Vector

FINANCIAL RESULTS FOR THE HALF-YEAR TO 31 DECEMBER 2018

SOLID HALF-YEAR RESULTS FUELLED BY AUCKLAND GROWTH

Vector's financial results for the six-months to 31 December 2018 demonstrated growth across all business segments within the Group, with much of this growth fuelled by the continued expansion of Auckland's city and population. The six-month period also saw ongoing change as the macro trends that Vector has long been anticipating, and in many cases leading, continue to play out.

Auckland continues to grow relentlessly. Meanwhile, new digital and energy technologies are disrupting sector economics and offering viable alternatives to the old-fashioned 40-year infrastructure assets that in previous decades would have been needed to accommodate this rapid Auckland growth. This will help reduce the potential burden on future generations created by unnecessary costs or obsolescent infrastructure.

Most importantly, consumers are demanding more empowerment over how, where and when they use energy, and have ever-higher expectations around the service they receive and the contributions that companies make to important societal issues.

Vector has been taking a lead on sustainability for many years because it's the right thing to do, because it is becoming more and more urgent to address, and because increasingly our customers expect us to. We also believe leadership in sustainability is good for business, providing us with better visibility of the potential role of new and more sustainable energy technologies in driving commercial benefit and material value.

These are the macro trends that have underpinned our strategic thinking around diversification and investment, and these are the trends that have contributed to our solid financial results for the six months to 31 December 2018.

Adjusted earnings before interest, tax, depreciation and amortisation (Adjusted EBITDA) for the six months to 31 December 2018 were $264.7 million, up $14.7 million (5.9%) on last year's result. The headline adjusted EBITDA result included an uplift as a result of accounting changes[1].

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[1] *For more details of these accounting changes, see page 21 of the Interim Report*

Excluding these accounting changes, adjusted EBITDA was up $10.0 million (4.0%) on the previous corresponding period.

Each business segment recorded an uplift in adjusted EBITDA relative to the previous corresponding period. Regulated business earnings were up $6.0 million (3.1%) largely due to higher electricity volumes because of continued Auckland residential growth and a colder winter compared with the prior year. Gas Trading earnings were up $2.3 million (12.5%) due to higher production levels at the Kapuni gas treatment plant and cost efficiencies from the new Bottle Swap plant in South Auckland.

Earnings in the Technology segment grew $8.2 million or 12.7% driven by continued growth in smart meter deployments in New Zealand and Australia. Within this segment, E-Co Group experienced some market and operational headwinds, and as a result underperformed against expectations. To address this, a new CEO and a new management team have been recruited, who have been repositioning the business to meet the growing demand for heating, ventilation and air-conditioning solutions.

Group net profit was up 5.4% to $83.3 million from $79.0 million in the prior period. This was largely due to higher earnings and an increase in capital contributions partially offset by an increase in depreciation and amortisation as well as non-cash changes within costs of finance. Capital expenditure increased 10.1% to $201.1 million from $182.7 million in the prior period. This was driven by an increase in Australian smart meter deployment and network capex to support the continued growth in Auckland.

The six months has also seen the commencement of the signalled Government review of the electricity sector which, along with the pending Interim Climate Change Commission report, will help guide New Zealand's transition to 100% renewable energy. Given the macro trends at play, it is timely the Government has this once-in-a-decade opportunity to incentivise investment in the new energy technologies that will help empower customers, help solve big market challenges, and help promote more innovation and competition.

It can set new ground rules for the sector that will maximise benefits for the next generation of energy consumers, promote equitable outcomes, as well as help enable New Zealand's sustainability ambitions. We also believe it's an opportunity to recognise the infrastructure demands of high growth areas such as Auckland. We need the right policy settings and investment incentives to ensure high growth and evolving energy needs are met.

The Electricity Pricing Review Panel's Options Discussion paper published last week is largely encouraging. It favours options that reflect the importance of new technology, greater resilience and improved customer choice, as well as options that improve market transparency and address practices that may stifle competition or unfairly penalise some consumers. As the review is finalised, we also hope to see an even greater focus on options that improve energy efficiency, and, most importantly, address problems experienced in the wholesale market.

Just as importantly, we are nearing the next reset of regulated pricing and quality standards for the electricity distribution sector, scheduled to take place in 2020. What is increasingly clear is that, given the pace of change, the existing regime for quality control, last reset in 2015, no longer reflects the reality of the changed operating environment, particularly related to health & safety legislation and the impact of Auckland growth. Therefore, we will continue to work constructively with the Commerce Commission on the new quality standards which will take effect on 1 April 2020 following the regulatory reset process.

Looking ahead to the remainder of FY19, the guidance given in August for adjusted EBITDA remains appropriate. As noted at the time, this guidance did not include the impact of adopting IFRS 15 & 16, which together with other minor accounting changes, is expected to impact FY19 adjusted EBITDA by approximately $10 million. Our guidance range adjusted for the impact of accounting changes is therefore $480 - $490 million. Our result in the first half of the year benefited particularly from strong electricity volumes. Should this continue in the second half of the year, we would expect the FY19 result to be towards the top end of the guidance range.

Looking further ahead, Vector's future earnings and ability to pay ongoing increasing dividends could be significantly influenced by the reset of our electricity network revenues for the period 1 April 2020 to 31 March 2025, which is known as Default Price Path (DPP3).

The Commerce Commission has now largely confirmed the methodology that will apply to this reset – the key remaining variables are the 5 year NZ Government bond rate during June, July and August 2019 (which is used to set the regulated WACC[2] for DPP3) and the network expenditure allowances and quality targets that will apply to DPP3. The Commerce Commission expects to announce its draft decision on 31 May 2019 with a final decision due on 28 November 2019. We will provide a further update when we release our full year results.

[2] *Weighted Average Cost of Capital*

In accordance with our dividend policy, we will review our dividend approach once the parameters of the 2020 reset have been confirmed.

Regardless, Vector will need to continue its transformation and continue to show leadership on technology, resilience and the provision of customer choice. 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 continue to balance the needs of customers today with those of the next generation.

Our vision is for Vector to create a new energy future for New Zealand. A future where customers are fully empowered and have control and choice over where, when and how they use energy. A future where all consumers get the benefits of new energy technologies, not just the more advantaged. We want Vector to attract the best talent in New Zealand and contribute more than its fair share to a more sustainable, more equitable energy system. We want all our people and the public to be safe around energy.

About Vector

Vector is the country's largest distributor of electricity and gas, owning the lines and pipes to households and businesses across Auckland. Vector is also the country's largest provider of energy metering services, and has installed advanced meters in almost 1.5 million premises across New Zealand, and more recently, in Australia. Vector 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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