

BOARD OF DIRECTORS RECOMMENDATION MEMORANDUM

To:	LineTrust South Canterbury
From:	The Board of Directors, Alpine Energy Limited
Date:	29 September 2020
Title	LineTrust South Canterbury Ownership Review 2020

BOARD RECOMMENDATIONS

1. **Note** contents and summary contained in this report
2. **Recommend** that LineTrust South Canterbury continues to retain its shareholding in Alpine Energy Limited (AEL) for the next three years

SUMMARY

In a recent letter addressed to AEL, the Line Trust South Canterbury (LTSC) Trustees initiated a review of the LTSC's ownership interest in AEL. This review was initiated under LTSC's Deed of Trust clause 4.1, which in summary requires the Directors of AEL to report to LTSC in a manner prescribed by the Deed of Trust.

The requirements are to deliver an analysis of the performance of AEL to the date of the report, together with a discussion of the advantages and disadvantages of continued Trust ownership. The Directors are to prepare a report considering proposals and available options for the future ownership of the AEL shares owned by the Trust. The Deed of Trust gives the Trustees three (broad) options:

- retain the shares in LTSC ownership; or
- dispose of a portion of the shares and retain the remainder in LTSC ownership; or
- dispose of all the shares

The requirements of the Trust Deed are further detailed in Annexure A of this report.

The above has been completed with the recommendation that LTSC continues to retain its shareholding in AEL within LTSC ownership until the next review.

INTRODUCTION

The Board of Directors of AEL have, in accordance with clause 4.1 of the LTSC Trust Deed, completed a review of LTSC's investment in AEL and considered the options available to LTSC.

The Deed of Trust requires the Directors to prepare a report considering proposals and available options for the future ownership of the shares in AEL owned by LTSC. LTSC currently owns 40% of the shares in AEL.

The Trust Deed requires the Trustees to initiate ownership reviews within three years of deciding on any previous review, as long as LTSC continues to hold any shares in AEL.

Clause 4.1 specifies the minimum contents of the report and specifically requires the Directors to set out their conclusions as to the most appropriate form of ownership for the future period.

This is the sixth ownership review of LTSC ownership interest in AEL. The last review was completed in 2017.

LINETRUST OVERVIEW

The LTSC was established in 2002 and holds 40% of the shares of AEL on behalf of the consumer beneficiaries, who are defined in the Trust Deed as consumers who are connected to the AEL network. The direct objective of the Trust is to hold the shares on behalf of the consumers, subject to the provisions of the Trust Deed and the outcome of ownership reviews.

BRIEF COMPANY HISTORY

The predecessors of AEL began in March 1906 when the Timaru Borough Council entered a contract with Scott Brothers of Christchurch to light the town with electricity. The price for this contract was £750 per year for four hours of light per night – except when the moon shone.

In 1915 the council purchased the Scott Brothers' electricity generator and a year later another generator was installed and about 580 customers had been connected.

All electricity developments were in Timaru until 1921 when a meeting of country delegates decided to form a South Canterbury Electric Power Board. The board set about forming a viable electricity supply enterprise across the province.

The South Canterbury Electric Power Board and the Timaru Borough Council agreed for the power board to purchase the town supply. However, the town's residents voted against the proposal. From that day, February 29, 1924, the Timaru Electricity Department, and the power board continued as separate entities.

The Timaru Borough Council purchased all its electricity from the South Canterbury Electric Power Board. This was from the Lake Coleridge power station supply which was made available at Temuka for distribution throughout Timaru and South Canterbury.

The two organisations grew and developed in their separate franchise areas until the Government industry reforms of 1992 prompted the separate bodies to look again at the issue of amalgamation.

A significant step in the 1992 merger and formation of AEL was the creation of a truly representative, community owned company, with its shares allocated to the three local government bodies, and the creation of a new body to represent and hold shares on behalf of consumers.

The Timaru District Council gained proportionally more shares because of its previous sole ownership of Timaru Electricity but the outcome ensured broad representation of these parties via their shareholdings.

