



**KING COUNTRY
ELECTRIC POWER TRUST**

**OWNERSHIP REVIEW
CONSULTATION DOCUMENT**

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KING COUNTRY ELECTRIC POWER TRUST

1 February 2017

The Beneficiaries
King Country Electric Power Trust

Ownership Review

Dear Beneficiary

1. I am writing to you on behalf of the Trustees of the King Country Electric Power Trust (**Trust**).
2. Under our Trust Deed, the Trustees of the Trust are required to carry out, at no more than five yearly intervals, a review of the available options for the future ownership of the Trust's 'Review Shares', which are the shares the Trust owns in King Country Energy Limited (**KCE**).
3. The purpose of this ownership review is to determine whether the Trust should retain ownership of its shares in KCE or not. We would like to draw your attention to the fact that this ownership review is particularly pivotal to the Trust as it includes an opportunity to reshape KCE that would change the nature of the assets owned by the Trust. We hope that you will consider this report carefully, and take part in the public consultative process to allow the Trustees to have the benefit of your input when making the right decisions for the future of the Trust, the beneficiaries and the community.
4. As required by clause 4.1 of the Trust Deed, we have engaged Pricewaterhouse-Coopers (**PwC**) to undertake an independent assessment of the Trust's share ownership options. PwC's report dated 17 January 2017 is **attached** for your information. The interests of our beneficiaries and the community have always been at the core of the Trust's focus and we are committed to providing accurate and transparent information about the options being considered. This letter and the PwC report have been prepared with these objectives in mind.
5. We provide below a summary of the factual background, followed by a summary of the key conclusions in PwC's report, the Trustees' views on PwC's report, and what to expect next (including the Public Consultative Procedure that will now take place).

Factual background

6. The Trust holds 20% of KCE's shares, and Trustpower Limited (**Trustpower**) is the major shareholder in KCE with a 64.6% shareholding. As such, Trustpower has a major controlling interest in KCE. **This is the reality that the Trust has to manage in the best manner it can for the beneficiaries (owners) of the Trust.**

7. Trustpower has offered the Trust the option to explore a set of transactions whereby the Trust may be able to own 100% of KCE (although KCE would have a different portfolio of assets following the transactions), and thus could have total control of KCE's destiny on behalf of its beneficiaries.
8. The PwC report provides information regarding the options available to the Trust, including whether the Trust retains or distributes the Review Shares. Of note, most options considered result in the Trust retaining ownership of the shares in KCE. The Trustees are seeking public feedback on the options, through the Public Consultative Process described later in this letter.

Key recommendations in PwC's report

9. PwC's report provides the detail required by clause 4.1(a)-(c) of the Trust Deed. It also represents the professional advice obtained by the Trust, which is summarised in this letter as required by clause 4.1(f) of the Trust Deed.
10. PwC's report contains the following recommendations:
 - (a) The options of distributing all shares in KCE to beneficiaries, or selling the shares to public or institutional investors, would be unlikely to deliver long-term benefits for KCEPT's beneficiaries;
 - (b) The remaining options involve the Trust retaining ownership of the shares, either under the status quo, or through a transaction with Trustpower. The decision on which of these options to prefer rests on the relative risks and opportunities between:
 - (i) the status quo (under which the Trust holds shares in a well-performing company and has a growing investment portfolio but faces some significant potential headwinds); and
 - (ii) the option to transact with Trustpower (which gives the Trust full control over post-transaction KCE, but reduces the diversity of KCEPT's investments). The option for transacting with Trustpower is described in the box below.

Summary of option for transaction with Trustpower

KCE currently owns five hydro-electric generation plant – Mangahao, which is a large plant, and four smaller plant and operates an electricity retail business.

KCE would sell its retail business and Mangahao generation plant to Trustpower and retain ownership of the four small hydros. It then would acquire the Hinemaiaia generation plant from Trustpower. The Trust would gain all the equity in KCE, but may be required to top up the transaction.

KCE would operate as a stand-alone generation business with the five generators. This would enable KCEPT to fully own and control an electricity hydro generation business. This would enable the Trust to set a direction for KCE that is aligned to the interests of the Trust's Beneficiaries.

There would be an initial cost to the transaction, likely resulting in reduced distributions to Beneficiaries in the short term but with the possible result of increased distributions over the medium and long term.

Depending on the extent of investment, this option may result in the Trust divesting its investment portfolio to fund the transactions.

The Trust, as sole shareholder of KCE, would need to ensure that it has the skills and expertise to provide appropriate governance to the Company, although it should also have these skills and expertise currently.

Trustees' views on the form of share ownership

11. As required by clause 4.1(d) of the Trust Deed, the Trustees' preliminary conclusions as to the most appropriate form of share ownership in response to the PwC report are as follows:
 - (e) The Trustees have a **preliminary unanimous view** on the best way forward. It is "that the Review Shares should be retained by the Trust."
 - (d) Based on the view expressed above, no distribution of Review Shares is recommended at this stage for the purposes of clause 4.1(e) of the Trust Deed.
12. These conclusions **are preliminary** until such time as the Trustees have had a chance to take account of the views expressed by the public through the Public Consultative Procedure referred to in clause 4.3 of the Trust Deed.

What to expect next

13. For the purposes of clause 4.1(g) of the Trust Deed, the Trustees have not yet had regard to any views expressed by the public with respect to ownership. These will now be obtained through the Public Consultative Procedure that the Trustees will undertake under clauses 4.2 and 4.3 of the Trust Deed.

14. Under this Public Consultative Procedure, persons interested in the proposals above will be able to make submissions to the Trustees. Any person who makes written submissions on the proposals will have a reasonable opportunity to be heard by the Trustees. Any meetings at which submissions are heard, or at which the Trustees deliberate on the proposals (including the final decision of the Trustees in relation to the proposal), will be open to the public. We are currently planning to hold the following public meetings:

Taumarunui: Friday the 17th of March, 7 pm at the Memorial Hall supper room

Turangi: Tuesday the 21st of March, 7 pm at the Senior Citizens Hall,
83 The Town Centre

Ohakune: Thursday the 23rd of March, 7 pm at the RDC Chambers

15. Under clause 4.3 of the Trust Deed, following completion of the Public Consultative Procedure, and in any event not later than six months after the date of this report, the Trustees will then decide whether to retain the Review Shares in the Trust, dispose of a portion of the Review Shares and retain the remainder in the Trust, or dispose of all of the Review Shares – after taking due account of the views expressed through the Public Consultative Procedure. If the Trustees decide to retain the Review Shares in the Trust, they will also decide whether to retain the status quo structure of KCE or enter into the transaction with Trustpower that is summarised above.
16. If the Review Shares are to be retained by the Trust, the Trustees will notify the public under clause 4.4 of the Trust Deed. Conversely, if the Review Shares or any portion of them are to be distributed, the Trustees will prepare a Distribution Plan and notify this to the public as required by clauses 4.5 and 4.6 of the Trust Deed.
17. We are keen to receive your views and input on the options for the Review Shares that are discussed in this letter and the PwC report. Please provide your feedback to the address below:
18. The Trustees welcome submissions on the report from interested persons. These are to be received no later than 3pm on 17 March 2017. Make your submission in writing or by electronic format to:

The Secretary,
King Country Electric Power Trust,
C/O Balance Chartered Accountants,
37 Miriama Street
PO Box 384 Taumarunui 3946

Email: carla@balanceonline.co.nz

Yours sincerely

Robert Carter
Chairman
King Country Electric Power Trust
Email: unca.rokit@xtra.co.nz

King Country Electric Power Trust

Ownership Review

*Ownership review of the
King Country Electric
Power Trust*

January 2017





The Trustees
King Country Electric Power Trust
PO Box 421
Taumarunui 3946

17 January 2017

Dear Trustees,

Ownership review

We are pleased to provide our report on the following:

- the performance of King Country Electric Power Trust (KCEPT, or the Trust), including a review of the recent performance of King Country Energy Limited (KCE, or the Company)
- the advantages and disadvantages of trust ownership of KCE
- a review of the share ownership options in respect of KCE.

Our report will contribute to the five yearly ownership review, as required of the Trustees by Clause 4 of the Trust Deed of KCEPT.

This report is provided in accordance with the terms of our Engagement Letter dated 1 July 2016 and the subsequent scope of work dated 14 October 2016 and is subject to the Restrictions in Appendix A.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Craig Rice', written in a cursive style.

Craig Rice
Partner
craig.rice@nz.pwc.com
09 355 8641

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1. Executive summary

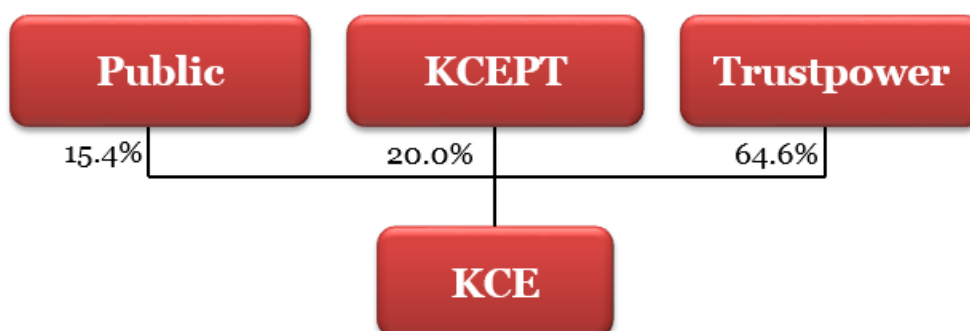
1.1. Introduction to KCEPT and KCE

KCEPT is an energy consumer trust based in Taumarunui. Its investments include a 20% stake in KCE, which is a regional electricity generation and retail business, and a portfolio of other investments valued at approximately \$15.5m. KCEPT also holds approximately \$4.4m in cash.

KCEPT receives dividends from its investments and makes distributions to the Beneficiaries of the Trust. The Beneficiaries are energy consumers living in the area previously supplied by the King Country Electric Power Board. In the year ended 31 March 2016, KCEPT distributed \$1.3m to its Beneficiaries and aims to maintain and grow these distributions. The KCEPT Trustees are elected every three years by the Beneficiaries. This promotes a strong focus by the Trust on the interests of the local community. KCEPT's objective, as specified in the Trust Deed, is:

The object of the Trust is to hold the Shares in the Company on behalf of the Consumers and to exercise the rights attaching to the ownership of the Shares and distribute to the Consumers in their capacity as owners, the benefits of ownership of the Shares in the Company including any dividends received by the Trust, and to carry out future ownership reviews involving public consultation in accordance with the terms of this Deed.

KCE's major shareholder is Trustpower, which owns 64.6% of KCE. The remainder is held by other, smaller, investors. The current ownership of KCE (as at 31 October 2016) is set out below.



Generation assets currently owned by KCE are summarised in the table below. Elsewhere in this report, the Kuratau, Mokauiti, Piriaka and Wairere plants are referred to collectively as the '4 small hydros'.

Plant	Location	Opened / commissioned	Installed capacity	Mean annual output
Mangahao	Shannon	1924	39.8 MW	127 GWh
Kuratau	Omori	1962	6.0 MW	28 GWh
Wairere	Wairere	1925	4.5 MW	17 GWh
Mokauiti	Aria	1963	1.9 MW	7 GWh
Piriaka	Piriaka	1924	1.5 MW	7 GWh
Total			53.7 MW	186 GWh

Source: PwC analysis

1.2. What this report is about

This report discusses options for the future of KCEPT and KCE. The options discussed have different advantages and disadvantages for KCEPT's Beneficiaries.

To put the options in context, this report first discusses the recent performance of KCEPT and KCE relative to their peers and the performance of the Trust's portfolio of other investments. It then considers the advantages

and disadvantages of Trust ownership of KCE. Finally, it outlines and assesses the options for the future of the KCEPT shareholding in KCE in the light of recent performance and expected market changes.

1.3. KCEPT performance review

Over 2012-2016 (March years), the Trust made average annual distributions of \$1.1m, peaking at \$1.3m in 2016. This represents an average payout of 69% of net surplus (excluding the profit on disposal of TLC shares during 2014).

We benchmarked KCEPT's expenses and trustee fees against other selected energy consumer trusts. Consistent with the last ownership review, the Trust's expenses were lower than the peer group average. Trustee fees were also lower than the peer group average, in particular trustee fees as a proportion of trust revenue.

Overall it appears the Trust has performed well in the period since the last ownership review. It has divested non-strategic assets and used the funds from this to build up its shareholding in its core asset and diversify into other investments. Distributions to Consumers have increased and KCEPT benchmarks well against comparable energy trusts in terms of the efficiency of its expenses and trustee fees.

