Vector

FINANCIAL RESULTS FOR THE YEAR TO 30 JUNE 2018

FY18 RESULT SLIGHTLY BELOW LAST YEAR'S, WITH APRIL STORM COSTS A FACTOR

Vector Chairman, Michael Stiassny, said, "Reflecting on the last twelve months, and indeed on the past decade, we've made solid progress on our mission to create a new energy future. We are continuing to take the lead on developing new energy technologies, customer-focused innovation and on the sustainability of our sector.

"We've continued to diversify into areas like metering, 'Internet of Energy', data analytics, solar and batteries. This diversification is essential to the future of Vector and the customers we serve.

"Shareholders will receive a fully-imputed final dividend of 8.0 cents, taking the final dividend to 16.25 cents per share, up from 16.0 cents per share in 2017. Despite delivering 12 consecutive years of dividend growth, as signalled last year Vector is a business operating in a challenging environment and responding to change does come at a cost.

"In particular, our ability to pay ongoing increasing dividends could also be significantly impacted by the reset of our electricity network revenues in 2020, which is largely a function of interest rates prevailing at the time, and of expenditure allowances set by the Commerce Commission.

"For the FY18 financial year, adjusted EBITDA was $470.1 million – slightly below last year's result[1]. Notably, the fierce storm in April 2018 caused widespread damage across Auckland and significant inconvenience for customers, as well as drove an additional $4 million in unexpected network repair costs."

While revenue was up across all business areas, group net profit was down 11.3% to $149.8 million, primarily due to a significant increase in depreciation and amortisation in the period.

[1] *FY18 guidance "at or around last year's result" of $474m*

Adjusted EBITDA (excluding capital contributions) generated by our Regulated Networks fell 0.7% to $358.6 million due largely to increased maintenance costs. In addition to the costs of the April storm, Vector spent an additional $4m on network maintenance in FY18, particularly to address additional vegetation and tree management needs in Auckland.

Gas Trading adjusted EBITDA fell 6.8% to $34.4 million from $36.9 million a year earlier. The prior year's result included an insurance settlement of $5.3 million in relation to damage to the Liquigas facilities at Lyttelton during the 2012 earthquake. Excluding this one-off, underlying Gas Trading EBITDA was up 8.9% with strong volumes and higher production at the Kapuni Gas Treatment Plant being offset by lower natural gas margins.

Adjusted EBITDA in the Technology business rose 6.5% to $130.5 million with further gains on smart metering following the Power of Choice reforms in Australia and continued meter deployment in New Zealand. That said, we are disappointed that growth in our Technology business was not higher. This can largely be attributed to lower than expected heat-pump business performance by E-Co Products Group, and by the investment in launching HRV Solar. The underlying E-Co Products Group business is well positioned to play a role supporting Government initiatives for energy efficient and healthy homes.

Capital expenditure (capex) rose 3.8% to $381.2 million from $367.4 million in the prior period. This was driven by Auckland growth, higher network replacement capital expenditure and an increase in Australian meter deployments. This was partially offset by lower Gas Trading capex (the prior period included investment in the Bottle Swap processing plant) and a slow-down in meter deployment rates in New Zealand.

Our balance sheet remains healthy, with gearing as at 30 June 2018 at 48.8%, up from 47.1% a year earlier, and 47.3% as at 31 December 2017.

Solid Operational Progress

Vector Group Chief Executive Simon Mackenzie said, "The twelve months saw a number of operational highlights, including a record number of new electricity connections, continued expansion of our metering business, a solid performance in Gas Trading, the repositioning of E-Co Products Group, the launch of Vector Lights, continued leadership on sustainability and becoming the first large New Zealand corporate to be Living Wage accredited.

"However, while the underlying operational performance was sound, the slower than expected growth in Technology and significant additional tree management and April storm related costs have dragged on the financial result.

"As well as the physical impact, the April storm also saw our outage app fail, resulting in a poor customer experience and causing other customer channels to be impacted. Since the storm, Vector has reviewed its storm response procedures, has engaged with a wide range of industry and Government stakeholders, and a number of corrective actions based on lessons from the storm are well underway. These include an overhaul of outage management systems, processes and tools to improve the customer experience.

