Meridian Annual Public Meeting, 7 December 2011

Chris: Good morning ladies and gentlemen. Welcome to Meridian Energy's Annual Public Meeting. Thank you for being here today. I am Chris Moller, Chair of Meridian, and here on stage with me are Meridian's Board from your right to left: John Bongard, Mary Devine, Catherine Drayton, Anake Goodall, Steve Reindler, Anne Urlwin, Peter Wilson – Deputy Chairman, Chief Financial Officer Paul Chambers, and outgoing CEO Tim Lusk. I would also like to introduce Mark Binns, our incoming CEO, who is here in the audience. Mark, can you stand up please? *[Discussion of emergency evacuation procedure 00.55 to 1.23]*

Today's proceedings will be made available on our website in the next few days. Accordingly, we are videoing the meeting and will be preparing a transcript of it. Therefore, if you wish to speak, I would ask you to wait for a microphone before introducing yourself and asking your questions or making a comment. Please direct all questions or comments to me as Chair, and where appropriate or necessary I will redirect those questions to my colleagues to respond. As a courtesy to other attendees at the meeting, who may wish to speak, please ensure your questions and comments are succinct and to the point and that you afford others the opportunity to speak.

I wish to advise that the meeting will need to close no later than 10.30am because the Board and management have other commitments that must be attended to this morning.

[slide 2] We will commence today's meeting with a presentation about Meridian. I will give you a brief background on Meridian, this year's highlights and significant events. The chief executive will provide you with an update on the year's progress against the company's strategy and other matters. The chief financial officer will take the meeting through the financial results for the year ended 30 June 2011 and the trading outlook, and then the floor will be open for questions.

[slide 3] For those of you who may not be that familiar with Meridian, the company focuses on generating electricity from renewable sources. Notwithstanding that positioning, we are still the largest generator in New Zealand and indeed, if the Government decides that Meridian should proceed with an IPO – which is an Initial Public Offering – we are likely to be the largest or the second largest company listed on the New Zealand Stock Exchange, as measured by market capitalisation. Internationally, we have developed and operated wind and solar generation facilities in Australia and the USA, erected three wind turbines at Scott Base in the Antarctic, and we have agreed in conjunction with the New Zealand Government to build a solar facility in the Pacific Islands, specifically, Tonga.

[slide 4] In 2010/11 we increased EBITDAF (earnings before interest tax depreciation and financial instrument revaluations) by 3% to a shade under $660 million in the face of considerable adversity, which I will cover later. In addition, we paid dividends of nearly $684 million, including a special dividend of $521 million which was declared after the disposal of the two Tekapo hydroelectric power stations at the head of the Waitaki River. We also successfully commissioned the Te Uku Wind Farm near Raglan earlier this year and we committed to the construction of the largest wind farm in Australasia at Macarthur in Victoria, in conjunction with our partner, AGL, one of Australia's leading energy companies.

Chris: Customer numbers grew 7% during the year on the back of a 35% increase in the North Island and the doubling of Powershop's business, which received the accolade of being ranked number 1 by Deloitte in its index of New Zealand's fastest-growing companies. Due to a very determined effort by management, we have achieved a very significant improvement in health and safety over the last two to three years. And another thing that we are proud of at Meridian is our hydro asset performance. Ranked in the top three in a global benchmarking study, this year Meridian's hydro forced outage factor was 0.18%, the best it has been in 19 years. This is a testament to our rigorous maintenance strategy.

[slide 5] I said earlier that we performed well financially in the face of considerable adversity. With about 40% of our customers and half of our staff and their families resident in Christchurch and its environs and our principal office destroyed, the earthquakes were a major disruption for the company. I would like to pay a tribute to our customers and our staff for their forbearance and commitment to Meridian during these very difficult times. In addition, during the year we were directed by the Government to sell the two Tekapo power stations as part of the Ministerial Review reforms. And we were challenged on the back of a sluggish economy with market demand being flat. The retail market was incredibly active with intense competition and high churn. Water flows across the whole country were high, thereby depressing wholesale prices. And significant resource was required to be directed towards preparing for the possibility of an IPO, which is an exciting prospect for the company and is now a potential reality following the general election.

