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CORPORATE PARTICIPANTS

Michael Stiasny *Vector Limited - Chairman*

Simon Mackenzie *Vector Limited - Group Chief Executive*

Dan Molloy *Vector Limited - CFO*

CONFERENCE CALL PARTICIPANTS

Matt Henry *Goldman Sachs - Analyst*

Grant Swanepoel *Craigs Investment - Analyst*

Stephen Hudson *Macquarie Securities - Analyst*

Greg Main *First New Zealand Capital - Analyst*

Andrew Harvey-Green *Forsyth Barr - Analyst*

Kate Barker *Energy News - Media*

PRESENTATION

Operator

Good morning everybody. Welcome to Vector Limited's webcast to discuss its financial results for the year ended June 30, 2015. (Operator instructions) I must advise you that this conference is being recorded today, Friday August 28, 2015. I'd now like to hand over to the Chairman, Michael Stiasny, who will take you through the call. Please go ahead.

Michael Stiasny - Vector Limited - Chairman

Good morning everyone and welcome to our results briefing for the 12 months ended June 30, 2015. Joining me on the call today is Simon Mackenzie, our Chief Executive and Dan Molloy, our Chief Financial Officer. I will begin today's presentation with a review of the 2015 dividend, Simon will then cover the highlights of the 2015 financial year and Dan will review the financial results for the period before Simon concludes the briefing with an operational review. As always, we will be more than happy to take your questions.

Vector today turned in another strong result ahead of the guidance we gave you in February. We have achieved this despite price cuts to our regulated energy networks and challenging conditions at our gas wholesale business. And as a result, the Board has today declared a final dividend of NZD0.08, taking dividend payments for the year to NZD0.155 per year, up NZD0.0025 on the prior year. This is the ninth year running that we have increased dividends, a record that is well ahead of most of our NZX peers. The dividend is ahead of our policy to target a payout ratio of 60% of free cash flow. This above policy payout is compensating for below target payouts in the four years prior the last financial year.

The Company is in good shape and we're looking ahead to the remainder of the current year with confidence. Before I hand over to Simon, I would just like to record the congratulation from all of the Board and myself especially to our team for winning the Tomorrow Workforce category and the Supreme Award winner at the Equal Employment Opportunities Trust Awards two nights ago. Really makes all of us very proud and tells you about the great culture we have at Vector.

Simon, over to you.



Simon Mackenzie - Vector Limited - Group Chief Executive

Thanks Michael and good morning everyone. So Vector's vision to create a new energy future for our customers simply reflects the reality we now face. I'd just like to briefly touch on a little insight which reflects this and I'm sure our analyst understand the way in which our regulatory model allows us to recover revenue, but a significant amount of analysis has shown that over the last 10 years, residential consumption has dropped on average by 11%. We see that this trend will continue to grow, which is a significant challenge for all the energy sector.

As a result of this, customers are seeking and gaining greater choice over the source of energy they use. They expect their energy services to be delivered like any other service. They want them to be at their fingertips, they want to be in control and have choice. Given the rise in electricity prices over the last few years, customers increasingly are becoming incentivised to make use of all the new developments to manage their energy costs. We are, and have for some years, been strategically focused on meeting these challenges with the focus on customers, by seeking sustainable growth, by engaging and collaborating with new partners to develop innovative options, by excelling operationally and doing all of this while setting standards for health and safety.

We've made significant strides in all of these areas and in addition, we are growing organically. New electricity connections rose 26%. Our metering business gained new contracts to roll out meters for the SmartCo consortium of power companies and Meridian Energy, and as the Arc Innovations acquisition demonstrates, we can grow by making value enhancing acquisitions. Our new online gas connection tool which cuts the quote time for a gas connection from days to a matter of seconds is among the latest examples of our efforts to deliver services in ways that customers expect and exceed their expectations.

Our outage app for smartphones which has received more than 8.8 million visits over the last two years continues to deliver the information customers need to avoid disruption to their lives in the event of a supply disruption. As you will see from our annual report, which we've also released today, we introduced a new Street Evaluating Laser Methane Assessment vehicle to improve safety, reliability and driver efficiency across our gas networks. However we faced a challenging year on our electricity networks. In the regulatory year to March 31, 2015, we weathered four major events that challenged our strong record for providing a reliable electricity supply. The frequency of major events is well ahead of the average of less than one major event over the prior 10 year period.

We were at the forefront of adapting new technologies that are transforming the electricity industry worldwide and creating new opportunities for the Company. The best of this is our ground-breaking relationship with Tesla Energy, to which we expect to bring residential and commercial battery solutions to New Zealand and in so doing, change the electricity landscape both in Auckland and further afield. Another good example of the work we're doing with a number of parties, including Auckland City BMW and the rollout of charging infrastructure for electric vehicles in Auckland.

Finally, we continue to raise the bar on health and safety practices. This year, we ceased most live-line work and we continue to deliver improvements in our safety record. It has been another good year for Vector and I'd like to now handover to Dan to take you through the financial highlights.

Dan Molloy - Vector Limited - CFO

Thanks Simon. Please move to slide, which summarises our key financial performance metrics for the year. This year, Vector's really benefitted from strong growth in Auckland and we've also seen a return to cooler temperature, more in line with historic averages. We've also benefitted from ongoing growth in our technology business. These have been somewhat offset by significant price cuts to our regulated networks. We've also seen lower natural gas volumes and weaker prices in our gas wholesale business.

As you can see from the graph, annual revenue was up about 2.8%. Around 80% of that increase was due to increases in Transpower charges and also local authority rates, both of which we pass through to our customers. Adjusted EBITDA was also up 2.8%, but net profit was down almost 13%. Operating cash flow up marginally, while CapEx has fallen by about 5%.

