# Management Discussion of the financial results for the year ended 30 June 2012

## Summary financial results

| | 2012<br>$million | 2011<br>$million | Change<br>$million | Change<br>(%) |
|---|---|---|---|---|
| **Revenue** | **2,270** | **1,834** | 436 | 24% |
| Total operating expenses(1) | 1,878 | 1,542 | 336 | 22% |
| **EBITDAF (2)** | **393** | **293** | 100 | 34% |
| Depreciation depletion & amortisation | 152 | 144 | 8 | 6% |
| Impairment | 12 | 9 | 3 | 33% |
| Revaluation | 0 | 97 | -97 | -100% |
| Fair value change (gains)/losses | 11 | 13 | -2 | -15% |
| Other (gains)/losses | 3 | -1 | 4 | 400% |
| **Earnings before interest and tax** | **214** | **31** | 183 | 590% |
| Interest | 89 | 49 | 40 | 82% |
| Tax | 35 | 1 | 34 | 3400% |
| **Net profit after tax** | **90** | **-17** | 107 | 629% |
| Shareholder's equity | 1,800 | 1,712 | 88 | 5% |

(1) Includes cost of electricity purchases
(2) Earnings before net finance expense, tax, depreciation, amortisation, fair value changes and other gains and losses

## Net Profit after Tax (NPAT)

New Zealand's largest energy retailer Genesis Energy is reaping the benefits of a greater focus on customer value combined with optimising the Company's generation portfolio, particularly last-year's acquisition of the Tekapo A and B hydroelectric power stations, and its strategic investment in the Kupe Oil and Gas project, reporting a strong uplift in profits for the year ended 30 June 2012 to $90 million from a loss of $17 million in the previous year. The previous year's result included an after tax revaluation loss of $68 million.

## EBITDAF

Earnings before interest, tax, depreciation, amortisation and fair value adjustments (EBITDAF) rose by $100 million to $393 million in the 2012 financial year from $293 million in 2011. The 34% rise in EBITDAF was largely due to the following factors:

- Higher wholesale electricity prices;
- Increased renewable generation (including Tekapo); and
- Higher thermal generation (including increased coal burn on the previous year)

## Revenue

Revenue increased to $2,270 million from $1,834 million. This largely reflected an increase in generation output, a full year contribution from Tekapo A and B and an increase in the average price received for wholesale electricity generation. The Kupe field also produced volumes across a full 12 months. In a very competitive market, a modest level of retail electricity price increases was implemented.

## Depreciation, depletion and amortisation ("DDA")

DDA charges increased from $144 million to $152 million. This reflected a full year's depreciation charge for Tekapo compared to one month in the prior financial year.

## Impairment and Revaluation

The impairment expense increased to $12 million from $9 million in 2011 due to higher capital spend on Huntly units 1 to 4 and 6.

Genesis Energy's revaluation charge decreased from $97 million ($68 million after tax) to nil. The 2011 revaluation charge was against the $821 million acquisition price of the Tekapo A and B hydro-electric power stations.

## Fair value change

Unrealised gains and losses on hedging instruments are recorded in the income statement when the instruments fail to meet the effectiveness test under IFRS accounting standards. Those that meet the effectiveness test are taken to the balance sheet. In 2012, fair value changes depressed reported pre-tax profit by $11 million, compared to $13 million last year. The majority of the fair value charge was due to electricity options and swaptions valuations impacts with changes to the projected price path and call volumes increasing offset by gains on crude oil price instruments.

## Borrowing costs

Borrowing costs for the year rose to $89 million from $49 million. This rise reflects a full year's borrowing costs for the acquisition of the Tekapo A and B power stations compared to one month in the prior financial year. The higher borrowings were partially offset by favourable interest rate movements.

## Cashflow & capital expenditure

| Cashflow year to June 30 ($m) | 2012 | 2011 | Change | % |
|---|---|---|---|---|
| Net operating cashflow | 369 | 246 | 123 | 50% |
| Net investing cashflow | -69 | -868 | 799 | -92% |

Operating cashflow increased by $123 million reflecting the contribution from a full year of operations from the Tekapo A and B power stations compared to one month in the prior financial year and a reduction in fuel inventory of $43 million.

