Infratil Operational Report for April to June 2014

Infratil's Annual Meeting was held in Auckland on 12th August. All resolutions were passed and the final voting on the various shareholder resolutions is available on Infratil's website www.infratil.com/for-investors/announcements

The management presentation covered similar points to those addressed in the Annual Report in June.

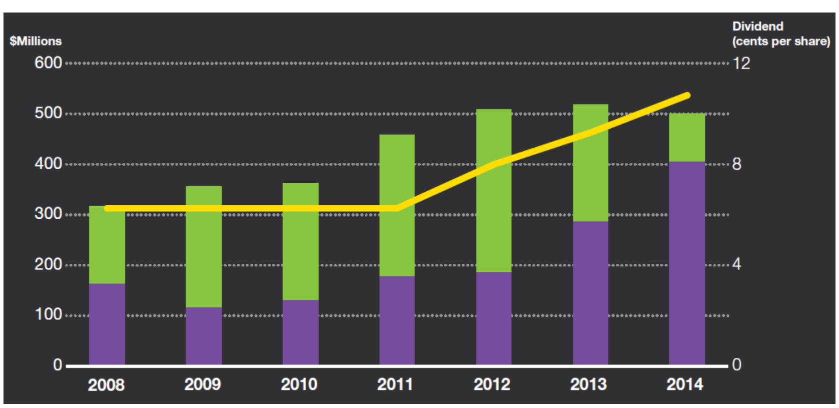
Operationally, Infratil's businesses are on track to meet earnings guidance targets while the capital investment guidance has been increased.

Year ended 31 March $Millions	Guidance 2015	Actual 2014
EBITDAF[1]	$530-$560	$500
Net interest	($180-$190)	($181)
Operating cash flow	$330-360	$407
Capital investment	$295-$365	$614

While Infratil's operations are largely "on target", what is proving harder to analyse and anticipate is the market for infrastructure assets and businesses. This is relevant for the value of Infratil's existing businesses and how new investments are prioritised and progressed.

Demand for better infrastructure is robust and an increasing share of that infrastructure is being privately provided. The supply of capital for the sector has also increased markedly as investors seek mature infrastructure assets and businesses. The challenge for Infratil is to take advantage of these factors; by selling down from businesses where there is strong investor demand while simultaneously undertaking new investments where the price of the assets is not fully reflective of value.

Before 2008 (and the Global Financial Crisis) shareholders supported Infratil making investments with very long-term return horizons. The Crisis shifted the priority to cash earnings and dividends. The effect of this change is shown in the following graph from the annual report.



The yellow line is dividends which have risen from 6.25 to 10.75 cents/share.The bars show EBITDAF (earnings before interest, tax, depreciation, amortisations, etc). The purple parts of the bars show the residual part of EBITDAF (operating cash flows) after payment of interest, tax and working capital adjustments.

[1] See http://www.infratil.com/assets/imported/nzx/193726.pdf for more detail on how Infratil calculates its EBITDAF.

The challenge is to continue the total return to shareholders and to give shareholders a high degree of confidence about that growth. Growth and confidence are often uneasy bedmates because seeking growth tends to mean taking risks, for instance by the sale of shares in a company such as Z Energy and the purchase of shares in a company such as Metlifecare. Selling good businesses is rarely difficult; it is much harder making good new investments. It inevitably requires a long lead time, expertise and accepting a level of risk that expectations will not be met.

