greater WELLINGTON
REGIONAL COUNCIL

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WRC Holdings Group 2014/15 draft Statement of Intent

1. Purpose

To receive the 2013/14 draft Statement of Intent (SOI) of the WRC Holdings Group (refer **Attachment 1**) and to identify any matters for consideration by the directors of WRC Holdings.

2. Background

WRC Holdings Ltd and its 100% owned subsidiary companies, Port Investments Ltd (PIL), Pringle House Ltd (PHL), are Council Controlled Trading Organisations (CCTOs) and Greater Wellington Rail Ltd (GWRL) is a Council Controlled Organisation (CCO) as defined under the Local Government Act (LGA) 2002.

The companies noted above, together with CentrePort, form the WRC Holdings Group. A single SOI, incorporating the CentrePort Statement of Intent, is prepared for the Group and provided pursuant to section 64 (5)(b) of the Local Government Act (LGA) 2002.

The LGA 2002 requires that a draft SCI for CentrePort and a draft SOI for WRC Holdings are provided to the shareholder by 1 March, covering the projected results for the three financial years from 1 July 2014.

The directors of WRC Holdings Ltd considered the draft SCI financials for CentrePort and draft SOI for WRC Holdings on 26 February 2014.

A letter enclosing the draft WRC Holdings SOI (incorporating the CentrePort SCI) was sent to the Chair of Greater Wellington Regional Council on 26 February (refer **Attachment 2**).

Greater Wellington Regional Council, as the shareholder, is now required to note the draft WRC Holdings Ltd SOI, which incorporates draft financial statements from CentrePort, and where it considers necessary, provide comments back to WRC Holdings Ltd directors.

This meeting is to receive the draft SOI and invite comments. The final version of this SOI must be passed by Council on or before 30 June 2013.

3. Statement of Intent

As noted in section 1 of this report the draft SOI for the WRC Holdings Group of Companies for 2014/15 and the following two years is attached (refer **Attachment 1**).

The following is an extracted summary of the projections for the next three years.

Financial Performance Measure	2013/14 * $000	2014/15 $000	2015/16 $000	2016/17 $000
Net profit (deficit) before tax (NPBT)	1,060	(4,873)	(4,959)	(1,731)
Net profit (deficit) after tax (NPAT)	1,500	(1,881)	(1,936)	320
Earnings before interest, tax and depreciation	30,942	30,506	32,265	33,375
Return on total assets	1.6%	0.9%	0.8%	1.1%
Return on shareholders equity	(0.4)%	(1.3%)	(1.2%)	(0.7%)
Shareholders equity to total assets	50.8%	55.5%	59.8%	63.2%
Dividends	2,329	2,215	2,299	2,506

* 2013/14 SOI

The deficits are stemming from the accounting treatment of GWRL, due to the fact that we do fund for depreciation, as a result GWRL is running a deficit in the vicinity of $18 million, this table is discussed in further detail in the last two paragraphs of section 7.5 of the Draft SOI (see **Attachment 1)**.

4. Statement of Intent without GWRL

A very crude analysis has been completed by deducting the operating results, and balance sheet items, including depreciation, tax, equity and assets of GWRL from the consolidated figures in section 4. It can then be seen what influence GWRL is having on these ratios.

	2014/15 $000	2015/16 $000	2016/17 $000
Net profit (deficit) before tax (NPBT)	13,298	14,835	16,103
Net profit (deficit) after tax (NPAT)	11,189	12,316	13,161
Earnings before interest, tax and depreciation	30,506	32,265	33,375
Return on total assets	7.0%	7.2%	7.5%
Return on shareholder's equity	6.5%	5.2%	5.3%
Shareholders equity to total assets	48.0%	46.8%	48.0%
Dividends	2,215	2,299	2,506

5. Detailed Operating Budgets

The draft operating budgets for each of the 100% owned companies within the WRC Holdings Group are attached (refer **Attachment 2**). These are discussed below for each company.