## Liquidity and balance sheet:

Total borrowings decreased by $198 million to $1,019 million due to strong operating cash flows, which were applied to paying down debt. As a result, Genesis Energy's gearing ratio (debt to debt plus equity) improved to 36.2% from 41.6% as at 30 June 2011. The Capital Bonds are treated as equity under the Group's bank funding covenants by Standard and Poor's for credit rating evaluation purposes. Treating the Capital Bonds as equity reduces gearing further to 26.4%, compared to a bank covenant threshold of 50%.

Interest[1] is covered by group EBITDAF 4.5 times. If interest on the Capital Bonds is treated as equity in line with the Company's bank covenants, interest is covered 6.2 times by EBITDAF.

At balance date Genesis Energy had available funding of $1,220 million with an average tenor of 9.4 years. Of the available facilities, $220 million was undrawn at balance date.

On 29 March 2012, Standard & Poor's re-affirmed Genesis Energy's BBB+ credit rating with a stable outlook.

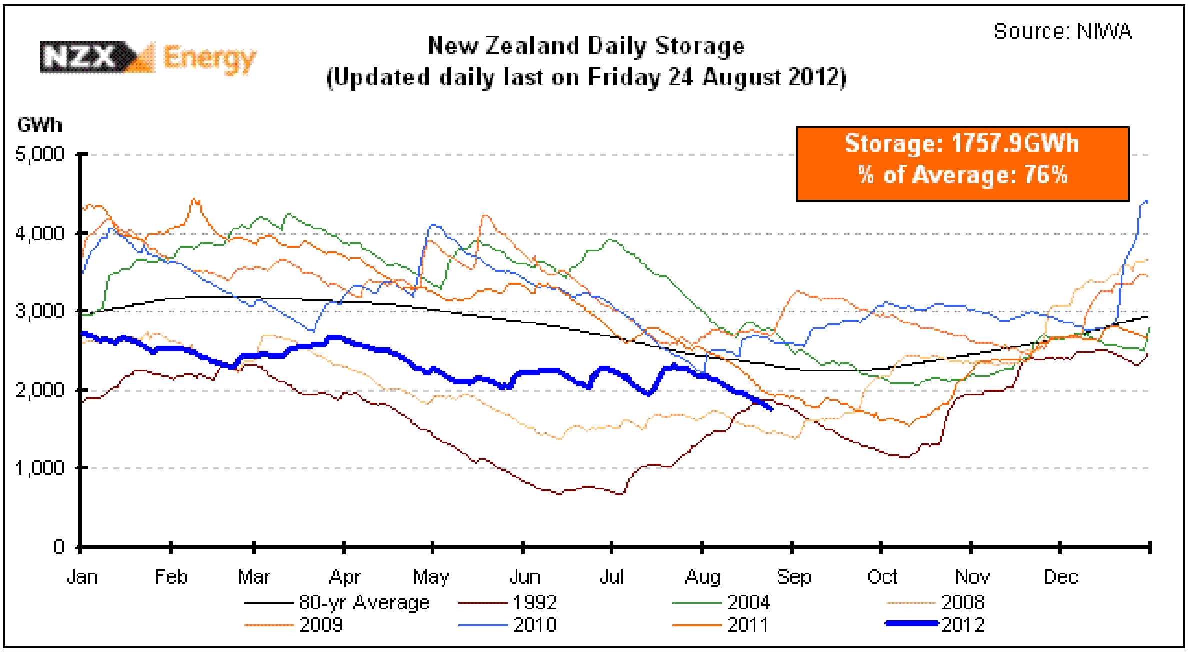
## Dividends

No dividends were paid or declared during the year. The Genesis Energy Board and the Company's shareholders agreed a two-year suspension of dividend payments was appropriate to assist the Company with funding the purchase of the Tekapo A and B hydro stations. Genesis Energy intends to resume paying dividends during the 2012/13 financial year with an Interim dividend payment in March 2013. It is Genesis Energy's intention to pay a dividend that provides shareholders with a consistent, reliable and attractive dividend yield even in periods of business cycle downturn. The amount of the interim dividend will be announced with the results for the first 6 months of the 2013 financial year.