If we move to slide 10, you'll see a breakdown of the EBITDA result in some more detail. The graph shows that we've turned in improved performances across most of the business units with the exception of the gas wholesale division, which has really faced some headwinds this year, most obviously from lower oil and gas prices but also due to falling volumes and a lot of competition.

If we move to the next slide now, the graph on the left shows you a breakdown of the movements in net profit year-on-year. The fall in net profit was due to higher buying costs, but perhaps more significantly, to the non-cash mark-to-market losses on derivatives. These principally reflected a weakening of the New Zealand dollar against the US dollar. For a long time, Vector's policy has been to fully hedge foreign denominated debt against currency movements and we've now updated our gearing metric to include the impact of the hedging. The gearing under this measure has risen slightly from 52.5% at the end of the previous financial year to 53.6% at June 30, 2015.

My final slide is the next slide which gives a breakdown of CapEx. Gross CapEx was down around 5% to NZD323 million, but net of capital contributions, CapEx was down almost 10%. These capital contributions were up significantly and that was on the back of relocations in the gas transmission business and also due to new subdivision growth across our networks. On the electricity network, CapEx was down as we concluded major reinforcement projects in the prior year and in gas transportation, CapEx was up 9%, largely due to the relocation activity in gas transmission, but also due to growth in the dairy sector, with new and upgraded delivery points in Pahiatua, Tuakau and Tatanui. In the [competitive] markets business, CapEx was 12% lower, and that was largely due to reduced levels of smart metering deployment.

Back to you, Simon.

Simon Mackenzie - Vector Limited - Group Chief Executive

Thanks Dan. Turning to slide 14. Of all the initiative we've embarked on upon this year, there's our new relationship with Tesla Energy that best exemplifies the new energy future we are creating for our customers. We expect to bring two Tesla Energy battery solutions to New Zealand. The first is the Powerwall solution with a variant for home use and another for small to medium sized enterprises, and the second is the Powerpack commercial solution, primarily targeted at distribution networks and large commercial.

The batteries offer energy storage at a cost that is significantly lower than other systems and represents a game changer for the country's energy industry. We expect both solutions to open up an array of new markets for us. In addition to the obvious benefits that come with pairing the Powerwall system with solar panels, we expect homes and small and medium sized businesses to deploy it for many other uses including backup power.

The commercial Powerpack systems are meanwhile creating new options for network investment. Later this year, we intend to deploy a cohort of the larger batteries to the network in place of traditional network upgrades. Early deliveries of the Powerwall batteries are targeted at our Future of Energy program, which is giving some Auckland families, schools and community groups a total of 130 solar panel and battery units to use for free for 10 years. The winners are chosen by popular vote. As of yesterday morning, 73 schools, close to 260 individuals, families and community groups, had been nominated to win one of the systems. These organisations and people have received more than 71,000 votes with over 155,000 visits to the site.

We took this approach because we wanted to make sure that the benefits of these systems are widely understood and shared with all sections of the communities and we understand how they interface with our networks. We see these batteries as the start of a significant change in the industry. Batteries' costs are declining rapidly as production ramps up and manufacturing plants start to benefit from economies of scale. Indeed between now and 2017, battery costs are forecast to halve and this will further drive demand.

Vector is positioned to be at the forefront of this technological shift, not only because we have embarked upon this new relationship with Tesla Energy, but also because we have for a long time been focused on customer trends and new technology. Batteries are a catalyst for change in the industry because they tie together a range of technologies that give customers numerous choices over the source of energy they use, who supplies it, when and how they consume it and the price they pay. As part of our focus on giving customers these choices has brought these technologies together and we understand the long term value they generate for customers as well as shareholders.

We have installed 400 solar systems across Auckland, some with batteries and some without. We have developed the engineering that adapts batteries to local conditions, including the control systems, the interface with local networks and a raft of health and safety protocols. We have also developed the HomeSense energy consumption monitoring service that when linked to a battery and/or a solar panel, gives customers the information they need to make informed choices about their energy use.

Meanwhile, electric vehicles are gaining traction in New Zealand and Vector is further expanding our charging infrastructure to meet this demand. We have also partnered with Auckland City BMW to provide charging solutions for its customers' electric vehicles and we are starting to rollout further public charging across Auckland.

Our metering business, which only a few years ago was a new technology solution in search of the markets, has grown into a substantial business and continues to prosper. It has grown earnings as deployments continued and it has benefitted from the December 2014 acquisition of Arc Innovations. We are now contracted to install 1.2 million smart meters and expect to have installed the majority of these at the end of the 2017 financial year. Our demonstrated capability to deliver on these commitments means we are well-positioned to grow our metering business offshore.

We see a positive future for the metering business in Australia. Following a great deal of work over the past two years, Vector's metering business is now well-positioned to leverage its New Zealand expertise to support a smart meter rollout. Our current focus is on Queensland, New South Wales, South Australia and Tasmania. The market in these states extends to approximately 6.3 million meters. Vector is well advanced to operate as a metering services provider in the Australian market.

Meanwhile rule changes which come into effect in 2017 are forcing Australian retailers towards assuming responsibility for mass market metering in a model that closely follows the development of the highly successful New Zealand market. These rule changes alone upon an initial market for an estimated 400,000 new meters each year as new customer connection points are established or old meters are replaced.

The gas wholesale business faced a tough year and faces no letup in the current year. Natural gas sales were down 20%, reflecting falling demand for thermal generation in the North Island and strong competition. Global prices have also fallen, however our LPG business performed strongly in the face of these challenges, further validating our investment into the bottle swap operation over the last few years as we observed the change in customer choice and environmental factors. The bottle swap movements are up and we will be well positioned to meet this rising demand with the commissioning of a new bottle filling plant next year. The low global oil and gas prices make LPG export markets less attractive and this is likely to weigh on the Liquigas tolling operation.