5.1 Pringle House Ltd (PHL)

The SOI assumes that the Regional Council Centre (RCC) will be disposed of during 2014/15 year. A significant write down in June 2013 resulted in a loss of equity.

A loss after tax is forecasted at $514,000 for 2014/15, which is due to a further hypothetical reduction in value to a level that brings the liquidated value of PHL to zero.

The decision on disposing of the RCC is an assumption at this junction and is used for planning purposes only.

Overall, the 2014/15 PHL budget shows a loss of $514,000 this includes a hypothetical write down of $563,000 before a small operating profit of 49,000. Overhead costs and operating expenses amount to $330,000 after revenues of $380,000, leaving a small profit available to meet minor capital expenditure if required to keep the RCC safe and secure while the disposal process is contemplated.

5.2 Port Investments Ltd (PIL)

The projected dividends from CentrePort (PIL's share) are forecasted at $962,000 in 2013/14, and then in 2014/15: $4.308 million, $4.692 million and $5.077 million for the 3 years respectively.

CentrePort has forecasted a $1.250 million dividend for 2013/14 in this SOI (Being a quarter of the forecasted $4.5 million in last year's SOI) our share being 10/13th i.e. $961,500 and was received in late February this year.

PIL while making an operating loss does however pay a $2.4 million dividend in the 2013/14 year to WRC Holdings which was declared post 30 June 2013 and relates to the 2012/13 year.

PIL is forecasting to make an operating loss in 2013/14 of $722,000, which erodes PIL's equity base to $1.638 million and compares to the closing equity in June 2012 of $2.3 million. This has impacted on the current account PIL has with the Council which was in funds at 30 June 2013 by $4.1million, and now reduces to $2.2 million by 30 June 2014. This is due amongst other things to the payment of the declared dividend of $2.4 million and the operating loss of $722,000 resulting from interest payments to WRC Holdings for its $44 million loan.

No subventions receipts are forecast to be received over the forecasted period by PIL. Indicative payments in the vicinity of $1.3 million in the two years 2015/16 and 2016/17 are anticipated to be paid to the Council. The reduction in subvention payments relates to the costs relating to the Seddon earthquakes which are tax deductible, meaning a lower tax liability for CentrePort.

The dividend from CentrePort for the three forecasted years is based on a pay-out ratio of 45% of net profit after tax. This compares to their policy of paying out between 40% and 60%.

Projected interest expense on PIL's $44 million loan from WRC Holdings is projected to rise gradually over the SOI period reflecting a gradual increase in interest rates, offset by the hedging currently in place by WRC Holdings.

5.3 Greater Wellington Rail Ltd (GWRL)

GWRL holds rolling stock and other related rail assets such as stations. It has recently completed the purchase of 48 two car Matangi train units from Rotem Mitsui in South Korea and is presently paying for the upgrade of these units and a further fleet of 28 Matangi trains.

Capital expenditure of $45.8 million is forecasted for the 2014/15 year increasing to $106.3 million in 2015/16 and then reducing to $19.3 million in 2016/17. The bulk of which is driven by the purchase of a further fleet of 28 Matangi trains.

These capital projects are funded 100% by equity which GWRL receives from its parent WRC Holdings and in turn from the ultimate shareholder the Wellington Regional Council.

In previous years the funding for train purchases was via a combination of capital grants and equity. This was because the Government provided part of the funding for the trains up front with the Council picking up the balance.

The Government is now going to pay their contribution back to the Council via an Interest and Principal loan over a 25 year period.

Capital Grants are required to be treated as revenue, and as such they created a large deferred tax liability in GWRL accounts ($76.9m at 30 June 2013). This was because if the trains were sold, a tax liability would arise, however, the depreciation expense over future years will offset this liability.

All operating costs (excluding depreciation) are met with a matching grant from the Council.

The statement of comprehensive income shows an increasing net operating loss, driven by slowly increasing operating costs and depreciation, with depreciation dipping in 2016/17 as the Ganz Marvag trains stop being depreciated and are scrapped.

