2007/08 half year results

supporting information

14 February 2008

Analyst supporting information 14 February

Vector Group – results summary

Six months ended 31 December

$m	2007	2006	% Change	2006/07 Full Year
EBITDA	332.1	331.8	+0.1	605.3
EBIT	255.4	263.7	-3.1	458.6
NPAT	90.7	110.6	-18.0	233.3

Vector Group – financial highlights

Six months ended 31 December 2007

- NPAT per share [1] 9.1 cents (1H 2006/07: 11.1 cents)
- Interim dividend 6.5cps: (1H 2006/07: 6.5cps)

  Record date: 31 March 2008; Payment date: 10 April 2008
- Total assets: $5,862.5m (1H 2006/07: $5,721.1m)
- Operating cash flow: $193.3m (1H 2006/07: $230.4m)

Business unit contributions

- Electricity EBITDA $211.3m (1H 2006/07: $200.8m)
- Gas EBITDA $128.2m (1H 2006/07: $136.6m)
- Technology EBITDA $23.6m (1H 2006/07: $23.2m)

(1) 1 billion shares

Vector Group – financial summary

Six months ended 31 December

$ millions	2007	2006	% change	2006/07 Full Year
Revenue	689.2	690.2	-0.1	1,307.1
Operating expenditure	(357.1)	(358.4)	-0.4	(701.8)
EBITDA	332.1	331.8	+0.1	605.3
Depreciation & amortisation	(76.7)	(68.1)	+12.6	(146.7)
EBIT	255.4	263.7	-3.1	458.6
Net interest expense	(123.2)	(116.1)	+6.2	(230.8)
Equity earnings	0.6	0.5	+26.2	0.7
Taxation	(38.9)	(35.3)	+10.1	9.0
Minority Interests	(3.2)	(2.2)	+44.3	(4.2)
NPAT	90.7	110.6	-18.0	233.3
NPAT per share (cents)	9.1	11.1	-18.0	23.3
Interim dividend per share (cents)	6.5	6.5	6.5	13.0

Financial Performance Discussion - *The results for the six months to 31 December 2007 have been prepared under NZIFRS and therefore comparative information has been adjusted accordingly.*

The company delivered a solid underlying operating performance for the half year with EBITDA slightly up taking into account $6 million of one-off costs.

Revenue was flat with increased electricity volumes and revenue growth offset by an expected reduction in natural gas sales.

Electricity volumes were marginally up (0.6%) with the cooler winter of last year pushing up consumption, as compared to this year which has been closer to the long term average.

The cessation of the short-term gas contracts with petrochemical producers, as signalled at the last annual results briefing, has seen natural gas sales drop by 6PJ, offsetting the increase across the rest of the gas business.

Net earnings after tax (NPAT) for the first half were $90.7 million, a reduction of 18.0% on the previous corresponding half year (‘pcp’). An increased asset base as a result of our capital expenditure programme and accelerated depreciation on metering assets, pending the rollout of the advanced metering programme, has seen depreciation and amortisation increase 12.6% on the pcp.

Interest on borrowings has increased due to the lift in borrowings and floating interest rates against the pcp. Borrowings have not increased on the June 2007 level in cash terms. The movement in the balance sheet relates to NZIFRS adjustments.

Vector Group – key ratios

Six months ended 31 December

	2007	2006	% Change	2006/07 Full Year
Net debt ($m)	3,001.5	2,918.2	+2.9	2,947.7
Equity ($m)	1,968.8	1,829.4	+7.6	1,936.1
Net debt/(net debt + equity) (%)	60.4	61.5	-1.8	60.4
Net interest cover (x times)	2.1	2.3	-8.7	2.0
EBITDA/operating revenue (%)	48.2	48.1	+0.2	46.3
EBIT/operating revenue (%)	37.1	38.2	-0.3	35.1

All metrics have been prepared under NZIFRS with pcp restated as required.

While debt appears to have increased over June 2007, this is a result mainly of the fair values required to be applied by NZIFRS. Net debt in cash terms has not changed since June 2007. Note this also in the context of increasing market costs for capital goods and labour.

All metrics are favourable against the 2007 full year and marginally down on the pcp.

Capital and Investment Management

The company is operating comfortably within its lending covenants and we retain our Standard & Poors BBB+ investment grade credit rating.

Maturing Debt Facilities

Our $320 million AUD credit wrapped notes mature in April this year and our NZ$700m bank facilities mature in October 2008. We are currently developing a number of alternatives in both the international and domestic markets to refinance this facility. The board and management are reviewing options both short and long term which aim to secure an acceptable debt profile both in terms of shape and maturity, at the best available cost.

