greater WELLINGTON
REGIONAL COUNCIL
Te Pane Matua Taiao

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| | |
| Committee | Council |
| Author | Mike Timmer, Treasurer |

# WRC Holdings Group 2016/17 draft Statement of Intent

## 1. Purpose

To receive the 2016/17 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 company Port Investments Ltd (PIL) are Council Controlled Trading Organisations (CCTOs). 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 SOI for WRC Holdings is provided to the shareholder by 1 March, covering the projected results for the three financial years from 1 July 2016.

The directors of WRC Holdings Ltd considered the draft SOI financials for CentrePort and draft SOI for WRC Holdings on 29 February 2016.

A letter enclosing the draft WRC Holdings SOI (incorporating the CentrePort SCI) was sent to the Chair of Greater Wellington Regional Council on 29th February (refer **Attachment 3**).

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 if any 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 2016.

## 3. Statement of Intent

As noted in section 1 of this report the draft SOI for the WRC Holdings Group of Companies for 2016/17 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 | 2015/16* $000 | 2016/17 $000 | 2017/18 $000 | 2018/19 $000 |
|---|---|---|---|---|
| Net profit (deficit) before tax (NPBT) | 586 | (1,511) | 544 | 459 |
| Net profit (deficit) after tax (NPAT) | 2,170 | 420 | 1,979 | 1,859 |
| Earnings before interest, tax and depreciation | 32,955 | 34,083 | 37,882 | 40,273 |
| Return on total assets | 1.4% | 1.0% | 1.4% | 1.4% |
| Return on shareholder's equity | 0.5% | 0.1% | 0.4% | 0.4% |
| Shareholders equity to total assets | 58.9% | 60.5% | 60.8% | 61.2% |
| Dividends | 2,557 | 2,784 | 3,559 | 3,842 |

* 2015/16 SOI

The deficits in 2016/17 and small profits stem 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 $13-14 million over the three years, this table is discussed in further detail in section 7.4 of the Draft SOI (see **Attachment 1)**.

If the results from GWRL are eliminated from the financial projection above the performance indicators are considerably better due to the deficit from GWRL previously impacting on the profitability.

| Financial Performance Measures without GWRL | 2016/17 $000 | 2017/18 $000 | 2018/19 $000 |
|---|---|---|---|
| | | | |
| Net profit (deficit) before tax (NPBT) | 16,772 | 18,997 | 20,359 |
| Return on total assets | 7.1% | 7.6% | 7.8% |
| Return on shareholder's equity | 5.7% | 6.2% | 6.2% |
| Shareholders equity to total assets | 46.5% | 47.2% | 47.7% |

## 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.

### 4.1 Port Investments Ltd (PIL)

The projected dividends from CentrePort, (PIL's share), is forecasted at $5.0 million, $5.423 million and $5.423 million for the 3 years respectively.

PIL is forecasting to make operating surpluses and 100% dividend pay-out of these amounting to $3.411 million, $3.715 million and $3.643 million in 2016/17 to 2018/19 years respectively. The reduction in 2018/19 is due to rising interest cost.

Indicative subventions receipts payments in the vicinity of $1.5 million, and $2.0 million are forecasted for the 2017/18 and 2018/19 years respectively with payment directly to Council.

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.

## 4.2 Greater Wellington Rail Ltd (GWRL)

GWRL holds rolling stock and other related rail assets such as stations. The second tranche of 35 Matangi trains are expected to all be in service by last quarter of 2016, bringing the total number of two cars units to 83.

Capital expenditure of $10 million is forecasted for the 2016/17 year moving down from a forecast of $139.6m in 2015/16 year due to the Matangi purchase. Capital expenditure increases to $22.2 million and $18.5 million in 2017/18 and 2018/19 respectively. The bulk of the expenditure is driven by infrastructure renewals and improvements, with some heavy maintenance/overhauls scheduled for 2017/18.

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 were 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 has been 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 $64.3m at 30 June 2017). 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.

### 4.3 WRC Holdings Ltd (WRCHL)

WRCHL is the holding company for PIL 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 a 90 day forward projection plus a margin for bank line facility cost and a market lending margin. They range from 3.50% to 4.0% over the three year budgeted horizon.

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

## 5. CentrePort

CentrePort is showing a steady increase in profitability with projected profit after tax forecast but before fair value adjustments of $14.3 million for the 2016/17 year moving to $15.7 million and $16.7 million for the 2017/18 and 2018/19 years respectively.

Dividend is $6.5 million for 2016/17 and increasing to $7.1 million for 2017/18 and to $7.6 million for 2018/19 of which 10/13th's or 76.9% is PIL's share.

## 6. Changes to the wording in the SOI since 2015

References to Pringle House Limited (PHL) have been removed and other updates relating to dates and other minor changes. Highlighted below are the major changes.

**2.0 –Reasons for WRC Holdings Group** – reworded second bullet point, changed "where applicable" position in statement

**3.1 -Objectives –** Ammended section c to note GWRL is a special case. Added in sections d, f, g and h to clarify the objectives. Stemmed partly from legal review by DLA Philips Fox and suggested enhancements by management, having reviewed other SOI's.

**4.1.3- GWRL Operational performance targets -** have been updated to reflect changes since last year, and a section on capital projects added.

**5.0 –CentrePort performance targets –** These have been ammended and updated to reflect the letter of expectation request to be more quantitatively focused.

**11.0 –Compensation -** updated to reflect the fact the Council Chair no longer receives remuneration from Council.

## 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 2016/17 and forwards any comments or recommendations to the directors of WRC Holdings Ltd for their consideration.*

| Report prepared by: | Report approved by: |
|---|---|
| Mike Timmer<br>Treasurer | Dave Humm<br>GM Corporate Services / CFO |

Attachment 1: WRC Holdings Group – 2016/19 Draft Statement of Intent

Attachment 2: Port Investments Ltd - Operating Budget 2016/26
Greater Wellington Rail Ltd – Operating Budget 2016/26
WRC Holdings Ltd - Operating Budget 2016/26

Attachment 3: Copy of letter to Chair, Greater Wellington Regional Council