ETNZ
ENERGY TRUSTS OF NEW ZEALAND

Energy Trusts of New Zealand

Capital: it’s cost and availability

28 November 2008

ABN·AMRO

Disclaimer

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Agenda

1 Capital markets environment

2 Cost of capital update

3 Trust mergers: aligning local resources

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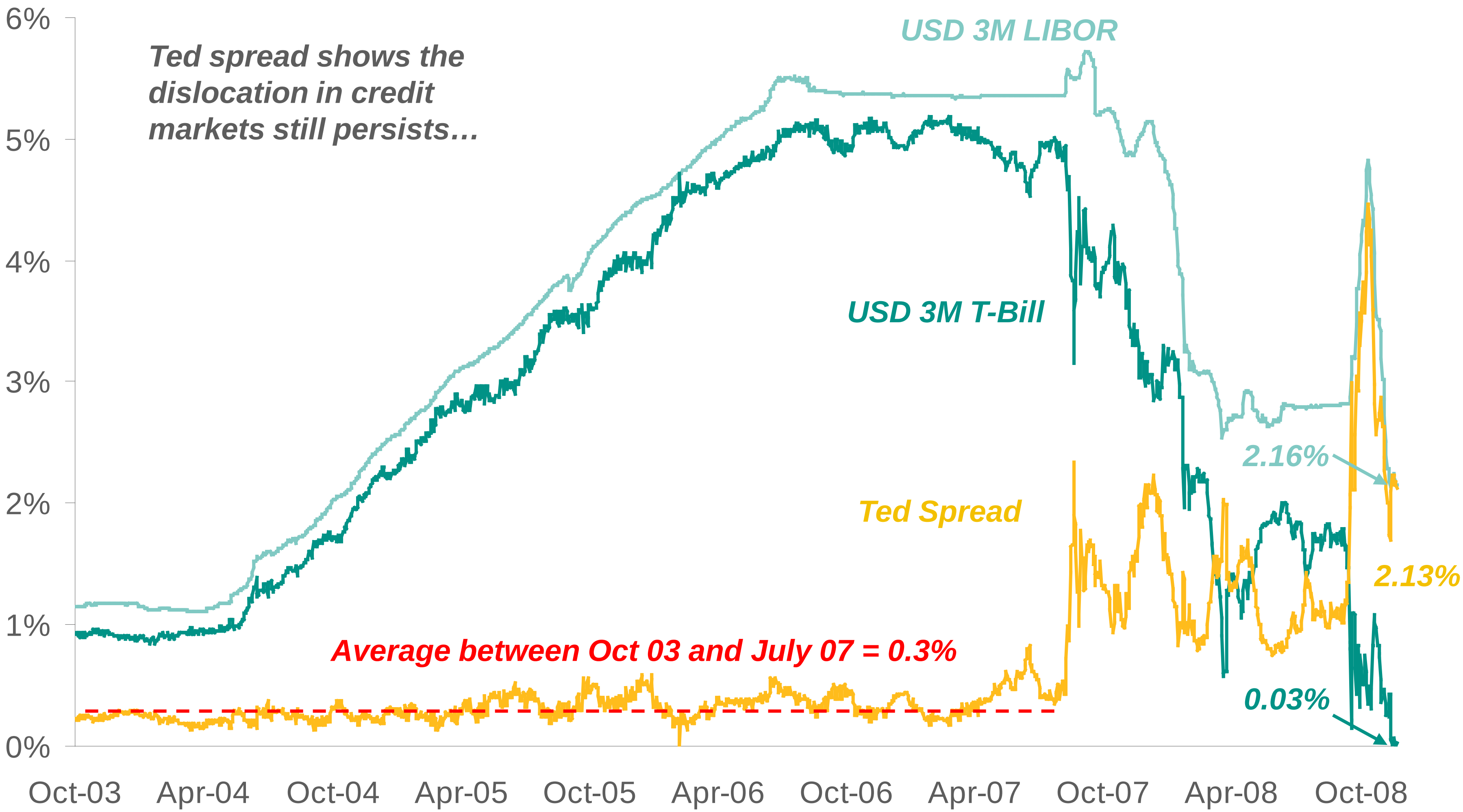
1 Capital Markets Environment