1.4. KCE performance review

KCE constitutes the main investment of KCEPT. We have reviewed the performance of KCE both as a New Zealand electricity generator-retailer and as an investment. We conclude that the company has for the most part performed well in challenging market conditions.

As a generation and retail business, we consider KCE has performed well because:

- KCE's cash flow (proxied by EBITDAF) and equity value per MWh compare favourably with the large generator/retailers, despite a large difference in the scale of operations. This illustrates KCE's ability to consistently generate per unit shareholder value comparable to its much larger competitors and may reflect its ability to effectively manage hedging arrangements.
- KCE has generated increased revenue levels over the review period, despite losing customers in its retail segment. This was driven by favourable hydrology conditions and wholesale electricity prices in the generation segment, as well as increased volumes of electricity in its retail customer portfolio.
- The company has achieved increasing profit margins (measured by EBITDA) on its generation segment since 2013. The retail segment has seen increased EBITDA since 2014, although this growth has been lower than that in the generation segment.
- The acquisition of the Mangahao asset has seen an increase to KCE's asset balance and a corresponding increase in debt borrowings, but has also facilitated a growth in revenues. The acquisition has increased KCE's gearing and reduced cash liquidity ratios as well as the Company's return on assets and equity, although KCE debt remains relatively low and within acceptable debt coverage ratios.

From an investment perspective, we consider that:

- Over the period from March 2010, KCE's share price has generally underperformed the NZX, which has seen much higher growth, particularly since 2013. However, KCE is a small company on the Unlisted market with limited liquidity, and thus its performance may not be expected to match the NZX. KCE's share price performance has been broadly consistent with that of other listed energy generation and retail companies.
- The dividend yield of KCE has averaged around 6% over the review period, which compares favourably to the other traded electricity companies. KCE's dividend return was higher than the average market returns generated by the NZX All Shares Index over the review period.
- However, KCE's return on assets and return on equity have been below the level we would expect a New Zealand generation business to earn over time. We note that these metrics can be affected by non-cash revaluations but these metrics are relevant as they can be compared to a reasonable benchmark cost of

capital in order to consider the return that is received on the capital invested. We have calculated a return on assets and a return on equity for KCE excluding revaluations and these remained below what we would expect.

- Total shareholder return, which incorporates share price appreciation and dividends paid, averaged 12.7% over the review period. The share price appreciation partly reflects increased interest in the company, including the recent sale of Todd's shares in KCE to Trustpower and offers made to minority shareholders.

It is also important to note that there are some emerging risks in the New Zealand electricity sector that suggest it may be challenging to maintain KCE's current level of performance. These include:

- Modest demand growth and the impact of excess capacity on wholesale prices
- Regulatory changes to the transmission pricing methodology (TPM) and pricing rules for distributed generation that are likely to reduce revenues for distributed generators like KCE
- The potential for rapid technology change (ie solar PV, energy efficiency)
- Retail margins that are under pressure from the competitive retail market, which continues to experience a high degree of switching and entry of retailers with innovative offerings.

1.5. Performance of portfolio investments

As noted above, KCEPT has an investment portfolio with a current value of \$15.5m.

The portfolio is heavily weighted to equity (44%) and fixed interest (42%) investments, with small amounts of property and cash. The equity investments are heavily weighted towards New Zealand Equities (69%), followed by International Equities (21%) and Australian Equities (10%).

Since the portfolio was established in May 2014 it has made an average annual return of approximately 6.8% (compounding) after tax and fees.

1.6. Options for the Review Shares and other opportunities

The Trust is required to prepare a report no more than every five years considering proposals and available options for the future ownership of its shareholdings in KCE, being the shares that it holds in trust on behalf of its beneficiaries (referred to as "Review Shares").

This ownership review is being held now because the Trust is considering how best to position its investment in KCE in light of emerging risks being faced in the electricity sector and in the context of Trustpower's majority ownership stake. The Trust is considering options for working with Trustpower to restructure KCE to remove its risk to the competitive retail market and restructure its generation portfolio. It is necessary to ensure KCEPT's Beneficiaries are fully informed about the performance of the Trust and the Company and the range of options available.

This section summarises five options for the future of KCEPT:

Options being considered by the Trust

No.	Option	Description	Assessment
1.	Status quo	No change – the Trust continues to own 20% of KCE and retains its investment portfolio	<p>KCE has performed reasonably well in maintaining profits despite a declining retail market share and retail sector margins as well as volatility in generation revenue.</p> <p>Future prospects for KCE as it is currently structured do not appear to be positive – retail market competition continues to squeeze margins and there is a proliferation of new, innovative, retail offerings making it difficult to compete. The majority shareholder, Trustpower, is unlikely to use KCE as a vehicle for future growth. As such, there is a case for change, provided it can deliver value to the Trust and its Beneficiaries.</p>
2.	Distribution	The Trust is wound up and all shares are distributed to the Beneficiaries	Winding up KCEPT would deliver a short-term benefit to today’s Beneficiaries but future generations of Beneficiaries would be disadvantaged as they would not receive future distributions from the Trust. We note that the Trust was established with an 80 year term.
3.	Sale to public	<p>(a) Some of KCEPT’s KCE shares are sold to the public. The proceeds received could be invested in other opportunities or distributed to the Beneficiaries.</p> <p>(b) Sell all of KCEPT's KCE share.</p>	<p>(a) Selling some of the Review Shares (ie KCEPT’s shares in KCE) could deliver funds for other investments.</p> <p>(b) If KCEPT sold all of the Review Shares then the Trust is required to be wound up.</p>
4.	Sale to investors	(a) Some of KCEPT’s KCE shares are sold to institutional investors. The proceeds received could be invested in other opportunities or	<p>(a) As for option 3(a).</p> <p>(b) As for option 3(b).</p>

		distributed to the Beneficiaries. (b) Sell all of KCEPT's KCE share to institutional investors.	
5	100% ownership of a restructured KCE	<p>The Trust is considering options with Trustpower to restructure KCE to better position the Trust's future investments. This would see the Trust own 100% of KCE.</p> <p>KCE would sell its retail business and Mangahao generation plant to Trustpower. It then would acquire the Hinemaiaia generation plant from Trustpower. The Trust would gain all the equity in KCE, but may be required to top up the transaction.</p> <p>KCE would operate as a stand-alone generation business with the five generators.</p>	<p>This would enable KCEPT to fully own and control an electricity hydro generation business. This enables the Trust to set the direction of KCE that is aligned to the interests of the Trust's Beneficiaries.</p> <p>There would be an initial cost to the transaction, likely resulting in reduced distributions to Beneficiaries in the short term but with the possible result of increased distributions over the medium and long term.</p> <p>Depending on the extent of investment, this option may result in the Trust divesting its investment portfolio to provide funds to KCE to allow it to expand its hydro generation portfolio of small scale generation.</p> <p>The Trust, as sole shareholder of KCE, would need to ensure that it has the skills and expertise to provide appropriate governance to the Company, although it should also have these skills and expertise currently.</p>

** Hinemaiaia is a hydroelectric power plant currently owned by Trustpower. Hinemaiaia is located on the eastern shore of Lake Taupo and was commissioned in 1952. It has an installed capacity of 6.1 MW and a mean annual output of 29 GWh.*

Conclusion

The options discussed above cover a broad spectrum of available choices for KCEPT. Based on our assessment of the Trust, the Company and the New Zealand electricity market, we consider that:

- Options 2-4 (distributing all shares in KCE to beneficiaries or selling the shares to public or institutional investors and distributing the proceeds to Beneficiaries) would be unlikely to deliver long-term benefits for KCEPT's Beneficiaries
- The remaining options are the status quo and the transaction with Trustpower.

The decision on which option to prefer rests on the relative risks and opportunities between the status quo (with a well-performing company and growing investment portfolio but facing some potential headwinds) and the opportunity for transacting with Trustpower (which gives the Trust full control over post-transaction KCE, lessens the risk to KCE in respect of its retail operations but reduces the diversity of KCEPT's investments).

This report does not provide detailed forecasts of returns that could be expected under each option so as to not prejudice the Trust's position in any negotiation with Trustpower.

The Trust seek Beneficiaries' views on the various options to allow it to consider which, if any, should be progressed and implemented if the trustees believe it appropriate.

2. Introduction

2.1. Background

KCEPT was established in 1993 by the King Country Electric Power Board as a consumer trust. Initially, KCEPT was the sole shareholder of KCE, which took over all of the assets and operations of the King Country Electric Power Board. Subsequently, regulatory changes required the ownership of distribution (lines) assets to be separated from the ownership of generation and retailing activities, and The Lines Company (TLC) was formed to hold KCE's electricity distribution business.

The map below shows the KCEPT distribution area, located in the central North Island.



At the date of the last ownership review in November 2012, the Trust owned the following stakes in KCE and TLC:

- **14.2% of KCE:** the remainder held by Todd Energy (54.1%) and public shareholders
- **10% of TLC:** the remaining 90% owned by the Waitomo Energy Services Consumer Trust.

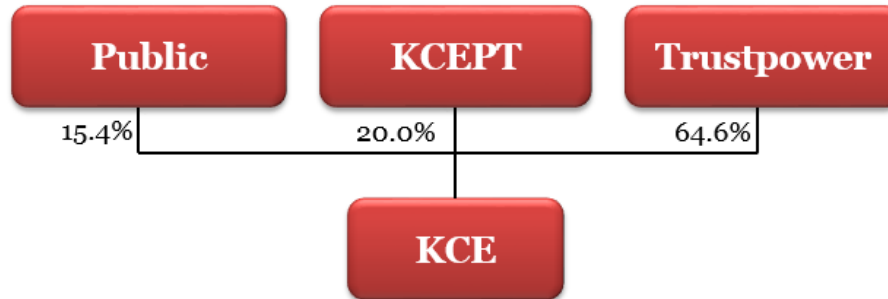
Since the last ownership review, there have been changes in the shareholdings of the Companies, as reported on by the Trustees in the annual reports and other communications:

- KCEPT divested its 10% shareholding in TLC in January 2014
- KCEPT built its KCE shareholding up to 20%
- In December 2015, Todd Energy sold its 54.1% stake in KCE to Trustpower. Subsequent to this, Trustpower made a two-tiered pricing offer under the Takeovers Code for 100% of KCE's shares. At the date of this report, Trustpower holds 64.5% of KCE's shares.

KCEPT now owns:

- **20% of KCE:** the remainder held by Trustpower (64.6%) and public shareholders
- **A portfolio of investments:** built up following the sale of the TLC shareholding, currently valued at approximately \$15.5m
- **Cash:** \$4.4m.

The ownership structure of KCE (as at 31 October 2016) is set out below:



The Trust's shares in KCE are referred to in the Trust Deed as the Review Shares, and we use this term in this report. The Review Shares are held in trust by KCEPT for the benefit of consumers, who are broadly speaking the customers of KCE's legacy electricity distribution business. Consumers are by definition also the beneficiaries of the Trust, and we have used the terms Consumer and Beneficiary interchangeably.

2.2. The ownership review

The Trust is required to prepare a report no more than every five years considering proposals and available options for the future ownership of its shareholdings in KCE (the Review Shares). This review is being conducted earlier than the five year period in order to consider a current opportunity and other available options for the future ownership of the Review Shares.

The report must comply with the requirements of Clause 4 of the KCEPT Trust Deed¹, which requires:

- a. an analysis of the performance of the Trust to the date of the report together with a discussion of the advantages and disadvantages of trust ownership
- b. an analysis of the various ownership options considered including, without limitation:
 - i. a distribution of the Review Shares to Consumers or Electors
 - ii. a sale of the Review Shares to the public or institutional investors
 - iii. retention by the Trust
- c. a comparison of the performance of KCE with the performance of other similar energy companies covered by the Energy Companies Act 1992 and subsequent legislation
- d. the conclusions of the Trustees as to the most appropriate form of ownership together with an indication whether the conclusions are unanimous and if the decision is not unanimous, a summary of the conclusions of the dissenting Trustees
- e. the matters contained in Clause 4.5 (being a Distribution Plan) if a distribution of shares is

¹ As amended on 19 October 2011

recommended

- f. a summary of the professional advice (if any) obtained in respect of the preparation of the report
- g. a statement as to whether or not the Trustees have had regard to any views expressed by the public with respect to ownership.

2.3. Scope of work

PricewaterhouseCoopers (PwC) has been engaged to provide professional advice in respect of items a, b and c for input into the ownership review. As a consequence of the options being considered, this report also considers options that affect KCEPT's other investments.