The Kapuni field offers significant potential for future developments. Nevertheless, the short to medium term outlook for the gas wholesale business is closely linked to the outcome of current and pending litigation covering firstly the price Vector is required to pay for the next tranche of Kapuni gas, secondly the extent of reserves in the Kapuni field and lastly gas processing arrangements at the Kapuni gas treatment plant.

The electricity network has benefitted from increased connection and volume growth due to cooler winter temperatures in line with historic norms. However it would be wrong to believe that the volume growth we have seen in the 2015 financial year means the long term trend in falling consumption per ICP has bottomed out. Our analysis to date suggests this decline is set to continue. As I mentioned earlier, the decline over the last 10 years on a per customer basis has been 11%. Weather adjusted that drops to 7%, however there are significant room for further efficiencies, in particular the home consumption to continue that downward trend.

The stormy weather in winter and the fire at Transpower's Penrose substation have challenged our strong record for network reliability. As foreshadowed in February, we have informed the commission that we have breached the service quality requirement that we do not exceed the quality threshold two out of every three years. Meanwhile we continue to work with the Electricity Authority and Transpower on the investigation into the Penrose outage. Vector and Transpower have delivered our draft technical report into the outage to the EA, which is now completing its report and a number of other components of that report for the Minister of Energy and Resources. The investigation and reporting process being undertaken by all parties will ensure the cause of the outage is accurately identified and any necessary risk management improvements are being actioned quickly.

Looking at the trends in electricity EBITDA, growth in volume and connections in Auckland gave a strong lift to the financial performance of the electricity business, but price cuts to the regulated business to compensate for the one year delay to the start of the previous price quality determination cut revenue by NZD12.2 million. From April 1, 2015, the new price quality determination for the electricity network was put in place, giving Vector a positive 0.8% starting price adjustment, setting the maximum allowable revenue the network can generate for the year ended March 31, 2016 at NZD395 million. A High Court decision on Vector's use of Transpower's Auckland transmission network resulted in a NZD3.3 million unrecoverable transmission charge.

As we signalled in June, we have begun a strategic review of the gas transmission and gas distribution assets outside of Auckland. That review is ongoing and we'll report to the market on its outcome once it is concluded. We would note there has been very strong and positive interest in these assets. The assets which represent around 70% of gas transportation EBITDA are highly attractive, but we constantly review our portfolio and will always consider options which maximise value for our shareholders.

Price cuts on the gas transportation business introduced in October 2013 were largely offset by price increases in 2014. The detail of these price changes are at the back of the presentation. Transmission volumes are up 2.8% as increased customer transport in the Taranaki region offset the impact of the decline in thermal generation in the upper North Island. Mirroring the trends we saw in the electricity business, volumes in the gas distribution business were up 2.3%.

Slide 23. We expect this growth in Auckland to continue for the foreseeable future and this has significant implications for investment into our energy networks. In the coming 10 years, our forecasts are around about NZD1.8 billion of capital investment required for our Auckland energy network. With this investment ring-fenced into a standalone company, it would create the country's second largest energy distribution company after our existing Vector networks. This level of investment is critical, given Auckland's significance to the national economy and stands in sharp contrast to those regions that have little or no growth.

As we have previously indicated, we believe the current regulatory regime does not adequately recognise the rising risks due to advances in technology that new investments could be made redundant before they have delivered an acceptable return to investors. Furthermore, most distribution companies do not earn the returns allowed by the regulator, since actual energy volume growth and the rate of inflation have been consistently and significantly below the forecasts used by the commission to set our allowable revenues.

In the last three years, these forecasting differences have cost Vector NZD175 million in lost electricity revenue and earnings. Indeed, were these forecasts more accurate, Vector's adjusted EBITDA in the current year would have been much stronger. These factors, combined with the continued concern over the potential for significant change to the regime create disincentives to new investment. To invest in our energy network, we need confidence that regulatory environments will enable us to recover our capital, earn a fair return and recognise the significant changes and risks we face looking forward.

The Commerce Commission is reviewing the key inputs that determine the prices Vector can charge for use of its networks. We have had positive discussions with the commission over customer adoption of new technologies and the impact of this on network infrastructure investment. We look forward to those positive conversations continuing. We are firmly of the view that the regulatory environment needs to recognise that however Auckland is a special case. We believe infrastructure provider should be able to reach binding long term special undertakings, whether it be Vector or other infrastructure providers, that enable investment in the face of these challenges and particularly in large growth situations.

Such arrangements which are already working in some success in the UK and Australia could allow Vector and others to seek credible long term tailored regulatory commitments which aim to match the asset life and expected recovery times of either existing or new infrastructure investment. Vector is meanwhile advocating on behalf of Auckland consumers against the Electricity Authority's recently announced proposed transmission pricing options, one of which could result in Auckland households and businesses bearing a much greater share of Transpower's electricity transmission costs.

The Electricity Authority's base option would result in a 59% increase in transmission costs in Auckland rather than being borne, as we believe, by generators. It is unfathomable that a generator located at the bottom of the South Island can supply energy into Auckland and not have to pay for



the use of transport. The price customers pay for the energy may in fact reduce if generators had to pay transfer for transporting their energy to their customers.

Turning to the outlook for the remainder of the year, Vector continues to benefit from its position as a provider of essential infrastructure to Auckland and the economy's [powerhouse]. We expect capital expenditure in Auckland to increase in the coming year in line with the significant increase we are seeing in new electricity connections. We continue to focus on customers with investments in new technologies such as solar, batteries, electric vehicle charging infrastructure and home energy monitoring services. We are confident of continued growth in our metering business and our bottle swap operation. We expect to install a further 140,000 smart meters in New Zealand and the first tranche of meters in Australia.