Ted spread and the credit crunch



Source: Bloomberg at 21 November

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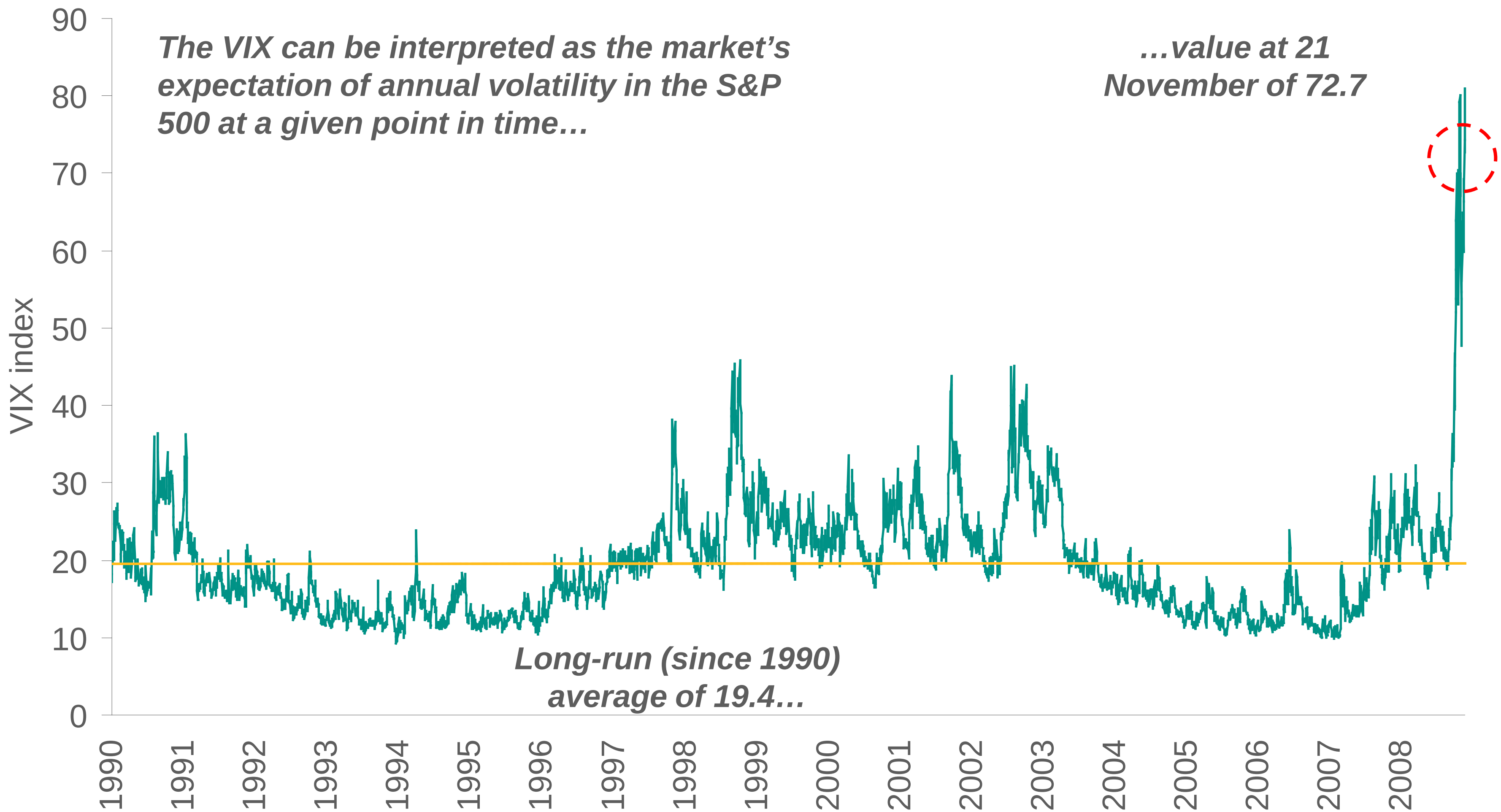
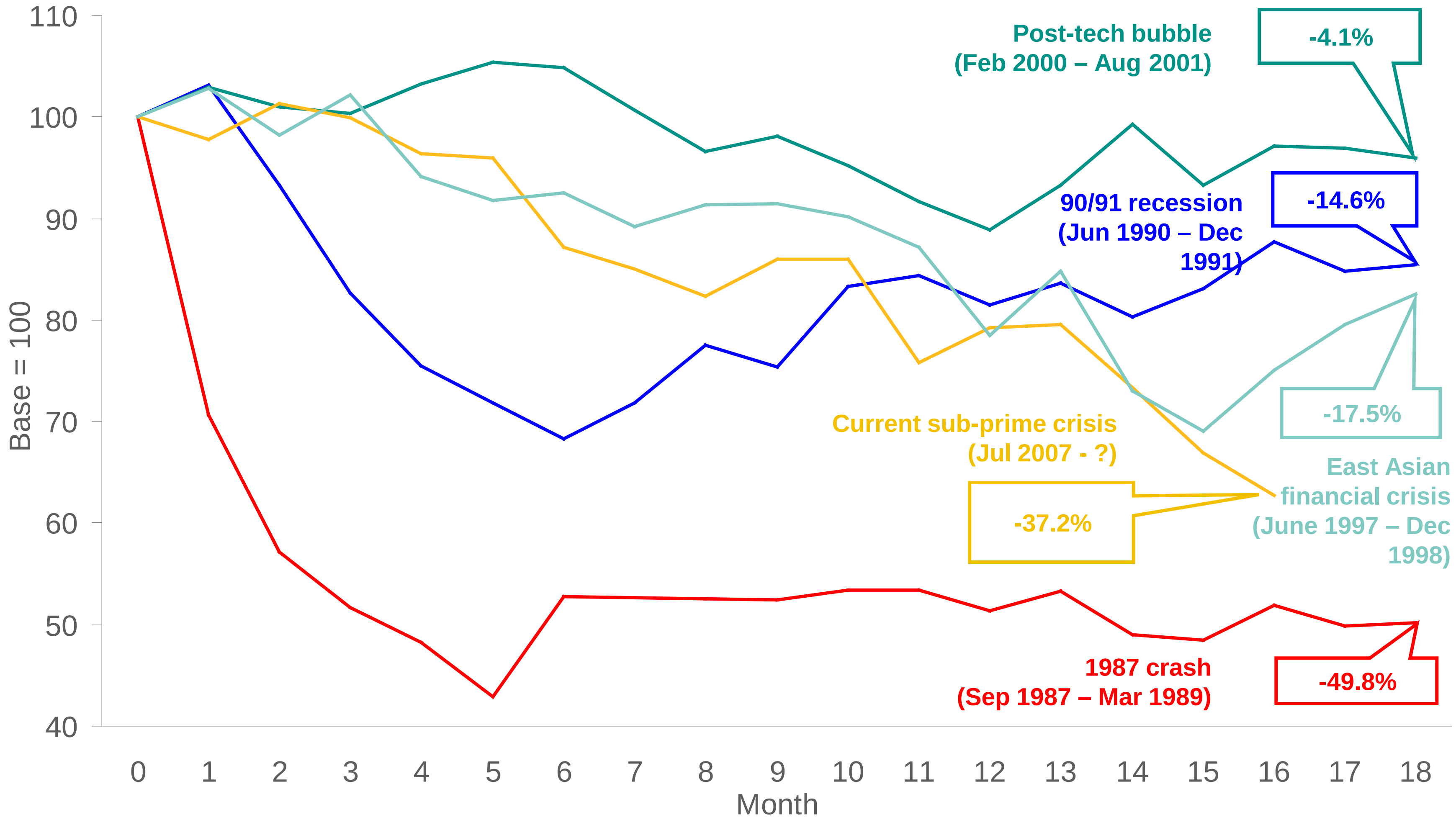
Equity markets volatility