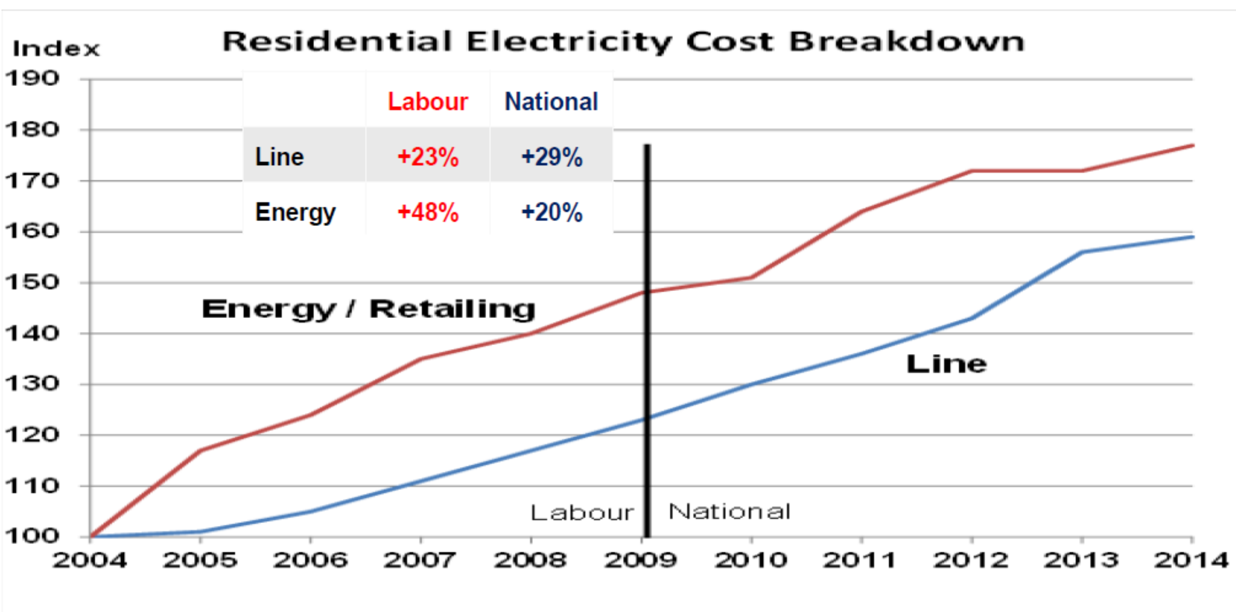
While most of Infratil's recent investment/divestment activities have been driven by these factors there is a more complex set of motives behind the review of Infratil Energy Australia (IEA), which could result in its partial or total sale. IEA was established a decade ago and has grown to be the most successful and profitable new-entrant energy retailers in Australia. But significant changes to the market now justify a pause and review. Potential purchasers/partners are now undertaking detailed examination of the IEA companies with the intention of providing bids or proposals in early September. Right now it is not possible to anticipate the outcome, but greater clarity as to IEA's value is certainly one of them.

Trustpower

The Ministry of Business, Innovation and Employment (MBIE) has recently released residential electricity price statistics calculated in a more accurate way. There has been criticism that its survey of prices does not take into account retailer discounts. In response MBIE produced a data series based on actual residential electricity consumption and cost.

Given the Labour Party plans to reform the electricity market if it is elected it is interesting to look at the movement in residential electricity prices over the last decade divided into the periods under Labour and National governments. Over the last five years the energy/retailing cost has risen less than half what it rose under the previous Labour government.

Taking out inflation, the energy/retailing cost has risen 8% over the last five years, 1.2 cents/kwh or under $90 per annum for an average household.



A second interesting point which can be inferred from this data is that more regulation does not necessarily mean lower prices. Over the last five years the transmission and distribution component of the average residential electricity bill has risen faster than the energy/retailing component. Line prices are set by the Commerce Commission.

Meanwhile in the market, it has been a warm and wet winter which is generally negative for power companies. Trustpower's figures for the three months to 30 June indicate that it did well as a retailer (gained customers), weaker as a New Zealand generator (low output and prices), and very well as an Australian generator (as Snowtown's wind turbines are gradually commissioned).

The quarterly breakdown of Trustpower's operations and wholesale energy prices illustrate the seasonality of New Zealand's electricity sector.

	Jun 2014 Quarter	Mar 2014 Quarter	Dec 2013 Quarter	Sep 2013 Quarter	Jun 2013 Quarter	Mar 2014 Year
Energy customers	246,000	238,000	233,000	228,000	204,000	238,000
Telco customers	59,000	54,000	51,000	48,000	46,000	54,000
Mass market electricity sales	420GWh	381GWh	346GWh	445GWh	406GWh	1,578GWh
Time of use electricity sales	579GWh	488GWh	466GWh	492GWh	488GWh	1,934Gwh
NZ generation	570GWh	473GWh	518GWh	639GWh	579GWh	2,209Gwh
Aust generation	256GWh	206GWh	137GWh	108GWh	85GWh	536GWh
Av. Spot price of NZ electricity generated	6.6c/kwh	9.6c/kwh	7.1c/kwh	5.4c/kwh	8.2c/kwh	6.7c/kwh
Av. Spot price of NZ electricity purchased	7.2c/kwh	10.6c/kwh	6.7c/kwh	6.0c/kwh	8.3c/kwh	7.3c/kwh

In addition to progressing the construction of Snowtown, Trustpower purchased Green State Power (GSP) from the NSW government for A$72 million in June. GSP has 106MW of hydro and wind generation and this plant is expected to generate 270GWh in an average year and provide an annual earnings contribution before interest, tax and depreciation of A$8.5 million.

