2006 annual result

Michael Stiassny, Chairman

Mark Franklin, Chief Executive Officer

Peter Fredricson, Chief Financial Officer

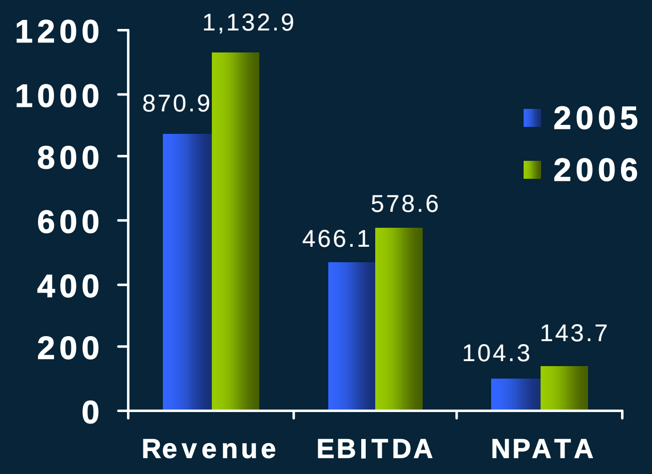
Simon Mackenzie, Group General Manager
Strategy, Regulation & Performance

14 August 2006

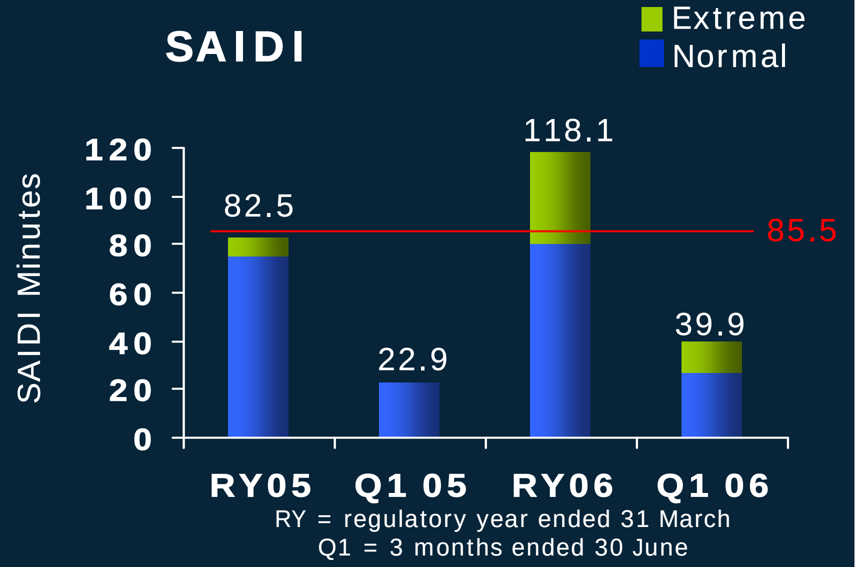
Health chart

Year ended 30 June

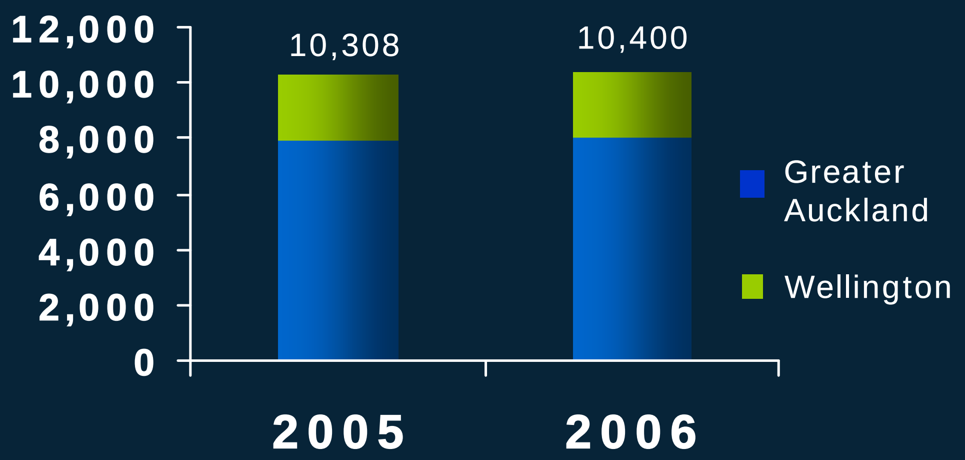
Earnings ($m)