Source: Bloomberg at 21 November

NZ equity market downturn in context



Source: IRESS at 21 November

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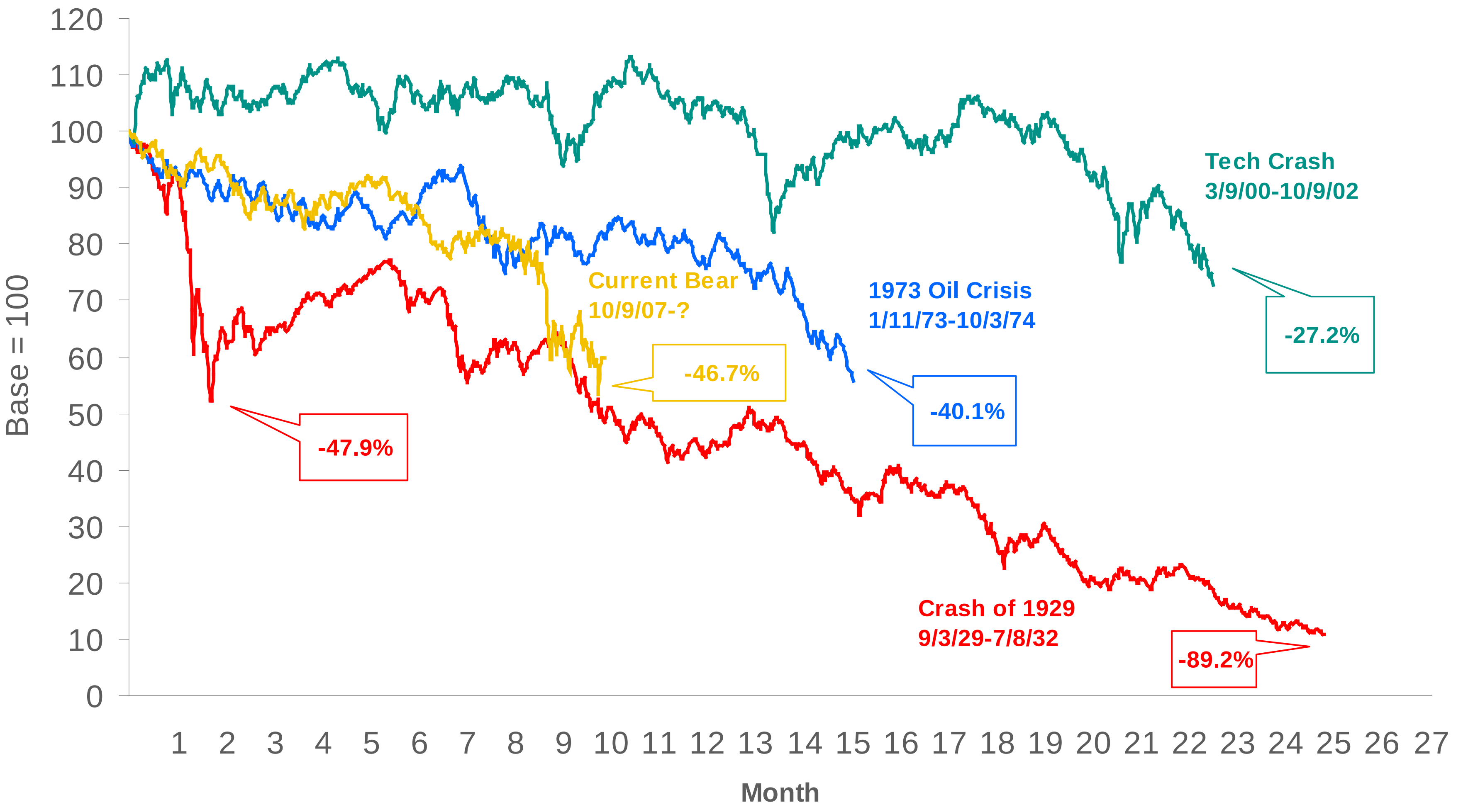
US equity market downturn in context



Source: Bloomberg. Note: Based on performance of Dow Jones Industrial Average

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But on the bright side…

1. New Zealand has suffered a lesser direct impact of the credit crunch (Australian banks had limited exposure to sub-prime products)
2. Inter-bank markets thawing as bail-out policies move from announcement to implementation stage
3. Oil price and exchange rate moving in the right direction
4. Significant fiscal stimulus through tax cuts and government expenditure (eg. infrastructure), as well as interest rate cuts
5. Governments worldwide have demonstrated their willingness to do whatever is required

What does this mean for you?