"The storm review also highlighted shortfalls in tree management regulation. The thousands of trees that damaged lines in April were not owned by Vector and under current regulations we have restricted abilities to manage them. Undergrounding is not necessarily a panacea. While 55% of the electricity network is underground, the cost to underground the remaining 45% of the network in Auckland is enormous (we estimate over $5 billion), and we believe there is little consumer or political appetite for the large energy price increases that would be required to fund this.

"Strong connection growth and an increase in replacement capex has resulted in a significant increase in regulated capex, up to $245.8 million from $210.6 million in the prior year. Given the size of the investment required to support the ongoing anticipated growth of Auckland's energy networks, it is of significant concern that our regulated electricity network is not earning its regulatory cost of capital. Vector's electricity network ROI[2] for the 2018 regulatory year was only 5.49% - significantly lower than the regulatory WACC[3] of 7.19%.

"This is largely due to Commerce Commission forecast errors in the current regulatory parameters. Absent these errors, Vector's electricity revenues for the 2018 regulatory year would have been almost $28 million higher. Whilst we anticipate the majority of these errors will be corrected at the next reset (April 2020), they will continue to significantly impact network returns until then.

"Although the regulatory environment is otherwise relatively stable, balancing safety, price, service quality, and future investment is challenging for network operators and regulators

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[2] *Return on Investment, as defined by the Commerce Commission*

[3] *Weighted Average Cost of Capital*

alike. In that regard, we are working closely with the Commission on penalties for breaches of the quality thresholds. The reality is the current Commerce Commission price and quality regime may not adequately account for Auckland growth, changes to health and safety best-practice, or more extreme weather events. As a result, meeting quality targets will be a significant challenge for Vector and the wider industry. It is crucial that this issue is addressed no later than at the 2020 reset of regulatory parameters.

“A political review of the New Zealand electricity sector is currently underway. We welcome the review, because distribution companies are already fully transparent through regulation and we hope to see greater transparency across the sector. The New Zealand generation and retail market has not been looked at in earnest for around a decade and it is right to question whether consumers are receiving the benefits of competition. Recent reviews in similar markets such as the United Kingdom and Australia have identified genuine market concerns at both the retail and generation levels of the market.”

Looking ahead

Mr Stiassny said, “When I joined the Board of Vector in 2002, the New Zealand electricity sector was in a state of flux on the back of the Bradford reforms and Commerce Commission intervention. Today, the electricity sector is once again transforming as new energy technology emerges, consumers take the driver’s seat and the regulatory environment struggles to keep pace with what are extraordinary changes and times.

“Over the past 12 months, we have continued to accommodate Auckland’s relentless and rapid growth through smart investment in quality network infrastructure, adding more than 14,000 new electricity and gas connections to our network. This is our responsibility, but we do so with an eye on the future and what’s coming down the track to ensure that we avoid unnecessary expenditure on obsolete technologies or traditional assets that load unnecessary costs on consumers. While we have a projected $2 billion investment spend to meet growth over the next 10 years, it can only be spent once. Vector can’t afford to get it wrong, so investment and technology decisions are not made lightly.

"Looking ahead we expect largely flat Regulated Network earnings through to the next electricity reset in 2020, and continued growth in our Technology business. We expect adjusted EBITDA for FY19 to be between $470 - $480 million[4]. Looking even further ahead, to the next decade and beyond, Vector will need to continue its transformation. It is certain that the industry will continue to be disrupted and the impacts of climate change will continue to be felt. Vector will need to not only stay ahead of the curve, but to balance the needs of customers today with those of the next generation."

Results Table

12 months ended 30 June	*FY18 $m*	*FY17 $m*	*Change %*
Revenue	*1,328.4*	*1,226.7*	*+8.3%*
Adjusted EBITDA	*470.1*	*474.4*	*-0.9%*
Net Profit after tax	*149.8*	*168.9*	*-11.3%*
Operating cash flow	*389.9*	*335.7*	*+16.1%*
Dividend per share (cents)	*16.25*	*16.00*	*+1.6%*

About Vector

Vector is the country's largest distributor of electricity and gas, owning the lines and pipes to households and businesses across Auckland. It is working innovatively to create a smarter and more affordable energy future. Vector is listed on the New Zealand Stock Exchange with ticker symbol VCT. Our majority shareholder, with voting rights of 75.1%, is Entrust.

For further information, visit www.vector.co.nz

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[4] *This excludes any impact from the adoption of IFRS 16 Leases.*