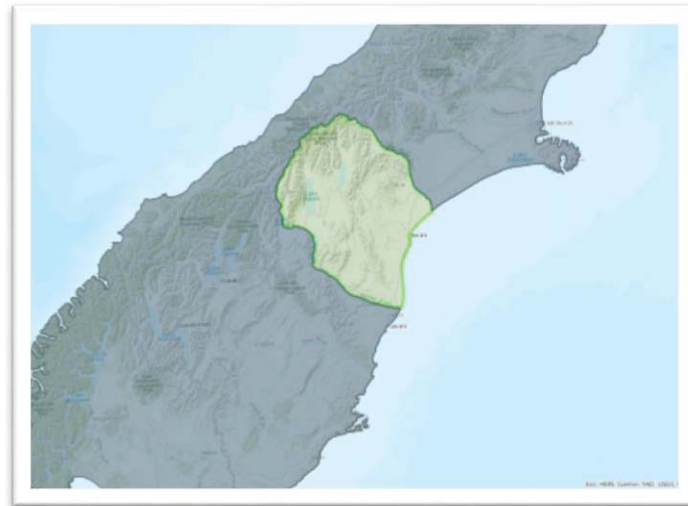
Timaru District Council 47.5% shares

Waimate District Council 7.5% shares

South Canterbury Power Trust 40.0% shares

Mackenzie District Council 5.0% shares

AEL's electricity network boundaries are from the Rangitata River in the north, to the Waitaki River in the south, and from the East Coast to Mount Cook in the west. The area stretches over 10,000 km².



AEL currently has an annual turnover of \$65 million and total assets of \$297 million. AEL's network supplies over 33,000 connected customers with approximately 841 gigawatt hours (GWh) of electricity per annum. The network includes 29 zone substations owned by AEL.

REGULATED BUSINESS

AEL is regulated by the New Zealand Government and the regulatory regime is administered by the Commerce Commission. AEL's regulated prices are determined by the Commerce Commission on a five-yearly basis.

UNREGULATED BUSINESS

AEL's unregulated business activities are operated through the following subsidiaries, associates or divisions:

NETcon Limited (100%) – NETcon constructs and maintains substations, overhead and underground lines and associated equipment for AEL and third party customers. It boasts a modern fleet, well-equipped workshops and experienced and committed staff. AEL accounts for approximately 95% of NETcon's business.

NETcon

Infratec Limited (100%)– Infratec designs, builds and commissions renewable energy projects in New Zealand and the Pacific.

INFRATEC

On Metering Limited (50%) - On Metering Limited (OML) is a joint venture company owned by AEL and Network Tasman Limited, to provide smart meter services within the distribution network boundaries for MainPower. OML is a member of the SmartCo Group which is deploying over 200,000 metres across New Zealand.



Alpine Data Networks (division)— owns and operates fibre optic telecommunications networks running alongside AEL’s electrical network as well as fibre networks in Otago. The fibre optic networks provide AEL with a high-speed communications platform as well as enabling the provision of ultra-fast internet access services to commercial customers.

DIRECTORS REVIEW

PERFORMANCE ANALYSIS

During 2019, AEL engaged PwC to conduct an independent comparative performance analysis of the company, against its peers in the electricity distribution business. The following criteria were assessed:

- Group financial performance
- Network business profitability and lines charges
- Operating expenditure
- Capital expenditure
- Network reliability

This review was presented to shareholders at an update held in November 2019. The results reflected AEL as either outperforming or performing within the benchmark ranges reviewed, with one exception of non-network operational expenditure per ICP (business support costs include consultant, legal and audit fees for the establishment of related party transaction disclosures).

The review covered the financial years FY15 – FY19. AEL has recently published its Annual Report for the financial year ended 31 March 2020. The financial performance review is summarised below:

- The level of revenue increased 43% from \$64M in Year Ending 2016 up to \$91M in the Year Ending 2020.
- Operating Profit After Tax increased 61% from \$13.4M in Year Ending 2016 up to \$21.6M in the Year Ending 2020.
- Total Shareholders’ Funds increased 27% from \$136M in Year Ending 2016 up to \$152M in the Year Ending 2020.
- Earnings Per Share increased 61% from 33 cents per share in Year Ending 2016 up to 52 cents per share in the Year Ending 2020.

TOTAL GROUP REVENUE

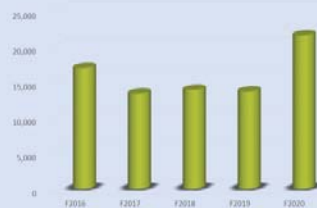


2020 reflected a 15% revenue increase, with a 17% increase in revenue considered core business.

Annual General Meeting 27th August 2020



OPERATING PROFIT AFTER TAX



The 2020 financial result was a record year, with an \$8m year on year increase at the Group's operational level. The increase in income tax to pay was offset by the reduced interest rate swap loss compared to 2019, resulting in an \$8m improvement also in after-tax profit.