The last PwC report was issued in November 2012, and covered the financial reporting periods ended March 2007 - 2012. This report includes the 2012-2016 financial reporting periods. We note that during the review period KCE changed its financial year from March to December for FY15 (9 months), and then back to March for FY16 (15 months).

Our report has been structured as follows:

- Section 1: Executive summary
- Section 2: Introduction
- Section 3: KCEPT performance review
- Section 4: KCE performance review
- Section 5: Performance of portfolio investments
- Section 6: Options for the Review Shares and other opportunities.

This report is subject to the Restrictions in **Appendix A**.

A detailed assessment of KCE's financial reports is set out in **Appendix B**.

An assessment of the advantages and disadvantages of trust ownership of the Review Shares is set out in **Appendix C**.

The sources of information we have had access to and relied upon in preparing this report are listed in **Appendix D**.

3. *KCEPT performance review*

3.1. *Introduction*

In this section, we consider the Trust's objectives, recent achievements and financial performance over the review period.

3.2. *Trust objectives*

The primary objective of the Trust is to hold the Review Shares on behalf of the Consumers. In relation to these shares the Trustees have, *inter alia*, a responsibility to:

- act as a diligent shareholder and monitor the performance of the directors of KCE
- exercise shareholder rights, such as voting on shareholder matters and considering offers for the shares
- assist KCE, to the extent possible, to meet their respective objectives, including optimising the return on assets
- receive and distribute dividends and/or other distributions received from KCE
- conduct ownership reviews
- take any action necessary or desirable to protect, maintain or promote the best interests of the Consumers.

The KCEPT Trustees are elected every three years by the Beneficiaries. This promotes a strong focus by the Trust on the interests of the local community. KCEPT's objective, as specified in the Trust Deed, is:

The object of the Trust is to hold the Shares in the Company on behalf of the Consumers and to exercise the rights attaching to the ownership of the Shares and distribute to the Consumers in their capacity as owners, the benefits of ownership of the Shares in the Company including any dividends received by the Trust, and to carry out future ownership reviews involving public consultation in accordance with the terms of this Deed.²

In short, the Trustees must ensure that KCEPT's investments are appropriately managed in order to maximise value, and above all that the interests of the Beneficiaries are protected. To this end, the Trustees have wide powers, including authority to dispose of existing investments, make new investments, borrow funds, and appoint directors to the boards of the investee companies (where permissible).

3.3. *Recent achievements*

KCEPT's recent achievements are:

- The Trust has rebuilt its shareholding in KCE to 20% through media advertising and letters to shareholders
- The Trust has sold its 10% shareholding in TLC, which was regarded as a non-strategic investment following the 2012 ownership review
- Funds from the sale of TLC shares were reinvested in assets which provide better returns and growth prospects for the Trust, including a fully managed investment portfolio with BNZ Private Banking
- Distributions were made to Beneficiaries of the Trust totalling \$5.6m over 2012 to 2016.

² KCEPT Trust Deed, page 1.

3.4. Review of financial reports: 2012-2016

Set out in the table below are summary statements of financial performance for the Trust for the past five years:

King Country Electric Power Trust (\$000 March year end)	2012	2013	2014	2015	2016
Dividend income	1,409	1,690	2,372	1,803	1,957
Interest income	433	334	261	573	414
Profit on disposal of investments	-	-	11,580	636	397
Other income	1	0	6	173	191
Total Revenue	1,843	2,025	14,220	3,185	2,959
General operating expenditure	(226)	(231)	(303)	(192)	(344)
EBITDA	1,617	1,793	13,917	2,993	2,615
Depreciation	(3)	(1)	(1)	(1)	(1)
EBIT	1,615	1,792	13,916	2,992	2,614
Tax Expense	(533)	(591)	(769)	(720)	(689)
Net Surplus	1,082	1,201	13,147	2,272	1,925
Distributions	1,119	931	960	1,253	1,314
Coverage ratio					
Distributions / Net Surplus	103.5%	77.6%	7.3%	55.2%	68.3%

Source: Annual Reports (2012-2016), PwC Analysis

The largest revenue stream for KCEPT is dividend income, which it receives from its shareholding in KCE and (up to 2014) TLC. A one-off profit on disposal of investments was recorded in 2014 arising from the Trust's divestment of its TLC shares.

The Trust made average annual distributions of \$1.1m to beneficiaries over the review period, representing a payout of approximately 69% of the aggregate net surplus (excluding the profit on sale of TLC shares in 2014).

The amount of dividend income received from KCE increased following 2014 as the Trust rebuilt its shareholding in KCE to 20%.

To assess KCEPT's performance it is helpful to benchmark the expenses and trustee expenses of KCEPT against other selected energy consumer trusts. There are more than 20 energy consumer trusts or energy community trusts in New Zealand. We have compared KCEPT to those other trusts that are most comparable to KCEPT. We selected comparable trusts in a three-step process:

1. Trusts for whom comparable data is not publicly available are excluded.
2. Most energy consumer trusts own electricity network businesses and only a few own generation and retail businesses like KCE. Thus we include the Trusts with available information that own generation and retail businesses in our sample. On this basis we included the Tauranga Energy Consumer Trust and the Central Lakes Consumer Trust, who own shares in Trustpower Limited and Pioneer Energy Limited respectively.
3. For the remaining trusts which own electricity network businesses, we selected those trusts whose total asset values were most comparable to those of KCEPT. The Counties Power Consumer Trust, Electra Trust, Network Tasman Trust and West Coast Electric Power Trust were selected in this way.

For the 7 trusts including KCEPT, we have assessed Trust expenses relative to the trust assets, while trustee fees have been analysed on a per trustee basis and as a percentage of trust revenue.

Consumer Trusts	Expenses Over Assets %	Trustee fees	
		Per Trustee \$000	Over Revenue %
Counties Power Consumer Trust	1.0%	21.5	21.3%
Electra Trust	1.7%	14.0	29.5%
Network Tasman	1.7%	17.5	5.0%
West Coast Electric Power Trust	0.5%	15.5	59.6%
Tauranga Energy Consumer Trust	0.2%	33.7	0.1%
Central Lakes Trust	n/a	16.0	n/a
King Country Electric Power Trust	0.8%	18.2	3.1%
Average	1.0%	19.5	19.8%

Source: Information Disclosures, Trust Annual Reports

We note that the level of variation seen in the table above is heavily influenced by the differing scale and investment portfolios of the trusts. Across the three metrics presented above, KCEPT's expenses as a proportion of assets and average trustee fees were more efficient than the average of comparable trusts. There is significant variation in the assessment of trustee fees as a proportion of revenue, reflecting the different scale of the companies. However, KCEPT's trustee fees as a proportion of revenue was significantly lower than the group average.

The financial position of the Trust over the review period is summarised in the table below.

King Country Electric Power Trust (\$000 March year end)	2012	2013	2014	2015	2016
Current Assets					
Cash and cash equivalents	97	1,108	3,024	8,111	918
Accrued interest / debtors	2	133	85	1	0
Provisions for income tax refund	58	26	105	85	111
Inventories	7	7	7	-	-
Investments	9,323	5,167	14,863	306	3,686
Prepayments	-	-	-	105	106
Total	9,487	6,441	18,084	8,607	4,821
Non-Current Assets					
Term investments	25,937	31,729	19,786	31,046	36,735
Property, plant and equipment	3	1	1	2	1
Total	25,940	31,731	19,787	31,048	36,736
Total Assets	35,427	38,172	37,870	39,655	41,557
Creditors	35	4	3	3	30
Total	35	4	3	3	30
Equity	35,393	38,168	37,868	39,652	41,527
Return on equity (ROE)*	3.26%	3.26%	4.12%	5.86%	4.74%

* Note: 2014 ROE has been calculated using the net surplus excluding profit on disposal of TLC shares

Source: Annual Reports (2012-2016)

The primary assets of KCEPT are non-current financial assets relating to the Trust's equity interests in KCE and the investment portfolio managed by BNZ covering both equity and fixed interest investments.

The Trust has mostly performed well over the review period. There has been an improvement in its return on equity (RoE) ratio, particularly since it implemented the investment portfolio, although this level of return is still considered relatively low. KCEPT's net return reflects the operating expenses incurred by the Trust.

A breakdown of the Trust's available for sale assets is presented in the table below.

Available-for-sale securities (\$000 March year end)	2012	2013	2014	2015	2016
KCE	13,537	19,329	19,321	20,481	21,746
TLC	12,400	12,400	-	-	-
Other securities	-	-	465	10,564	14,989
Total	25,937	31,729	19,786	31,046	36,735

Source: Annual Reports (2012-2016)

3.5. Conclusion

Overall it appears the Trust has performed well in the period since the last ownership review. It has divested non-strategic assets and used the funds from this to build up its shareholding in its core asset and diversify into other investments. Distributions to Consumers have increased and KCEPT benchmarks well against comparable energy trusts in terms of the efficiency of its expenses and trustee fees.

4. KCE performance review

4.1. Introduction

This section considers the performance of KCE, the largest investment of KCEPT. It first provides an overview of the Company, its ownership and its activities. It then considers the performance of the Company from two perspectives – as a New Zealand electricity generation and retail business and as an investment, before considering future prospects and risks for the New Zealand electricity sector. It ends with a conclusion on the performance of the Company from both perspectives discussed.

4.2. Company overview

KCE is an integrated electricity generator and retailer based in Taumarunui, King Country, in the North Island. The Company took over the electricity retail operations of the King Country Electric Power Board in 1991 and evolved to its present form (no longer including electricity distribution services) after the 1998 electricity industry reforms.

Given the history and ownership of the Company, KCE has a strong regional focus in its operations. Four of its five generation plants are located in the King Country region with the Mangahao plant located in the Manawatu. KCE primarily supplies retail services in Waikato, Manawatu and Auckland with smaller numbers of customers in other regions.

Ownership

In December 2015, Todd Energy sold its 54.1% stake in KCE to Trustpower. Subsequent to this, Trustpower made a two-tiered pricing offer under the Takeovers Code for 100% of KCE's shares. The ten largest shareholders as at 31 October 2016 are set out in the table below.

King Country Energy Major shareholdings	Number of shares	%
Total shares on issue	25,312,277	
King Country Energy Holdings Limited (Trustpower)	16,339,846	64.6%
King Country Electric Power Trust	5,057,142	20.0%
Montrose Account	124,000	0.5%
General Finance Holdings Limited	59,626	0.2%
John Laurence Nation Fam Account	58,740	0.2%
Allan John Nation	42,164	0.2%
Steven Campbell Nation	42,163	0.2%
Leon Darryl Cherry	26,770	0.1%
Louis Keith Falkner	25,000	0.1%
Crusader Meats New Zealand Limited	21,869	0.1%

Source: www.companiesoffice.govt.nz

Generation

KCE owns four hydroelectric power plants in the King Country region and the Mangahao plant in Manawatu. All of the plants owned by KCE are renewable, hydro generation technologies with a mix of run-of-the-river and dam installations. A summary of the plants owned by KCE and their expected output is set out in the table below.

Plant	Location	Opened / commissioned	Installed capacity	Mean annual output
Mangahao	Shannon	1924	39.8 MW	127 GWh
Kuratau	Omori	1962	6.0 MW	28 GWh
Wairere	Wairere	1925	4.5 MW	17 GWh
Mokauiti	Aria	1963	1.9 MW	7 GWh
Piriaka	Piriaka	1924	1.5 MW	7 GWh
Total			53.7 MW	186 GWh

Source: PwC analysis

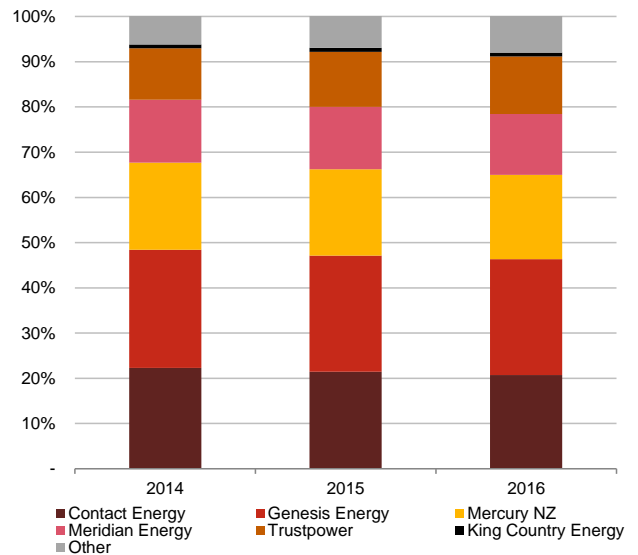
In the context of the national supply system, KCE is small player. In 2016, the ‘big five’ generators produced over 38,000 GWh of electricity. The smallest of the ‘big’ companies, Trustpower, generated 2,312 GWh of electricity (approximately 11 times KCE’s 2016 generation) and Meridian Energy, the largest generator in the market, generated 13,707 GWh of electricity (approximately 66 times KCE’s 2016 generation).

