KiwiRail

Statement of Corporate Intent

2013-2015
Front Cover Photographs

DL 9066: © Marcus Adams, Travelling Light Photography 2011
Aratere: Lindsay Keats
Workshop: © Marcus Adams, Travelling Light Photography 2011
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This statement has been submitted by the Board of New Zealand Railways Corporation (trading as KiwiRail) in accordance with Section 14 of the State-Owned Enterprises Act, 1986. It sets out the Board’s intentions and objectives to June 2015.

As noted on page 17, a reorganisation is expected under which a new SOE company (NewCo) will be established to hold all the rail assets and liabilities currently held by the NZRC Group other than rail use land. It is expected that this reorganisation will have legal effect on 1 January 2013. The activities of NZRC following the reorganisation will be limited to residual matters, and NewCo will produce its own SCI which will reflect KiwiRail’s business as outlined in this SCI.
KiwiRail is a business with a long and proud history of service to New Zealand. A State Owned Enterprise, we were established in 2008 as a vertically integrated, rail and ferry business that brought the different elements of the rail industry back together.

Many years of under-investment has reduced rail’s competitiveness. Our challenge is to improve the quality of our assets and services and to compete on even terms with other modes of transport, while also cooperating with other players to create solutions for customers. The more successful we are in meeting this challenge, the greater the contribution we will make to the New Zealand economy.

KiwiRail’s strategic plan has the overall objective of transformation into a business able to meet its long term investment requirements, following an initial investment period from the Crown. This prioritised investment plan includes the much needed upgrading of our network, rolling stock, plant, equipment, facilities and systems.

The plan will be delivered by improving reliability, timeliness and providing more flexible services underpinned by the implementation of an organisation-wide customer-focused culture. This will attract more freight and enable yield growth.

The 2012 financial year was the second full year of implementing this strategic plan. In the last year we have continued to address the challenges that have affected our business growth including the Christchurch earthquakes, landslides, droughts, floods and a mining disaster. The adverse economic effects in New Zealand of these events and the impact of the stilted global economy have been well documented. KiwiRail has also faced internal challenges that have had an impact on our results, but despite these and the impacts of the above we have managed within the funding that has been made available to us from our Shareholder.

We have continued to make good progress against our plan. Our freight revenue growth has well exceeded GDP growth, our customers have made tangible commitments to move more by rail such as moving operations to rail-sided land, we have markedly improved the performance of the national rail network, and have delivered $1.2 billion of metro rail projects on time and on budget.

We are also preparing to make the hard decisions regarding those parts of the business that are non-core. These include the decision to seek to sell the Hillside Workshops, the future of loss making minor lines such as Napier to Gisborne and the search for a partner for our long distance passenger service.

Due to the challenges of the past two years, and the resultant negative impact on our financial objectives, we have undertaken a review of our original 10-year strategic plan. The result has been the development of a revised plan that incorporates what we have learned and experienced over this time. Further information on the revised plan is provided in the Outlook and Strategy section of this Statement, but the foundations of the original plan, such as growth in freight and network improvements, are still in place. Importantly, the objective of financial sustainability by 2020 is unchanged. While the revised plan forecasts less internally generated cash flow than the original 2010 plan, this is offset by a reduced capital programme over the 10 years. This reflects the lower growth projections in the revised plan and a reassessment of the capital expenditure required to catch up on past under investment and bring the condition of our asset base to a steady state position.

The major changes to the plan over the next three years include reducing our network spend to bring our investment curve back behind our earnings growth, reprioritising our freight capital spend, reviewing our support structures and investigating options for the ship replacement strategy. Making these changes to our original plan gives greater certainty to deliver our financial targets over the next three years and achieve financial sustainability by 2020. This is underpinned by strategic and operational project plans identifying the key activities and timing for delivering productivity and performance improvements. Performance against these plans will be closely monitored by the KiwiRail Board.
KiwiRail is a State Owned Enterprise and the backbone of New Zealand’s integrated transport network. Our vision is to be a world class mover of freight and people by rail and ships, and to be the natural choice for our customers in the markets in which we operate.