Our gas wholesale business still enjoys a strong position in the market but faces increased competition, uncertainty over the quantity of gas reserves remaining in the Kapuni field and the price we pay for gas. It also faces tighter margins due to weaker global oil and gas prices and weaker demand from the major electricity generators. Nevertheless, we are confident of meeting analyst expectations of adjusted EBITDA for the 2016 financial year, which range from NZD605 million to NZD620 million. Excluding capital contributions which are volatile and driven by developer and relocation activity, we expect adjusted EBITDA to range between NZD550 million and NZD565 million.

I'd like to now hand over to the moderator for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator instructions) Your first question comes from the line of Matt Henry from Goldman Sachs. Your line is open, please go ahead.

Matt Henry - Goldman Sachs - Analyst

Morning, Simon, Dan. A number of questions. You sort of mentioned the ongoing impact of efficiency. Are you able to give us any colour on specifically what do you think are the drivers of efficiency and what are the most material impacts on efficiency and whether you're also seeing that trend in the commercial industrial space, or is it most pronounced in residential?

Simon Mackenzie - Vector Limited - Group Chief Executive

Yes hi, Matt. Yes we've been doing a significant amount of analysis on this. I guess once we back out of the 11% residential (inaudible) then we get to around 7% on the adjusted decline for residential. If we deconstruct that, interesting enough, a lot of people thought housing had a big -- sorry, heating had a big impact on that. It's been a less impact on that reduction. The key reduction has occurred through renovations of homes. It's been new appliances. So we've been able to get a lot of information around new appliance and where that's located across -- where that -- people have adopted those across Auckland and looking forward, there's still further big efficiency gains to probably be driven through the likes of LED lighting in particular.

In the commercial sector, we're seeing that mainly through operational practices with better information on energy consumption and customers looking to install again lighting solutions and/or manage their production in better ways so they don't create so many peaks on their demand.

Matt Henry - Goldman Sachs - Analyst

Okay thanks. Second question, on Australia, can you just give us some colour around how much capital you'd be prepared to commit to that market and I guess what a target gearing level looks like, how much balance sheet capacity you think you've got available?



Dan Molloy - *Vector Limited - CFO*

G'day mate. It's Dan. Thanks for the question. Look I guess it all depends on how the market shapes up and what contracts we end up getting. We're expecting to put meters on the wall. You know, there will be a different cost base to New Zealand mainly due to installation costs which are looking more expensive in Australia but you know, until we see how the contracts shape up, it's really impossible to know.

Matt Henry - *Goldman Sachs - Analyst*

Okay on that opportunity, is it -- how do we think about it? You know, is it simply a return on asset type investment? You know, is this going to be a cost of capital type shootout or do you think you can bring something more to the offering beyond price?

Dan Molloy - *Vector Limited - CFO*

Yes look, I think that the thing that we're really finding over there at the moment is we can talk to a very credible track record about what we've done in New Zealand and how we've delivered on our contract in New Zealand and how the market has evolved in New Zealand and it's really seen -- over there is a real success relative to the sort of market -- the rollouts in Victoria which was a [distributive] model. So look, I think we've established a lot of credibility. People are looking at the this sort of service stack that we've rolled out in New Zealand. And if you sort of look at the power of choice project that is -- that -- they're really focusing in Australia around demand response and a whole lot of other initiatives, then smart metering is the real key to unlock that and some of the things we've done in New Zealand sort of speak very well to what they want to achieve there.

Matt Henry - *Goldman Sachs - Analyst*

Are you hearing at all whether there's other people sort of actively engaged in discussions over there? Or are there many people engaged?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

It's a relatively big market opportunity so there's definitely going to be competition. Look, you'll probably see some of the big generator retailers potentially go their own way, but I think you'll also -- there's very much a space in the market for the model that we're operating in New Zealand.

Matt Henry - *Goldman Sachs - Analyst*

Okay thanks and maybe just a last one. Are you able to give us any sort of colour around, you know, what the economics of solar and battery look like and whether you think there's the potential for these things to be competitive on price alone?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Hi Matt. Look, I think the reality is we've often said is that as solar is still a product that we're seeing customers choosing. It's not necessarily being chosen primarily on the spend alone economics of it. So it's interesting that there's still significant growth in that market and it rests back on the point that we make around customers are wanting choice and the price is not always the primary reason why they want choice with regards to solar. A lot of the research that we have is that they want to actually feel they have control over their own energy, that they have a concern about future energy prices increasing, that they have -- in many cases they have environmental perspectives.

So in the New Zealand market without those feed in tariffs that we see in many other markets, obviously it's quite a different proposition. We don't necessarily package solar and batteries together. We see batteries have a raft of other solutions, you know, in the residential space then yes, there is the ability to link those up with solar. So as you put the energy into a -- in a time zone coupled up with some of the new retail offerings out there that makes sense for customers that want exposure to wholesale. We also see that there's a raft of other opportunities where there's existing battery

solutions out there that are of an old technology, that these batteries will displace and actually displace a significant amount of other support equipment around them.

Then as we mentioned in the commercial space, there's also a -- sorry, commercial and/or network space, there's the ability for the batteries to displace traditional solutions such as UPS systems, uninterruptible power supplies, diesel generators and also potentially into the network side of -- meaning that we can cover peak demands through charging and discharging at peak times and [zone] substations rather than actually deploying a significant amount of capital into traditional cables and transformer.

Matt Henry - *Goldman Sachs - Analyst*

Okay great. Just are you able to give us any colour around what you think the economics of solar look like today?

