



# Dear Shareholder

26 March 2015

## TĒNĀ KOE (GREETINGS)

The first half of the 2015 financial year was a transitional period for Contact as the new retail customer billing and service system and the Te Mihi geothermal power station were integrated into the business following their commissioning earlier in 2014.

Contact's statutory profit for the six months ended 31 December 2014 was \$51 million; \$61 million (54 per cent) lower than the prior corresponding period. This was primarily due to an unfavourable movement in the fair value of financial instruments and transitional costs from the Retail Transformation project and associated activities. This was further impacted by EBITDAF reducing by \$7 million (3 per cent) to \$257 million, predominantly due to a \$20 million reduction in retail margins as a result of the continued intensity of retail competition. Through our capital investments and with the progress made during the first half of the 2015 financial year Contact is well positioned to improve performance and remain competitive in the New Zealand market.

We have announced that the interim distribution to shareholders will remain stable at 11 cents per share. The distribution represents a payout ratio of 106 per cent of underlying earnings after tax.

## OVERVIEW OF RESULTS

	6 months ended 31 December 2014	
EBITDAF <sup>1</sup>	\$257m	down 3% from \$264m
Profit	\$51m	down 54% from \$112m
Earnings per share (cents)	6.9 cps	down 55% from 15.3 cps
Underlying earnings after tax (UEAT) <sup>1</sup>	\$76m	down 22% from \$97m
Underlying earnings per share (cents)	10.4 cps	down 21% from 13.2 cps
Interim dividend (cents)	11.0 cps	no change from 11.0 cps
Underlying operating cashflow after tax (OCAT)	\$227m	up 31% from \$173m
Free cash flow	\$180m	up 51% from \$119m
Capital expenditure	\$48m	down 69% from \$153m

## EMBEDDING OUR RETAIL CUSTOMER BILLING AND SERVICE SYSTEM

Following the go-live of our new retail customer billing and service system we have made considerable progress in stabilising the system and the processes that support it. A system change of this size always creates challenges and I am pleased with the way we have been able to manage this process while holding sales volumes stable during a period of continued intense competition and price discounting.

## INTEGRATING TE MIHI GEOTHERMAL POWER STATION INTO THE BUSINESS

We have now successfully integrated the Te Mihi geothermal power station into our generation portfolio which saw our renewable generation increase from 68 per cent to 76 per cent. Work completed during an extended outage at Te Mihi has lifted the performance of the plant above original specifications and this, combined with improved availability across the remainder of our power stations, is expected to further reduce our cost of energy.

1. EBITDAF and UEAT are non-generally accepted accounting practice (non-GAAP) profit measures. EBITDAF is calculated as statutory profit for the period before net interest expense, tax, depreciation, amortisation, change in fair value of financial instruments and other significant items. UEAT is statutory profit excluding items that do not reflect Contact's ongoing performance. The CEO monitors EBITDAF and UEAT as key indicators of Contact's performance and believes they assist investors in understanding the performance of the core operations of the business. Reconciliations of EBITDAF and UEAT to statutory profit are provided in Note 2 of Contact's financial statements for the 6 months ended 31 December 2014 (available at [www.contactenergy.co.nz/halfyearlyreports](http://www.contactenergy.co.nz/halfyearlyreports)).

## COMPETING STRONGLY IN AN INTENSE RETAIL MARKET

The retail electricity market remains highly competitive. Maintaining sales volumes has been important to us as we grew our share of the small business market, and cooler temperatures drove a one per cent increase in residential usage per customer. This was partially offset by residential customer losses as we reduced sales activity during the implementation of our new retail customer billing and service system. We resumed marketing activity late last year with early signs of success and 931 customers gained by the end of February 2015.

## MAINTAINING A STRONG HEALTH AND SAFETY CULTURE

We remain focused on the health, safety and well-being of our people. Our people worked over two million hours during the period with five people hurt. While this is still five more than we want, our year to date Total Recordable Injury Frequency Rate has improved to 2.4, down from 3.9 in the prior period. We have also launched an integrated programme of work to further improve process safety performance and capability, simplify safety systems and advance our safety culture.

## LOOKING FORWARD

Our capital investments have positioned us well for the New Zealand market with limited need for further investment in the operating business.

Following a transitional period in the six months to 31 December 2014, we expect to see improvement in the second half of the 2015 financial year. Improved Te Mihi power station performance, combined with changes to the existing Wairākei resource consent are expected to increase our geothermal generation to over 1,600 gigawatt hours for the six months to 30 June 2015. The increase in renewable generation, subject to hydrology, will allow further reductions in our use of gas-fired generation and the cost of energy. New natural gas and LPG contracts will reduce costs and, along with Ahuroa gas storage, provide flexibility to cover any shortfall in hydro generated electricity.

In the retail business, our new customer billing and service system provides a platform for efficiency and innovation in a highly competitive market. One-off impacts due to changes in network billing timing are not expected to repeat going forward although retail margins are likely to remain under pressure.

In the 2016 financial year I expect a reduction in the cost to serve our customers that will provide a positive contribution to profits above the increase in interest and depreciation costs from the new system. The supply side of the business will continue to focus on efficiency and availability. The new Te Rapa contract, utilisation of our diverse and flexible fuel and asset portfolio, and wholesale prices that reflect the reduction in oversupply are all expected to add to profitability.

Moving forward Contact will be a strongly cash generative business, providing new opportunities to create value for shareholders. The New Zealand electricity market is mature with no material growth in electricity demand expected and risks around the future of the Tiwai aluminium smelter, and continued erosion of retail margins. Given this context we have begun to investigate opportunities to invest overseas.

When we made the announcement in mid-February that we were looking at opportunities to invest overseas we saw a negative response from investors through a drop in our share price. As a management team and Board our focus is on creating and delivering long-term value for our shareholders and we see international markets as providing the best opportunity to leverage Contact's long history in geothermal and hydro development and operations. At this point we are investigating options to best utilise our skills and experience in international markets with our initial work indicating there could be value adding opportunities for us to pursue. This investigation is at an early stage and I will continue to speak with a wide range of investors about the opportunities we see and the appropriate balance between distributions to shareholders and investing for growth.

Our priorities remain the safe operation of our business, providing customers with the quality of service and products they expect and creating long-term value for our shareholders. Overall, I believe we are now well positioned to perform in the New Zealand market. Thank you for your ongoing support of our company.



*Dennis Barnes*

**Dennis Barnes**  
Chief Executive Officer