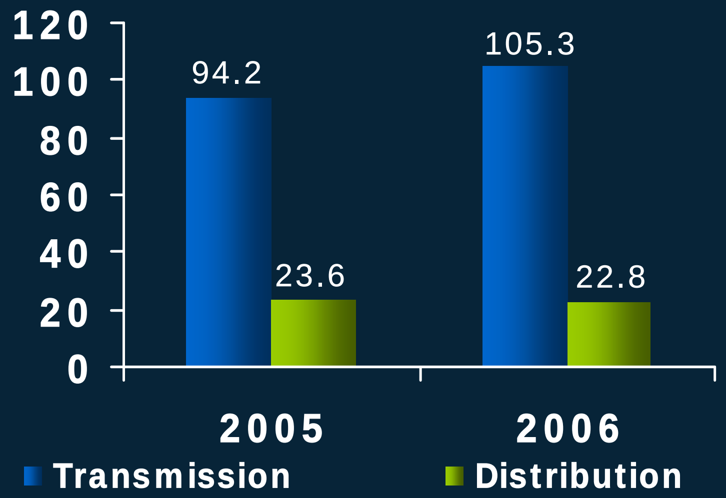
SAIDI



Electricity distributed (GWh)



Gas throughput (PJ)



Financial Results

Peter Fredricson

Chief Financial Officer

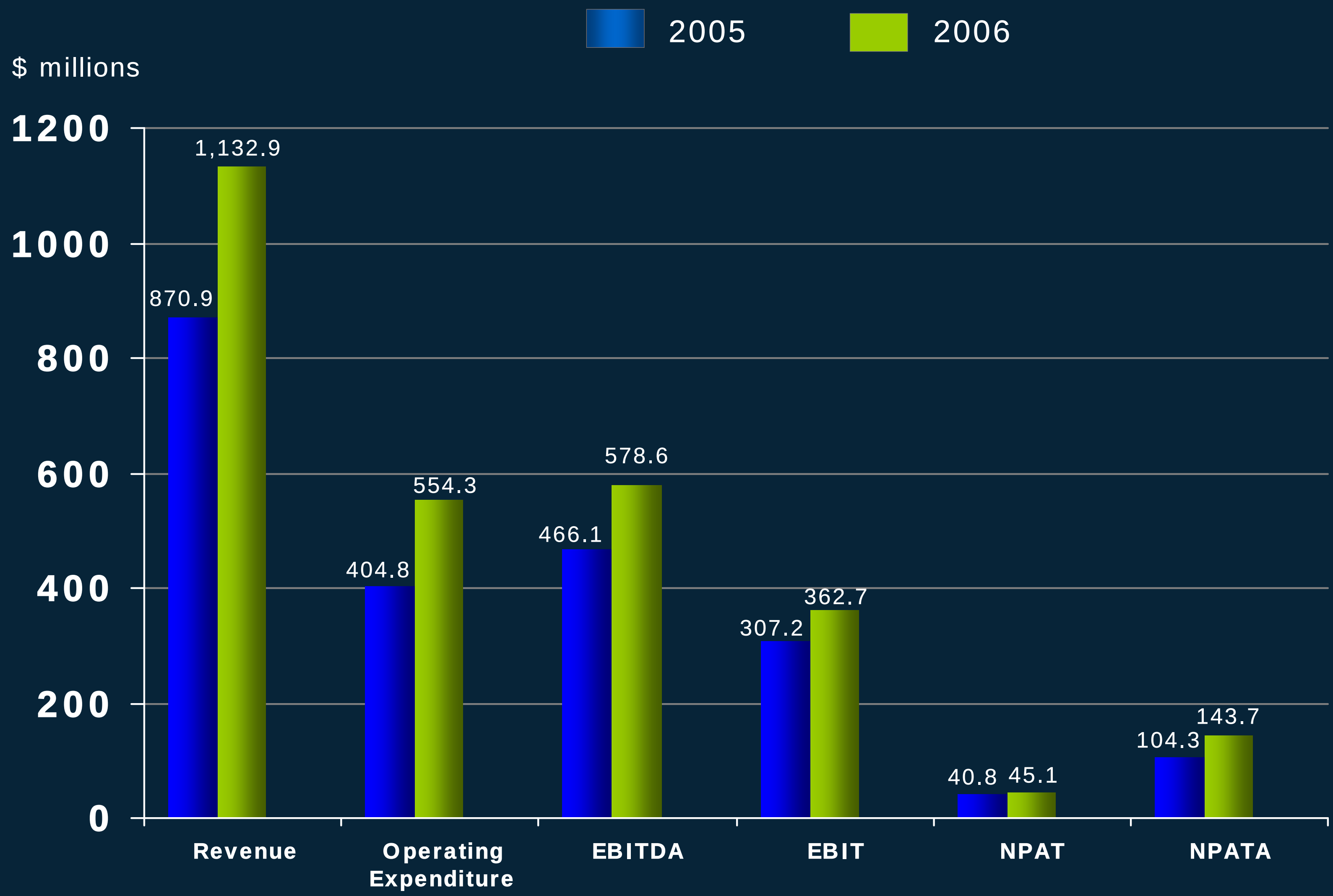
Results summary

Year ended 30 June

$m	2006	2005	% Change	2006 Prospectus	May '06 projection
EBITDA	578.6	466.1	+24.1	578.8	In line with prospectus
EBIT	362.7	307.2	+18.1	358.3	n/a
NPATA	143.7	104.3	+37.8	134.8	142 - 146
NPAT	45.1	40.8	+10.5	36.5	43 - 47