Annual General Meeting 27th August 2020



TOTAL SHAREHOLDERS' FUNDS

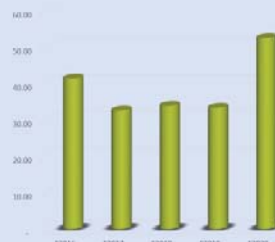


This year saw an extraordinary increase of \$9.4m in Total Shareholders' Funds. This was due to a record surplus being achieved, while dividends paid were maintained. This combination enabled a \$15m reduction in bank debt, providing a strong foundation for future years.

Annual General Meeting 27th August 2020



EARNINGS PER SHARE



Due to the record surplus, this directly reflected the earnings per share, with the 2020 result being a record 52 cents per share.

Annual General Meeting 27th August 2020



RELIABILITY OF SERVICE

SAIDI and SAIFI performance measures ascertain the reliability of the network. Where maximum caps for SAIDI and/or SAIFI are breached, the regulatory regime provides for financial penalties.

The SAIDI and SAIFI performance over the review period is provided below. The reliability of the network has comfortably exceeded the targets set by the regulator.

SAIDI (System Average Interruption Duration Index)

SAIDI (Average Minutes per Interruption)	YE 2020	YE 2019	YE 2018
Maximum Cap	154.15	154.15	154.15
Target	132.81	132.81	132.81
Result	121.80	136.77	115.29

SAIFI (System Average Interruption Frequency Index)

SAIFI (Interruptions per Customer)	YE 2020	YE 2019	YE 2018
Maximum Cap	1.51	1.51	1.51
Target	1.30	1.30	1.30
Result	0.84	0.99	0.99

TRUST OWNERSHIP OPTIONS

1. **Trust Ownership** (100% Trust ownership of shares, status quo)

This is the ownership model currently in practice. All of the shares in AEL are held in Trust for the benefit of consumers. Five persons elected from the community operate LTSC. Elections are held every three years. Every LTSC beneficiary can vote or run for election themselves. Trustees look after the interests of all consumers. Decisions about the company remain in local control. Every year LTSC participates in the formulation of the company's Statement of Corporate Intent (SCI), providing an opportunity to input into the Alpine's strategic direction and engagement. Included in this SCI is a requirement for AEL to engage with shareholders throughout the year. Under this model, consumers can expect to benefit from the most efficient network costs as trust beneficiaries receive direct benefits by way of discounts on power accounts. The current ownership model focuses on the interests of present and future consumers.

2. **Mixed Ownership** (distribution or sale part of shares)

Under this model, the shares would be divided between individual consumers and LTSC. Depending on the distribution of shares, LTSC would have a greater or lesser influence on the direction of the company, and the relationship between consumers and the network company might or might not have a local focus. Consumers would experience a taste of both forms of ownership, but probably not the greatest benefit of either. Administration would be more complex.

3. **Individual Ownership** (distribution of 100% of shares to existing consumers)

Under this model, all the shares in AEL would be issued to individual consumers, who would then become individual shareholders. After-tax benefit from the profitable business activity would be received as a dividend, and would extend to anyone who owned shares, even if they ceased to be consumers. Individual shareholders, no matter where they lived, would have the usual rights of shareholders to elect directors, attend general meetings, receive dividends, sell shares, etc. Consumers would no longer have a collaborative voice or benefit from receiving dividends if they sold their shares. Experience in other geographical regions has shown that many consumers are likely to sell their shares. Eventual ownership and decision making could easily transfer outside of South Canterbury.

4. **Private Ownership** (sale of 100% of LTSC's shares)

Under this model, LTSC would sell all of LTSC's shares in AEL and distribute the proceeds among existing consumers or hold the proceeds in Trust. In the event of an outright sale, it would then limit consumer's ability to influence company decisions or to exercise control of the company at a future date. There would be no foreseeable benefit to consumers from any profitable business activity unless they were shareholders in the company that purchased AEL.

DIRECTORS SPECIFIC RESPONSE TO CLAUSE 4.1 OF LINETRUST TRUST DEED

The Directors specific responses to the matters specified on Clause 4.1, and which are to be contained within the report, are:

- a) *an analysis of the performance of the Company to the date of the report, together with a discussion of the advantages and disadvantages of continued Trust ownership;*

Directors' comment: The analysis of AEL's performance is included in this report and the benchmarking analysis from PwC. The advantages and disadvantages are discussed earlier in this report. The Directors consider that the Company's operating performance has been satisfactory over the last five years and has demonstrated consistent growth in earnings and value.