Dan Molloy - *Vector Limited - CFO*

Matt it's -- I guess it depends on so many factors but from a residential perspective, where we see the key benefit of solar at the present time is that it enables you to increase your self-consumption. So generally with solar you're obviously generating power during the day. Most people aren't at home during the day so the advantage of the battery is that it lets you load shift, let's you use that solar generation rather than being exposed to the really low export tariffs that are currently in the market. So effectively the combination of the battery lets you significantly improve the economics of your solar.

Matt Henry - *Goldman Sachs - Analyst*

Okay look I'll leave it there. Thanks.

Operator

Your next question comes from the line of Grant Swanepoel from Craigs Investment. Your line is open, please go ahead.

Grant Swanepoel - *Craigs Investment - Analyst*

Morning Michael, Simon and Dan. Can I just -- I've got a couple of questions. Just the first one following on from Matt on the economics of the PVs and batteries. You guys spent quite a bit of time on the presentation. Just wanted to push you a little bit harder on the economics of them right now. Do they stack up against the gen-tailers or is this just still a gimmick for now and in a few years' time it might be economically viable?

Second question on that, the development costs and start-up costs of bringing the batteries in et cetera, are you going to be able to put any of that cost against your regulatory expenses? Then just following, metering, you've got NZD4.2 million of extra costs that are due to technology and other. Can I assume that's not normal over time or will there be some more of that in FY16? Then the final question, on your gas wholesale, if we assume that the Kapuni determination is okay, that you haven't overused and that you don't get a new price on the Kapuni, what is the normalised EBITDA we'll expect from that without further Kapuni gas? So there's my questions, thank you.

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Yes hi, Grant. I guess with regards to -- try and recall the first question, that you're asking more about the solar and battery. I think the first starting point we take from this is that we put a lot of focus on batteries probably primarily and solar, we recognise in the New Zealand market that solar is still, as I said to Matt, is -- the price is not the key consideration. If we look at that, then the install costs of a solar unit is probably still above the install cost of a -- sorry, is -- the delivered cost is still probably above what you get in the wholesale market.



However I think that the important point to note here is that many people can focus too much on what would be seen to be the rational market kind of pricing and economics. What we're seeing is quite a change with regards to consumer demand (inaudible) and perspective around what they want to do on their own [light] and I think that we've seen that occur in Australia where even when feed in tariffs were removed, energy prices -- energy -- solar installations were still increasing about 10% per annum.

So the cost of solar and installations still continues to decline. Where that ends up, we don't know but we believe we have to understand not only what that option means for consumers but what it also means in the operations of our networks. When we go into battery, as you've probably seen, the battery pricing currently sits in Tesla at about \$3500 for their Powerwall solution, that's \$3500. Those prices are expected to halve in the next two and a half to three years so we should see a significant downward trend in those. And the applications of the batteries we don't see as just being connected with solar as mentioned earlier.

There's a raft of solutions such as where people need to increase their consumption or their demand in their premises. There's a lot of displacement of existing battery technology that needs to be met and then when we get into the utility space, they are clearly and have been becoming more and more prevalent now in networks overseas, batteries being utilised for demand response or providing energy solutions into like the frequency keeping market. Globally PJM are big on this over in the States and also we have a number of zone substation areas where these battery solutions will be deployed as opposed to expensive network upgrades.

So the ability to put into our asset base, yes the -- we are able to put in, in our view, the network related batteries because these will go into provide a substitute for what would have been a traditional network investment. Dan, you've got the second--

Dan Molloy - *Vector Limited - CFO*

So Grant, to your question on metering, so you -- I think on slide 16, the graph there you're referring to the NZD4.2 million of other costs. So you're right, that includes expenditure on our Australian initiative and it also includes some of the work we're doing, the R&D we're doing around these new technologies. So including batteries, home energy management and solar. Look I would expect -- or we expect that we are going to have to keep spending in Australia over the coming year. We have some more work to do to complete our accreditation and one of the requirements of that accreditation is you pretty much have to stack up an operating business model before you can go and get customers.

I think your last question was on Kapuni and what we're expecting this year. So I think EBITDA or segment earnings out of gas wholesale this year were around NZD47 million. Look, I think we'd be this year something in the order of NZD40 million but obviously that's subject to a number of provisos. One of them is obviously oil prices which as of now are down around \$40. Other ones obviously post-(inaudible) and that will have a material financial or potentially will have a material financial impact. So look, in terms of actually answering your question about what a sort of normalised earnings estimate is for that business, it's just -- it's very hard to give you that.

Grant Swanepoel - *Craigs Investment - Analyst*

Thanks Dan. Just back to the batteries. I know we're just not letting it go, are we? Are you expecting to install 500 or 10,000 or 100,000 per year type quantum?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

I'm not too sure what you mean as in kilowatt hours or -- (multiple speakers)

Grant Swanepoel - *Craigs Investment - Analyst*

Sorry Simon. I'm just talking about how many of these--



Simon Mackenzie - Vector Limited - Group Chief Executive

From our perspective, the area we primarily see in the network space will be large scale megawatt, two megawatt, four megawatt type combo solutions. In the residential space, we've got the original 130 coming out to the energy program that we're doing. We've had a fairly large demand of people just registering on our website which is up now near around about 700 people registering this, not only in Auckland but also across the country.

Outside of that, as I mentioned the -- what we're doing through is still scoping the size of the market. There's a significant amount of batteries that are utilised in other applications that are for example UPSs, [stand-by] power systems and also just control system requirements where there's a -- we've already seen quite a strong demand for the Tesla type of battery solution to be deployed into those rather than the traditional lead-acid batteries. Why that is, is because in many circumstances, the cost is cheaper, the operational characteristics are much better and they don't need a lot of supporting equipment such as heating and ventilating to maintain their operational levels.

Grant Swanepoel - Craigs Investment - Analyst

Thank you.