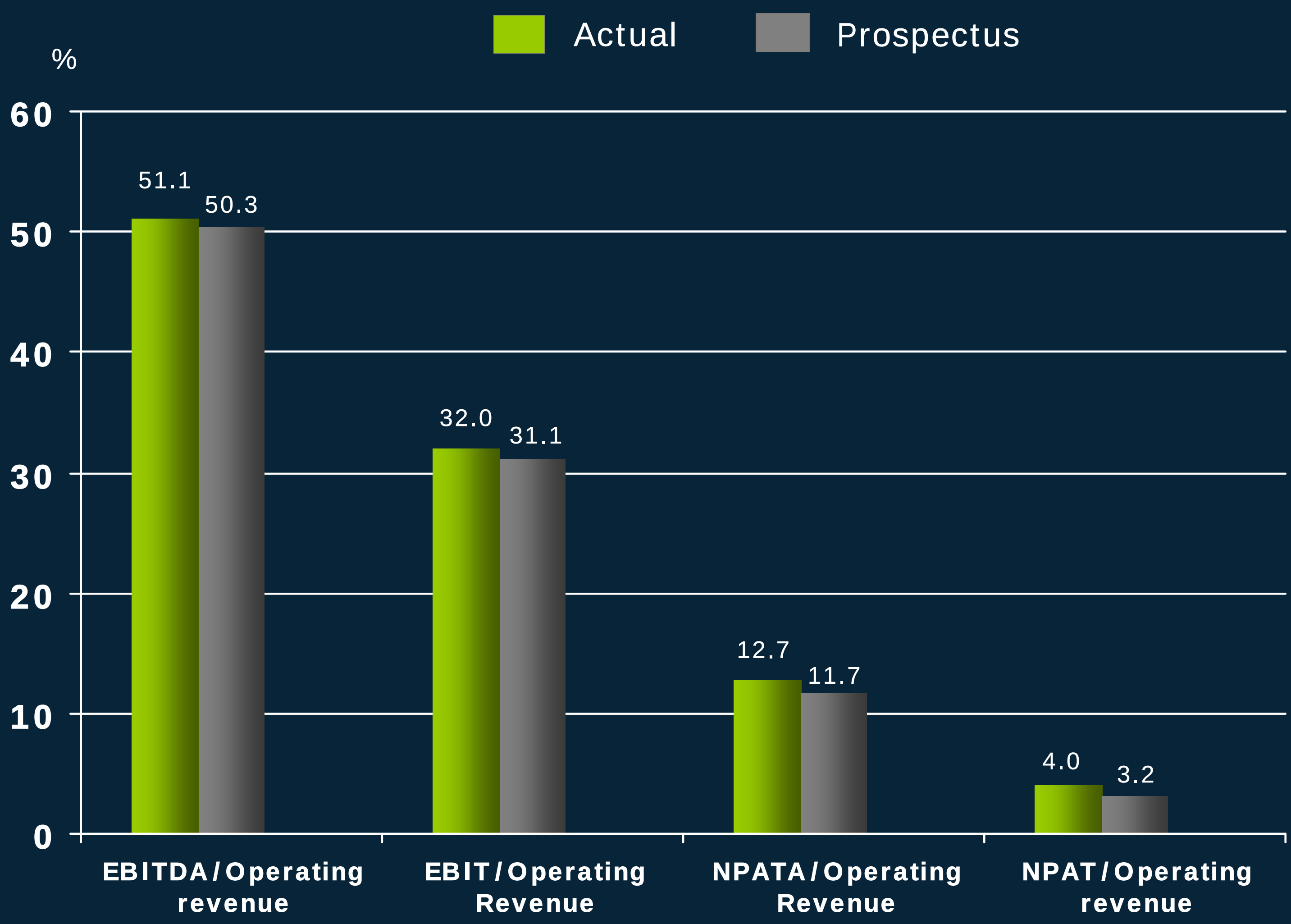
Financial results

Year ended 30 June

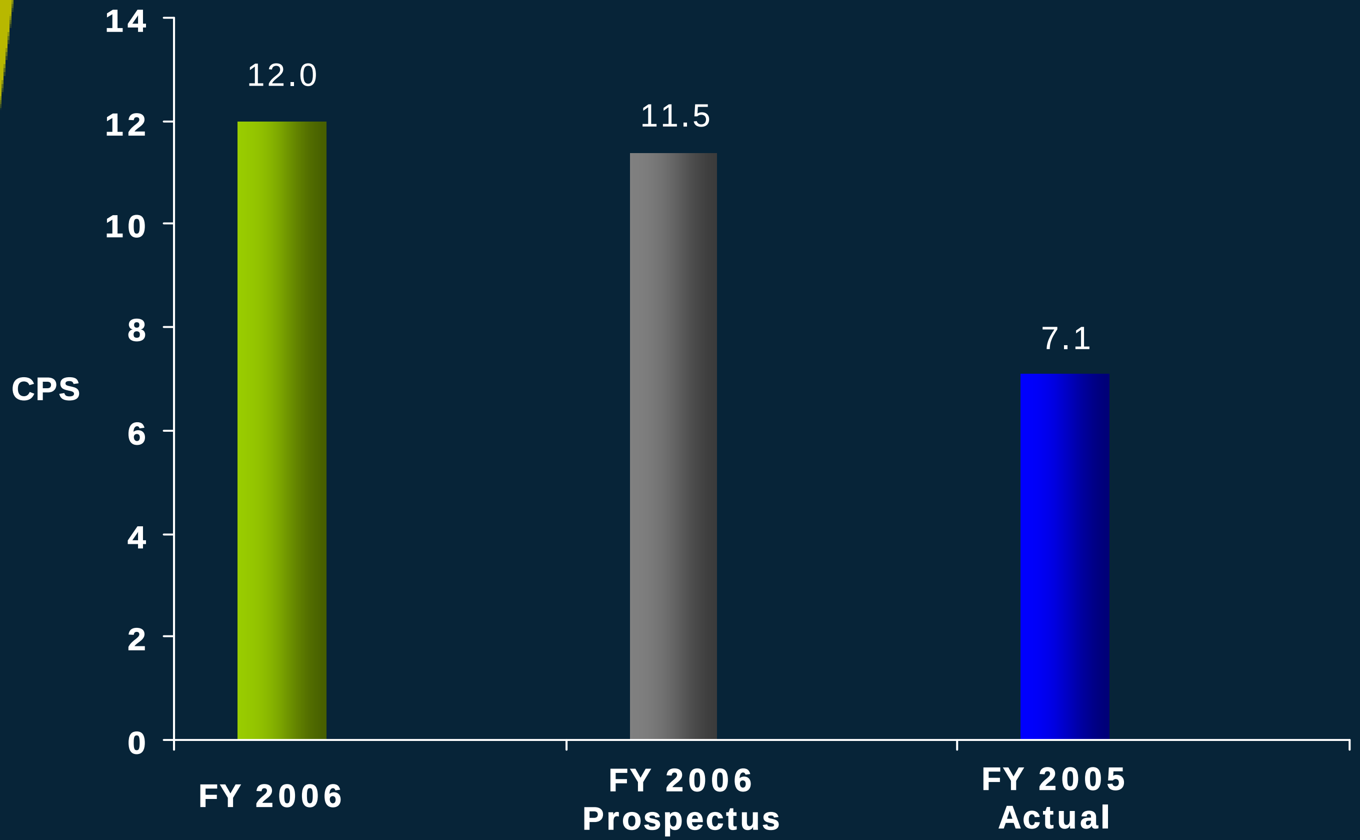


Financial highlights

Year ended 30 June 2006



Dividends



- All dividends shown are fully imputed
- FY 2005 based on 751 million shares
- FY 2006 based on 1 billion shares

Divisional results

Year ended 30 June

2006	Electricity	Gas	Technology	Corporate / Other	Total
Operating Revenue	580.1	486.1	60.3	6.4	1,132.9
Operating Expenditure	(215.6)	(279.0)	(18.4)	(41.3)	(554.3)
EBITDA	364.5	207.1	41.9	(34.9)	578.6
% Revenue	62.8	42.6	69.5	n/a	51.1