- b) *if a distribution of shares is recommended, a draft Share Allocation Plan detailing:*
- *the manner in which and the Consumers to whom the shares (if any) and assets constituting the Trust Fund are to be distributed and such shares and assets may be distributed to a greater or lesser extent to some or all of the Consumers;*
 - *the manner in which and the Consumers to whom the proceeds of the sale of shares (if any) received as a result of a disposal of shares are to be distributed and such proceeds may be distributed to a greater or lesser extent to some or all of the Consumers;*

Directors' comment: The distribution of shares is not recommended.

- c) *a summary of the professional advice (if any) obtained in respect of the preparation of the report.*

Directors' comment: No external professional advice has been obtained in respect of the preparation of this report.

- d) *a statement as to whether the directors have had regard to any views expressed by the public with respect to ownership.*

Directors' comment: AEL directors have given regard to the public consultation undertaken in 2019 whereby Timaru District Holdings Limited proposed to sell its shares. Of the submissions received, 501 were opposed, 32 mixed/neutral and 40 in favour. A petition was further launched to contest the proposal to sell its shareholding in AEL.¹ This demonstrates a strong desire by LTSC consumers to retain ownership of AEL.

RECOMMENDATION

After considering the main outcomes of the above, being:

- AEL's strong performance and efficiency
- The desire of consumers to continue with LTSC ownership of AEL
- The vision of current Trustees that ensures AEL contributes to the growth of South Canterbury

AEL Directors have discussed the matter of LTSC and its ongoing role.

The following recommendation represents the AEL Board's view:

THAT the Directors of AEL recommend that LTSC continues to hold its ownership interest in AEL.

¹ <https://www.stuff.co.nz/timaru-herald/news/109277586/pressure-mounting-on-council-to-abandon-alpine-energy-share-sale-proposal>

ANNEXURE A - REQUIREMENT OF THE TRUST DEED

The Deed of Trust extract is included for reference below:

4. REVIEW

- 4.1. *Within 3 years from the date of the last review completed by the Trustees of the Initial Trust, the Trustees shall require the Directors to prepare a report considering proposals and available options for the future ownership of the shares. Such report shall contain the following detail:*
 - a) *an analysis of the performance of the Company to the date of the report, together with a discussion of the advantages and disadvantages of continued Trust ownership;*
 - b) *if a distribution of shares is recommended, a draft Share Allocation Plan detailing:*
 - *the manner in which and the Consumers to whom the shares (if any) and assets constituting the Trust Fund are to be distributed and such shares and assets may be distributed to a greater or lesser extent to some or all of the Consumers;*
 - *the manner in which and the Consumers to whom the proceeds of the sale of shares (if any) received as a result of a disposal of shares are to be distributed and such proceeds may be distributed to a greater or lesser extent to some or all of the Consumers;*
 - c) *a summary of the professional advice (if any) obtained in respect of the preparation of the report.*
 - d) *a statement as to whether the directors have had regard to any views expressed by the public with respect to ownership.*
- 4.2. *The Trustees shall comment on the report to the Directors and upon completion of their review of the report, the Trustees shall make the report available to the public together with a summary of their comments. [‘available to the public’ means making the information available for inspection at any office of the Trust or any office of the Company or at any other place in the District on normal business hours on any business day, after giving 3 days’ notice of the place(s) and times in a newspaper].*
- 4.3. *The Trustees and the Directors shall in respect of the report and no later than 1 month after the date of the report, implement the Special Consultative Procedure set-out in Schedule 2 of the Deed of Trust.*
- 4.4. *Following completion of the Special Consultative Procedure and not later than 6 months after the report date, the Trustees and the Directors shall meet and, after taking due account of the view expressed by the public and the Directors, the Trustees shall decide whether to:*
 - a) *retain the shares in the Trust; or*
 - b) *dispose of a portion of the shares and retain the remainder of the Trust; or*
 - c) *dispose of all of the shares*
- 4.5. *If the shares are to be retained by the Trust, the Trustees shall notify the public by making the information available for inspection at any office of the Trust or any office of the Company or at any other place in the District on normal business hours on any business day, after giving 3 days’ notice of the place(s) and times in a newspaper.*
- 4.6. *If the shares or any portion of them are to be distributed, the Trustees shall prepare a Share Allocation Plan in terms of Schedule 3 of the Deed of Trust.*