

## IN GOOD SHAPE



*"It is a well-documented fact that generally only one in four mergers ever succeed. I am, therefore, extremely pleased to report that Vector has beaten those odds and continues to make significant progress as a newly-merged organisation."*

In just under 18 months, the company has successfully brought two of the largest energy organisations in New Zealand (Vector and UnitedNetworks) together to deliver a performance that has exceeded all forecasts.

Vector's annual result reflects, for the first time, a full contribution from both businesses for a full year, and illustrates the significant efficiencies that are being achieved by the business through savvy management, innovation and exceptional teamwork.

### **Financial**

Vector's net surplus for the 12 months to 30 June 2004 was \$57.8 million compared to \$49.7 million for the previous 15-month period – an increase of 16.3%.

This financial result demonstrates the value that has already been created within the business by the merger. It also reflects the consistently high operational performance across all areas of the business throughout a year which has seen significant growth, efficiency and cost-effectiveness.

The company's strong performance and resulting free cash flow has enabled Vector to reduce debt by more than \$56 million during the period. As a result, Vector's net debt to debt plus equity ratio decreased from 67% to 65% over the year.

The second half of the year saw the establishment of an efficient financing structure for the long term – particularly in relation to refinancing the remaining acquisition facilities. This restructure led to Vector successfully raising NZ\$418 million through a US private placement (post balance date), which has enabled the company to significantly extend the term of its debt portfolio and reduce its reliance on short term facilities. The placement, which was significantly oversubscribed, will see Vector's interest costs reduced by more than \$900,000 per annum going forward.

It is particularly pleasing that investors in the US private placement market have seen Vector as an attractive long-term investment proposition. The level of subscription and pricing clearly reflects investor confidence in the quality of Vector's assets, management, financial structure and earning capabilities.

The year in review also saw the settlement of several claims which, as a result, have reduced the company's liabilities and ongoing costs.

## **The team**

Knowledge is power in the 21st century and I am continually impressed with the high level of intellectual capital, competency and commitment that exists within the business. It has been particularly satisfying to watch the company develop a unique culture and work environment over the past year that will not only help drive it forward, but also make it one of the best places to work in New Zealand. This has been led by CEO Mark Franklin and a dedicated team of executives who recognise the true value of their people and what it takes to be a top employer.

This success was demonstrated when Vector was ranked in the top quartile of an international employment survey which benchmarks staff satisfaction in over five hundred top corporates. To achieve such a high ranking at the same time as merging a \$3 billion portfolio of assets together is truly outstanding.

It was also pleasing to see Vector receive recognition for its commercial achievements, commitment to keeping its people safe and its innovative use of technology by several industry and national awards during the year, which further confirms the company as a leader in its respective fields.

## **Governance**

In line with the company's commitment to maintaining the highest standards of corporate governance, Vector carried out a comprehensive review of its governance practices during the year, and has developed a new corporate governance framework.

We are confident the framework developed ensures transparency, fairness and recognition of the interests of Vector's stakeholders and is in line with the standards of other best practice models. For more information on Vector's governance policy, see page 44 of this report.

## **Dividend**

On 31 August 2004 Vector paid a dividend of \$49.1 million to its sole shareholder, the Auckland Energy Consumer Trust (AECT). The Trust has the responsibility of distributing the dividend to its beneficiaries, Vector's customers in the Auckland, Manukau and Papakura regions.

## Changes to the board

There were a number of changes to the Vector board during the period under review. Both Don McLaren and Brian Plimmer were reappointed as directors and Wayne Boyd and John Collinge left the board.

Margo Oliver-Buchanan also left the board (post balance date) due to family reasons. Mark Franklin has been appointed to a casual vacancy.

It is expected that the vacant positions will be filled in the new financial year.

## Looking ahead

Looking ahead, the company's size and robust financial structure put it in a very strong position to take advantage of future growth opportunities.

Vector has set itself a clear objective of being a leading network infrastructure owner and manager in this region. The company will continue to work constructively with its shareholder on appropriate growth options that will not only achieve this goal and enhance shareholder value, but also provide significant benefit to the New Zealand infrastructure sector and the economy as a whole.