Retail

KCE’s customer share of the New Zealand electricity retail market is approximately 0.9%. This is highly concentrated in the targeted service area of the wider King Country region. KCE’s 2016 annual report stated that it held 64% of the market share by volume in the King Country region. This is a relatively high proportion of customers for any single New Zealand electricity retailer to hold in a region.

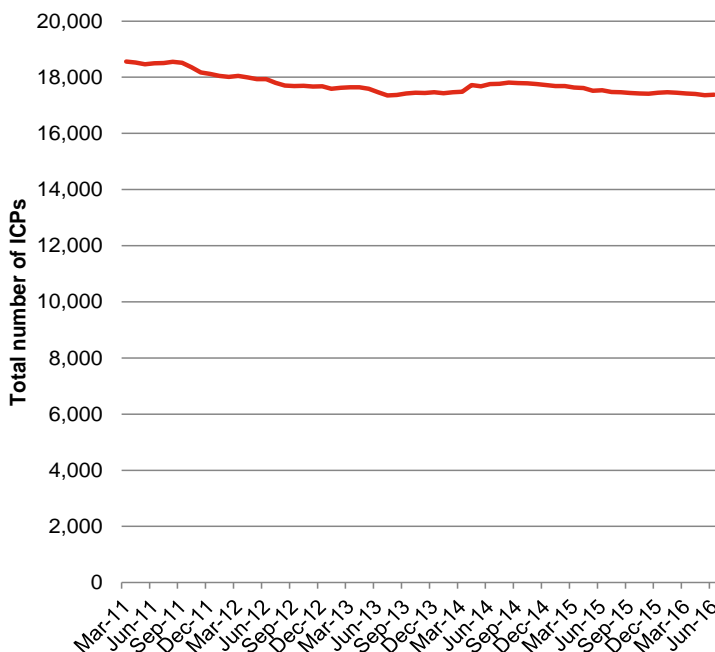
The chart opposite summarises the market shares of the national retail electricity market and illustrates the relatively small size of KCE.

Market share ICPs



Source: Electricity Authority

King Country Energy ICPS



Source: Electricity Authority

The retail market has seen more active levels of customer switching (‘churn’) as a result of increased awareness from the “What’s my number” campaign and the entry of multiple new retailers – there are now 31 retail brands in the market. The chart opposite illustrates the downward trend in KCE’s customer base. Since March 2011, KCE has lost approximately 1,200 (6.3%) of its retail customers.

Despite the increased generation output provided from the acquisition of the Mangahao station, KCE holds a retail customer portfolio that demands a volume of electricity in excess of the volume it generates. This gap between generation supply capability and retail demand obligation is a state that is referred to as being ‘long on retail’ and ‘short on generation’. To bridge the gap, KCE typically enters into

supply agreements (known as hedges) in advance and purchases electricity at spot rates from competitors in the wholesale market as required.

The table below presents a breakdown of the generation and retail load of KCE for the past five years.

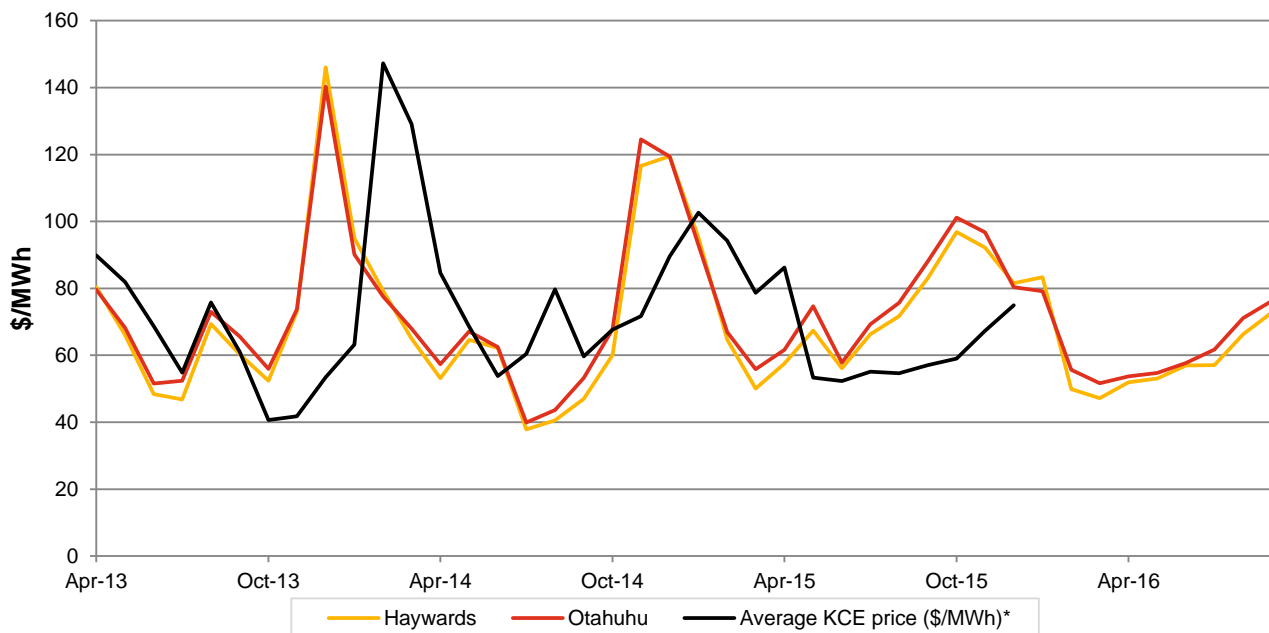
GWh	2012	2013	2014	2015	2016
Retail load	201	207	214	225	229
Own generation	131	164	185	184	206
Wholesale market purchases	70	43	29	41	23

Source: Annual reports (2012 to 2016), KCE Management Information

The average retail load over this period was 215 GWh compared to the average generation load of 177 GWh. This represents an average net exposure of 38 GWh that KCE has purchased from the wholesale spot market or entered into hedge arrangements to cover.

Given the volatility in the wholesale spot price, as illustrated in the chart below, failure to successfully hedge the Company's net exposure at a reasonable price can have a material impact on KCE's financial results. An example of this is the unfavourable movements in the fair value of electricity derivatives during 2013 (caused by an unusually high spot price event in February 2013) that reduced KCE's profits in that year, although we note this was a non-cash item. As illustrated in the chart below, while KCE's average MWh price lags the wholesale market price changes (as a result of billing timeframes) it closely shadows key changes in wholesale market prices.

Mean price in dollars per MWh



Source: www.emi.ea.govt.nz, KCE Management Information
 * Note KCE monthly generation volume data was provided up to December 2015.

4.3. KCE's performance as a generation and retail business

Financial ratios

A detailed assessment of KCE's financial performance is set out in Appendix B. In this section, as a summary, we consider the key financial ratios for the Company over the review period.

The liquidity ratios shown below indicate that the Company's ability to pay its current obligations as they fall due has weakened over the review period. The leverage ratio has increased as debt was used to fund the Mangahao acquisition, however we note that KCE's leverage ratio is conservative compared to that of the Big 5 gentailers.

The asset turnover ratio shown below has reduced slightly from 2012 to 2016, as the Mangahao acquisition increased the Company's asset balance by more than the change to net profit. Aside from an asset revaluation in 2012, there have been minimal revaluations in the remaining years of the review period.

The return on assets and return on equity of the Company have been strongly correlated over the historical period. These ratios fell in 2013 as a result of the Mangahao acquisition before recovering back to 2012 levels in 2016. The ratios in 2016 were positively influenced by the higher net profit derived from gains in the fair value of electricity derivatives.

Financial Ratios	2012	2013	2014	2015	2016
Liquidity and Solvency					
Current ratio	3.63	0.53	1.11	3.25	1.22
Debt / equity	0.00	0.19	0.21	0.22	0.17
Debt / (Debt + Equity)	0.00	0.16	0.17	0.18	0.14
Assets / equity	1.27	1.38	1.45	1.46	1.45
Profitability and Efficiency					
Asset turnover	0.27	0.26	0.21	0.24	0.24
Return on equity	5.7%	2.3%	3.8%	3.0%	6.0%
Return on assets	4.4%	1.6%	2.6%	2.0%	4.2%
Return on equity (excluding revaluations*)	7.0%	2.2%	4.5%	3.3%	7.7%
Return on assets (excluding revaluations*)	5.7%	1.6%	3.1%	2.3%	5.3%

Source: Capital IQ, Annual Reports (2012-2016), PwC analysis, KCE Management Accounts

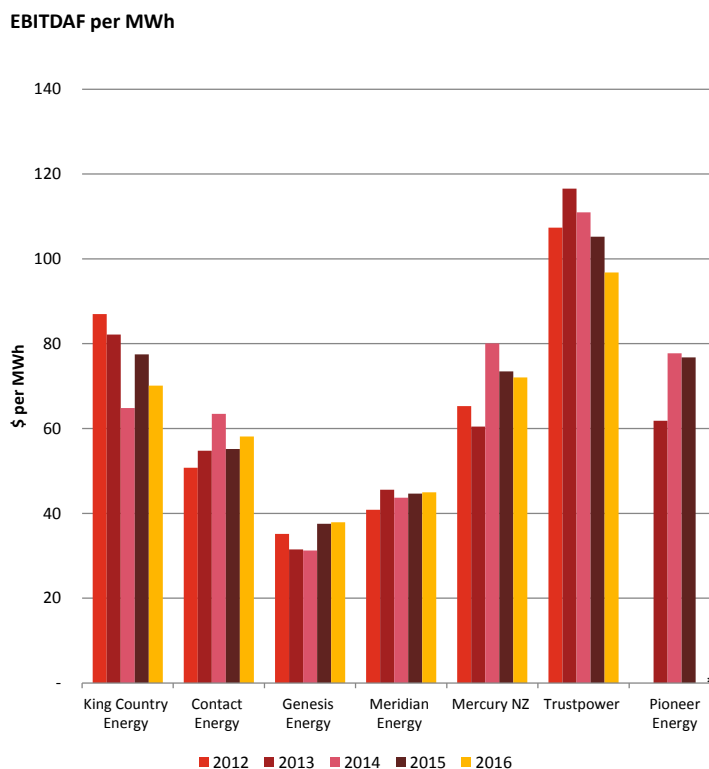
*Assuming simple average depreciation of 2%, tax at 28% and no material asset disposals or impairments

KCE performance against comparable companies

Set out in the charts below are three metrics comparing KCE to the 'big 5' generator-retailers in the national electricity market. Each measure is relative in nature, allowing a meaningful comparison between the companies irrespective of their scale differences.

The chart opposite sets out the earnings before interest, tax, depreciation, amortisation and fair value adjustments (EBITDAF) per MWh for the last five years for each company. EBITDAF per MWh is a proxy measure that can be used to approximate the operating cash flow each company achieves based on its generation base. We have also included Pioneer Energy (for the years where data is available) as, similar to KCE, it is trust-owned and operates both generation and retail businesses and is small relative to the 'big 5' companies.

Trustpower typically achieves the highest EBITDAF per MWh of the 'big 5' generator-retailers. The company is long on retail and has good management of fixed price supply



Source: Company annual reports (2012-2016), KCE Management Accounts
* Note Pioneer Energy MWh information in 2012 and 2016 is not available

agreements with third parties which enables it to consistently generate higher cash flows, relative to its generation base and compared to the other major generator/retailers. KCE tends to have a higher EBITDAF per MWh than the other big generator-retailers, which may reflect its current hedging strategy.

The EBITDAF per MWh for KCE during the review period has been consistent if not better than the levels achieved by the other major generators in the market. On a per MWh basis, KCE is outperforming Contact Energy, Genesis Energy and Meridian Energy, and is largely on par with Mercury NZ. This indicates that KCE is able to compete on a per unit basis with its competitors despite the significant difference in scale. The Company's EBITDA per MWh is also largely in line with that achieved by Pioneer Energy.