The chief executive will now talk to you about the strategic themes and other aspects of the company.

Tim: Thank you Chris, kia ora, good morning. I've got five slides to talk to. The first three are around some key strategic themes for our company, and then I want to talk briefly about our communities, health and safety and our environmental performance.

[slide 6] Sustainably improving our earnings: I just want to pick up two points there, because Paul will talk quite a bit more to these also, but principally our productivity measure, EBITDAF per megawatt hour, a strong underlying performance there now over five years, increasing 27% since 2007. Also, just to note that measured on average annual total shareholder return over the last five years, 15.8% average.

[slide 7] The second strategic theme I want to comment briefly on: growing value through the development of renewables. We do have a very strong pipeline of options in New Zealand and we hold the consents on three wind farms and one small hydro station. As Chris said, we have leveraged our expertise into our Australian market with our partnership with AGL, and a week ago the first turbine was erected on the Macarthur site. Two and a half years ago the board committed to enter solar technology as the next renewable technology for this company and we can now show a track record in the commissioning and operation of our five megawatt plant in California and now one megawatt in Tonga.

Tim: A remark I wanted to make about this area of our company is that we have developed critical expertise in wind over the last six or seven years. We are on our, I think Ken, eighth wind farm. Every wind farm you learn more. We are the pre-eminent wind farm developer in Australasia and we now have excellent best practice disciplines around how we business case and commit investments in wind, and our other technologies in particular, and a commercial board that ensures that every investment is a high quality investment for the shareholder.

[slide 8] The third strategic theme I'll comment briefly on is one we call lifting our customer game. It's principally around our two brands in retail, our main retail brand and Powershop. Chris has alluded to the stellar performance of Powershop in the market. I just want to comment really on the customer service piece because at the end of the day it is the service the customer sees which is paramount and we can say that against the Fair Go survey, which is probably the best one we could think of, of 1,800 customers taken in October, Powershop and Meridian Retail were ranked first and second, receiving the highest percentage of good experience.

[slide 9] Turning to people, health and safety. I really appreciate Chris' comment around the effort this company put in to health and safety. What the slide doesn't show is that in 2007 we had nine lost time injuries across our staff and contractors. We had some work to do, it has been quite an incredible journey to get down through five in 2010 and as we speak tracking at three around lost time injuries. We are heading for zero harm and have a belief that we can get there.

[slide 10] My last two slides are key components of our brand: our relationship with our communities and our environmental performance. We build and maintain large industrial plants in the renewable space and typically these are remote installations, they are always amongst communities of some form or another and they always make some impact on the environment. Critical success factor for Meridian is our relationship with our communities, both in development and in an enduring sense, given that wind typically is there for at least 25 years and hydro for an excess of 100 years. So we're proud of our record in community funding, we're innovative around that, we are up-rating the capability we put into community liaison, and we have a nicely matched set of national and local sponsorships which support that endeavour. It is crucial to our success.

[slide 11] Environmental performance: you cannot do what Meridian does without the greatest attention to the environment, particularly in New Zealand. We are the largest user of fresh water in New Zealand. We have extensive IP in the knowledge of river systems in particular and quality, and the impact on the community and environment, which means that we do take part by invitation in the most important forums that are going on in New Zealand, as we speak, around water reform. We have adopted the highest standards in any farmland that we accumulate around some of our consented options. We continue to win the most prestigious environmental awards, and we are a certified CEMARs company in terms of our attention to our environmental credentials.

I'd like to introduce Paul Chambers to take us through the numbers. Paul.

Paul: I'm going to take you through the numbers fairly briefly. You will be able to pick up the full details of our annual results in the annual report at the entrance, or on our website which also contains analyst presentations and various other useful information.