1. Need to actively manage balance sheets – it will be equityholders that are impacted (diluted) by balance sheet mis-management

2. Good relationship with debt capital providers is paramount

3. Diversification of funding sources (eg. banks, private placements, public issues, etc.) and maturities (short/medium/long term)

4. Economic and financial market conditions are likely to create a number of acquisition opportunities (e.g. Powerco)

5. Trade buyers are back in the market – synergies/scale are more important, deals are no longer being driven by leverage (e.g. leveraged infrastructure model less prevalent)

2 Cost of Capital Update

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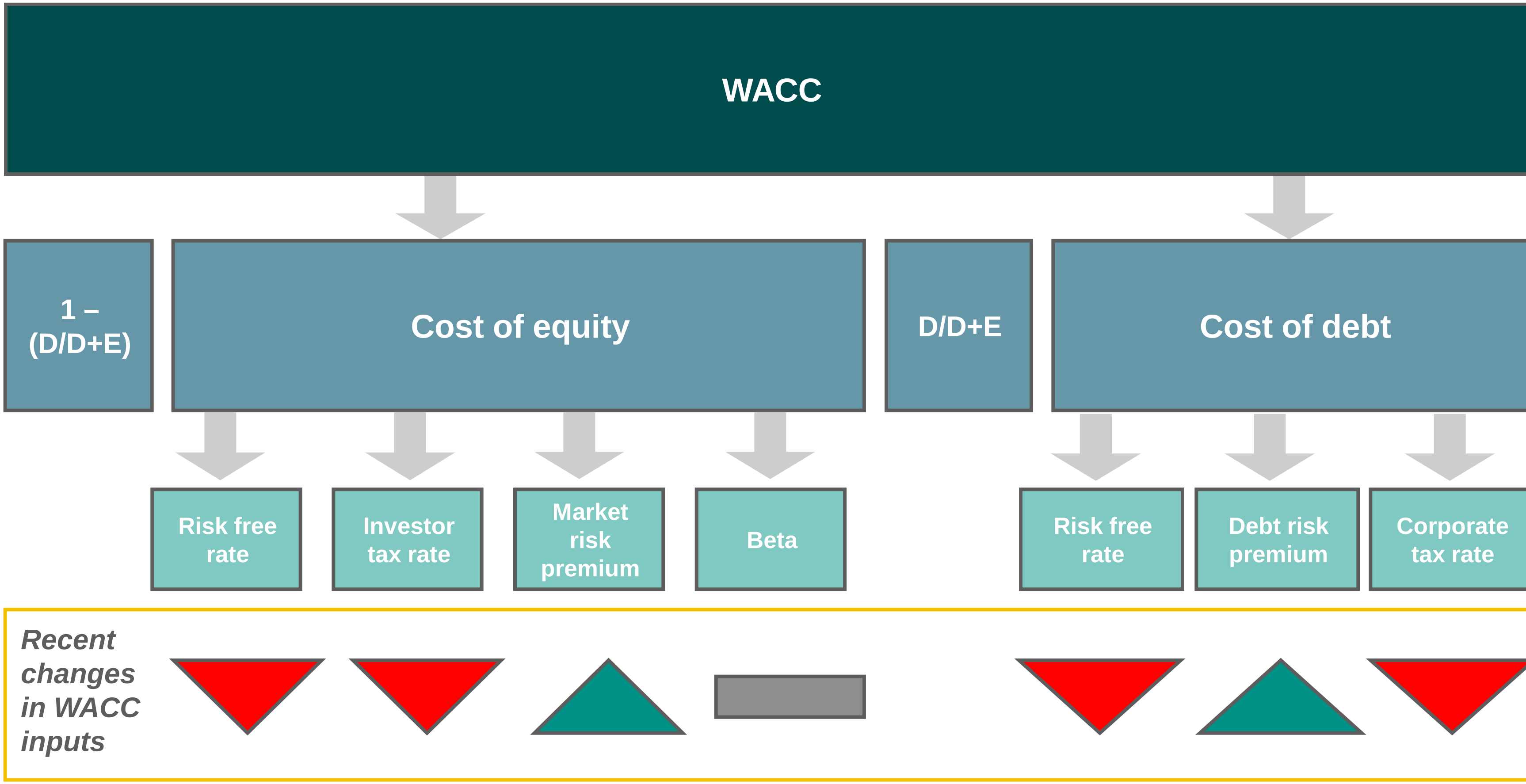
The Weighted Average Cost of Capital



