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Committee Council
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# WRC Holdings Group 2015/16 draft Statement of Intent

## 1. Purpose

To receive the 2015/16 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 2015.

The directors of WRC Holdings Ltd considered the draft SCI financials for CentrePort and draft SOI for WRC Holdings on 26 February 2015.

A letter enclosing the draft WRC Holdings SOI (incorporating the CentrePort SCI) was sent to the Chair of Greater Wellington Regional Council on 27 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 2015.

## 3. Statement of Intent

As noted in section 1 of this report the draft SOI for the WRC Holdings Group of Companies for 2015/16 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 | 2014/15* $000 | 2015/16 $000 | 2016/17 $000 | 2017/18 $000 |
|---|---|---|---|---|
| Net profit (deficit) before tax (NPBT) | 16 | (1,640) | (1,945) | (1,589) |
| Net profit (deficit) after tax (NPAT) | 2,114 | 530 | 219 | 503 |
| Earnings before interest, tax and depreciation | 32,209 | 33,322 | 35,244 | 37,621 |
| Return on total assets | 1.6% | 1.2% | 1.1% | 1.2% |
| Return on shareholder's equity | (0.3%) | (0.7%) | (0.7%) | (0.7%) |
| Shareholders equity to total assets | 55.7% | 59.0% | 62.0% | 62.5% |
| Dividends | 2,275 | 2,555 | 2,722 | 3,023 |

* 2014/15 SOI

The deficits are stemming from the accounting treatment of GWRL, due to the fact that we do not fund for depreciation, as a result GWRL is running a deficit in the vicinity of $17-20 million over the three years, this table is discussed in further detail in section 7.5 of the Draft SOI (see **Attachment 1)**.

If the GWRL numbers are removed from the financial projection above, the results are considerably better.

| Financial Performance Measures without GWRL | 2015/16 $000 | 2016/17 $000 | 2017/18 $000 |
|---|---|---|---|
| Net profit (deficit) before tax (NPBT) | 15,651 | 16,744 | 18,320 |
| Return on total assets | 7.2% | 7.5% | 7.8% |
| Return on shareholder's equity | 5.7% | 5.8% | 5.9% |
| Shareholders equity to total assets | 46.3% | 47.1% | 48% |

## 4. 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)

No budgets have been provided for Pringle House Limited as the sole assets of the company, the Regional Council Centre (RCC), is planned to be sold. The plan assumes the RCC and the company will be disposed of prior to 30 June 2015.

Should this not be the case then this can be updated in the final SOI. At that point the assumption will be that the rental revenue from Council will equal property and administration costs. The only uncertainty that remains is the sale price.

For a sale prior to 30 June 2015 we have assumed the sale price will be slightly more than the recent valuation. This allows for the assets and liabilities to be equal, meaning the company is wound up at in a break even position.

Should there be a profit after settling all liabilities and assets the surplus funds will be returned to WRC Holdings. Should there be a loss then WRC Holdings will have to write off the loss. The main liability of PHL is its current account with WRC Holdings. There are no material external party liabilities.

## 5.2 Port Investments Ltd (PIL)

The projected dividends from CentrePort (PIL's share) are forecasted to begin in full again in 2015/16: with $4.692 million, $5.0 million and $5.423 million for the 3 years respectively.

PIL is forecasting to pay a $2.4 million dividend in this financial year to WRC Holdings which will need to be declared before 30 June 2014 and relates to the 2014/15 years earnings.

PIL is forecasting to make operating surpluses and 100% dividend pay-out of these amounting to $2.739 million, $2.910 million and $3.217 million in 2015/16 to 2017/18 years respectively.

No subventions receipts are forecast to be received over the forecasted period by PIL. Indicative payments in the vicinity of $1.3 million, $1.4 million and $1.6m for the three budget years are anticipated to be paid, but this is to Council directly.

The dividend from CentrePort 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%.

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.

PIL equity remains steady at $2.6 million over the forecasted period and is at a similar level to that before the reduced dividends from CentrePort as a consequence of the Seddon earthquakes.

## 5.3 Greater Wellington Rail Ltd (GWRL)

GWRL holds rolling stock and other related rail assets such as stations. It recently completed some minor modification of the 48 two car Matangi train units purchased from Hyundai-Rotem South Korea. GWRL is expecting the first delivery of the second instalment of 35 two car Matangi trains to begin in the second quarter of 2015.