## Market conditions:

The electricity market was largely characterised in 2011/2012 by below average inflows and below average storage levels in hydro-electric schemes, particularly in the South Island. Overall, the country experienced a cool and cloudy summer with high rainfall in the North Island, but lower than average falls into the major hydro catchments in the South Island. Inflows to the southern hydro schemes picked up in May and reached average levels by the end of June 2012.

[1] Interest expense on borrowings is finance expense from the income statement less time value of money adjustments on provisions (see note 14 from the financial statements)




## Customer Experience

| Retail: Year to June 30 | 2012 | 2011 | Change | % |
|---|---|---|---|---|
| Electricity Customers | 548,356 | 549,255 | -899 | -0.2% |
| Gas Customers | 112,718 | 113,434 | -716 | -0.6% |
| LPG Customers | 7,610 | 5,239 | 2,371 | 45.3% |
| **Total Customer Numbers** | **668,684** | **667,928** | 756 | -0.1% |
| | | | | |
| Total Advanced Meters Installed | 267,675 | 178,102 | 89,573 | 50.3% |
| | | | | |
| Retail Electricity Sales (GWh) | 5,429 | 5,705 | -276 | -5% |
| Retail Electricity Purchases (GWh) | 5,781 | 6,086 | -305 | -5% |
| Retail Gas Sales (PJ) | 5.4 | 4.6 | 0.8 | 17% |
| Retail Gas Purchases (PJ) | 5.6 | 4.6 | 1 | 22% |
| Retail LPG Sales (tonnes) | 2,002 | 1046 | 956 | 91% |

The electricity and gas market for domestic and commercial users has been characterised by intense competition between suppliers. New Zealand has one of the highest electricity customer churn rates in the world. Genesis Energy's target is to improve margins.

Genesis Energy's electricity and gas market shares at 30 June 2012 were 26.6 per cent and 42.7 per cent, respectively. Market shares for this period are slightly lower than the same period last year (electricity at 26.8 per cent and gas at 43.5 per cent). Total customer churn for the year was 18 per cent.

Customer numbers held steady against significant market competition and the Electricity Authority's public campaign encouraging customers to compare and switch energy retailers.

While the total number of customers dropped 2%, the customer base in the South Island increased to 67,935 from 42,500 at the end of June 2011.

## Energy Management

| Generation: Year to June 30 | 2012 | 2011 | Change | % |
|---|---|---|---|---|
| Gas (GWh) | 3,041 | 3,408 | -367 | -11% |
| Coal (GWh) | 2,613 | 980 | 1,634 | 167% |
| **Total Thermal (GWh)** | **5,654** | **4,387** | **1,267** | **29%** |
| Hydro (GWh) | 2,788 | 2,111 | 677 | 32% |
| Wind (GWh) | 25 | 27 | -2.5 | -9% |
| **Total Renewable (GWh)** | **2,813** | **2,138** | **675** | **32%** |
| **Total Generation (GWh)** | **8,467** | **6,526** | **1,941** | **30%** |
| Average Price Received for Generation ($/MWh) (4, 5) | 91.10 | 59.67 | 31.43 | 53% |

Cold temperatures and low inflows into southern hydro lakes resulted in increased generation from Genesis Energy's North Island assets. Total generation output for the full year was up 30% as the Company benefited from a full year's contribution from Tekapo A and B, plus higher output from its thermal units at the Huntly Power Station.

Generation from the Company's four coal/gas fuelled units was up 63% as the Company met its contracted wholesale market position and sought to improve its balance sheet by reducing its coal stockpile.