Vector – electricity business

Six months ended 31 December

	2007	2006	% Change 2006/07
Revenue ($m)	329.9	324.0	+1.8
EBITDA ($m)	211.3	200.8	+5.2
Volume throughput (GWh)			
- Greater Auckland*	4,267	4,217	+1.2
- Wellington	1,268	1,283	-1.2
Total	**5,535**	**5,501**	**+0.6**
Total connections			
- Greater Auckland	515,696	509,091	+1.3
- Wellington	162,076	160,433	+1.0
Total	**677,772**	**669,524**	**+1.2**

** Greater Auckland comprises the Auckland and Northern networks*

Highlights

- improved financial result with steady revenue growth and a focus on cost reduction;
- strategic focus on network efficiency and emerging technologies;
- security of supply initiatives.

Total network throughput increased by 0.6% to 5,536 GWh, with 1.2% higher throughput on the greater Auckland networks, and a 1.2% decline on the Wellington network; reflecting the cooler winter in 2006 (particularly Wellington) and more normal, slightly warmer, conditions for the current year.

Connections to our networks have increased steadily by 1.2% since 31 December 2006 to total 677,772 at the end of the current half-year.

Financial Result

EBITDA is up $10.5m (5.2%) on the pcp.

New customer connections and higher consumption has led to a 1.8% increase in revenue.

Operating maintenance expenditure is higher this year as a result of the July storm, but has been more than offset by a reduction in Transpower charges over the pcp.
Overhead costs have been reduced by the cost reduction programme and a continued focus on operational excellence.

Vector – electricity business

Six months ended 31 December

	2007	2006	% Change
Assets employed ($m)	3,674.0	3,614.8	+1.6
CAPEX ($m)			
- Growth	37.0	31.9	+16.0
- Maintenance	32.7	35.9	-8.9
- OIP	4.6	4.4	+4.5

Electricity network length stood at 21,946 km at the end of December 2007. This figure excludes auxiliary cables and lines.

Vector's under grounding programme continues with support from our major shareholder, Auckland Energy Consumer Trust (AECT). Good progress continued with the under grounding programme in the Auckland, Manukau and Papakura areas. The programme has been dominated through this period by a project in Orakei which is expected to be completed in March.

Vector – gas business

Six months ended 31 December

	2007	2006	% Change
Revenue ($m)	347.4	353.4	-1.7
EBITDA ($m)	128.2	136.6	-6.1
Natural gas transported (PJ)			
Transmission	55.6	47.8	+16.3
Distribution	11.7	12.1	-3.3
Sales volumes			
Natural gas (PJ)	25.5	31.5	-19.0
Gas liquids (tonnes) (1)	51,928	57,225	-9.2%
Liquigas (tonnes) (2)	75,000	73,200	+2.5%
Gas entitlements (PJ)	197	269	

(1) *Includes On gas LPG sales and KGTP LPG & natural gasoline production/sales*
(2) *Includes domestic market wholesaling and domestic/export tolling*

The gas business comprises natural gas transportation (transmission and distribution), processing and sales, and gas liquids (LPG and natural gasoline) production and sales, and the LPG wholesaling and tolling activities of our 60.25% owned subsidiary, Liquigas Limited.

Financial Result

- Revenue down $6m, with improved transportation revenues offset by the reduction in natural gas sales through the cessation of the short-term petrochemical contracts, partially mitigated by new contracts with electricity generators.
- Cost of natural gas up due to a full half of Pohokura and ROFR supply, with less availability of cheap Maui legacy gas, resulting in reduced gross margin.
- All legacy gas is expected to be consumed by year end.
- Transmission volumes have increased by 16.3% with increased volumes transported to large customers, particularly electricity generators.
- Distribution has declined through lower average consumption related to more normal weather conditions.
- Gas liquids – while OnGas LPG tonnages have increased, total liquids are down with the Kapuni plant operating on minimum flows due to maintenance on the Kapuni gas field.
- Liquigas tonnages growth 2.5%.

Vector – gas business

Six months ended 31 December

	2007	2006	% Change
Assets employed ($m)	1,758.0	1,768.6	-0.6
CAPEX ($m)			
- Growth	9.8	10.2	-3.9
- Maintenance	5.1	5.7	-10.5
System length (km)			
Transmission			
- owned/operated	2,286	2,286	--
- operated/managed (other owners)	1,194	1,194	--
Distribution	6,774	6,668	+1.6
Distribution network connections	145,162	140,999	+3.0

Note - maintenance capital expenditure is down (-10.5%) mainly as a result of the operational excellence and cost efficiency initiatives underway.

Vector – technology business

Six months ended 31 December

	2007	2006	% Change
Revenue ($m)	35.4	33.2	+6.7
EBITDA ($m)	23.6	23.2	+1.6
Assets Employed ($m)	239.5	228.5	+4.8
CAPEX ($m)			
- Communications	5.2	6.5	-20.0
- Energy Metering	5.0	7.3	-31.5

The Technology business incorporates Vector Communications and energy metering - NGC Energy Services and Stream Information (70% owned).