EBIT	269.8	121.7	12.9	(41.7)	362.7

2005	Electricity	Gas	Technology	Corporate / Other	Total
Operating Revenue	557.7	271.2	36.9	5.1	870.9
Operating Expenditure	(207.5)	(141.4)	(13.1)	(42.8)	(404.8)
EBITDA	350.2	129.8	23.8	(37.7)	466.1
% Revenue	62.8	47.9	64.6	n/a	53.5
EBIT	262.0	83.5	7.1	(45.4)	307.2

Capital expenditure ($225.2million)

Year ended 30 June 2006

- Electricity - $146.3 million, comprising

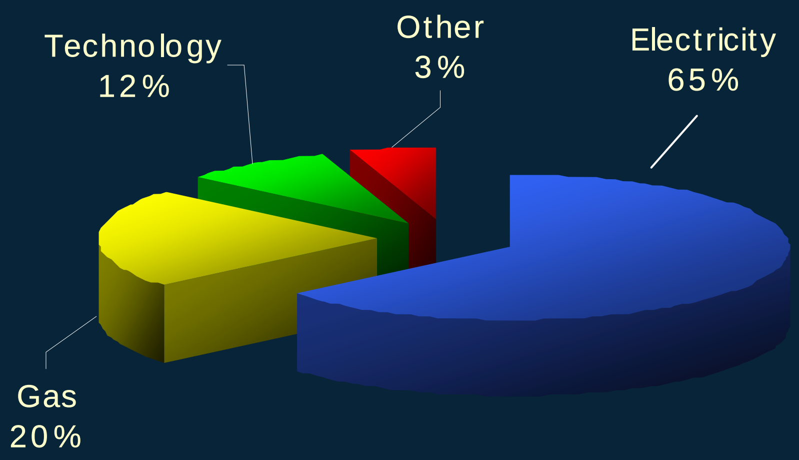
$m	Growth	Maintenance/ Improvement	Total
Auckland	36.9	37.4	74.3
Northern	23.4	23.1	46.5
Wellington	8.5	17.0	25.5
Total	**68.8**	**77.5**	**146.3**