Operator

Your next question comes from the line of Stephen Hudson from Macquarie Securities. Your line is open, please go ahead.

Stephen Hudson - Macquarie Securities - Analyst

Hi Simon, hi Dan. Firstly just a question for Simon. You referenced a sort of special undertaking that you might be proposing. I just wondered if that was going to be similar to sort of a flat nominal return PPP type solution, given the sort of technology risk that you've identified for your networks.

Then just a couple of questions for Dan. I guess I'm just interested in the current net debt to EBITDA ratio. It's targeted by Standard & Poor's for your BBB and also whether or not that's sort of face value or reported value of debt? Then just secondly, on customer contributions, they're obviously going to be about NZD55 million this year. If you can just remind us of the regulatory treatment for those amounts, that would be great too.

Simon Mackenzie - Vector Limited - Group Chief Executive

Sure. Hi Stephen, the -- we don't actually think a PPP type arrangement is in any way, shape or form the type of tool that is appropriate for what we see in Auckland. As mentioned, we're expecting network investment of about NZD1.8 billion over the next 10 years just to facilitate the growth expected. So what we're talking about a special undertaking has been used in some other markets, we're essentially there as a -- the input methodologies are largely locked in. They don't get reopened on a regular basis and they're locked in for a reasonably long period of time, you know, 20 odd years of limited ability to reopen them. That gives the confidence on the cash flow.

The other aspects that can get adjusted on the way through are for example is to shore up things such as volume forecasts and TPIs so we don't wear these significant reductions off the back of forecasts that haven't translated into the reality of the situation, as well as the ability to flex the CapEx up and down as the growth essentially materialises or doesn't materialise. So it's actually a longer term framework to give us confidence that we can go to the capital markets and invest to undertake the growth as opposed to sitting with these constant reviews, reopeners and changes to some of those input parameters.

Stephen Hudson - *Macquarie Securities - Analyst*

So just as a follow up, the prospect of sort of getting kind of a flat 7% sort of nominal return as opposed to sort of a rising 5% real return, you know, isn't enough for you. You're more sort of focused on, as you say, locking in IM certainty over decades.

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Yes I mean absolutely because I mean the other aspect for us is the certainty about the cash flow profile as we've constantly said. We've had problems with regards to the way in which the re-evaluation occurs from a cash flow perspective, particularly when that gets coupled up with the potential risks around technology. So we're looking for a much -- a profile which -- sorry, a methodology which takes into account all those issues, else it becomes extremely difficult to basically operate. A CPP is realistically just a modification of the current DPP in so much that when you choose to take one, you get the WACC that's prevalent at that point in time based on the cost of debt and other than that, you might get a five year window but it doesn't address some of the fundamental issues that we are seeing as problematic to investment.

Dan Molloy - *Vector Limited - CFO*

Steve, it's Dan. Your question around gearing, so I guess it just -- firstly obviously with these sort of at first face, mark-to-market movement, they swing profits around quite a bit. From Vector's perspective, you know, we hold our debt to maturity. We lock in currency rates when we take it out. So over the lifetime of the debt instrument, obviously these derivative movements net to zero. The rating agencies look at debt in a very similar manner in that they look at the face value. So we've got two primary ratings metrics and that's FFO to total debt and FFO interest cover.

I can't remember what your third question was.

Stephen Hudson - *Macquarie Securities - Analyst*

Sorry just on that one, Dan. So can you give us an idea what S&P are targeting for your BBB on either of those metrics at the moment?

Dan Molloy - *Vector Limited - CFO*

Yes I can. So FFO total debt, I think it's -- we're sitting in the sort of in the 12%, around 12%. S&P is -- or target is 9%. So above 9%, we're in BBB territory. Below 9%, we'd be in BBB- territory. (Microphone inaudible).

Stephen Hudson - *Macquarie Securities - Analyst*

Thank you. That's great. Sorry--

Dan Molloy - *Vector Limited - CFO*

I can't remember what the interest cover covenant is off the top of my head.

Stephen Hudson - *Macquarie Securities - Analyst*

No, that's fine. Sorry my last question was just around capital contributions. There's obviously quite a large amount at the moment, NZD55 million I think is the guidance the next year. I think you have to amortise that over a 10 year period, I can't quite remember. Just wondered if you can give us a bit of a brief refresh on the regulatory treatment for those CCs.

Dan Molloy - *Vector Limited - CFO*

One of the reasons we've provided a bit more information on capital contributions is because we recognise for you guys it's really hard to forecast them. They are abnormally high at the moment due to some really big relocation projects around the gas transmission business. Transmission Gully and MacKays to Peka Peka and few projects like that. So from a reg perspective, they are netted off against the RAB and I think, you know, we are not likely to -- beyond sort of next year, we're not likely to see the current level of contributions for relocation.

Stephen Hudson - *Macquarie Securities - Analyst*

Okay, thanks guys.

Operator

Thank you. Your next question comes from the line of Greg Main from First New Zealand Capital. Your line is open, please go ahead.

Greg Main - *First New Zealand Capital - Analyst*

Good morning guys. Just a couple of questions, mostly around the metering business. I guess we kind of look at that business as sort of like a return on asset business at the moment. But I guess going forward -- what I want to understand is whether you're getting much benefit from all the data that supposedly these meters are capturing and benefitting from? And are the contracts that you have with the retailers, is there a split between just using the meter from an access point of view as opposed to using other services off the meter? If there is, are you getting much revenue from data services off the meters at the moment?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Yes, hi Greg. The metering business I guess from our perspective does follow (inaudible) business, but we've got a return asset (inaudible) the way in which we look at the business is split between the physical nature of data services, the data services being primarily at this point in time which we're seeing starting to increase but it's primarily been the provision of what we call the base level services of essentially the billing data being provided to the retailers and also some functionality such as disconnect and reconnect and other related services. Potential there to move more into the pre-pay solution provision.