The Australian government is reviewing its policy of seeking to have 20% of the country's generation from renewable sources by 2020. The outcome of this will be material for Trustpower which has a number of consented wind farms which are likely to be progressed if the 20% by 2020 policy is retained.

Lumo/Infratil Energy Australia

Lumo increased its customer accounts by 15,199 over the first three months of the financial year, bringing the annual gain to 32,716. The annual rate of growth was 7%, which had accelerated to 12% over the last quarter.

	Vic Electric	Vic Gas	SA Electric	QLD Electric	NSW Electric	NSW Gas
Jun 2013	210,604	147,663	48,432	43,993	38,687	8,389
Mar 2013	207,927	145,073	48,485	45,129	36,760	7,396
Sep 2013	207,666	147,385	47,545	44,450	38,162	8,593
Mar 2014	212,175	151,336	46,385	50,262	43,370	11,757
Jun 2014	215,913	154,863	46,809	52,199	46,941	13,759

For the market as a whole, many events and developments are unfolding at once.

- Customer churn (the propensity of customers to switch suppliers) continues to decline.
- The Australian Government repealed the carbon tax which resulted in a fall in wholesale energy prices by about 1c/kwh (unlike New Zealand, Australia has a high proportion of its electricity generated by coal and gas fired power stations and the carbon tax was reflected in the prices they offered electricity into the market).
- The Australian Government is reconsidering the policy of seeking to have 20% of the country's electricity provided by renewable generation by 2020. Pursuit of this goal has resulted in lower wholesale energy prices (care of a substantial over-supply of electricity as wind farms are commissioned against a backdrop of falling demand) but also a charge on consumers to pay for the new generation.
- A warm winter, along with high prices and solar roof-top photovoltaics, have also reduced average demand by households.

NZ Bus

The disparate growth rates in Auckland and Wellington patronage continues with the three months' figures showing 4.4% growth in the north while Wellington and Hutt patronage rose 1.6%.

Northern	Month	12 months	3 months
Mar 2013	3,616,343	37,482,829	-
Jun 2013	2,972,737	37,237,023	9,597,017
Mar 2014	3,790,979	37,591, 015	-
Jun 2014	3,161,186	38,008,821	10,014,823

Southern	Month	12 months	3 months
Mar 2013	1,870,215	20,331,222	-
Jun 2013	1,629,919	20,312,581	5,222,672
Mar 2014	1,946,155	20,373,202	-
Jun 2014	1,744,781	20,458,564	5,308,034

Disappointingly Greater Wellington Regional Council decided to discontinue the City's 113 year use of electric trams and trolley buses from 2017. A report undertaken by accountancy firm PwC found that diesel buses would be lower cost. While Greater Wellington has decided that the existing trolley buses will be discontinued there is no plan at present to provide for their replacement.

The existing trolley bus fleet was purchased by NZ Bus over the period 2007 to 2010 and in 2017 they will be approximately half way through their economic lives. An informative explanation of the 2007 decision to renew the trolley bus fleet is contained in Infratil's March 2006 Update newsletter. http://www.infratil.com/assets/Uploads/PDF/update_mar2006.pdf

Reflecting operational and scheduling initiatives, NZ Bus's punctuality performance is up an average of 6% on a year ago (being punctual means not more than 1 minute early at the first stop on a route and not more than 5 or 10 minutes late. Some routes require 5 minutes and some 10).

North Star	92%
Go West	88%
Metrolink	91%
Waka Pacific	89%
Valley Flyer	96%
Go Wellington	94%

The investment in telematics bus monitoring and driver training is also paying dividends with a marked drop in complaints. These are down to 16 per 100,000 passengers, from 24 per 100,000 a year ago. By 31 March 2015 all drivers will have been through the training update and NZ Bus will have invested over $1 million in this initiative.