4.4. KCE's performance as an investment

Comparative returns

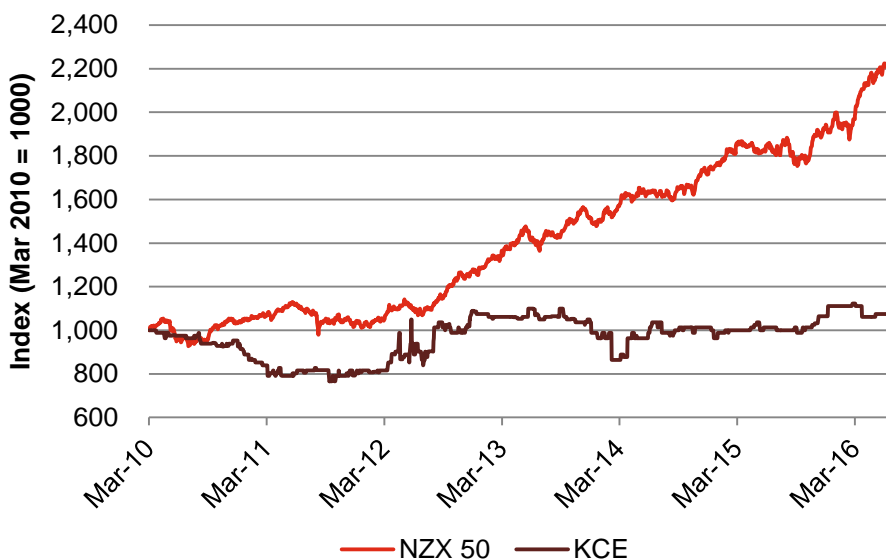
In this section, we compare how the performance and returns of KCE have compared to other energy companies and the wider New Zealand market.

KCE share price performance and the wider market

To assess the performance of KCE it is appropriate to measure the Company's performance relative to the domestic market as a whole and to other comparable companies.

As a proxy for a comparison to the performance of the broader market in New Zealand, the chart below sets out the relative changes in the NZX50 equity index and the relative changes in the share price of KCE on the Unlisted exchange. We have considered this since March 2010 to show the trend over a reasonable period of time but avoiding the significant market disruption in the years immediately following the Global Financial Crisis.

KCE performance



Source: Capital IQ, www.unlisted.co.nz

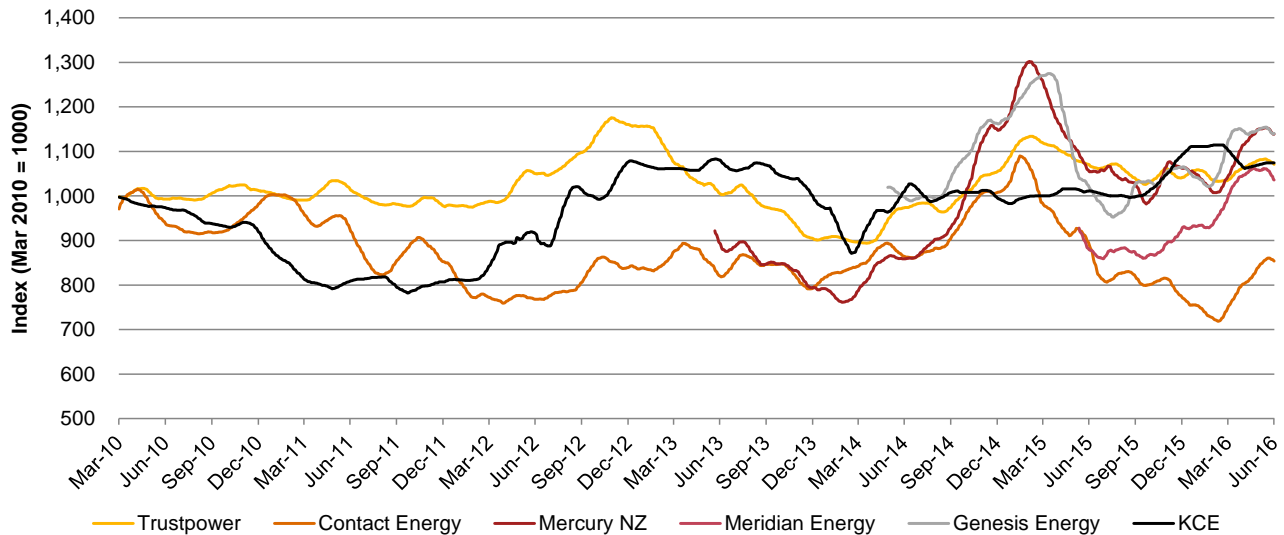
As can be seen, KCE's share price has remained relatively flat since March 2010, with a fall in 2011 and 2012 and a recovery in 2013, with little significant change in that time. The increase in share price around March 2016 is likely to reflect Trustpower's activities in relation to its takeover offer for all the shares in KCE. KCE has generally underperformed the NZX50, which has seen much higher growth, particularly since 2013. However, KCE is a small company on the Unlisted market with limited liquidity, and thus its performance may not be expected to match the NZX.

The chart below sets out the relative changes in share price of KCE compared to the listed electricity companies Trustpower, Contact Energy, Mercury NZ, Meridian Energy and Genesis Energy (on a one-month rolling average basis). These companies are all electricity generator/retailers and so provide a sound basis for

comparison to KCE. Like KCE, Trustpower is part owned by a trust and majority owned by private shareholders. Contact Energy is owned by private shareholders and Mercury NZ, Meridian Energy and Genesis Energy are majority owned by the Crown.

Mercury NZ, Meridian Energy and Genesis Energy were first listed during the review period, which is why share price data for these companies is not shown for all years in the chart.

Comparison of KCE's share price performance



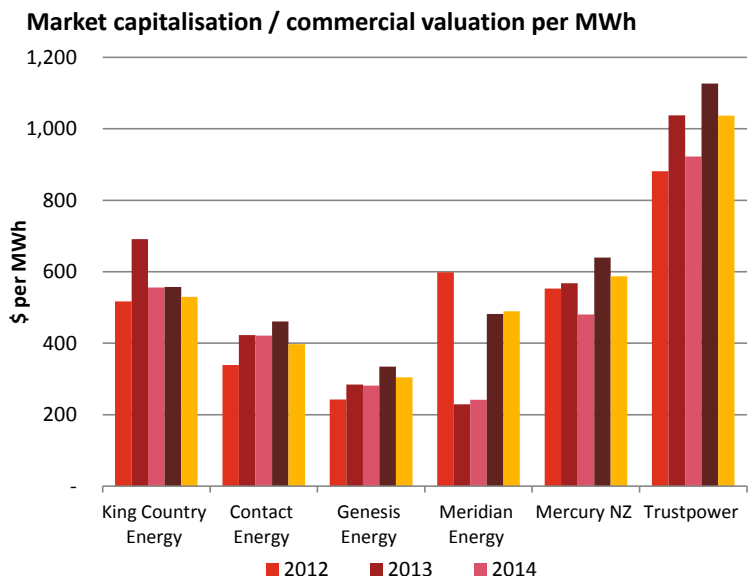
Share price index calculated on a 30 day rolling average basis
Source: Capital IQ, www.unlisted.co.nz

As illustrated by the data in the chart above, the historical returns of KCE were closely correlated with those of other listed energy generator/retailers in 2010, performed less well in 2011 before improving relative to peers in 2012 and 2013 – the decline in energy company share prices over this period was partly driven by concerns regarding the proposed NZ Power policy, but these concerns do not appear to have affected KCE’s share price. Since 2013 KCE’s share price has been less volatile than those of the other generator/retailers, reflecting the limited liquidity in KCE’s shares. Overall, the performance of KCE is broadly consistent with the listed company peer group.

KCE performance against comparable companies

The chart below presents the estimated market value of equity per MWh for each of the major generator/retailers for the past five years.

The equity values for Contact Energy, Genesis Energy and Meridian Energy prior to the Government’s partial privatisation initiative have been taken as the commercial value stated in their Statements of Corporate Intent. The market capitalisation has been used following the initial public offering (IPO) of the companies. The market capitalisation has also been used for KCE, Contact Energy and Trustpower in the chart opposite. As KCE is traded on the Unlisted platform, we note the KCE share price may be depressed by the low level of trading on the Unlisted exchange compared to the companies which trade on the NZX. We have not made any adjustment for this.



Source: www.unlisted.co.nz, Capital IQ, Meridian Energy results press release, NZX Company Research

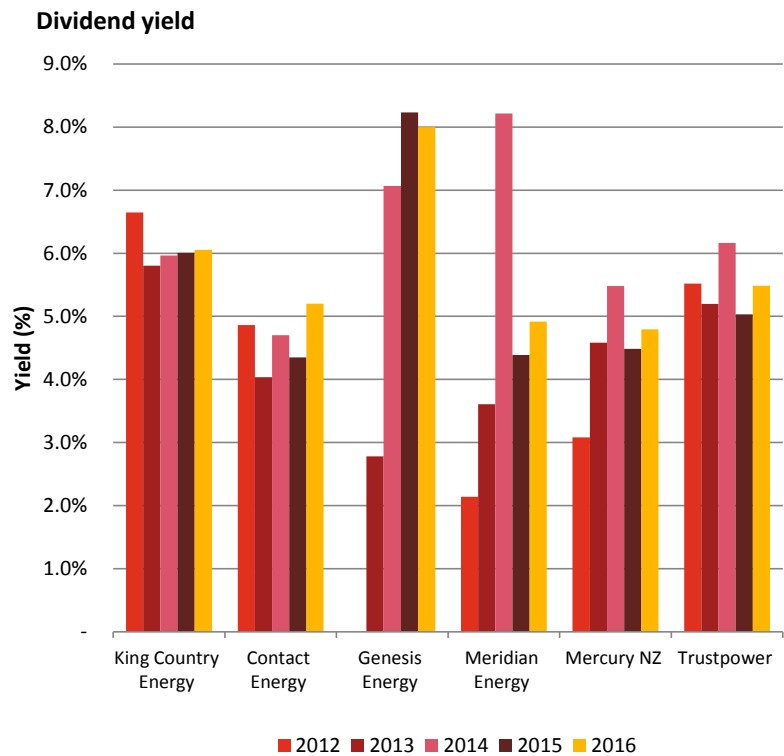
Irrespective of any adjustment for implied minority or liquidity discounts, the chart above broadly demonstrates the same characteristics as the EBITDAF per MWh chart, whereby Trustpower is again the market leader in value per MWh of generation due to their successful operation of a long-retail strategy. The remaining groups, with the exception of Genesis, are broadly consistent with each other, with Meridian improving its metric over the last two periods. Genesis Energy consistently lagged below the group benchmark.

Once again, this illustrates KCE's ability to consistently generate per unit shareholder value comparable to its much larger competitors, despite not having their scale.

The third metric compares the dividend yield of KCE against the 'big 5' generator/retailers.

In the 2012 ownership report, we noted that KCE consistently paid \$4.5m in dividends every year. In this review period the company has increased its dividend payment by an average of \$1.9m per annum, with dividend payments ranging from \$6.1m in 2014 to \$6.6m in 2013 and 2016. KCE's dividend yield is below the level it reached in 2012 but has increased since then. It is positive compared to other generator-retailers.

In contrast, the 'big 5' companies demonstrate an irregular dividend pay-out policy. For example, Genesis Energy suspended dividend payments in 2012 while Meridian Energy paid a special dividend in 2014. The dividends also reflect the lack of alternative and attractive investment opportunities so the companies are choosing to pay full dividends.



