2014 OVERVIEW

- 2014 was a challenging year for KiwiRail. Leading into it, the company had had steady growth in the three years prior.

- The operating surplus reached $108M in 2013 and on the back of that, solid growth was budgeted for the 2014 financial year.

- There were then two unexpected and high profile events.
  - The first was the loss of a propeller on the Aratere.
  - The second was asbestos contamination in our new freight locomotives.

- This was frustrating as the 2014 year had started off well: the freight business was set to exceed its revenue and profit targets for the year.

- On 5 November 2013 the Aratere lost her starboard propeller. Within 8 weeks the Stena Alegra was secured as a replacement. However, it did not have Aratere's rail capacity.

- Aratere has been and continues to be critical to New Zealand's freight movement. She provides 45% of our Cook Strait capacity, and provides an interisland service at critical times of the day for freight customers.

- In the third quarter asbestos containing materials were found in 40 new DL Freight locomotives. They had to be taken out of service to have the asbestos carefully removed.

- The temporary loss of 20% of KiwiRail's locomotive fleet put added strain on the freight business in the second half of the financial year.

- Finally, there was a slowdown in export logging and dairy volumes from April to June this year as the prices for those goods fell on international markets. The company's bulk, dairy and import / export customers make up 40% of revenue, so any movement there impacts on the bottom line.

- As a result of all these factors, the operating surplus in 2014 fell over 28% from 2013 to $77.5M. 2014 was extremely frustrating for KiwiRail, our customers and our stakeholders. However the company is determined to recover and continue its growth programme.

- While the financial side of the business is very important, KiwiRail has also been intensifying and refreshing its focus on safety. There has been a 45% year on year drop in total injuries but there is a long way to go to be best in class.

- KiwiRail is cautious about the outlook for 2015. While the economy is solid in some sectors, it's patchy in the core commodity sectors that make up 40% of the company's revenue.
CROWN SUPPORT

- The ongoing support of the Crown as shareholder has been and continues to be important.

- Including 2015, the total invested by the Crown since 2010 exceeds $1 billion, excluding any investment in metro passenger transport.

- Most of the Crown’s contribution was as part of the turnaround plan which started in 2011.

- There has also been one-off additional support in the 2014 year for loss of earnings from the Aratere outage.

- KiwiRail has made good use of that money in combination with the company’s own contributions. However years of under-investment, coupled with unexpected events in the first 4 years of that plan, means getting the business financially sustainable is still a significant challenge.

- The Global Financial Crisis, Pike River, the Christchurch Earthquakes and the two events this year have all had a material impact on KiwiRail’s operating surpluses.

- To achieve the company’s long term goals is going to require partnering with our customers, our shareholder and transport agencies to build an integrated game plan.

REVENUE

- The bulk of KiwiRail’s 2014 revenue was derived from freight (64%), Interislander (16%) and passenger services such as Scenic Journeys (7%).

- Between 2013 and 2014 freight revenue was steady at just over $460 million. There was an almost 5% decline in the bulk business segment and over 2% decline in import export freight.

- On the other hand domestic freight grew by over 6%, a real achievement considering the Aratere outage and one that indicates strong customer support for rail in a tough year.

- Interislander passenger revenue was down over 9% because of the Aratere, but some of that was made up for by a nearly 2% increase from commercial vehicle freight.

- Tranz Metro, which is our passenger transport business in Wellington, and our Scenic Journeys operation both performed well.

- So in the circumstances, holding the overall revenue at $724M, close to the 2013 level of $727M, was an acceptable outcome.

EXPENSES

- As noted, the operating surplus was down 28%. Since revenue was steady, the difference is in the expenses for 2014:
  - Greater maintenance and reduced capital expenditure
  - Costs of seismic work across our 1500 building portfolio
  - Wage and salary increases (av 2% across 4000 staff)
There were on-off costs in 2014. These were primarily the lease of the Stena Alegra, the cost of the asbestos disruption and insurance receipts for our Christchurch properties.

**ARATERE RESUMES 3 SAILINGS, TUES-FRI**

- KiwiRail is making good progress removing asbestos from our DL locomotives. We will be able to meet the demands of the upcoming peak season.
- And from this week the Aratere has resumed three sailings a day from Tuesdays to Fridays. She had been reduced to two sailings a day since returning from Singapore.

**CONTINUING INVESTMENT**

- Despite the setbacks in 2014, KiwiRail continued its ongoing investment in the business using both Crown money and our own.
- In 2011, at the start of the turnaround plan, the company was faced with ageing infrastructure and ageing rolling stock.
- The strategy was and still is to modernise and refresh our fleet of rolling stock, and upgrade our network. Since that time we’ve acquired 40 new generation DL locomotives.
- It’s the first time in 35 years that the business has bought new locomotives.
- One new DL loco can move the same freight as 100 trucks. That’s a lot of congestion off our motorways and many tonnes fewer of carbon emissions. So Government and KiwiRail investment in these assets makes real economic sense.
- KiwiRail has also invested in new container flat wagons to which modules can be attached depending on whether timber, milk, coal or steel is being freighted.
- Lead times for new rolling stock procurement have been shortened so we’re now much more responsive to market changes.
- The company is steadily replacing or upgrading bridges so they can carry heavier trains.
- Passing loops have been extended and train control systems upgraded to allow more frequent freight services.
- These combined government and company investments improve reliability and on-time performance which are the key value drivers for a supply chain and passenger transport business like ours.
- Examples of the impact they are having include improved on time performance since 2009 for freight and Interislander; improving track quality; journey times shortening or staying shorter and a significant fall in disruptions from minor incidents and derailments.

**BUSINESS CHANGES**

- All these trends are positive, but the bottom line is that we cannot rely on revenue growth alone to get us to a sustainable position.
To improve our performance and continue to grow we need a more cost-effective and efficient business model.

Our focus will be on improving asset and labour productivity, making processes more efficient and delivering consistent on time performance for our customers.

This can only be achieved by the company operating as a single business across New Zealand.

To kick this off we’ve started an internal “Back to Basics” programme and we’re also reviewing all parts of the business including our initial turnaround plan assumptions.

Freight and Market Trends

There are major changes taking place that will impact over the longer term. The second national freight demand study was published by the Ministry of Transport in March 2014.

It showed that up to 2042, commodity freight is expected to increase by about 70-75 percent in terms of tonnes lifted and in terms of tonne-kms transported. And rail’s predicted share of that increased tonnage is significant. It’s a big increase on the current flows, an annual average increase of about two percent.

On top of this our big exporters are trying to improve their competitiveness and reduce their carbon footprints.

Bigger ships into New Zealand’s ports will change freight flows and the intermodal freight hubs that are emerging across the country will lead to more integrated transport options.

So the landscape is changing. We have a key role to operate and optimise our transport rail system to enable export, domestic and passenger patronage growth.

We’re now working closely with Treasury, the Ministry of Transport and the New Zealand Transport Agency to review our forward plans in light of these trends and the need to create a sustainable rail business.

We have therefore commenced a comprehensive review of our operations. It’s our intention to improve the performance of the rail business in a way that realises economic benefits for New Zealand.

Summary

2014 has been a tough year but we’re determined to improve.

In 2015, we’ll be partnering with our customers and stakeholders to support their growth.

We’ll be working hard to improve our safety performance and reduce cost and waste.

We will review our strategy to align with market and freight trends.