Revenue growth was achieved by all of these businesses which together provided a 1.6% higher EBITDA contribution of $23.6 million.

Vector – corporate
Six months ended 31 December

$m	2007	2006	% Change
EBITDA	(31.0)	(28.8)	+7.8
Net interest expense	(123.2)	(116.1)	+6.2
Taxation	(38.9)	(35.3)	+10.1
Net short term debt	724.4	199.7	+262.8
Long term debt	2,277.1	2,718.6	-16.2
Equity	1,968.8	1,829.4	+7.6

EBITDA for Corporate has reduced for the half by $2.2m with the key elements being the inclusion in the pcp of the gain on sale of Wanganui Gas shares and the inclusion of non-recurring expenditure in the current period of $3.8m of restructuring costs.

Vector runs a shared services model in which centres of excellence in Finance, IT, Organisation Development (including HR) and Property, in particular, support the business groups.

The results for Utilitech, a stand-alone Private Training Establishment within Vector that provides skill training for our own and other network operations, are included within corporate.

Outlook

Currently a total of seven sell side research analysts publish regular and widely distributed research on Vector. As at 31 December 2007 those analysts had published a relatively broad range of expectations for Vector's annual results in the period to 30 June 2008.

At this point, the business continues to track on budget and Vector believes that its revenue, EBITDA and NPAT will fall comfortably within or above the range of analysts' expectations.

Regulation

Regulatory update

Regulation remains a critical issue and area of focus for Vector. The company continues to commit considerable resource into securing regulatory outcomes and working closely with all relevant regulatory bodies. We also work closely with government, officials and our industry peers.

Commerce Act Review Outcomes

The Commerce Act review was released in November 2007 and contained a number of features designed to meet the Government's objectives to provide a more stable, transparent and certain infrastructure investment environment. A key element of the reforms is to require the Commerce Commission to establish enduring input methodologies, which will be merits reviewable to the High Court.

The proposed new regime for electricity and gas will see the Commission establish default price and quality paths. Businesses may propose alternatives to these default terms (according to pre-defined input methodologies) if, for example, there are specific factors that are not able to be considered (e.g., rising investment requirements) in setting the default arrangements. The Commission must accept proposals if they meet certain pre-defined criteria.

Legislation is due to be introduced to Parliament in the early part of 2008 and the Commerce Act reforms are expected to come into force prior to the election.

Commerce Commission

As stated in our main presentation, there is a timing issue in that while the Government is planning to change the Act, the Commerce Commission has started the process of re-setting the electricity price quality thresholds regime.

Along with a number of other electricity lines businesses, Vector believes that, while we wait for the changes to the Commerce Act to be legislated, the practical thing to do is have the current thresholds regime remain in place. This would allow the Commerce Commission to work through the reset process under the new legislation not the old. Significantly, it would also assist in delivering the Government's, and industry's, goal of regulatory confidence and certainty.

As we have stated, the Commission's first discussion paper on the 2009 threshold reset, released late December 2007, underlines the need for such a transitional solution in the short term.

We are about to lodge a submission on the initial discussion paper. There will be consultation on methodology in May-June and further consultation in September-October.

Meanwhile, our administrative settlement on electricity pricing is progressing with the public consultation process underway. Regarding Auckland gas pricing, there will be a gas pricing conference the week of 18 February which we will participate fully in.

In October 2007, the Commission released its draft decisions on the Final Authorisation for the Auckland Gas Distribution network. There is considerable ground to cover before decisions on the Auckland Gas Network are made. The Commission has demonstrated in the past its willingness to consider submissions and make amendments to its initial proposals to achieve more balanced regulatory outcomes.

Security of supply

While current issues around generation and transmission are generally out of Vector's control, the company continues to work closely with the industry to assist and mitigate the impact as much as possible. The aim for Vector and the industry is to provide secure, reliable, high quality energy supply and infrastructure. Vector will continue to work with the industry, government, Commerce Commission and Electricity Commission to do our level best to deliver to customer needs.

Transmission

As indicated in our main half year presentation, we have had very constructive discussions with Transpower regarding the wider transmission grid issues for this region and further afield. We are also working with the Electricity Commission on the subject of coordinating upgrades and are hopeful that there will be a constructive and positive outcome that will lead to transmission security of supply.

Generation

As stated, Vector supports the National Energy Strategy in principle and the view that there should be more renewable energy sourcing, but this is tempered by the need to tread carefully in order to ensure pressing energy demand is met regardless of the source. This includes providing a peak-load generation plant in the Auckland area, a need best taken care of by a modern, energy-efficient gas-fired generation plant.

Vector has an investment in a windfarm initiative, New Zealand Windfarms, and we have also recently signed an agreement with Hills Industries of Australia for the supply of solar-augmented hot water systems. We support the principle of more renewable energy sourcing and will continue to explore the opportunities for our business and customers.