The company will, however, remain firmly focused on enhancing its core businesses and operating in an efficient and reliable manner, while also working with our partners to leverage the growth opportunities created by the merger.

Finally, the board of directors would like to acknowledge the exceptional efforts of the entire Vector team, who have embraced the challenge of some tough goals during the year and delivered well beyond expectation.

I must also thank my fellow board members for their contribution. Their combined advice and insight is invaluable in these exciting times.



**Michael Stiassny**

*Chairman*

*"Working with customers at the time they are planning and designing their operations means that together with Vector, I can help them optimise their energy requirements."*

*Bob Monk, Director, All-Gas Solutions  
Pure Energy Commercial Channel Partner,  
seen here with Jeroen Vanvijk, Production  
Manager of Homestead Products*

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*"Leadership and teamwork are fundamental to Vector, regardless of what area we work in. We set ourselves firm goals, and achieve them as a team – we're proud of the fact that we operate to industry best standards."*

*Tony Hooks, Vector's Revenue Manager,  
pictured here with members of the Revenue Team*

## MOVING AHEAD



*"A year ago Vector set itself some challenging targets. The 2004 financial year has seen the majority of these targets achieved, in a year of consolidation which has focused on the enhancement of our core businesses and the development of a strategic direction for the company going forward."*

### **A solid year of progress**

The year in review has predominantly been about achieving what we have termed 'readiness' for the next phase of Vector's evolution. With the integration of Vector and UnitedNetworks essentially complete, the company recorded substantial gains in all areas of the business and is now in a strong position to move ahead.

### **Financial performance**

In the 12-month period under review, Vector's net cash flow from operating activities was \$180.1 million compared to \$113.2 million in the previous 15-month period.

While this result includes for the first time, a full year of operations for the newly-merged company, it also reflects the significant efficiencies now being realised despite increasing costs in some areas and one-off integration-related costs.

While comparisons to previous years are difficult given the business is now significantly larger and more complex, the company's progress can be illustrated by EBITDA to 30 June 2004 which was \$341.1 million compared to \$305.8 million for the previous 15-month period – an increase of 11.5%. In turn, Vector's efficiency of operation is reflected in EBITDA per employee which has increased from around \$810,000 per

KEY PRIORITIES FOR 03/04 (AS NOTED IN 2003 REPORT)	PROGRESS TO DATE
ACHIEVE OR EXCEED ALL SET FINANCIAL AND PERFORMANCE TARGETS	FOUR OUT OF FIVE TARGETS ACHIEVED (SEE THIS SECTION FOR MORE INFORMATION)
COMPLETE INTEGRATION OF VECTOR AND UNITEDNETWORKS	ACHIEVED
ENHANCEMENT OF CORE BUSINESS PROCESSES AND FUNCTIONS	ACHIEVED
DEVELOPMENT OF FUTURE GROWTH PATH AND STRATEGY OPTIONS	ACHIEVED
DEVELOPMENT AND LAUNCH OF A UNIQUE CULTURE AND SET OF VALUES	ACHIEVED
BUSINESS MODEL REVIEW	ACHIEVED

employee prior to the merger to around \$1.25 million in 03/04.

Synergies from the merger can also be illustrated by Vector's EBITDA to revenue which has increased to 59.6% – up from a consistent level of around 58% in previous years.

Revenue performance was strong due to higher than anticipated connection and consumption growth across both the electricity and gas networks. Vector Communications also recorded significant gains through increased utilisation of its existing networks and is well positioned to make further progress in the coming year.

### Our people

Our company is run by a team of dedicated, passionate professionals at all levels, and their expertise, drive and enthusiasm is the key to our continuing success.

At the time of the merger, we recognised one of the biggest challenges would be to bring two very strong and individually unique cultures together. The company has focused intensely on developing a new set of values and behaviours over the last year, and this

has provided us with a strong platform to nurture a new culture going forward. Quite simply, our values define “the way we do things around here”. What has been most satisfying has been the team's willingness to quickly embrace our new culture and live our values through their everyday language and decision-making.