Paul: [slide 12] As Tim has said, it's been a fairly challenging year and so a 2.8% growth in EBITDAF is a good achievement. The big impact on the results this year have been the conjunction of flat demand, high in-flows into national catchments across both islands and the impact of the Canterbury earthquakes, and so this performance is particularly pleasing. The other item to take out from this slide is net profit after tax is significantly up, including the profit on sale of the Tekapo assets which were sold at the beginning of June for $821 million with a gain of $157 million.

[slide 13] The next slide is a bit of a waterfall and I'll leave you to study that at your leisure, but the key takeouts here are some significant improvements in our retail position, in our cost base, in our overseas activities. A settlement of our dispute with NZAS offset to a large degree by weakness in the wholesale market in terms of low prices and high in-flows and the impacts of the Canterbury earthquakes which overall, spread across all of those lines, probably $20-25 million.

[slide 14] So the big story of in-flows you can see on this chart here, and the light blue line means storage catchment across 80 years of history into the Waitaki which is our major catchment area. And you can see the blue line which is the 2011 year significantly above mean throughout the year, which is unusual, and significantly above the mean not just in the South Island but also north as well, which has had, as you'll see in the next slide, a very significantly depressing impact on wholesale prices. [slide 15] We always run with more generation than we have retail load in order to allow ourselves emergency cover if you like in case it becomes dry, and so the impact is quite significant on us. And you can see that that price is not one which you'd expect to maintain in the long term.

[slide 16] We've been working very hard over the last couple of years to strongly integrate our retail and our generation positions – so our customer end and our production end – and this year we would have expected probably off the back of those in-flows to have had a worse result, but the close coordination of our book, if you like, have been very advantageous – it allowed us to see what was happening and to firm up our position early and really mitigate the impacts on our results.

[slide 17] I mentioned operating expenditure. It's been very pleasing to see the degree of discipline that the business has shown. We've had some significant drivers of increasing costs: increased generation through wind, increased profile overseas and high retail churn, which tends to drive retention and acquisition costs, and so seeing a reduction of this nature has been very good.

[slide 18] All of that, as Tim mentioned, has resulted in some strong shareholder returns. We paid a dividend of $683 million and declared a final of $69 million; $521 million of that came from the sale of the Tekapos, and underlying return on equity of 18.5% continues to be strong.

[slide 19] Of great interest to me obviously we've maintained our ratings position that allows us to access funds at reasonable rates and provides us head room in the case of any sort of hydro shock. At the year end we had significant cash in undrawn facilities which we later used to pay down debt, and you can see here a good variety of tenor of debt and within that there's a significant variety of sources of debt which puts us in a strong position whatever the choppiness of the water ahead of us.

Paul: [slide 20] And where is the money being spent? Well, last year principally on Te Uku. This year most of the money will go into the Macarthur wind farm. That is 70% funded from project finance. What that means is, that the project has very little impact on our ability to build in New Zealand and our ability to pay dividends.

I'll just touch on some of our key segments. [slide 22] Tim's mentioned retail customer growth and our retail position and look here, you can see very clearly how we have grown north and reduced our position south. You can also see Powershop's growth, and that really reflects our generation position, post-Ministerial Review. The retail market is extremely competitive. We sit in the top three probably in the world in terms of churn and competition along with Victoria in Australia and Ireland. That's a challenging place to be, but it's invigorating. [slide 23] As Tim mentioned, customer satisfaction is the key to actually maintaining position in that sort of market. And this is another independent survey done by Consumer NZ in August showing the same sort of results as the Fair Go survey.

[slide 24] Generation was relatively flat year on year with us having high in-flows but the North Island having also high in-flows. We will see a result this year of the Tekapos not being there, so a thousand gigawatt hours, on average, of generation which will be leaving our portfolio. [slide 25] The generation pipeline, Tim's mentioned this. I'm not going to dwell on this except to leave you two thoughts: one is that it's very important that you maintain diversity, both of source of energy and of geography and that we absolutely apply rigorous investment disciplines before we spend any money – a very commercially focussed approach. [sldie 26] The same applies of course to our international pipeline, the same sort of disciplines are absolutely applied to those investments.