What we also recognise is -- then we're seeing more and more now coming through. There's a split between information that the retailers see as valuable but the meters can also collect network information. And off that network information, we've been doing a significant amount of work ourselves around how we can utilise network information data to drive a lot more operational efficiencies and look at how we can proactively repair or get on top of maintenance or customer events before they have to call into call centres which obviously saves both parties. Those are services that we expect. The model being that you know the baseline return on the actual meter on the wall will stay the same and developing a suite of services and products above the baseline data services that as the customers require them, whether they be the retailer or [FLs] as a network operator.

Dan might add something else to --

Dan Molloy - *Vector Limited - CFO*

Simon, the only other thing I'd add is yes, we've definitely built this business up by being an asset owner and so you know, your question around return on asset play is fair. I guess going into the future it doesn't necessarily need to be like that. You'll see that we're starting to roll out meters

over this year for the SmartCo consortium and those meters won't be owned by Vector. They'll be owned by the individual networks and we'll be providing the smart services for them.

Greg Main - *First New Zealand Capital - Analyst*

Yes, well has the data sort of revenue stream I suppose that you're earning off the meters, has that evolved as what you thought it would, if you go back say three years? I know that you're rolling out smart meters still, but has the actual data side --

Dan Molloy - *Vector Limited - CFO*

Look I think it's better to say that we were expecting a level of services type of revenue and that sort of goes up and down depending on what's happening in the market. I think it's very early days for the data revenue streams. It's not a significant part of the business as yet but I think, you know, definitely focused on it as a significant opportunity.

Greg Main - *First New Zealand Capital - Analyst*

Right. So if you're going into Australia knowing what you know now, I mean how are you kind of looking at that proposition? As in mostly just an asset type play or do you think there is an inherent data or services value that you actually can capture over time?

Dan Molloy - *Vector Limited - CFO*

To be honest Greg, I think the retailers are -- in Australia, they're a number of steps behind on the smart metering place so very much that they're just starting to get their heads around the fact that come 2017, they're going to be responsible for metering and will have to be able to provide metering for new connections and replacement meters. So look, I -- obviously we think they're going to be more focused on rolling out those meters, you know, getting the benefit of remote reading and some of those things and I suspect that the data stuff will evolve subsequent to that.

Greg Main - *First New Zealand Capital - Analyst*

All right.

Simon Mackenzie - *Vector Limited - Group Chief Executive*

So the data like the -- to Dan's point, got the SmartCo kind of model where other parties install the meters that we provide the data services. We expect Australia to roll out in a similar way with regards to that separation between the meter and the data layer and that's important also to manage the switching risk of meters because in some cases we also through the data management layer expect the outputs from other parties' meters.

The -- I think what we're also seeing and had discussions around is other meter providers outside of electricity, that are also interested in not having to basically build their whole data systems as well. Just think as we see the market mature more and more with regards to different products and services out there in the retailer, it makes sense for us to have a base layer of service and then price other options on top of it, whether these be, you know, retailer information or network information type services -- information and control, I should say.

Greg Main - *First New Zealand Capital - Analyst*

Okay. Cool, thank you.



Operator

Your next question comes from the line of Andrew Harvey-Green from Forsyth Barr. Your line is open, please go ahead.

Andrew Harvey-Green - Forsyth Barr - Analyst

Morning guys. Just a couple of questions from me. First of all just on the battery side of things, can you just explain the business model you're using there? Are you going to be taking on volume of risk buying and a whole bunch of particularly I guess the residential and (inaudible) type product and then hoping to sell them or are you going to be doing very much a sort of an order basis? Once the order comes in, then you'll procure the battery?

Simon Mackenzie - Vector Limited - Group Chief Executive

Yes hi Andrew, Simon. So I guess with regards to that, you know, we've certainly got areas now where we've got customers that are already putting their hands up or for the batteries. We're obviously still scoping. The market is much wider than what we'd anticipated with regards to other applications for the battery. I think it'd be fair to say that it primarily will be looking at not bringing in huge volumes and then trying to sell them. Our focus will be very much on matching the quantities we bring in with the expected demand and/or the contracted demand from customers.

Essentially you know at the moment we're bringing in two container loads which is around about 250, 300 of the units which we have envisaged having no problem deploying those. Then on the large scale, large scale battery solutions as mentioned, you know, they'll be deployed in their own network and potentially other networks across the country. We would be bringing those in on a, you know, once a contract has actually been entered into and we had certainty around that.

Andrew Harvey-Green - Forsyth Barr - Analyst

Yes okay. My second question is just around I guess the impact of Otahuhu closing and that there's a -- has a reasonable revenue stream on the gas transport side. I presume that will have an impact on your FY15 (sic) numbers and you haven't been able to I guess really smooth that out to other customers and so are you able to give me -- give us a little bit of feel on I guess how quickly you might be able to do that over time?

Dan Molloy - Vector Limited - CFO

Thanks Andrew. It's Dan. Look I guess we're in a relatively privileged perspective with the gas transmission business in that it has a revenue cap, so we can recover that in the next -- we won't suffer any loss in 2016.

Andrew Harvey-Green - Forsyth Barr - Analyst

Okay. So that's already been factored into other customers' prices in there?

Dan Molloy - Vector Limited - CFO

Our prices haven't been announced yet but it will be.