- Gas – $44.2 million
  - ($27.7m growth; $16.5m maintenance/improvement)
- Technology - $26.9 million
- Other - $7.8 million

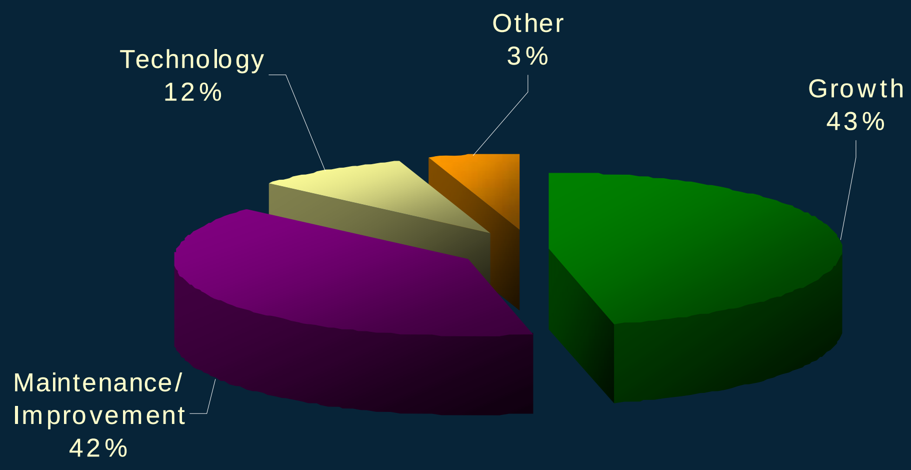
Capital expenditure ($225.2milion)

Year ended 30 June 2006

Capital expenditure – by business



Capital expenditure – by type



Capital structure

Asset Backing and Capital Structure		2004	2005	Prospectus (1)	2006
Net Debt	$m	1,783.9	3,147.6(2)	3,067.8	3,081.1
Equity / Total assets	%	30.8	21.6	28.0	33.7
Debt* / Debt* + Equity	%	65.4	75.1	67.9	61.5
Interest (net) cover	X times	1.6	1.6	1.6	1.6

*net debt

(1) Prospectus as at 30 June 2006

(2) Includes PIPES $354 million as debt under NZ GAAP

Looking ahead

- Vector to adopt New Zealand International Financial Reporting Standards (NZ IFRS) from 1 July 2007
- Good access to debt markets
- Treasury policies – transparent
- Capital bonds first election date 15 December 2006
- $200 million MTNs due for repayment 7 April 2007

Commerce Commission Intention to Declare Price Control

Regulatory - background

2001 - 04

- CC process to develop thresholds regulatory regime for lines companies under Part 4A of the Commerce Act 1986
- Vector fully engaged in process
- Price and Quality thresholds regime put in place
- Price regime: CPI – X (not a rate of return)
- Tax methodology: NZGAAP – accounting tax
- Still the methodology that lines businesses have to comply with under CC's Information Disclosure regime
- This regime did NOT require lines businesses to rebalance

Regulatory – background

- 2004 disclosure reveals minor technical breaches of thresholds set by CC:
  - price breach of $76,000 on $477m of revenue (0.016%) due to difference in budgeted vs actual Transpower transmission costs
  - quality threshold breach due to severe storms
- CC accepts that price path breach outside Vector’s reasonable control

Note – in August 2004 CC cleared six lines businesses for the same beach. One involved a $1m breach on revenues of $44m

Rebalancing - background

- Vector acquired UnitedNetworks inheriting different pricing structures and ROIs
- CC introduced interim thresholds for all lines businesses in 2003/04 pending finalisation of current thresholds
- Vector identified under investment by previous owner posed asset and public safety risk
- Investment programme initiated to address risk
- ROI imbalances recognised
- Vector voluntarily commenced a four-year rebalancing programme in 2005 in the interests of consumers

Rebalancing - background

- Lines companies were advised via energy conference on July 17 that rebalancing was necessary and should be completed by 2009 (ie: when CC resets price thresholds)
- There is no CC methodology or regime on rebalancing
- There has been no formal guidance on the process

Rebalancing – action taken

- Vector moved quickly to address rebalancing once thresholds regime implemented
- Vector's rebalancing programme aimed at:
  - level playing field - consistent/equalised return structure across Vector's seven customer categories in three regional networks
  - fewer tariff levels
  - smooth transition to avoid bill shock
- All customers impacted by price increase or reduction. AECT region customers facing some of largest increases
- Half way through four year programme due to complete in 2009