Now we will discuss each of these in turn…

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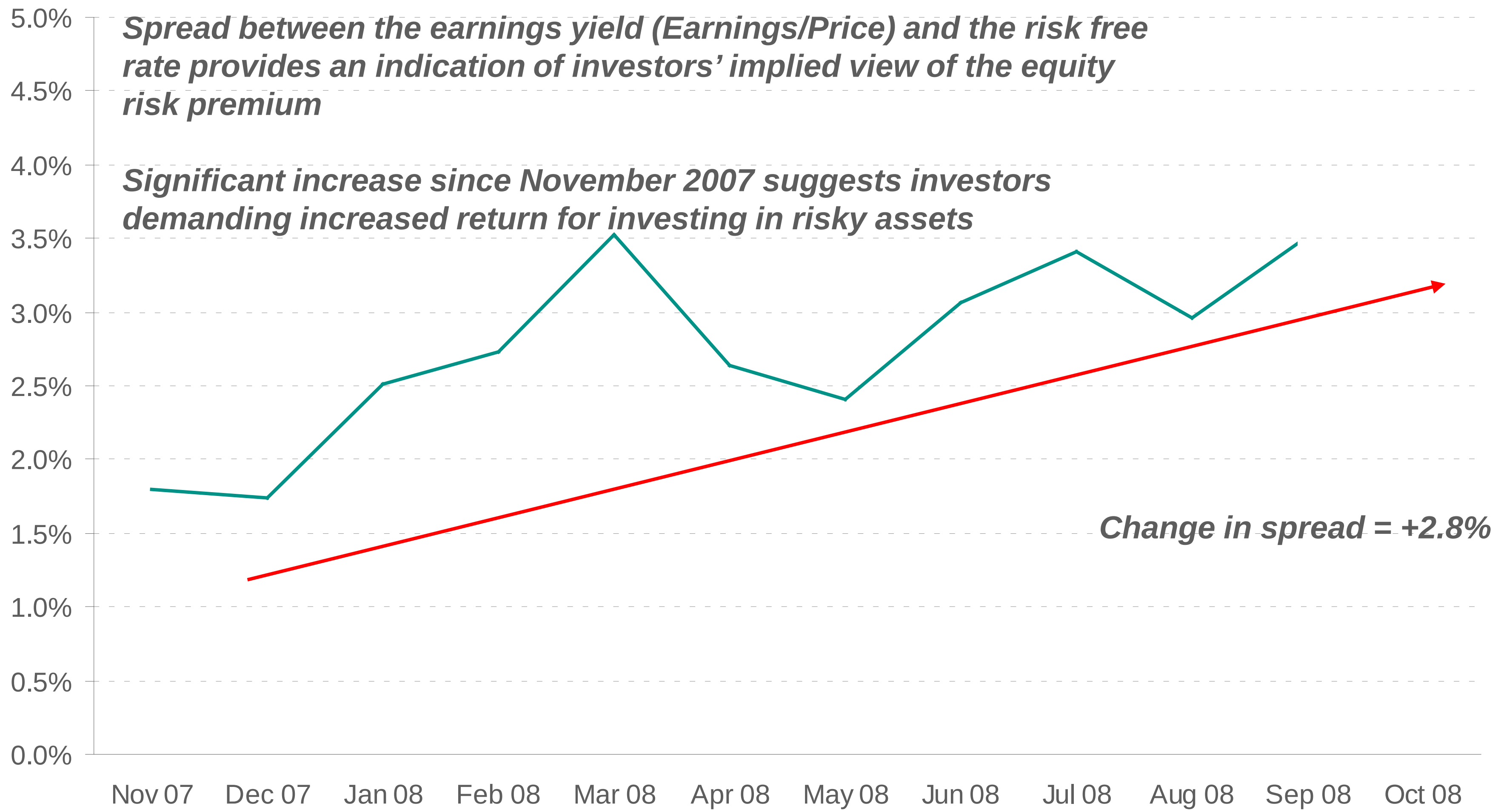
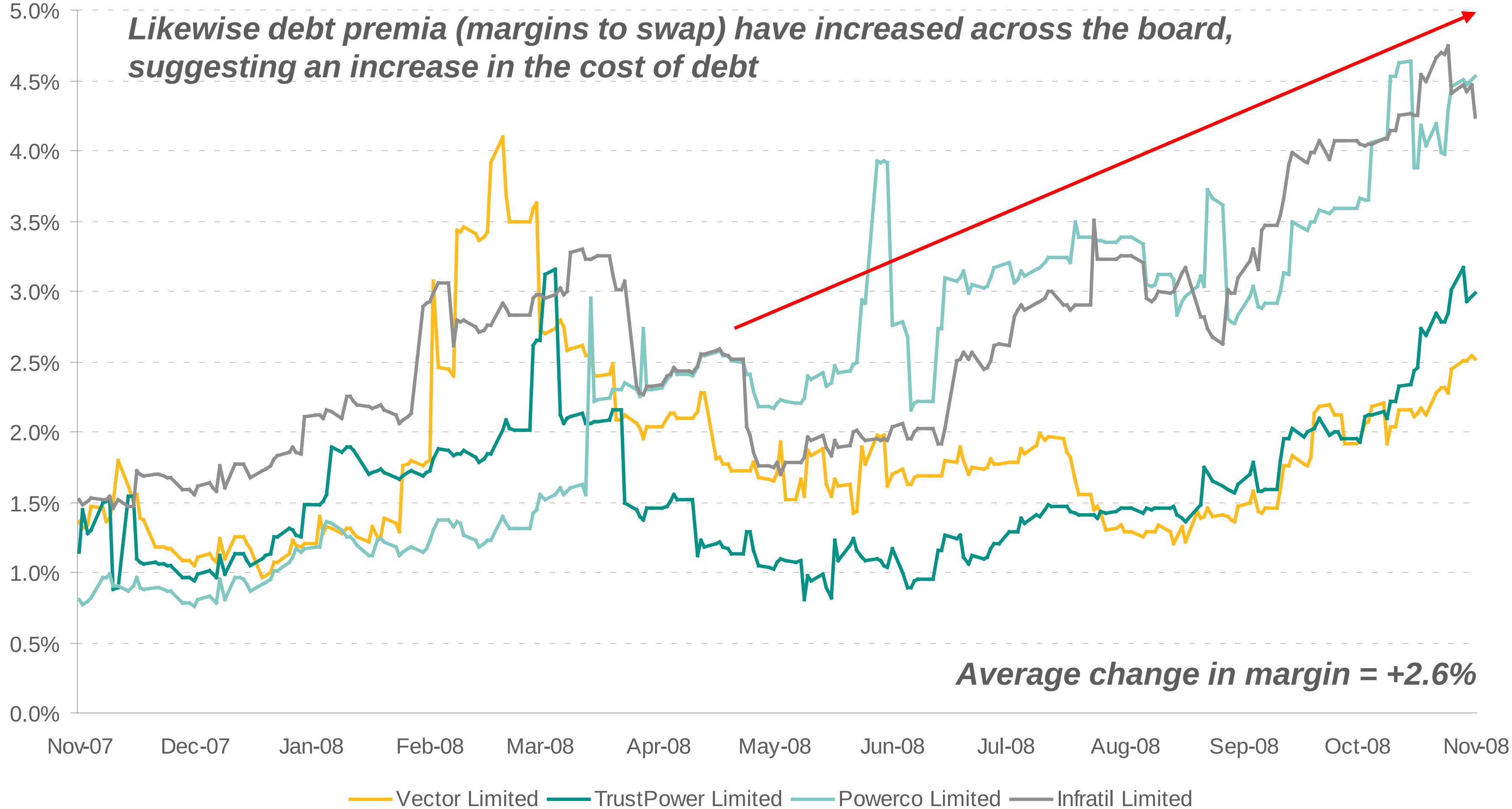
NZX 50 earnings yield/risk free rate spread