Andrew Harvey-Green - *Forsyth Barr - Analyst*

It will be. Yes. Final question is just around I guess the discussion of the Commerce Commission on those SAIDI breaches and just giving a little bit more flavour about where you're at with those and what the Commerce Commission is coming back to you with. I mean are there any sort of potential implications other than sort of closer scrutiny on what you're actually doing around the maintenance side?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Yes look, it stands at the moment we've obviously alerted the commission to the fact of these breaches. We alerted them much earlier in the year because it was evident off the back of the significant weather events that we were going to breach them, not unlike a number of other companies across the country and they haven't actually come back with anything in particular. They will go through their process of reviewing what information they seek from us. We'll provide that information and you know, they just go through that process which could arise in asking us to keep a closer eye on something or they may find nothing of concern and just recognise that the predominant issues were weather the other obvious contributor was the Penrose substation which is subject to the report that we're doing with the Electricity Authority.

Andrew Harvey-Green - *Forsyth Barr - Analyst*

All right. Great. Thanks for that.

Operator

(Operator instructions) We have a question from Kate Barker from Energy News. Your line is open, please go ahead.

Kate Barker - *Energy News - Media*

Morning guys. I've just got a couple of questions. First of all I just wanted to know in terms of the interest that's coming in for the gas distribution and transmission assets, is that interest coming from organisations in New Zealand or is it coming from more offshore people?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Yes, coming from both.

Kate Barker - *Energy News - Media*

Right. What kind of timeframe are you looking at for confirming and making an announcement around that?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Well I think the first thing is that we -- is we're very clear that as we identified, it's a strategic review. There's been no decision made obviously. We're working through with interested parties the process. We're expecting timeline wise to have reached the end of that phase of the process around about the middle of October and all going well, we should be able to give an update at the annual general meeting which is scheduled for around about the 23 -- October 22 or 23.

Kate Barker - *Energy News - Media*

Right, okay. With the Penrose report, now that that's gone off to the EA, what does Vector do now? Do you wait until the EA send their report off to the Minister and see what the outcome is? Or is there any work that Vector does in the interim while an outcome is waited for?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Yes. Kate, the process is basically we've provided that report to the Electricity Authority. The Electricity Authority and their people within the Electricity Authority that are working through that. We have regular dialogue and meeting with them as they go through it and they ask questions and basically probe into different areas of the report that they wish to understand. There are a number of other reports that they've also received from other parties. They also have to work through other parts of their process such as the economic impact. They want to understand the way in which customer response works.

So all those areas are still being worked on and we continue to fully engage with them through their process to a point where I can't speak for them, but they'll obviously have finished with all their inquiries and then they'll finalise their report and provide it to the minister who he himself may have some queries and as we understand, he'll release it when he's basically finished his line of inquiry and that, you know, closed everything up that they needed to under the terms of reference.

Kate Barker - *Energy News - Media*

Right, okay. Just with the Powerwall batteries coming in, just after a bit more detail about what Vector's looking to do with the deployment of batteries on the network. Are there any details around how many you're looking to deploy and what size of them and whereabouts on the network?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Well we're still -- we've got a couple of areas where we're looking at deploying these batteries. They'll be in around about the two to four megawatt storage capacity range. They will be probably in the latter part of next year, mid to latter part of next year. The point as discussed earlier is that in a number of these areas where they'll be deployed and a zone substation whereby that area is either experiencing some growth that may necessitate a network upgrade.

Typically those types of situations though are just short periods of demand that you'd have to cater for with a traditional network investment but by being able to put in four megawatts of load at the substation rather than the transfer capacity from the Transpower grid exit point means that we can defer and in many cases avoid the need to put those transfer cables from the Penrose grid exit point for example to a substation and avoid a significant amount of capital investment in order of magnitude. In one case in particular we're looking at the solution -- the traditional solution would have been priced in the order of about NZD10 million and the battery solution is in the order of about NZD3 million.

Kate Barker - *Energy News - Media*

Right.

Simon Mackenzie - *Vector Limited - Group Chief Executive*

So a significant capital reduction which will obviously a) still provide the expected level of service but b) lower the costs from a network perspective and obviously that flows through to consumers in the long run.



Kate Barker - *Energy News - Media*

Yes, yes. What's the current cost (inaudible) against the larger size batteries?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Well it's very dependent on a number of things. I mean to be fair, we're still working through a lot of those pricing details on the larger batteries because it depends on the combination of the battery capacities that you want for the specific solution and the type of control arrangements you require. So typically it's reasonably close on a per kilowatt basis to the Powerwall solution because the actual chemistry of the batteries themselves are pretty similar, but it's the control environment that we still have to finalise. In that case we're talking a 2.5 megawatt solution for that number I quoted just before.

Kate Barker - *Energy News - Media*

Yes. Okay and has Vector been in discussions yet with any of the other networks around New Zealand about deploying these batteries?

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Absolutely. There's been a number of other networks that we've spoken with. A number of networks contacted us. They see it very viable for their solutions as well and it'd be fair to say that that's a -- if you look at the global trends, I think that's something that Tesla have found has equally caught them slightly by surprise. There's just a significant demand for these types of solutions, not only in markets such as California to couple up with solar but also a significant amount of demand in the networks environment. Some markets in the States in particular are looking at large scale battery storage to avoid significant peak and smooth out a lot of the network issues and it'd be the same in Australia, particularly up in the Queensland area where they've had a significant penetration of solar which is causing them network anxiety.

Kate Barker - *Energy News - Media*

Oh right. Thank you for that.

Operator

There appears to be no further questions on the phones. I'd like to hand the call back over to you gentlemen for any closing or additional remarks.

Simon Mackenzie - *Vector Limited - Group Chief Executive*

Well thanks very much everyone for joining us and if there's no further questions, we'll end the teleconference and webcast. If analysts have any further questions, please contact Dan and if media could contact Sandy Hodge. Thank you very much for joining us and we look forward to updating you at the half year.

Operator

That does conclude today's call. Thank you for your participation. You may all disconnect.



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