Wellington Airport

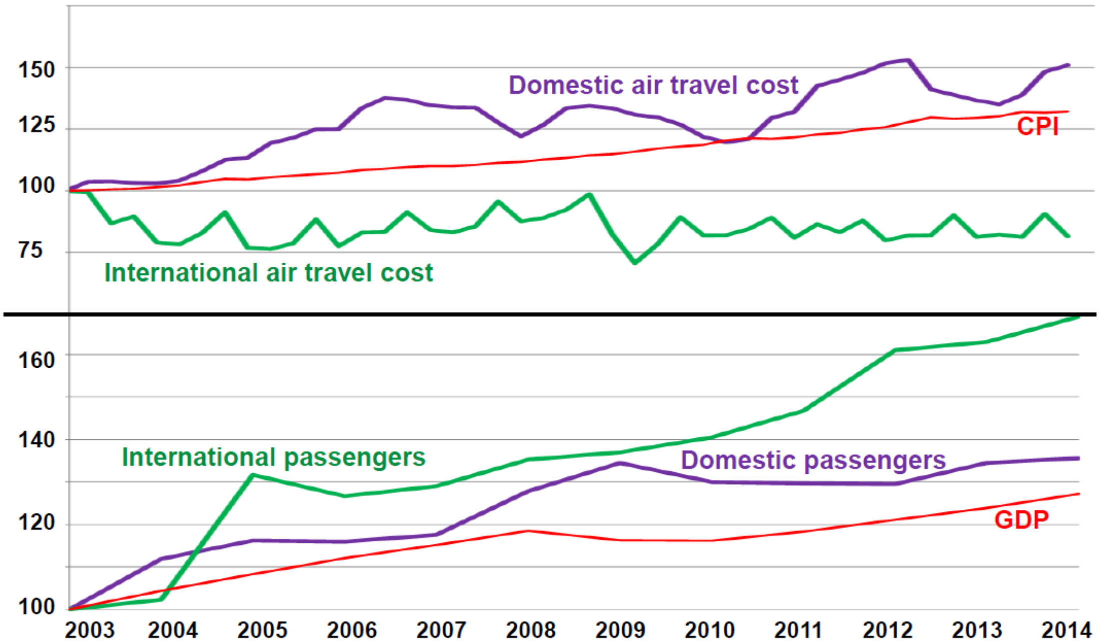
Traffic figures for the 3 months to 30 June were in line with budget, but lower on domestic services, disappointing compared to the previous year. The decline in domestic passengers was largely related to reduction in Jetstar's capacity on Queenstown and Auckland routes.

Domestic Passengers	**Month**	**12 months**	**3 months**
Mar 2013	432,486	4,646,724	-
Jun 2013	360,936	4,731,698	1,184,589
Mar 2014	414,984	4,684,020	-
Jun 2014	360,616	4,630,353	1,130,922

Inte'l Passengers	**Month**	**12 months**	**3 months**
Mar 2013	58,738	722,032	-
Jun 2013	50,359	732,697	167,352
Mar 2014	65,564	753,355	-
Jun 2014	52,984	761,214	175,211

Two key factors drive passenger numbers, incomes (personal and corporate) and airfares. The following graphs compares Department of Statistics indices for domestic and international air travel costs, and Wellington's growth in domestic and international passenger traffic.

The linkage between fares and traffic is very clear.



The Airport is continuing to assemble facts about extending the runway for its project partner Wellington City Council. The Airport and City are jointly funding an evaluation of the feasibility, costs and benefits. If it looks sufficiently prospective it is expected that the project will progress to the next stage of seeking resource consents.

Wellington Airport's runway has a history of extension. In 1950 to 1959 a 1630 metre runway was built in what may well have been the largest urban infrastructure project undertaken in New Zealand up to that time. Between 1970 and 1972 the airfield was extended south to 1930 metres and between 2009 and 2010 it was extended a further 112 metres north and south.

The engineering work now undertaken indicates that another step to the south is more commercially plausible than going north. Evans Bay's muddy bottom is likely to create additional costs which would make extension in that direction uneconomic.