Rebalancing – CC involvement

- CC requested an update on rebalancing progress in October 2005
- In June 2006 CC suggested administrative settlement formalising rest of rebalancing to clear 2003/04 breaches
- Vector put forward a draft offer in July 2006

Rebalancing – CC involvement

- Draft offer by Vector not accepted
- In response the CC raised concerns about overall returns from electricity networks for first time in July 2006
- CC initiates post-breach inquiry in July 2006 (Vector informs market)
- Vector provides extensive information to CC under s98
- CC announced its intention to control on 9 August after it initiated post breach inquiry less than one month earlier

Government's policy statement released

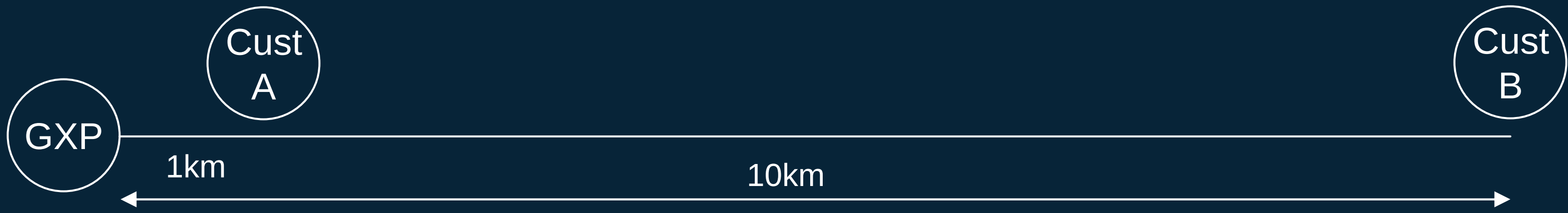
- One week ago today
- Focus on infrastructure investment and security of supply
- Statement requires:
  - regulatory transparency, consistency
  - realistic commercial returns to encourage investment
  - no cross regulation in other investments
- CC must "have regard" to statement under s26 of the Commerce Act
- Vector encouraged and starts to consider investment in more certain environment

Intention to declare control

- CC advises of intention to declare control – Wednesday 9 August
- Implication is Vector's pricing strategy is to cross subsidise customer groups
- Fact is Vector strategy is to voluntarily correct historical customer anomalies

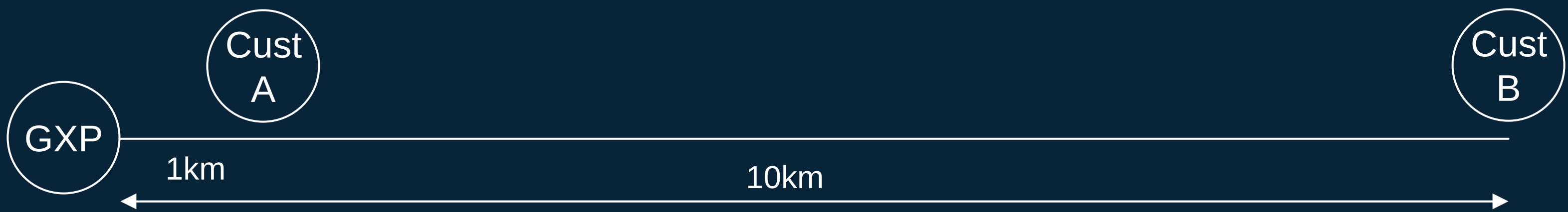
Note: CC tax methodology to assess ROI differs from that used in disclosure and when setting the thresholds