The recent results of an employee survey show a strong sense of pride within the company and a desire to move Vector forward on all levels. As a knowledge-based organisation, Vector will continue to challenge itself to find new ways to develop and inspire our people and translate that energy and enthusiasm into additional value within the business.

Our focus on our people will not be confined to our own organisation. With New Zealand's resource pool becoming increasingly leaner, we will continue to work with the industry and their respective bodies, government and recruitment specialists, both here and overseas, to explore new ways to attract new and experienced talent to our critical infrastructure sectors.

### Living up to the high standards we set

High performance in relation to network reliability, customer satisfaction, health, safety and environment are a top priority at Vector. In fact, they are non-negotiables. It's about constant improvement, and each year the company sets itself tough targets in the form of company-wide key performance indicators (KPIs) to achieve this. I am pleased to report that this year the company has over-delivered in almost all areas. With extreme weather events removed, Vector's reliability performance was marginally above the target set. However, the company exceeded all other objectives by, in some cases, up to 25%.

### Review of operating models

The merger of Vector and UnitedNetworks saw the company inherit two distinctly different customer operating models for our electricity and gas networks. Vector has begun a major review of the current models with the goal of developing a recommendation on how it manages these relationships going forward. Not only is this an important decision for Vector but also for the industry as a whole given the various functions under review. Significant progress has been made to date however,

considerable work remains before a clear view can be reached. This project will remain a focus for the company in the new financial year with the expectation of an outcome within the next 18 months.

## Compliance

Vector committed significant resources to a range of regulatory matters over the last year including the Gas Pipelines Industry Inquiry, the introduction of the new electricity thresholds regime, the Electricity and Gas Industries Bill, promotion of vertical re-integration of the electricity industry, the review of the Resource Management Act, distributed generation regulations, the establishment of the Electricity Commission (and its initial work) and the Gas Industry Steering Group (GISG). Vector will continue to proactively and constructively engage with government and regulatory agencies on these and other matters, with the goal of ensuring government policy and

regulation delivers value to consumers, as well as promoting a positive investment environment and sustainable growth opportunities for New Zealand.

## Growth

Our growth focus remains on network infrastructure ownership and/or management in the Australasian region. We believe that our experience, resources and technology position us strongly to apply our knowledge to other networks either through acquisition or provision of management services.

We have watched with great interest the changing dynamics of the energy industry throughout the year and expect further changes to be played out in the new financial year. Vector has also made no secret of the fact that it is exploring a range of opportunities and we look forward to further progress on these in the coming year.

### OUR PRIORITIES FOR 04/05

TO ACHIEVE ALL SET PERFORMANCE AND FINANCIAL TARGETS

TO CONTINUE TO INVEST IN OUR PEOPLE ON BOTH A PROFESSIONAL AND PERSONAL LEVEL

TO CONTINUE TO ENHANCE OUR CORE BUSINESS AND ACHIEVE FURTHER EFFICIENCIES ACROSS THE BUSINESS

TO COMPLETE THE REVIEW OF THE NETWORK OPERATING MODELS

TO FURTHER INVEST IN NEW TECHNOLOGY THAT INCREASES OPERATIONAL EFFICIENCIES ON OUR NETWORKS

TO OPERATE AS A RESPONSIBLE CORPORATE CITIZEN, BALANCING THE NEEDS OF THE BUSINESS WITH THAT OF THE COMMUNITY AND SURROUNDING ENVIRONMENT

TO CONTINUE TO EXPLORE NEW GROWTH OPPORTUNITIES THAT ADD VALUE TO THE BUSINESS

## Looking ahead

Our outlook for the next year is equally promising. Vector will continue to invest in assets – which include both infrastructure and our people.

Each of our businesses is expected to continue to grow at similar or higher levels. The company will also continue to improve its performance across all networks in regard to service delivery, network efficiency, asset optimisation and customer service. Vector will also remain focused on balancing the economic needs of reliable network infrastructure with the local community and environments in which we operate.

My thanks must go to the Vector team for an outstanding result this year and also to the Vector board who continue to provide valuable direction and support.



**Mark Franklin**

*Chief Executive Officer*