*Note: Genesis Energy paid no dividend in 2012

Source: www.unlisted.co.nz, Capital IQ, Meridian Energy results press release, NZX Company Research

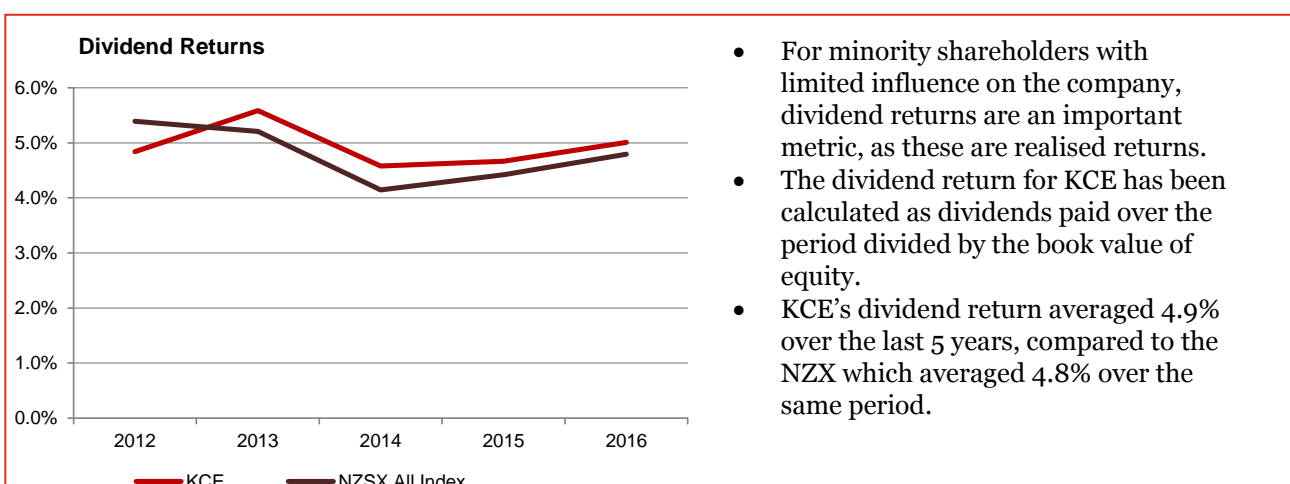
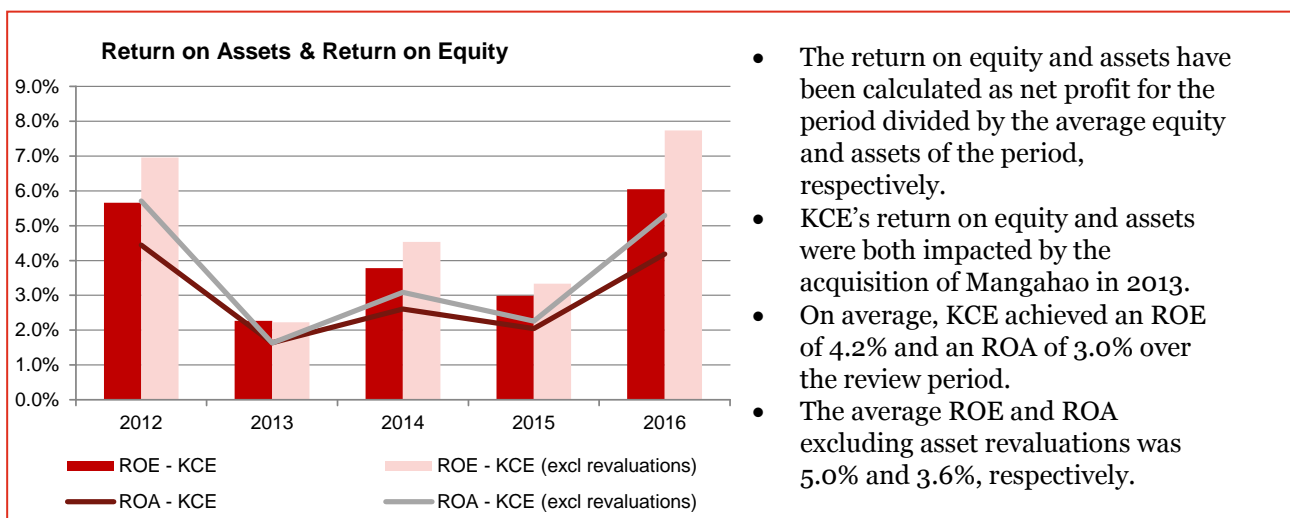
Performance of the Review Shares

While the performance of a company is important to its shareholders, the critical issue for shareholders is the return received on the capital invested. Accordingly, we consider the performance of KCE based on the following metrics which are relevant from a shareholder perspective:

1. Return on assets (RoA) and RoE
2. Return from dividends (Dividend Returns).

We also consider the performance of the NZX All Share Index for the first two metrics, in order to provide a context for the returns achieved by KCE.

RoA and RoE metrics can be affected by non-cash revaluations but they remain relevant as they can be compared to a reasonable benchmark cost of capital in order to assess the return that is received on the capital invested.



4.5. Sector outlook and risks

The key issues facing the electricity generation sector in New Zealand are:

- Modest demand growth and the impact of excess capacity on wholesale prices
- The long-term carbon pricing arrangements for stationary energy
- Regulatory changes to the TPM and pricing rules for distributed generation
- Uncertainty around the closure and/or reduction in demand of the Tiwai Point aluminium smelter and its effect on electricity demand
- Fuel price inflation and fluctuations
- The potential for rapid technology change (ie solar PV, electric vehicles, energy efficiency) which could change the size of electricity demand and the relationships between consumers and suppliers of electricity in New Zealand – the introduction of new technologies such as solar PV and increased energy efficiency could reduce the wholesale price, but this could be offset by the adoption of electric vehicles and general population and economic growth which are expected to increase electricity demand. The overall effect of technology change on total energy demand is still unclear, although sector scenario modelling (ie by BEC2050) still suggests demand for electricity should increase.

KCE outlined at its 2016 Annual Meeting that it is a medium sized full service player operating in a challenging sector environment. The modest demand growth in the sector was reiterated by the Company, noting that there are no current generation development opportunities. This modest demand growth combined with an oversupply of generation is also depressing wholesale prices.

The proposed changes to the TPM and distributed generation pricing rules are likely to affect KCE's profitability by:

- Reducing 'Avoided Cost of Transmission' payments made to KCE
- Potentially increasing the charges network businesses apply to KCE for connecting the generation plant to the networks.

In the retail sector, retail margins continue to come under pressure from the competitive retail market, which continues to experience a high degree of switching and entry of retailers with more innovative offerings. As a relatively small retailer, KCE lacks the scale to match the cost-efficiency of the larger industry players and may find it challenging to fund any one-off system upgrades to continue to serve its customers.

As such, these factors may make it challenging for KCE to maintain its recent strong level of performance.

4.6. Conclusion

Based on the information outlined above and in Appendix B, we consider that KCE has for the most part performed well in a challenging market. We also note the risks discussed above regarding future challenges for the industry.

As a generation and retail business, we consider KCE has performed well because:

- KCE's cash flow (proxied by EBITDAF) and equity value per MWh compare favourably with the large generator/retailers, despite a large difference in the scale of operations. This illustrates KCE's ability to consistently generate per unit shareholder value comparable to its much larger competitors and may reflect an ability to effectively manage hedging arrangements.
- KCE has generated increased revenue levels over the review period, despite losing customers in its retail segment. This was driven by favourable hydrology conditions and wholesale electricity prices in the generation segment, as well as increased volumes of electricity in its retail customer portfolio.
- The company has achieved increasing profit margins (measured by EBITDA) on its generation segment since 2013. The retail segment has seen increased EBITDA since 2014, although this growth has been lower than that in the generation segment.
- The acquisition of the Mangahao asset has seen an increase to KCE's asset balance and a corresponding increase in debt borrowings. This has increased KCE's gearing and reduced cash liquidity ratios as well as the Company's return on assets and equity, although KCE's debt remains low and within acceptable debt coverage ratios.

From an investment perspective, we consider that:

- Over the period from March 2010, KCE's share price has generally underperformed the NZX, which has seen much higher growth, particularly since 2013. However, KCE is a small company on the Unlisted market with limited liquidity, and thus its performance may not be expected to match the NZX. KCE's share price performance has been broadly consistent with that of other listed energy generation and retail companies.
- The dividend yield of KCE has averaged around 6% over the review period, which compares favourably to the other traded electricity companies. KCE's dividend return was higher than the average market returns generated by the NZX All Share Index over the review period.

-
- However, KCE's return on assets and return on equity have been below the level we would expect a New Zealand generation business to earn over time. We note that these metrics can be affected by non-cash revaluations but these metrics are relevant as they can be compared to a reasonable benchmark cost of capital in order to consider the return that is received on the capital invested. We have calculated return on assets and a return on equity for KCE excluding revaluations and these remained below that level.
 - Total shareholder return, which incorporates share price appreciation and dividends paid, averaged 12.7% over the review period. The share price appreciation partly reflects increased interest in the company, including the recent sale of Todd's shares in KCE to Trustpower and offers made to minority shareholders.

5. Performance of portfolio investments

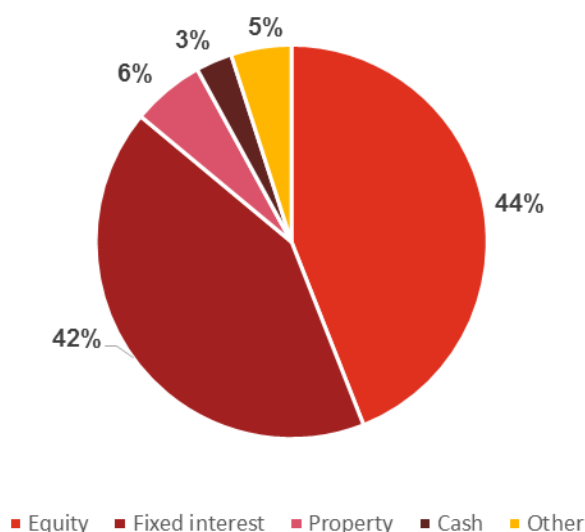
5.1. Introduction

Following the sale of KCEPT's shares in TLC in 2014, KCEPT used the proceeds from the divestment to invest in other securities through an investment portfolio arranged by BNZ. In principle diversification of KCEPT's investments away from a sole focus on the electricity sector reduces the Trust's cash-flow risks and improves its ability to make disbursements to Beneficiaries.

5.2. Assessment of the performance of the portfolio

The balance of the portfolio between different types of investments is shown in the chart below. As can be seen, the portfolio is heavily weighted to equity and fixed interest investments, with small amounts of property and cash.

The equity investments are heavily weighted towards New Zealand Equities (69%), followed by International Equities (21%) and Australian Equities (10%).



At the date of this report, the portfolio is currently valued at approximately \$15.5m. Since the portfolio was established in May 2014 it has made an average annual return of approximately 6.8% (compounding) after tax and fees.

6. Options for the Review Shares and other opportunities

6.1. Background

This ownership review is being held now because the Trust is considering how best to position its investment in KCE in light of emerging risks being faced in the electricity sector and in the context of Trustpower's majority ownership stake. The Trust is considering options for working with Trustpower to restructure KCE to remove its risk to the competitive retail market and restructure its generation portfolio. It is necessary to ensure KCEPT's Beneficiaries are fully informed about the performance of the Trust and the Company and the range of options available.

This section discusses the options, but first it considers some background information including changes in KCEPT's shareholdings since the last ownership review and the objectives of the Trust.

It is appropriate for KCEPT to consider the transaction opportunity alongside other ownership options. Clause 4 of the KCEPT Trust Deed directs that the Trustees should 'prepare a report considering proposals and available options for future ownership of the Review shares', as well as considering the performance of the Trust and the Company. The wording in the Trust Deed anticipates the need to consider specific proposals (if any), as well as a more general review of the options in relation to ownership of the Review Shares.

6.2. Changes since the last review

The 2012 Ownership Review report reviewed the Trust's holdings in both KCE and TLC. The 2012 ownership review considered the following options with respect to the two sets of shares under review:

- Option 1: Continue to hold the shares
- Option 2: Sell the shares and reinvest the proceeds
- Option 3: Acquire additional shares.

In relation to the TLC shares:

- The 2012 report noted that given KCEPT's minority 10% shareholding in TLC, the investment was no longer strategic
- If KCEPT decided that it wished to sell its TLC shares, proceeds from the disposal would provide the Trust with capital to be deployed either in new investments or for the acquisition of additional shares in KCE.

In relation to the KCE shares:

- The 2012 report demonstrated that KCE performed well against its peers, continued to deliver an above average dividend return and had reasonable prospects for growth in the medium to long term
- The report supported KCEPT buying additional KCE shares with the intent of rebuilding its shareholding back to 20%.

Subsequent to the publication of the 2012 report, the Trust entered into transactions to gradually increase its KCE shareholding back up to 20%. The Trust also disposed of its shares in TLC in January 2014.

As a result of the TLC share sale and reappraisal of the Trust's Investment Policy Statement, the Trust has adopted a wide ranging portfolio of investments arranged by BNZ Private Banking which took effect over the 2015 financial period. These investments are currently valued at approximately \$15.5m.

In December 2015, Todd Energy sold its 54.1% stake in KCE to Trustpower. Subsequent to this, Trustpower made a two-tiered pricing offer under the Takeovers Code for 100% of KCE's shares. The offer was subject to an independent adviser's report which resulted in the Independent Committee recommending that shareholders not accept the offer as it was not deemed adequate to compensate shareholders. At the date of this report, Trustpower holds 64.5% of KCE's shares.

