiative to enhance operations and workshop efficiency.

With the new Public Transport Operating Model (PTOM) contracting regime about to be introduced for urban bus public transport, NZ Bus has to ensure its operational efficiency positions it to successfully participate in future contract tenders and negotiations.

PTOM is based on the principle of operators and local contracting authorities working together in partnership to grow patronage, improve commerciality and to demonstrate value for money. Auckland Transport has begun consultation on its new contracts which are expected to be completed over the next few months.

In Wellington change is a couple of years behind Auckland, but the Regional Council has announced that one change it will be making in 2017 is the termination of Wellington City's iconic electric trolley buses. This is a disappointing decision given the lack of economic alternatives (outside of diesel) and the inevitable increase of emissions that will come from ending the use of electric public transport which dates back to 1904. At this stage it is unclear what timing the Regional Council is working to in respect to fleet transition, nor is there clarity on the economic model for new investment.

Year ended 31 March **Six months ended 30 September**	**30 September 2014**	**30 September 2013**	**31 March 2014**
Patronage north	20,299,964	19,387,236	37,591,015
Patronage south	10,715,152	10,571,606	20,373,202
Bus distance (million kilometres)	23.7	23.9	47.9
Bus numbers	1,097	1,094	1,177
Passenger income	$67m	$66m	$128m
Contract income	$47m	$45m	$89m
EBITDAF	**$20m**	**$22m**	**$40m**
Capital spending	$10m	$39m	$68m
Infratil's holding value [1]	$301m	$284m	$303m

1. Infratil's share of net assets excluding cash and deferred tax at period end


Lyall Bay
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GO WELLINGTON
332
EEG63

The Creation and Sale of Infratil Energy Australia

On 30 September Infratil sold subsidiary Infratil Energy Australia for a net $670 million. This was $398 million over the 31 March 2014 book value and the culmination of a 14 year journey. While Infratil's approach to investment is often articulated in reports, results announcements and presentations, the evolution and sale of IEA showed it in action.

A Brief History

In 1999 New Zealand's electricity companies were legally required to separate ownership of distribution (lines) from generation and retailing. Amongst other things this was intended to open the door for new ways to sell electricity and the emergence of new retailers.

The exciting idea of the time was "virtual" retailers who would communicate with customers via the internet and undertake back-office functions electronically. Infratil management spent two years looking at such plans, but the star "emerging retailer" which was identified was more old-school having quickly grown to over 10,000 customers in Auckland via telemarketing. The two managers of this business had savvy, energy and were very practical; "nothing matters more than getting an accurate bill out and getting paid". However, by then it had become apparent that structural characteristics of New Zealand's SOE dominated market made the viability of independent energy retailers problematic, whether customer communication was via internet or telephone.

In the meantime the state of Victoria was also privatising and deregulating its electricity industry. This was a market where Infratil's management had considerable experience at the generation and wholesale levels so a proposal was developed for the formation of "RyanEnergy". In exchange for a shareholding, the two Aucklanders would manage retailing with energy to be purchased from Loy Yang on a fixed-price/variable-volume basis. (As with many plans, this one had to change when it became apparent that Loy Yang's prices were too high. Open market procurement was then adopted with Infratil's management overseeing risks.)

In March 2002 Infratil committed $500,000 to meet the initial set up costs of Victoria Electricity, as the company had become, and on 1 September 2002 the company signed on its first employee. The first customer took a further two years and almost $10 million as a back office was built and regulatory approvals secured. A year after that a small generation unit was acquired for $20 million as it had become apparent that at least in South Australia market weaknesses made owning some generation desirable.

Over the following decade retailing expanded and sister brands joined Victoria Electricity (South Australia Electricity, Queensland Electricity and NSW Electricity) before they were combined in 2010 to become Lumo Energy. More peaking generation was built in South Australia and NSW. Customers were offered gas as well as electricity. The two Aucklanders who set up the retailing operation were bought out in 2007 for $40 million to give Infratil 100% ownership. Many ways to attract and sign-on customers were trialled, including Direct Connect which became a runaway success backed by almost half of Australia's real estate agents.

And then it was all sold to Snowy Hydro, a state/commonwealth owned generator and retailer which saw IEA as a route to making "the Big 3" eastern state generator-retailers into "the Big 4".

Market Characteristics & Their Evolution

Infratil has principles which guide its approach to investment, including investing where management has expertise and in businesses which operate in markets offering a reasonable prospect of good risk-adjusted returns.

In 2002 the circumstances confronting the start-up Victoria Electricity were encouraging. The company had "battle hardened" Kiwi management who had the jump on the locals because New Zealand had deregulated first. Australian incumbent energy retailers had been protected from risk and competition, consumers were disgruntled and back office costs and margins were high. There was also the potential of almost unlimited scale as other states were expected to follow Victoria into deregulating and selling assets.