The balance sheet has equity and rolling stock balances increasing as new trains are purchased (see the asset addition schedule in the detailed GWRL budgets). The deferred tax liability reduces over time as tax losses from operations arising from depreciation are applied to reduce the deferred tax liability balance.

5.4 WRC Holdings Ltd (WRCHL)

WRCHL is the holding company for PIL, PHL and GWRL. Income is sourced predominately from dividends and interest income from PIL.

WRCHL has a $44 million loan via commercial paper backed by a facility from the Commonwealth Bank of Australia (CBA).

Interest charged on the $44 million loan by CBA is offset by the income received from PIL on its $44 million advance by WRC Holdings.

Costs are inflated by 2.5% and interest costs are rising gradually reflecting a general increase in base interest rates. However, $10 million of the $44 million debt is now locked in at a base funding cost of 3.9% until September 2014 and $10 million at 3.78% till September 2015.

The dividends that are paid by WRCHL are as follows: In 2012/13 there was no divided paid to the Council, rather this was declared post balance and paid in 2013/14 and amounts to $2.345 million. In 2014/15 a dividend is to be declared prior to balance date amounting $2.178 million and this pattern repeats going forward.

The dividend increases slowly over time reflecting higher earnings in PIL which are derived from higher CentrePort dividends.

6. CentrePort

CentrePort is showing a steady increase in profitability with projected profit after tax forecast at $12.5 million for the 2014/15 year moving to $13.6 million and $14.6 million for the 2015/16 and 2016/17 years respectively.

Dividend is $5.6 million for 2014/15 and increasing to $6.1million for 2015/16 and to $6.6 million for 2016/17 of which 10/13th's or 76.9% is PIL's share.

It also should be noted that CentrePort provides the Council with subvention payments and these have amounted to around $1 million per year plus a guarantee fee on its debt which is presently around $400,000 per year.

A detailed Statement of Intent for CentrePort, incorporating the performance indicators and other related information was presented to the WRC Holding Board, along with a presentation from CentrePort at the February Board meeting.

7. Changes to the wording in the SOI since 2013

5.0 - CentrePort Performance targets – These have been expanded and include more information. CentrePort has also updated their performance targets these are discussed in Report 14.8 – CentrePort Draft Statement of Intent.

7.6 - Statement of Accounting Policies – These have been updated to reflect changes emanating from the 30 June 2013 annual accounts.

7.7 - The planning assumptions have been updated to reflect changes since last year, bullet points 2 and 6.

8.0 - Issues facing the Group have been updated.

9.0 - Distribution of profit to the Shareholders - Updated to reflect the new **numbers.**

12.1 - Compensation - Updated to reflect current remuneration arrangements

8 The decision-making process and significance

The matter requiring decision in the report has been considered by officers against the requirements of Part 6 of the Local Government Act 2002 (the Act).

Officers have considered the significance of the matter, taking the Council's significance policy and decision-making guidelines into account. Officers recommend that the matter be considered to have low significance.

Officers do not consider that a formal record outlining consideration of the decision-making process is required in this instance.

9 Recommendations

That the Council:

(1) ***Receives*** *the report.*

(2) ***Notes*** *the content of the report.*

(3) ***Receives*** *the draft Statement of Intent of WRC Holdings Group for 2014/15 and forwards any comments or recommendations to the directors of WRC Holdings Ltd for their consideration.*

Report prepared by:	Report approved by:
Mike Timmer Treasurer	Warren Tocker Chief Financial Officer

Attachment 1:	WRC Holdings Group – 2014/15 Draft Statement of Intent
Attachment 2:	Copy of letter to Chair, Greater Wellington Regional Council
Attachment 3:	Pringle House Ltd – Operating Budget 2014/22 Port Investments Ltd - Operating Budget 2014/22 Greater Wellington Rail Ltd – Operating Budget 2014/22 WRC Holdings Ltd - Operating Budget 2014/22