



23 February 2010

Restoration of portfolio flexibility in sight

Result

Following an extended period of high inflows into the country's hydro lakes and low wholesale prices, Contact Energy recorded Earnings Before Net Interest Expense, Income Tax, Depreciation, Amortisation, Financial Instruments and Other Significant Items (EBITDAF) for the six months ended 31 December 2009 of \$225.0 million, the same as the prior corresponding period.

Underlying earnings after tax for the six months to 31 December 2009 were \$80.1 million, which was also the same as the six months to 31 December 2008.

Contact's Board of Directors resolved to hold the interim distribution for the six months to 31 December 2009 at the equivalent of 11 cents per share, under the company's Profit Distribution Plan.

Contact Managing Director David Baldwin said the challenging conditions posed by high hydro inflows resulted in low wholesale prices, which when combined with a lack of operational flexibility, led to a result which was not surprising.

The extreme weather and transmission constraints which negatively impacted Contact's performance by around \$40 million in the late winter of 2008 did not reoccur. However, Contact's operating costs in the six months to 31 December 2009 were higher by about the same amount, primarily due to higher costs of gas-fired generation.

"The costs of generating electricity increased nine per cent in the six months to 31 December 2009, primarily due to increases in thermal costs," said Mr Baldwin.

In addition to higher generation costs, transmission and distribution costs were also five per cent higher than last year, and customer retention costs and debt write-offs were up 76 per cent.

Recent price increases reflect some of these higher operating costs, the majority of which are external to Contact.

Investments in increasing portfolio flexibility

Mr Baldwin said Contact had anticipated and planned for the reduction in operational flexibility, particularly through fixed take or pay gas supply contracts. He said two key projects initiated two years ago would be commissioned over 2010, significantly improving portfolio flexibility.

"Our \$250 million, 200 megawatt gas-fired peaking power station at Stratford is approaching the commissioning stage and is on track to be in commercial operation in winter 2010," he said.

"This fast-start plant will support greater volumes of weather dependent renewables in the system and make an important contribution to the country's security of supply."

The other project under development to address operational flexibility is the country's first underground natural gas storage facility at Ahuroa, which is also progressing well. In total, six petajoules of natural gas have been injected into the reservoir. Since the commissioning of a new compressor in October 2009, gas has been consistently injected into the storage reservoir at the target rate of around 40 terajoules per day.

Stage two of the Ahuroa development involves the drilling of three additional wells which will enable the continuation of injection. The drilling of these three wells is nearly complete.

The installation of the gas extraction and processing equipment will begin in March and is expected to be completed and the project commissioned during the fourth quarter of 2010. At that point Contact expects to be able to extract gas at around 45 terajoules per day.

“This is a particularly important project for Contact in that it will enable us to store natural gas in the reservoir when it is not needed for electricity generation, to be extracted and used when it is most needed and valued,” said Mr Baldwin.

“The commissioning of the Stratford peaking power station and the Ahuroa gas storage facility will help Contact mitigate the extent to which hydrology and fixed gas supply contracts can impact negatively on the company’s earnings, as we have seen over the last year.”

Contact’s financial strength enabled the company to invest half a billion dollars into these two projects – in addition to \$100 million for the first phase of the Tauhara geothermal project – during the global financial crisis, while maintaining the company’s investment grade credit rating.

Pricing and investment

Mr Baldwin said that over the six months in review, neither wholesale nor retail prices had reflected the true costs of energy.

“While we have seen some encouraging trends in wholesale prices since December 2009, we are still yet to see the true costs of electricity reflected in retail tariffs, which is a concern.

“New Zealand’s generation capacity remains tight and in order for investment in new generation to occur, prices need to reflect the cost of that capacity. With new geothermal generation requiring a price of around \$80 per megawatt hour, Contact’s retail margins are unsustainably low to enable this investment, which must be committed shortly to ensure ongoing security of supply.

“In addition, electricity prices over the six months in review have not covered the costs of having gas-fired capacity available to the market,” said Mr Baldwin.

“If the investment in new capacity that New Zealand needs is to be made, and if existing thermal plant is to continue to support the system, retail prices will need to rise,” he said.

Investing in the future

In addition to Contact’s investment in gas-fired peaking capacity and gas storage, Contact is making good progress on a number of other important energy developments, including three significant geothermal projects.