Source: Datastream, IRESS at end of October 2008. Note: Spread defined as (1/forward market PE – post-tax yield on 3 year government bond)

Margin (to swap) on NZDX listed instruments



Source: IRESS at 27 November 2008

The 'Risk Free Rate' – 3 year government bond

Source: IRESS at 27 November 2008

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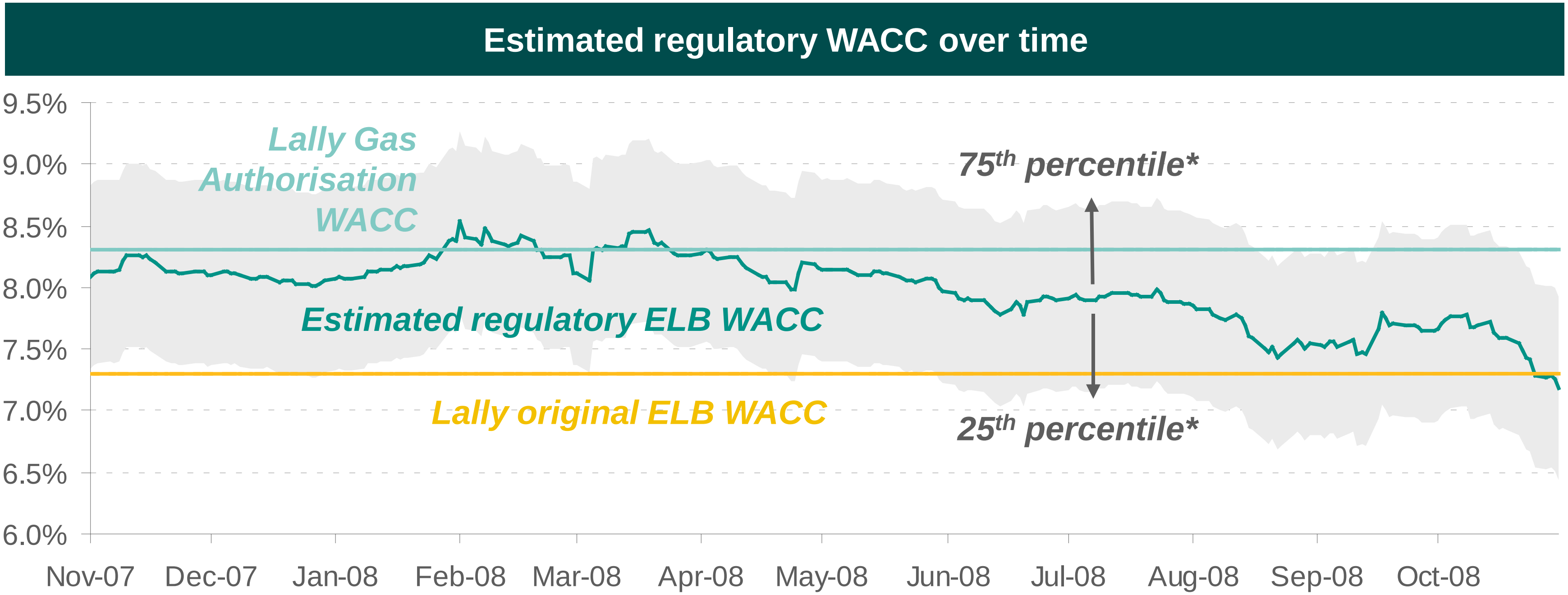
Estimated regulatory WACC over time



- Is it possible to raise capital from the market in sufficient volume at this cost of capital, at this time?
- Are Lally's calculations premised on the assumption that ELBs are financed by captive capital?

*Source: ABN AMRO estimates at 27 November 2008. Note: * Assumes standard deviation of WACC distribution of 1.1% per Lally ELB WACC discussion*