Infratil's strategy and goals were:

- Set up and grow an energy retailing business in Victoria and then the other states
- Target 1,000,000 customers
- Buy and build a substantial generation portfolio as opportunities arose

Measured against these aspirations, IEA was a partial success. Unfortunately the features of the market which had been so attractive in 2002 were diluted or subverted by a raft of government interventions. These resulted in uneconomically low wholesale energy prices while also increasing retail prices. Whether as a result, or because of other factors, household energy consumption fell as people used more efficient appliances and generated their own electricity with subsidised solar panels. Regulation also encouraged retailer competition, but at the same time made it harder to compete with strict rules, enforcement and penalties.

The interventions made retail growth challenging and increased compliance costs, while offering generators very low prices and hence returns, except those with carbon or renewable credits.

Creating Value For Infratil

The evolution of IEA is a lesson in how changing market circumstances require changes to goals and strategies if maximum value is to be derived.

In 2014 IEA had become a smoothly functioning business. It delivered bills on time, it was growing customers, bad debts were amongst the lowest in the industry, risks and wholesale costs were well contained, it had consumer agency approval of its quality of service and its customer turnover was relatively low.

But set against this was regulatory interventions, industry uncertainty and the potential for competition regulation to limit merger/sale choices. Even though Infratil had overseen the creation of an efficient and successful business it was the right time to look at alternatives, which include selling to extract the capital for other uses.

The Complete Package Of Capabilities

The brief history of IEA doesn't do justice to the many and hard challenges which were overcome.

Managing electricity price risk required particular skills which were available to Infratil's management, but once IEA started to offer gas to its customers the unique risks associated with gas procurement also had to be managed. It took several years and an estimated $30 million to contract reliable wholesale gas supplies that were not susceptible to outages or price volatility.

With both electricity and gas procurement, IEA had to be able to purchase in the wholesale market at the same price as the much larger integrated generators-retailers.

At the other end of the business, the back-office had to ensure every customer's consumption of electricity and gas was measured and billed and late payments chased. That is across 500,000 accounts, while also managing a weekly gain and loss of about 5,000 accounts.

In addition to energy procurement and systems expertise, success also required marketing and sales capability.

IEA was the only new entrant energy retailer to reach anything like its scale and value. Infratil invested $272 million and created a 500,000 customer company worth a net $670 million.

Tenacity, Talent, Flexibility

IEA's success came from its flexibility in the face of changing market circumstances and its ability to attract the people necessary to undertake a wide range of difficult operational tasks. Capable people were willing to take up the challenge because of Infratil's track record and because the calibre of Infratil's management gave confidence to others that they were part of a winning team.

There is a tendency to see history as a series of semi-inevitable milestones. IEA's history had nothing inevitable about it, its evolution was due to it having good people who put in exceptional effort, and a willingness to shift strategy and goals as circumstances changed.

Infratil's Management

Infratil is managed by H.R.L. Morrison & Co. In 1994, when Infratil was established, the management fee was set as a percentage of the market value of Infratil's shares and 100% group net debt. Last year the management fee was $19.0 million or about 0.8% of Infratil's average $2,350 million capitalisation (debt + equity) over the year.

In 2002 the fee was amended to provide the potential for additional payment in situations where management would be more difficult and/or expensive. For investments in Australia an incentive element was added to the base fee so that management could earn 20% of returns over a 12% per annum threshold. In the case of Lumo/IEA it was revalued as at 31 March 2014 at $463 million and Infratil beat the 12% per annum return threshold by $216 million so 20% of this will, in due course, be paid to the Manager. (Although IEA had a 31 March 2014 book value of $272 million its independently assessed economic value was $463 million).

Was Lumo/IEA a Good Investment For Infratil?

Infratil invested approximately $272 million over a twelve year period and got back $670 million. The return on total capital invested for the full period was over 16% per annum and the return on Infratil's equity was over 20% per annum.

It was a good investment, but Infratil shareholders may wonder how good an investment it was for them along the way. Someone who acquired Infratil shares in 2002 and sold then in 2013 probably didn't greatly benefit from IEA's value uplift because it is unclear whether IEA's value was fully reflected in Infratil's share price prior to that value being crystallised.

In May 2014, when the potential sale of IEA was announced, the six broker analysts who cover Infratil had an average value for IEA of $474 million, which was consistent with Infratil's own $463 million independent valuation. That the sale value was well above this in part reflected conservatism in the "retention values" and in part that there was a strategic premium in the sale price.

If there is a lesson it is perhaps that Infratil is a long term investment and the benefit of potential capital recycling is not recognised in the market's value of Infratil's share price.

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