[slide 27] Our other segments, our subsidiaries in sort of venture businesses, have also seen improvements. We sold Right House at the end of the year to Mark Group – probably a better owner for its future life. Whisper Tech is now producing units in Spain which are going into the domestic market and EFI has seen some very significant improvement in results across the year – that's our industrial generation business.

[slide 29] Moving on to where we are now. We've published figures for the first quarter to the market. The first quarter's really been notable by very low in-flows. Prices spiked up reasonably high as all players in the hydro market acted conservatively in order to maintain water. That's actually had a negative impact on our results and was posing some challenges to us meeting our year end targets. [slide 30] Since then we've seen some fairly strong in-flows and hydrology levels are back to around average and that's really improved our chances of meeting our targets for the year. The loss of the Tekapo stations, that will reduce our net profit by somewhere around $70-75 million, including the retail impact of that, and we do expect retail competition to remain pretty intense.

[slide 30] On the longer term, we do have an extremely well-placed medium term pipeline which we believe can fill a significant chunk of the next 10 years of New Zealand's demand. It's going to be nice to see a Pole 3 finished that'll reintroduce a bit of stability into the market which has been lacking with various outages. We think that retail competition will continue to be intense, but our retail brands we believe are well-placed for the future. So with that I'll pass you over to Chris for any questions you might have.

Chris: Thank you Tim and Paul for your presentations. We're now moving into time when we welcome your questions or comments.

Roger: Roger Conway's the name. Just a question: why was Tekapo sold? And give me an indication please as to the proportion of wind generation into the future. What are you targeting? Is there an optimum level that you are going for? I mean you wouldn't be eliminating hydro altogether and going fully with wind, would you? Just give me an indication of the proportion of wind that you're heading for in the near future?

Chris: Thanks for your questions Roger. The first one I'll deal with and then I'll ask Tim to comment on the wind proportion. The sale of the Tekapo stations to Genesis was an outcome of the Ministerial Review. It was something that the board of Meridian would prefer not to have happened, but having said that, we absolutely endorsed the process. We are owned by the Crown, and as a consequence we do what the Crown wishes us to do. The reason for the Crown wishing to do that, and we understand their reasons, was to generate more competition in the retail market. So although we were a reluctant bride, we do understand the Government policy in this area and worked hard to support it and implement it. It was a sad loss for some of the people though who used to be Meridian staff for many years. Tim, would you like to comment please on the question of the wind proportion.

Tim: I'd prefer Paul answers that. He heads up our Strategy Group and will probably have a more precise answer than I could make.

Paul: New Zealand's pretty well-placed in terms of the amount of wind penetration that it can take without it having a significant effect on market cost, because of the strong domination of hydro still making up 60% of generation. So we would view that potentially somewhere in the 15 to 20% range of national generation being possible without it actually being significantly more costly. After that you get into some sort of firming costs that are required.

Ralph: Ralph Matthes from the Major Electricity Users Group. I just wonder if the board has a view about the ability to maintain earnings or grow earnings in the future with respect to some of the external regulatory constraints that you may face or changes coming into force. In particular, what's the strategic risk to the board around the water reform process, changes to the RMA, and has the board any view on the performance of the Electricity Authority and its impact on future earnings?

Chris: Thanks very much Ralph. All of those are key strategic issues, particularly the first two obviously. We keep them carefully under review on an ongoing basis with management. I don't think I would stand here today and make any predictions about where those are going, but we of course are integrally involved in all of those deliberations, as are your own organisation and the Major Users Group. In terms of the Electricity Authority, again they are our regulator. We work closely with them. There's obviously the UTS case in front of them at the moment or in front of the courts at the moment which I shouldn't comment on, because it is a matter for the courts to decide. But we strive to have the closest possible working relationship with them as the regulator and I believe that's in good shape. Tim, do you want to add anything?