The Trust noted in its 2016 Annual Report that its intention is *"to work collaboratively with the new major shareholder to gain the best outcome for the company and the Trust in the future."*

6.3. Trust objectives

The objective of the Trust is to hold the Review Shares on behalf of the Consumers (ie the Beneficiaries). The Trustees are required to take any action necessary or desirable to protect, maintain or promote the best interests of the Consumers. The Trustees have wide ranging powers, including authority to dispose of existing investments, make new investments, borrow funds, appoint directors to the boards of the investee companies (where permissible), and exercise shareholder rights. More specifically, the Trust can invest in:

- Additional equity or debt securities in KCE
- Other equity securities (of any company)
- NZ Government securities
- Interest bearing accounts
- Any investment the Trustees consider to be proper and expedient.

The Trustees must follow the requirements of the Trust Deed if they wish to sell or distribute any of the Review Shares, which includes public consultation. The requirement placed upon the Trustees to conduct regular reviews and consider proposals for the ownership of the Review Shares suggests the Trustees should not be entirely passive investors.

With respect to ownership options, the Trust Deed outlines four general options for the Review Shares:

1. Status quo
2. Distribution to the Beneficiaries
3. Sale of KCEPT's shares in KCE to the public
4. Sale of KCEPT's shares in KCE to institutional investors.

6.4. Transaction option

As noted above, the Trust is considering both the emerging risks being faced by KCE and the Trust's response to these as well as the opportunity presented by having Trustpower as KCE's major shareholder.

Within this environment, an option is being considered to acquire all of KCE, dispose of KCE's riskier retail operations and restructure KCE's hydro generation assets by focussing on a smaller scale generation in the Central North Island. Under this option KCE would sell the retail business and Mangahao to Trustpower in exchange for equity in KCE and the acquisition of the Hinemaiaia hydro station. The Trust may need to make a top up payment to Trustpower, but would own 100% of the equity in KCE.

Hinemaiaia Hydroelectric Power Scheme

Near eastern shore of Lake Taupo

Year commissioned: 1952

Average annual output: 29.2 GWh

Capacity: 6.1 MW



Source: Trustpower

6.5. Review of ownership options

We consider the options described above for the future of KCEPT in two groups:

- The four options specified in the Trust Deed in relation to the Review Shares
- The transaction option with Trustpower which would reshape the structure and ownership of KCE.

The advantages, disadvantages and assessment of each are considered in the tables below.

Options being considered by the Trust

Option	Advantages	Disadvantages	Assessment
1. Status Quo	<ul style="list-style-type: none"> Avoids transaction costs of the other options KCE will indirectly benefit from Trustpower's expertise and scale KCEPT retains the \$15.5m investment fund, which delivers diversification and may have scope to grow further 	<ul style="list-style-type: none"> KCEPT remains a minority shareholder in KCE with limited rights (but a seat on the Board and the ability to block a full takeover) KCE has insufficient scale to justify being listed Trustpower is unlikely to use KCE as a growth vehicle going forward 	<ul style="list-style-type: none"> KCE has performed reasonably well in maintaining profits despite a declining retail market share and declining retail sector margins as well as volatility in generation revenue Future prospects for KCE as it is currently structured do not appear to be positive – retail market competition continues to squeeze margins and there is a proliferation of new, innovative, retail offerings making it difficult to compete. The majority shareholder, Trustpower, is unlikely to use KCE as a vehicle for future growth. As such, there is a case for change, provided it can deliver value to the Trust and its Beneficiaries
2. Distribution	<ul style="list-style-type: none"> Distribution of shares provides a source of income to Beneficiaries 	<ul style="list-style-type: none"> Creates problems of inter-generational equity, where future generations do not benefit from the shareholding If Beneficiaries on-sell shares, the new shareholders may have objectives and interests that diverge from the Beneficiaries If KCEPT was to distribute 100% of its KCE shares, it would be wound up 	<ul style="list-style-type: none"> Winding up KCEPT would deliver a short-term benefit to today's Beneficiaries but future generations of Beneficiaries would be disadvantaged as they would not receive future distributions from the Trust. We note that the Trust was established with an 80 year term
3. Sale to public	<ul style="list-style-type: none"> Provides additional funds to invest in other opportunities Increased diversification reduces risk associated with events in the energy industry Some Beneficiaries may choose to buy shares 	<ul style="list-style-type: none"> It may be difficult to identify a more attractive investment opportunity If KCEPT was to sell 100% of its KCE shares, it would be wound up 	<ul style="list-style-type: none"> Selling some of the Review Shares (ie KCEPT's shares in KCE) could deliver funds for other investments but we do not see sufficiently attractive alternative investment options within the Trust's investment objectives that would make this worthwhile
4. Sale to investors	<ul style="list-style-type: none"> As for option 3, may generate more revenue for the Trust 	<ul style="list-style-type: none"> As for option 3 	<ul style="list-style-type: none"> As for option 3.

<p>5. 100% ownership of post-transaction KCE</p>	<ul style="list-style-type: none"> • KCEPT owns 100% of post-transaction KCE and can control the business • KCE can manage market and operating risks through a Power Purchase Agreement and Operations & Maintenance contracts with Trustpower³ • The potential risks associated with the retail business is eliminated 	<ul style="list-style-type: none"> • Depending on the structure of the transaction it could result in: <ul style="list-style-type: none"> ○ KCE being too small; or ○ reduced diversification of KCEPT's investments (as it could need to give up some or all of its other investments to fund the transaction). • KCEPT incurs transaction costs • Initially puts all of KCEPT's "eggs in one basket" (as KCEPT's cash and investment portfolio could be needed to be used to fund the transaction), although the Trust can diversify in the medium term • May forego some dividends in the early years post-transaction 	<ul style="list-style-type: none"> • This would enable KCEPT to fully own and control an electricity hydro generation business, enabling the Trust to set direction for the Company that is aligned to the interests of the Trust's Beneficiaries • We note that there is an initial cost to the transaction and it is likely to reduce dividends in the short term but with the possibility of increased distributions over the medium to long term • As the sole shareholder in post-transaction KCE, KCEPT would need to provide all governance for the business • This option would give KCE additional scale and potential revenue growth prospects. However, KCEPT could need to use its investment portfolio to fund the transaction
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³ These contracts do not necessarily need to be struck with Trustpower. KCEPT could consider other providers of these services or choose to provide them in-house. If the contracts are arranged with Trustpower or another party, KCEPT would still be able to review these contracts over time.

6.6. Conclusion

Based on our assessment of the Trust, the Company and the New Zealand electricity market, we consider that:

- Options 2-4 (distributing all shares in KCE to beneficiaries or selling the shares to public or institutional investors and distributing the proceeds to Beneficiaries) would be unlikely to deliver long-term benefits for KCEPT's Beneficiaries
- The remaining options are the status quo and the transaction with Trustpower.

The decision on which option to prefer rests on the relative risks and opportunities between the status quo (with a well-performing company and growing investment portfolio but facing some significant potential headwinds) and the opportunity for transacting with Trustpower (which gives the Trust full control over post-transaction KCE, but reduces the diversity of KCEPT's investments).

We note that both the status quo and option 5 contain risks relating to the ownership and operation of generation assets, including exposure to fluctuations in the wholesale price, the risk of damage to the plant and risks regarding the costs of operating the plant. If these are risks the Trust does not wish to continue to bear then options 2-4 may be worth considering further. However, we note that different investment risks would still need to be managed under these options.

This report does not provide detailed forecasts of returns that could be expected under each option as this might prejudice any potential negotiations with Trustpower.

The Trust seeks Beneficiaries' views on the various options to allow it to consider which, if any, should be progressed and implemented if the trustees believe it appropriate.

6.7. Other matter – KCEPT becomes a community trust

Another matter considered was the prospect of KCEPT changing from an energy consumer trust to a community trust. This would change the way in which the Trust makes distributions to the community and consumers. Instead of paying dividends directly to consumers within the Trust area, it could fund projects and activities that are of benefit to the community and can consider applications for funding, or it could choose to do both. Other New Zealand community trusts that own energy companies include:

- Eastern Bay Energy Trust (owner of Horizon Energy Distribution Limited)
- WEL Energy Trust (owner of WEL Networks Limited)
- Central Lakes Trust (owner of Pioneer Energy Limited)
- Eastland Community Trust (owner of the Eastland Group, including Eastland Network Limited).

Some of these community trusts, notably the Eastern Bay Energy Trust, have a particular focus on energy-related projects in their grants, such as improving energy efficiency for consumers in their region. The community trusts also fund broader community projects, such as those that promote health and well-being.

Appendix A: Restrictions

This Report has been prepared for King Country Electric Power Trust to support the Trust's requirements to carry out an ownership review every five years, consistent with the Trust Deed. This Report has been prepared solely for this purpose and should not be relied upon for any other purpose.

This Report (or extracts from it) can be made available for public inspection in accordance with the requirements of the King Country Electric Power Trust Deed. Apart from this noted exception, our Report is not intended for general circulation, distribution or publication nor is it to be reproduced or used for any purpose without our written permission in each specific instance.

To the fullest extent permitted by law, PwC accepts no duty of care to any third party in connection with the provision of this Report and/or any related information or explanation (together, the Information). Accordingly, regardless of the form of action, whether in contract, tort (including without limitation, negligence) or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind to any third party and disclaims all responsibility for the consequences of any third party acting or refraining to act in reliance on the Information.

Our Report has been prepared with care and diligence and the statements and opinions in the Report are given in good faith and in the belief on reasonable grounds that such statements and opinions are not false or misleading. In performing our review, we have relied on the data and information provided by King Country Electric Power Trust and King Country Energy Limited as being complete and accurate at the time it was given. The views expressed in this Report represent our independent consideration and assessment of the information provided.

No responsibility arising in any way for errors or omissions (including responsibility to any person for negligence) is assumed by us or any of our partners or employees for the preparation of the Report to the extent that such errors or omissions result from our reasonable reliance on information provided by others or assumptions disclosed in the Report or assumptions reasonably taken as implicit.

We reserve the right, but are under no obligation, to revise or amend our Report if any additional information (particularly as regards the assumptions we have relied upon) which exists at the date of our Report, but was not drawn to our attention during its preparation, subsequently comes to light.

This Report is issued pursuant to the terms and conditions set out in our Engagement Letter dated 1 July 2016.

Appendix B: Review of financial reports, 2012-2016

Historical financial information

KCE made two changes to its financial year end over the review period:

- KCE first changed its balance date from 31 March to 31 December in 2014. Accordingly, the 2015 statutory audited accounts are for a nine month period from 1 April 2014 to 31 December 2014
- For the 2016 financial period, with the change in majority shareholder from Nova Energy to Trustpower, KCE changed its financial year end back to 31 March to align with Trustpower. Accordingly, the 2016 statutory audited accounts reflect the 15 month period from 1 January 2015 to 31 March 2016.

To facilitate meaningful comparison of KCE's financial performance and position, KCE has provided monthly management accounts which enables calculation of 12 month results. For the purposes of this ownership review report, unless stated otherwise:

- Figures presented for 2015 reflect the 12 month period from 1 April 2014 to 31 March 2015
- Figures presented for 2016 reflect the 12 month period from 1 April 2015 to 31 March 2016.

The figures presented for the 2012 to 2014 periods reflect the financial results and balances as stated in the audited financial statements.

Historical financial performance

Set out in the table below are summary income statements for the past five years.

King Country Energy Limited (\$000 March year end)	2012	2013	2014	2015	2016
Total Revenue	32,355	42,416	41,781	46,245	45,840
Operating Expenses	(20,960)	(28,946)	(29,792)	(31,995)	(31,433)
EBITDAF	11,395	13,470	11,989	14,250	14,407
Fair value movement on electricity derivatives	(646)	(3,269)	2,527	(688)	4,104
Depreciation and Amortisation	(2,919)	(5,290)	(5,912)	(6,005)	(6,042)
EBIT	7,830	4,911	8,604	7,557	12,469
Interest Expense	(77)	(1,183)	(1,419)	(2,072)	(1,978)
Tax Expense	(2,489)	(1,063)	(2,115)	(1,546)	(2,536)
Net Profit	5,264	2,665	5,070	3,940	7,955
Dividends	4,500	6,581	6,135	6,156	6,587

Ratio analysis

Margins

EBITDAF	35.2%	31.8%	28.7%	30.8%	31.4%
EBIT	24.2%	11.6%	20.6%	16.3%	27.2%
Net Profit	16.3%	6.3%	12.1%	8.5%	17.4%

Coverage ratios

EBIT / Interest coverage	102x	4x	6x	4x	6x
Dividends / Net Profit	85.5%	246.9%	121.0%	156.3%	82.8%

Source: Annual Reports (2012 - 2016), KCE Management Accounts, PwC Analysis

During the review period, KCE's total revenue has seen positive growth, increasing from \$32.4m in 2012 to \$45.8m in 2016. The largest step up in revenue occurred during the 2013 period, driven by the Mangahao acquisition. Revenue reached a higher level in the most recent two periods as the generation business experienced favourable conditions for hydrology and spot prices, while an increase was also seen in retail. Noting that KCE has experienced a net loss of 1,200 retail customers (approximately 6.3%) over the review period, so the revenue growth is a strong result.