Rebalancing – illustration of issues



Underground cable $2m/km, return 10%, asset value $20m

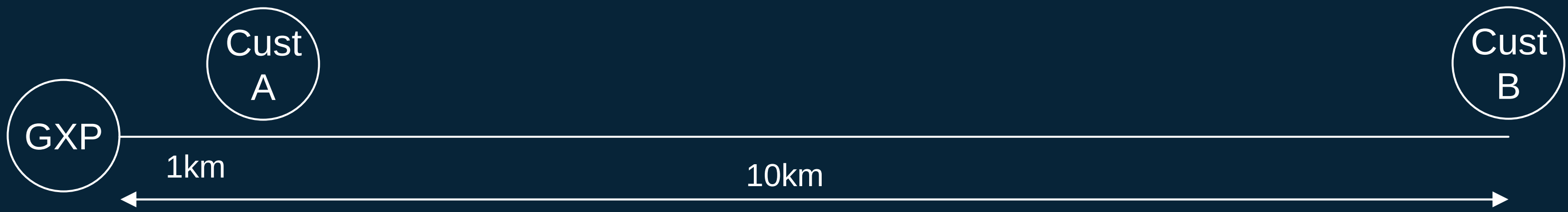
Rebalancing – illustration of issues



Underground cable $2m/km, return 10%, asset value $20m

Methodology	A		B	
	Price	Return	Price	Return

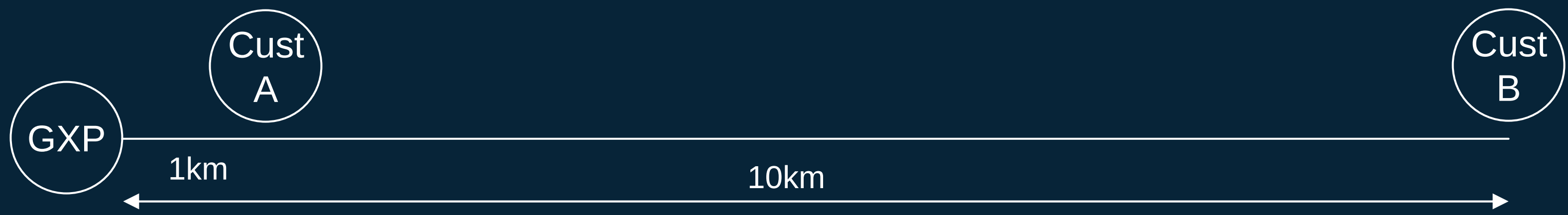
Rebalancing – illustration of issues



Underground cable $2m/km, return 10%, asset value $20m

Methodology	A		B	
	Price	Return	Price	Return
Average	$1m	50%	$1m	5%

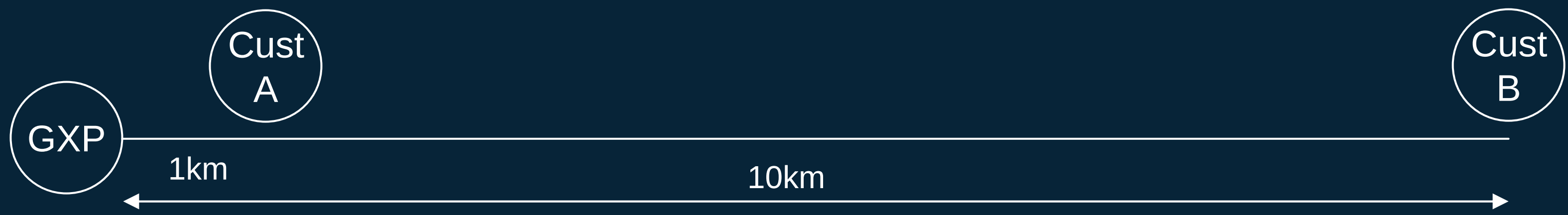
Rebalancing – illustration of issues



Underground cable $2m/km, return 10%, asset value $20m

Methodology	A		B	
	Price	Return	Price	Return
Average	$1m	50%	$1m	5%
Distance	$200,000	10%	$1.8m	10%

Rebalancing – illustration of issues



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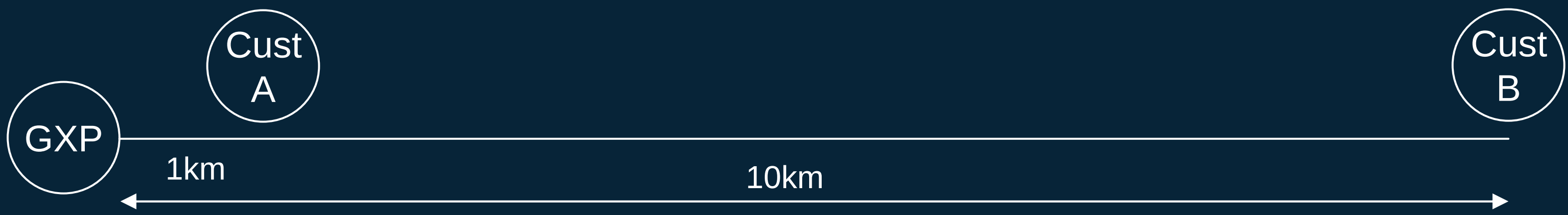
Methodology	A		B	
	Price	Return	Price	Return
Average	$1m	50%	$1m	5%
Distance	$200,000	10%	$1.8m	10%
Age (75% depreciated)	$50,000	10%	$450,000	10%

Rebalancing – illustration of issues



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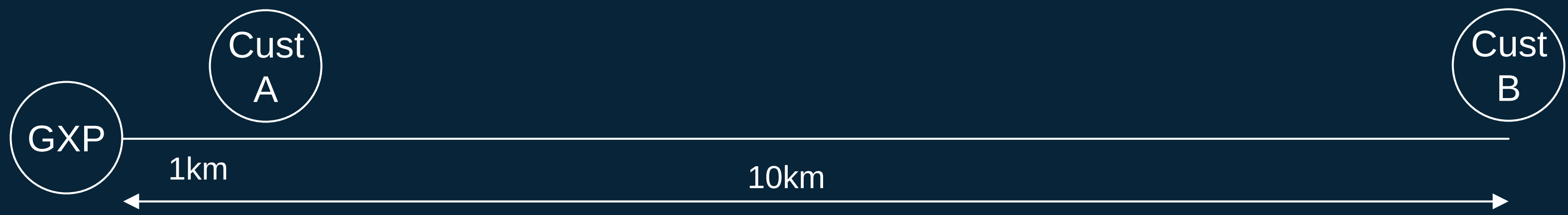
Asset Type (overhead)	$50,000	10%	$450,000	10%

Rebalancing – illustration of issues



Underground cable $2m/km, return 10%, asset value $20m

Methodology	A		B	
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Age (75% depreciated)	$50,000	10%	$450,000	10%
Asset Type (overhead)	$50,000	10%	$450,000	10%

Moving from average prices and more aggregated groups (eg: from Commercial to Small, Medium and Large), coupled with attempting to find a fair allocation methodology has given rise to these issues. This is NOT a deliberate pricing strategy.