Tim: I'd add – and I think Ralph would be in the same place – that the new Electricity Authority is I think moving very nicely to demonstrate that they are quite proactive and interested in facilitating a competitive market. I mean we like the way they engage with the industry, so after a year I think it's going pretty well.

Jason: Hi Chris, Jason Lindsay from First NZ Capital. Rio Tinto have signalled they are looking to exit a number of smelters, one of which is the Comalco plant in the South Island. How confident are you in the longer term operation of that smelter and have you got any studies, where does it rank in the cost curve under the new contract which I think kicks in from 1 January 13.

Chris: Thanks Jason. If Rio was sold, Comalco was sold, then there is no effect on our contract, so there is no direct impact on that. Clearly they are going through a process of whether they can sell a number of assets across Australasia – the facility at Tiwai Point is one of those facilities. We have undertaken quite comprehensive studies – Paul can give you more detail than I on the whole aluminium market world-wide, where that company exists on the cost curve and where that plant exists, and it seems to be in a pretty satisfactory place. So we're very hopeful that this will not be an issue for this business. That said, I suspect if there was a closure, which would phase in over time under our contract arrangements, it's a problem for the whole market as opposed to Meridian just by itself. Paul, do you want to add anything?

Paul: No, I think that sums it up nicely. Transmission lines are being beefed up substantially enough to mean that any exit would be a market-wide issue and at the moment they look reasonably well-placed in the cost curve. So we'll just wait and see what happens I think.

Edward: Edward White, Energy News. Can you give us an update on the Australian wind market and where you see or how you see Meridian placed in that in the next sort of two to three years?

Chris: Again, it'd probably be better if I ask Tim or Paul to comment on that. I mean we obviously have some significant assets over there with the Macarthur Farm being built – that's a joint venture project financed with AGL. It's a significant wind farm in terms of Australasia, it's our way of getting our foot into that market and getting a better understanding of what is going on in that market. We're receiving a presentation later in the day from our Australian colleagues, so your question probably slightly pre-empts just where we're at in terms of having that presentation later today. But, Paul?

Paul: You'd be aware that the market for renewables is dominated by the LRET scheme and that there's some short-term weakness in volumes for a variety of historical reasons. But market consensus seems to be that that's going to be eaten through relatively quickly. Even if there is any lengthening in that I mean worse case scenario looks like 2015/16. Some time there'll be heavy demand again for those renewable energy credits, so we see the long-term prospects for renewables in that market good and we have various other points of expertise which we believe that we can bring to bear profitably in Australia.

Roger: It's a very interesting subject, the degree that you may be moving into solar generation. You've got a percentage target obviously for wind energy: perhaps solar energy might be featuring soon and perhaps give us a perspective on that please?

Chris: Well sitting right behind you or slightly to your left are our two colleagues from the USA who are also going to be presenting to us later in the day. Solar at this moment is a toe in the water to understand that technology. As I said earlier, we are going to construct a plant with the New Zealand Government in Tonga; we are considering Australian opportunities. But given that our two colleagues are here, Bill or Steve, would you like to make a comment?

Bill: Bill Overholt, the chief executive for Meridian's US subsidiary in solar and we've been at it since 2009 with Meridian in solar. And it was mentioned we have the five megawatt CalRENEW-1 facility. We have several other projects that are under development and we proceed with them very carefully in a coordinated fashion with Paul and his team and with Tim. In the future we expect to do more of these, but right now it's really in the development phase.

Chris: So to answer the final part of your question Roger, no we don't have any specific target at this stage, it's just too early to make that conclusion. I mean clearly there's the technology issues and proving it – although obviously it's proven in California, but it's then the economics of where we can do it in other parts of the world.

Chris: Okay, well on the basis of that, can I thank you for attending this meeting. We appreciate your interest in Meridian. We look forward to much bigger meetings when we are possibly listed on the New Zealand Stock Exchange and seeing you again at those meetings. So please join us for a cup of tea and I will now draw the meeting to a close. Thank you very much.

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