Capital expenditure of $125.4 million is forecasted for the 2015/16 year moving up from a forecast of $40.1m in 2014/15. Capital expenditure reduces to $10.2 million and $23.4 million in 2016/17 and 2017/18 respectively. The bulk of the expenditure is driven by the purchase of a further fleet of 35 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.

The first set of 48 Matangi trains purchased was funded 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 second instalment of the 35 Matangi trains will be funded 100% via Council through WRC Holdings. The Government will contribute around 50% which will be paid to Council via an Interest and Principal loan over a 25 year period.

Capital Grants, previously used to fund around 90% of the first instalment of Matangi trains were required to be treated as revenue, and as such they created a large deferred tax liability in GWRL accounts (forecasted at $71.2m at 30 June 2015). This was because if the trains were sold, a tax liability would arise due to part of the initial purchase being funded by revenue as opposed to equity as it is now. The depreciation expense over future years will however offset this liability.

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

The statement of comprehensive income shows a slowly increasing net operating deficit, which is driven by slowly increasing depreciation, which is not funded. In time the losses will offset the equity injections for the capital expenditure at which point the assets will be fully depreciated and ready for replacement.

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. Interest costs are based on a 90 day forward projection plus a margin for bank line facility cost and a market lending margin. They range from 4.4% to 4.8% over the three year budgeted horizon.

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 the 2013/14 year and amounted to $2.304 million. In the 2014/15 year a dividend of around $2.3 million is forecasted to be paid and declared prior to that financial year end. In 2015/16 a dividend is budgeted to be declared prior to balance date with similar pre balance date declarations going forward. Dividends of $2.6 million, $2.7 million and $3.0 million are budgeted for the 3 years to 2017/18 respectively.

The steady growth reflects the increasing dividend from PIL emanating from CentrePort.

## 5. CentrePort

CentrePort is showing a steady increase in profitability with projected profit after tax but before fair value adjustments forecast at $13.6 million for the 2015/16 year moving to $14.5 million and $15.7 million for the 2016/17 and 2017/18 years respectively.

Dividend is $6.1 million for 2015/16 and increasing to $6.5 million for 2016/17 and to $7.05 million for 2017/18 of which 10/13th's or 76.9% is PIL's share.

## 6. Changes to the wording in the SOI since 2014

**5.0 -CentrePort Performance targets** – The environmental performance targets have been reworded.

**Note:** WRC Holdings directors will be asking CentrePort to consider rewording these performance targets as they felt a number of them were more like objectives rather than specific targets.

**7.6 -Statement of Accounting Policies –** These have been updated with minor changes to reflect changes emanating from the 30 June 2014 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 with the section from CentrePort not completed pending final SOI.

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

## 7. The decision-making process and significance

Officers recognise that the matters referenced in this report may have a high degree of importance to affected or interested parties.

The matters requiring decision in this report have been considered by officers against the requirements of Part 6 of the Local Government Act 2002 (the Act). Part 6 sets out the obligations of local authorities in relation to the making of decisions.

### 7.1 Significance of the decision

Part 6 requires Greater Wellington Regional Council to consider the significance of the decision. The term 'significance' has a statutory definition set out in the Act.

Officers have considered the significance of the matter, taking the Council's significance and engagement 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.

### 7.2 Engagement

Engagement on the matters contained in this report aligns with the level of significance assessed In accordance with the significance and engagement policy, no engagement on the matters for decision is required.

## 8. 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 2015/16 and forwards any comments or recommendations to the directors of WRC Holdings Ltd for their consideration.*

Report approved by:

Mike Timmer
Acting CFO & Treasurer

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|---|---|
| Attachment 1: | WRC Holdings Group – 2015/16 Draft Statement of Intent |
| Attachment 2: | Copy of letter to Chair, Greater Wellington Regional Council |
| Attachment 3: | Pringle House Ltd – Operating Budget 2014/15<br>Port Investments Ltd - Operating Budget 2015/25<br>Greater Wellington Rail Ltd – Operating Budget 2015/25<br>WRC Holdings Ltd - Operating Budget 2015/25 |