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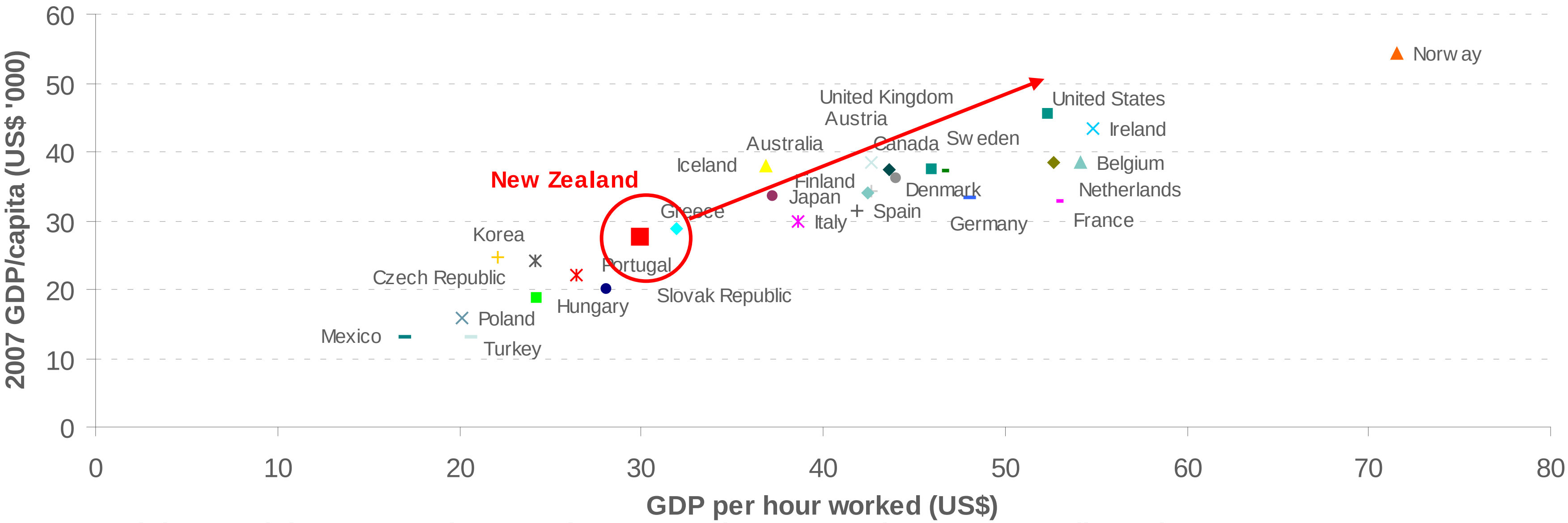
3 Trust Mergers: Aligning Local Resources

We believe that…

- National Government will focus on increasing productivity in order to increase GDP/capita

OECD productivity and GDP per capita



- To achieve this goal, the nation needs to work 'smarter/harder'
  – industry segments need to be structured so as to deliver the lowest cost to serve

Source: OECD Stats Extract

Current industry structure is irrational from a productivity perspective

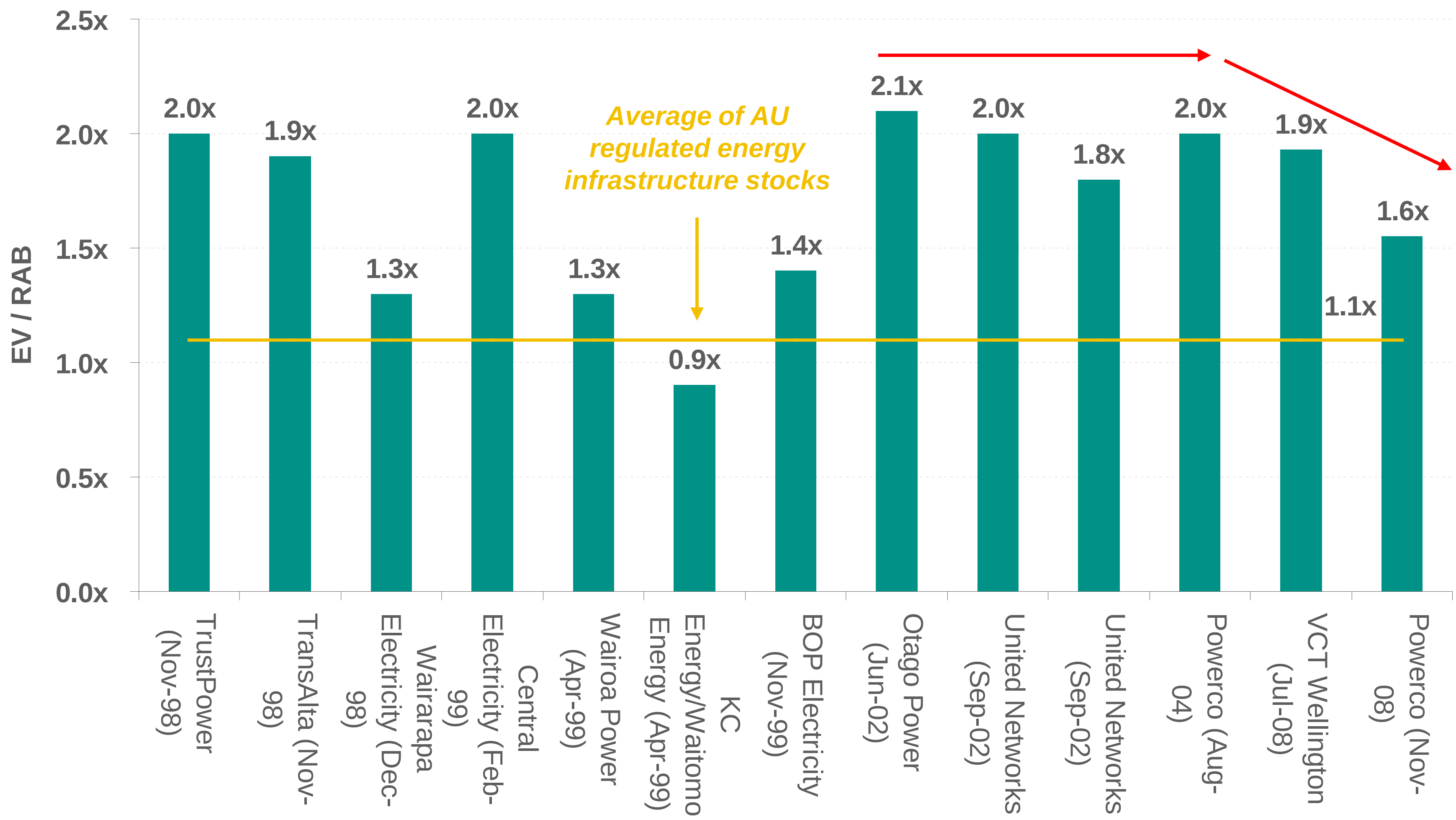
- Industry has circa 30 players
- Consolidation that was occurring at a respectable pace of 3-4 per year stopped dead (actually reversed this year) under the ComCom regulation
- Expect a National Government with a view to improving national productivity to **scrutinise** industry