Mr Baldwin said the six months in review had been a period in which the building blocks had been put in place to take Contact’s geothermal development strategy to the next level.

The first stage of the development of the Tauhara steam field near Taupo, a \$100 million, 23 megawatt geothermal power station, is in advanced stages of commissioning and is expected to be transferred to Contact for commercial operation in mid 2010.

On 19 February, Contact filed resource consent applications for the company’s 250 megawatt Tauhara stage two (Tauhara 2) geothermal power station at Taupo. Contact has requested that the resource consent application be considered under the new Environmental Protection Agency (EPA) process which facilitates the potential award of consents within nine months of the application being accepted by the EPA.

In addition, Contact also holds consents for a 220 megawatt geothermal power station at Te Mihi. Mr Baldwin said the Te Mihi project had been delayed by the global financial crisis and unfavourable market conditions, but the company was looking to commit to a final investment decision once it had confidence in improving market conditions.

Last weekend, Contact and the Taheke 8C and Adjoining Blocks Incorporation signed an agreement that will see the two organisations work together in the appraisal and development of the Taheke geothermal field near Rotorua.

“We’re delighted to have signed this agreement to work with the Taheke 8C and Adjoining Blocks Incorporation in the development of the Incorporation’s geothermal resources around Lake Rotoiti,” said Mr Baldwin.

“This project will be the first development beyond the company’s legacy geothermal entitlements and represents the company’s commitment to developing trusted commercial relationships with tangata whenua in the sustainable development of geothermal resources.”

Additionally, Contact continues to work on consenting wind generation options in the Waikato and southern Hawke’s Bay and on advancing a future hydro development option on the Clutha River.

“Contact is prepared to continue to lead investment in a secure energy supply for New Zealand, but in order to commit shareholders’ capital we must have confidence that there is commercial competition across the sector and that prices support commercial investment decisions,” said Mr Baldwin.

New independent director appointed

Contact today also announced that Whaimutu Dewes has been appointed to the Contact Board as an independent director.

Mr Dewes is the third new director appointed to the Contact Board over the last 18 months, following the appointments of Sue Sheldon as an independent director and David Baldwin as Managing Director.

Mr Dewes holds a Master in Public Administration from Harvard University and Bachelor degrees in Arts and Law from Victoria University. He has held numerous directorships in organisations including Television New Zealand and the AMP New Zealand Advisory Board. He has acted as Deputy Chair of Sealord Group between 1992 and 2008, has held senior management roles at Fletcher Challenge and the Department of Maori Affairs and is currently a Director of Central North Island Iwi Holdings.

Mr Dewes is of Ngati Porou and Ngati Rangitahi descent and lives in Rotorua.

Contact Chairman Grant King said Mr Dewes is a highly experienced and respected director with particular experience in resource management, commercial negotiation and management of relationships between the business and government sectors.

“We’re pleased to have somebody of Whaimutu’s mana on the Contact Board and believe he will bring valuable experience, skills and insight to the Board table,” said Mr King.

The Board has determined for the purposes of Listing Rule 3.3.3(b) that Whaimutu Dewes is an Independent Director.

Ministerial Taskforce Review

Mr Baldwin said the Ministerial Taskforce Review into the electricity sector has been a robust piece of work, but had created some uncertainty over the six months in review.

“The outcome of the review itself is not of particular concern to Contact. While the reallocation of assets among the three State Owned Enterprises is an interference in the market, we are pleased that the market model has remained intact as the most efficient way to deliver electricity to consumers.”

Mr Baldwin said Contact supported the Government’s changes to disclosure requirements for State Owned Enterprises as a step towards improved commercial scrutiny and performance.

Outlook

Mr Baldwin said Contact’s financial performance for the second half of the current financial year will depend on various factors including hydrology, wholesale prices and the extent to which higher operating costs (gas, transmission and distribution, customer retention) can be reflected in retail prices.

Retail competition remains intense and Contact will be faced with a further increase in gas costs in the second half of the financial year as there is a major step up in gas price in one of its major contracts.

Therefore, there are a range of possible outcomes for the full year as a result of continued volatility in the retail and wholesale markets. Based on current conditions, Contact is not uncomfortable with current market consensus estimates for the current financial year.

“Contact is very well positioned. We have the three projects reaching completion in this calendar year and a range of further investment opportunities which will enhance Contact’s ability to deliver improved performance over a range of operating conditions,” said Mr Baldwin.

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