As discussed previously, KCE has a long-retail strategy where it has to actively participate in the electricity derivative market in order to have enough volume of electricity to cater for its retail customer portfolio. The movements in the fair value of these derivatives contracts are volatile and can swing net profit significantly in any given year. This can be seen in the \$3.3m negative movement in fair value in 2013, compared to a positive movement of \$4.1m in 2016. Moreover, the derivative income or expense on electricity sales and purchases in the market can result in net cash gains or costs with potentially material impacts on profits.

The EBITDAF margin has decreased by around 4 percentage points from 2012 to 2016. This reflects the continued pressure on retail margins and increased retail operating cost requirements. The net profit margin displayed relatively more volatility over the review period, in line with the significant influence from the fair value movement on electricity derivatives.

The interest coverage ratio, expressed as how many times earnings before interest and tax (EBIT) will cover the interest expense, has fallen from 102 times in 2012 to 6 times in 2016. This is reflective of the increased debt used to fund the Mangahao acquisition.

Historical financial position

Set out in the table below are summary balance sheets and key balance sheet ratios for the past five years for KCE:

King Country Energy Limited (\$'000 March year end)	2012	2013	2014	2015	2016
Cash and cash equivalents	11,180	360	1,501	5,120	2,225
Other current assets	4,275	3,584	3,695	3,940	4,194
Current assets	15,455	3,944	5,196	9,059	6,420
Property, plant and equipment	111,612	190,053	185,773	181,605	177,607
Other non-current assets	2,132	2,076	1,946	1,560	3,870
Non-current assets	113,744	192,129	187,719	183,165	181,477
Total assets	129,199	196,073	192,915	192,224	187,897
Trade and other payables	2,408	4,244	2,003	2,001	3,117
Other current liabilities	1,852	3,227	2,696	786	2,143
Current liabilities	4,260	7,471	4,699	2,787	5,260
Derivative financial instruments	480	2,030	823	2,709	644
Long term debt	-	25,200	27,400	29,000	22,200
Other non-current liabilities	23,783	26,541	26,923	26,877	27,571
Non-current liabilities	24,263	53,771	55,146	58,586	50,415
Total liabilities	28,523	61,242	59,845	61,373	55,675
Equity	100,676	134,831	133,070	130,851	132,222

Source: Capital IQ, Annual Reports (2012-2016), KCE Management Accounts

Financial Ratios	2012	2013	2014	2015	2016
Liquidity and Solvency					
Current ratio	3.63	0.53	1.11	3.25	1.22
Debt / equity	0.00	0.19	0.21	0.22	0.17
Debt / (Debt + Equity)	0.00	0.16	0.17	0.18	0.14
Assets / equity	1.27	1.38	1.45	1.46	1.45
Profitability and Efficiency					
Asset turnover	0.27	0.26	0.21	0.24	0.24
Return on equity	5.7%	2.3%	3.8%	3.0%	6.0%
Return on assets	4.4%	1.6%	2.6%	2.0%	4.2%
Return on equity (excluding revaluations*)	7.0%	2.2%	4.5%	3.3%	7.7%
Return on assets (excluding revaluations*)	5.7%	1.6%	3.1%	2.3%	5.3%

Source: Capital IQ, Annual Reports (2012-2016), PwC analysis, KCE Management Accounts

*Assuming simple average depreciation of 2%, tax at 28% and no material asset disposals or impairments

The liquidity ratios indicate that the Company's ability to pay its current obligations as they fall due has weakened over the review period. The current ratio fell significantly in 2013 as a result of the Mangahao acquisition which reduced the cash balance and increased borrowings. The ratio has recovered to a more stable level since 2013 and when considered in conjunction with the interest coverage ratio, indicates the Company is able to service its debt.

The asset turnover ratio has reduced slightly from 2012 to 2016, as the Mangahao acquisition increased the Company's asset balance by more than the change to net profit. Aside from an asset revaluation in 2012, there have been minimal revaluations in the remaining years of the review period.

The return on assets and return on equity of the company have been strongly correlated over the historical period. These ratios fell in 2013 as a result of the Mangahao acquisition before recovering back to 2012 levels in 2016. The ratios in 2016 were positively influenced by the higher net profit derived from gains in the fair value of electricity derivatives.

KCE can be roughly divided into retail and generation operating segments. A brief review of the performance of each segment is set out in the following section.

Retail segment

The ability of the retail segment to convert sales revenue into strong earnings is dependent upon the average margin that the Company can achieve given their demand load and prevailing hydrology conditions. Due to its long-retail strategy, KCE can be exposed to purchasing at market rates for electricity volume in excess of that hedged through the derivatives contracts.

Over the review period, KCE has seen retail electricity sales volume increase from 2012 to 2016 despite a net customer loss of 1,200.

Despite the revenue growth, the retail sector has been dominated by the increasingly competitive market conditions, which has resulted in reduced margins and increased operating costs across the industry. KCE has done well to generally maintain its margins in this environment.

The retail segment does not require a high level of assets or liabilities to operate, mainly requiring working capital items such as debtors and creditors. This also results in a lower level of capital expenditure required to maintain the operations of the retail business.

Generation segment

The generation segment of KCE generates revenue from both internal and external sources. Internally, the generation segment sells wholesale electricity to the retail segment. Externally, the generation segment is able to take advantage of periods when the local production is high (relative to the local demand) and electricity can be sold into the national wholesale market. The acquisition of the Mangahao station has increased the volume of electricity generated in each period and enables KCE to generate higher external revenue.

2013 was a distinctive year for KCE's generation segment, as the increased revenue associated with the higher volumes from Mangahao was offset by higher depreciation expense associated with the Mangahao asset and increased electricity market settlements. This is also demonstrated by the dip in EBITDA and net profit margin for the generation segment in 2013.

The majority of KCE's fixed assets sit within the generation segment and relate to the hydroelectric power stations. Assets of the company increased significantly in 2013 due to the addition of the Mangahao asset, which was also reflected in the larger capital expenditure amount incurred in the same period. Capital expenditure in the other periods primarily relate to regular maintenance.

Appendix C: Trust ownership of the Review Shares

Introduction

KCEPT holds 20% of KCE on behalf of current and future Consumers. The Consumers of the day are the Beneficiaries of the Trust. In this section, we consider:

- as context, various factors that give KCEPT influence over KCE
- the advantages and disadvantages of trust ownership compared with direct ownership by the Beneficiaries, which would be achieved by a distribution of the Review Shares to Beneficiaries.

Influencing factors

The advantages of trust ownership arise primarily from the Review Shares being held in a common pool by the Trust, allowing for a 'shareholding block' that provides benefits through:

1. voting thresholds
2. relative shareholding
3. Board representation.

These factors enable the shareholding block to exercise influence and extract shareholder value which cannot otherwise be gained by a shareholder with a negligible minority holding.

Voting thresholds

There are various common thresholds that are important from a valuation and corporate governance perspective:

100%	Absolute control and unfettered access to cash flows
75%	Ability to pass resolutions requiring a special majority
50% + 1 share	Often referred to as a controlling stake, ability to pass resolutions requiring an ordinary majority and control the board of directors
25% + 1 share	Often referred to as negative control, ability to block special resolutions
10% + 1 share	Ability to prevent compulsory acquisition of minority shareholdings

In addition, in terms of the Takeovers Code⁴, a shareholder that crosses the 20% ownership threshold is required to make an offer (either partial or full) that is compliant with the Takeovers Code rules. This may become a consideration if KCEPT were to increase its holding in KCE to more than 20%.

Relative shareholding

Aside from the absolute thresholds, the size of the relative shareholding should also be considered. For example, in the case of KCE, although the Trust does not have negative control (>25%), it is the second largest shareholder with 20% shareholding. This represents a significant shareholding position relative to other shareholders, particularly in a thinly traded market and this provides a degree of influence.

By contrast, a shareholder owning 20% of a company's shares would have no special advantage if there are other shareholders with similar sized holdings. For example, if the Company had two other notable

⁴ Takeovers Code Approval Order 2000

shareholders who each owned between 20% and 25% of the company's shares, KCE's shareholding would most likely be less influential. Furthermore, if the shares are well traded then a similar stake also is more likely to be acquired by a patient buyer on the market.

Board membership

The Chair of KCEPT is a Board member of KCE, which provides direct input into governance and decisions regarding the Company.

While there are no set rules to assess these dynamics, they play an important role in corporate governance and shareholder value.

Advantages and disadvantages of KCE's trust ownership

Given the background outlined above, we consider the advantages and disadvantages of Trust ownership in the table below.

	Advantages		Disadvantages
1	<p>As the second largest shareholder, with board representation, the Trust has some influence over:</p> <ul style="list-style-type: none"> • Corporate governance • Strategy • Investment in long term assets • Non-commercial and environment objectives, including Consumers' interests. <p>This is likely to enhance long term shareholder value for the benefit of both current and future Beneficiaries.</p>	1	<p>The Trust incurs costs from share ownership. These costs include administration, compliance and accounting costs, as well as Trustee fees. These are relatively low in the case of KCEPT.</p>
2	<p>The Trust's 20% shareholding has the ability to prevent the controlling shareholder from triggering a compulsory acquisition for the remaining 10% of KCE's shares.</p> <p>It also supports KCEPT having a seat on the KCE Board.</p>	2	<p>The Trust has limited ability to support a substantial equity raising. This means if significant capital projects or acquisitions are undertaken by the Company, the Trust's shareholding is at risk of dilution.</p>
3	<p>The Trust may be able to block a special resolution if it was supported by other shareholders holding 0.5%.</p>	3	<p>The Trustees need to balance shareholder and commercial objectives with those of the Beneficiaries. These may not be aligned at times.</p>
4	<p>A holding of this nature and the limited liquidity of the shares enhances the opportunity for the Trust to extract value from corporate action as strategic buyers or significant shareholders may pay a premium to acquire the shares.</p>	4	<p>Trustee elections and rotation can result in loss of stability and continuity, although this has not been an issue for KCEPT.</p>
5	<p>Trust ownership of the shares allows benefits to be accrued across current and future beneficiaries. This avoids the inter-generational issue whereby current beneficiaries receive all the benefits through a one-off distribution of shares.</p>	5	<p>Beneficiaries are not able to vote directly on Company resolutions and rely on the Trustees to vote as they see fit.</p>
6	<p>Consumers retain some control over their shares via the election of trustees.</p>	6	<p>Tax rates for Trust entities (30%) are less favourable compared to corporate tax rates (28%).</p>

Appendix D: Sources of information

In preparing this Report, PwC has relied upon the following sources of information:

Internal sources

- KCE Management Accounts 2014 – 2016
- KCE Management Information

Public sources

- Annual Reports, King Country Electric Power Trust, 2012 – 2016
- Annual Reports, King Country Energy, 2012 – 2016
- Annual Reports, Contact Energy, 2012 - 2016
- Annual Reports, Genesis Energy, 2012 – 2016
- Annual Reports, Meridian Energy, 2012 – 2016
- Annual Reports, Mighty River Power/Mercury NZ, 2012 – 2016
- Annual Reports, Pioneer Energy Ltd, 2014 – 2016
- Annual Reports, Trustpower Limited, 2012-2016
- Annual Report, Central Lakes Trust, 2016
- Annual Report, Electra Trust, 2016
- Annual Report, Network Tasman Trust, 2016
- Annual Report, Tauranga Energy Consumer Trust, 2016
- Financial Statement, Counties Power Consumer Trust, 2016
- Financial Statement, West Coast Electric Power Trust, 2016
- Statement of Corporate Intent 2013 – 2015: Genesis Power Limited
- Statement of Corporate Intent 2013 – 2015: Meridian Energy Limited
- Capital IQ (www.capitaliq.com)
- Companies Office (www.companiesoffice.govt.nz)
- Electricity Market Information (www.emi.ea.govt.nz)
- NZX Company Research (www.companyresearch.nzx.com)
- Unlisted (www.unlisted.co.nz)