*Source: Information disclosures of New Zealand's electricity lines businesses for the year ended 31 March 2007 as published in the New Zealand Gazette and TransPower information disclosure for the year ended 30 June 2007 as published in the New Zealand Gazette. Note: * Assumes ABN AMRO Research's ODV for Wellington from ABN AMRO Research report dated 28 April 2008*

M&A – A regional vs national perspective

- Currently observe no M&A between 100% trust-owned lines businesses
  - the reason being: the shareholders who acquire lose all of the synergy benefits to consumers
- Under the ‘right regulatory structure’, there should be benefits from pursuing consolidation
  - increased scale = productivity gains/synergies (particularly contiguous networks)
  - this potentially means lower costs to consumers
- Beneficiaries of the ‘merged’ entity share in the productivity gains and can be ‘net net’ better off
  - smaller share of a larger pie BUT
  - sum of parts greater than the whole (by the value of synergies)

Regulatory uncertainty and its impact on M&A



Source: ABN AMRO estimates. Note: Powerco/QIC ODV multiple based on implied 100% purchase price of NZ$2,050m, electricity ODV of NZ$948.1 at March 2007 (regulatory filing), and NZ gas network net book value of NZ$371.6m at June 2007 (annual report); AU regulated energy infrastructure RAB multiple based on Spark Infrastructure, SP AusNet, and Envestra at 21 November; Vector Wellington ODV multiple based on ABN AMRO Research estimate from report dated 28 April 2008

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Regulatory uncertainty and its impact on M&A

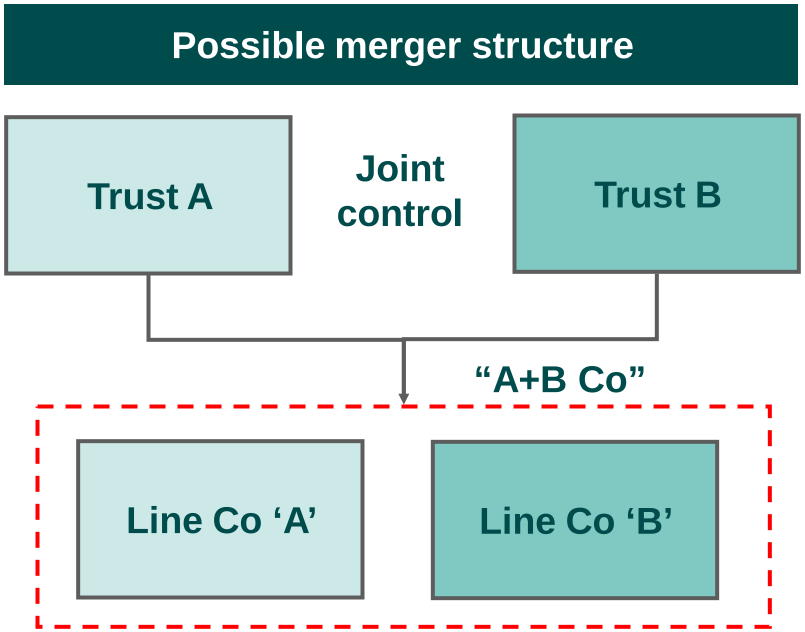
- Recent decisions by the regulator in the Gas Enquiry around asset valuation methodology have reinforced the uncertainty around the next electricity reset
  - what pricing could an acquirer ascribe to a target with any certainty?
  - why pay >1.0x ODV? Which ODV to use?
- Impact of economic crisis and availability of financing likely to further impact risk aversion and therefore attitudes towards undertaking M&A
- Necessary catalysts for industry rationalisation therefore include:
  - a national focus on increasing productivity in the industry, which feeds through to regulation
  - resolution of regulatory uncertainty
  - acquirers allowed to retain meaningful synergies for taking on the risk of M&A (particularly in this ‘higher risk premium’ environment)
  - customers ‘share the benefit’ of M&A

What are the ‘synergies’?

- Synergies are intrinsically low as it’s a high fixed cost business, therefore price of acquisition AND regulatory certainty are crucial
- Potential synergies include:
  - – network management
  - – administrative and compliance efficiency
  - – operating costs
  - – regulatory & pricing management
  - – scale benefits for capital spend
  - – bargaining power vis-à-vis contractors
  - – leverage with financiers
  - – shared development projects for the benefit of the consumer (eg. gas/lpg/other utility services/telco)

How to align local ownership and M&A

- M&A discussion tends to focus on outright 'change of control' – ie. a full sale
- However, there are a number of other structures which provide better alignment of local and national interests:
- A 'merger'-type structure would allow trusts to retain significant influence over their local network
  - ownership interest (minority or majority)
  - board representation
  - remain advocate for regional issues
- Importantly in this environment, a share-based merger does not require cash consideration
  - takes absolute valuation issues (ie. regulation) 'off the table'
  - does not require debt financing



Conclusion

- Industry structure supports potential for productivity-led consolidation
- Regulatory uncertainty is a key impediment
- Synergies for consolidation are real and potentially significant
  - wider regional stakeholder issues can be addressed
- In order to get ComCom ‘on side’, need to convince them that merger synergies will be shared with customers
  - eg. through regulatory formula?
- ComCom needs to acknowledge need to promote new capex in the industry
  - increase in capex spend
  - attracting new capital to the sector