The claims and the facts

Claim

Vector is abusing its monopoly power by overcharging/undercharging customers.

Fact

Untrue. Vector is aware of the need to rebalance and commenced a voluntary four-year programme two years ago to address imbalances.

The CC is aware of rebalancing progress to date and has information showing it can be achieved:

- within the timeframe
- within the CC price path thresholds
- with a net revenue neutral effect

The claims and the facts

Claim

Vector is not making sufficient progress to redress the imbalances

Fact

Untrue: We have made good progress.

CC was fully aware of our plans and commitment to rebalance.

Only last month the CC indicated that lines companies have until 2009 to correct price differentials.

The claims and the facts

Claim

Vector is focussed on the short term interests of customers who are also AECT beneficiaries.

Response

Untrue. Vector’s pricing strategy is to have balanced returns across its customer tariff groups and geographic networks. Auckland residential users have already sustained the biggest price increases from the rebalancing. The four-year programme is aimed at smoothing the necessary price adjustment and avoiding a severe price impact of implementing too quickly.

Price decreases have occurred in other regions.

The claims and the facts

Claim

Vector is earning excess revenues. Vector will earn $13m-$75m in excess revenue per year over the next few years. Price reductions of 2%-11% per year are needed to bring returns to a “normal” level.

Facts

Untrue. Vector is operating within the CC thresholds and deliberately earns less than allowed to ensure compliance.

Since 1 April 2004, Vector has foregone over $8m in revenue.

Vector’s overall rate of return to 31 March 2007 is estimated to be 8.2%. The “excess” reflects the CC’s assumptions about cost of capital and changes in tax treatment. This goes to heart of the new Government Policy Statements.

The claims and the facts

This table replicates CC Appendix B , adds upper bounds returns

$'000

	2005	2006	2007	2008	2009
Est. return on ODV	8.37%	8.04%	8.25%	9.03%	9.12%
Excess returns calculation - lower bound					
efficient at WACC * ODV	139,569	144,348	152,678	161,073	169,894
WACC	**7.35%**				
returns - efficient returns	19,381	13,560	18,634	36,807	**40,998**
Excess returns calculation - upper bound					
efficient at WACC * ODV	160,456	165,951	175,528	185,179	195,320
WACC	**8.45%**				
returns - efficient returns	**-1,506**	**-8,043**	**-4,216**	**12,701**	**15,572**

Note: This is not a revenue/profit thresholds regime

Vector's response to CC's move

- CC has not held industry consultation on rebalancing despite calling for it to be done by 2009. Nor is there a methodology.
- Vector criticised by CC for rebalancing process, yet vacuum of CC guidance
- CC did not consult with Vector on effect of the Government policy statement with regard to infrastructure investment.
- Little account taken of Vector's voluntary measures to rebalance, or of future pricing proposals
- We question transparency and consistency

Vector’s response

- Inconsistent with previous CC decisions in similar cases:
  - CC recognised 2004 price breach minor and beyond Vector’s control
  - in 2004 cleared six other lines businesses for similar or greater breaches with no evidence of investigating pricing and return imbalances
- Indicates Vector singled out for special treatment

Where to now

- Vector will provide submissions and follow process
- Vector will seek to continue administrative settlement discussions with CC
- Legal action under consideration – no firm decision made
- We have suspended plans to resurrect or accelerate investment projects

Other regulatory issues

Other significant regulatory developments:

- CC proposal for Final Authorisation for controls over Vector's Auckland gas networks
  - 8 July CC decision not to amend the Provisional Authorisation
  - nominal price freeze will remain until the Final Authorisation
  - submissions closed on 7 August; conference 5-6 September
- Telecommunications legislation to increase competition and incentivise investment may open opportunities
  - Telecommunications Amendment Bill introduced on 29 June
  - Government intends to have it passed by year end
- Ministerial review of regulatory frameworks
  - Vector sees priority for review of Part 4 and 5 of the Commerce Act, with potential for changes to be carried over to Part 4A; and
  - expanded merit appeal process to improve transparency and confidence

Where we’re headed – future strategy

- Continue to manage core business beyond integration
- All large and new investments suspended depending on resolution of regulatory issue
- Existing capital expenditure plans on electricity and gas networks (and corresponding operations) being reviewed

Questions?