## Huntly

On 27 April 2012, Genesis Energy was granted replacement operating consents for the Huntly Power Station site by the Waikato Regional Council, for a further 25 years. No appeals were received against the Council's decision.

The addition of new baseload renewable generation has continued to impact the market, resulting in a significant excess of thermal capacity and the continued declining utilisation of the older Huntly Units 1 to 4, notwithstanding dry conditions this past year. In February 2012 the Company announced that Huntly Unit 3 would be placed into long-term storage from the end of November 2012. The Company intends to keep the remaining Huntly Units available to meet market needs for as long as they are commercially valued.

A second Huntly Unit (Unit 1) remains scheduled for entry into long-term storage in December 2014. However, a degree of optionality will be maintained over the storage schedule for the second Unit to respond to any changes in anticipated supply or demand.

## Tekapo

On-going monitoring at the Tekapo Canal has been undertaken as a continuation of activity by Meridian Energy, previous owners of the Tekapo assets. This monitoring has indicated that the canal has deteriorated since August 2011, with new leaks in the canal appearing.

Renewed focus on seismicity issues since the major Canterbury earthquakes in 2010 and 2011 has also brought additional focus on the long-term serviceability of the canal. The current risk of progressive canal failure is considered in excess of normally accepted levels.

The Company views the Tekapo Canal remediation as a priority and has allocated in excess of $125 million for remediation work to address long term stability and serviceability of the canal, as well as known occurrences of leakages. The remediation programme is expected to be completed over a two-year period, and will involve two (2) fourteen week outage periods for the Canal, the first commencing in January 2013.

## Other generation developments

Genesis Energy continues to develop a pipeline of future economic generation opportunities that position the Company for growth. Genesis Energy remains open to opportunities for partnerships in these developments. The Company is advancing a range of wind farm options including two potentially significant wind farm sites - Castle Hill in the Wairarapa region and Slopedown in Southland. Resources consents for the Castle Hill Wind Farm were announced by independent commissioners on 11 June 2012. Subsequently, the Company appealed certain conditions within the consents to the Environment Court, as have three other parties. Genesis Energy continues to progress work on other generation prospects.

## Fuel Management

| **Fuel management** | **2012** | **2011** | **Change** | **%** |
|---|---|---|---|---|
| Wholesale Gas Sales (PJ) | 15.4 | 13.2 | 2.2 | 17% |
| Wholesale Gas purchases (PJ) | 44.1 | 45.8 | -1.7 | -3.7% |
| Gas used in internal generation. (PJ) | 23.1 | 27.9 | -4.9 | -17.4% |
| Wholesale Coal Sales (kt) | 74.9 | 34.9 | 40.0 | 115% |
| Coal purchases (PJ) | 19.4 | 21.5 | -2.1 | -10% |
| Coal Used in internal generation (PJ) | 28.7 | 11.3 | 17.4 | 154% |
| Coal Stockpile (kilotonnes) | 1,059 | 1,532 | -473 | -31% |

The coal stockpile reduced 31% during the year as coal-fired generation increased and efforts to re-profile deliveries under existing coal supply agreements continued. During the year the Company used 28.7PJ of coal and 23.1PJ of gas for electricity generation. Gas generation was down 17% due to higher coal burn and the Maui gas pipeline outage in October 2011.

## Kupe

| Kupe: year to June 30 | 2012 | 2011 | Change | % |
|---|---|---|---|---|
| Gas Sales (PJ) | 5.9 | 5.5 | 0.4 | 7% |
| Oil Sales (kbbl) | 531 | 563 | -32 | -6% |
| LPG Sales (kilotonnes) | 25.5 | 24.5 | 1.0 | 4% |

Genesis Energy's share of natural gas, oil and LPG sales from Kupe is proportionate to its 31% share of the Kupe Oil and Gas Field. The Company, however, has contracted to take 100% of natural gas from the field.

## Carbon costs

The cost of carbon emitting by the Company's generation plant under the New Zealand Emissions Trading Scheme in year to 30 June 2012 was $17.5 million, an increase from $14 million in the previous year.

**Ends**