We have five business units:
- KiwiRail Freight provides rail freight services and locomotives for passenger services
- KiwiRail Interislander operates the Cook Strait ferry passenger and freight services
- KiwiRail Infrastructure and Engineering maintains and improves the rail network and controls the operation of trains on the network – it also operates the workshops which maintain our rolling stock
- KiwiRail Passenger provides urban passenger services in Wellington under contract to the Greater Wellington Regional Council through the Tranz Metro team, and the Scenic team operates the long distance passenger rail services
- KiwiRail Corporate provides support services to all business units and manages KiwiRail’s extensive property portfolio including both operational and commercial property holdings.

> Operations

Each week, train control operations manage the movement of:
- 900 freight trains
- 44 Inter-city passenger trains
- Approximately 2,200 suburban passenger services in Wellington
- Approximately 2,000 suburban passenger services in Auckland.

In a year, Interislander manages 4,600 sailings carrying:
- 755,000 passengers
- 52,000 rail wagons
- 71,000 trucks
- 215,000 cars.

> Assets

- Approximately 4,300 staff
- 4,000 kms of track
- 1,628 bridges
- 144 tunnels
- 12,000 culverts
- Six million sleepers
- 18,000 ha of property managed
- 198 mainline locomotives
- 4,585 freight wagons
- 2 owned and 1 leased ferry.
3 NATURE AND SCOPE OF THE BUSINESS

The business activities of KiwiRail over the next three years will be:

- To own and operate a national rail network
- To provide for the transport of bulk and consolidated freight
- To provide inter-island ferry services (forming the ‘bridge’ between the North and South Islands) for rail, road freight, and passengers and their vehicles
- To provide and/or support rail passenger services in metropolitan areas and, unless changed, long distance services for both domestic and tourist markets
- To manage and develop property holdings for rail operations and appropriate third party land use
- To undertake or participate in business activities which add value for customers and leverage the capabilities of KiwiRail. For example container repair and upgrade services, and refrigerated container monitoring services.

4 CORPORATE RESPONSIBILITY COMMITMENT

KiwiRail’s commitment to corporate responsibility has been defined across five impact areas:

- To deliver to our customers what we have promised; we will listen to them and involve them in our solutions and innovations
- To be a good employer, treating our people fairly and with respect, and valuing their diversity. We are committed to creating a workplace that makes people want to join, stay and work to their full potential. Our commitment to the safety and well-being of our people is a priority
- To work with our suppliers to develop long term partnerships based on best practice procurement methods which reflect mutually agreeable codes of conduct
- To recognise the environmental, social and economic needs of the communities we work in and endeavour to be a good neighbour. We will involve relevant communities in initiatives we implement
- To help protect the environment by better understanding, managing and measuring our environmental impacts and minimising the carbon intensity of our services. We will do this by commissioning new, more fuel efficient locomotives, increasing our focus on fuel saving behaviour and opportunities to improve efficiency, and the completion of some of the Metro Projects including Auckland metro electrification.
KiwiRail’s operating surplus before major one-off items was $104.9 million, compared to the target of $139.5 million. Major one-off items relate to a write down of inventory items ($11.7 million) and a provision for restructuring costs in relation to our infrastructure and engineering business ($15.6 million).

As mentioned previously, some of the contributing factors to the lower operating surplus were outside our control, but we have also experienced our own challenges with delays to new rolling stock and the Aratere project cost overruns.

Underlying this however, our core Rail business achieved revenue growth of $68.4 million on the prior year and its operating surplus before major one-off items has improved by 12.5%.

The Freight team has continued to perform well with the Bulk and Import-Export categories growing revenue by 12.7% and 16.0% respectively compared to 2011. This is due to a combination of record milk production and the increase in the number of containers being moved by rail, particularly in the upper North Island. The flat economy resulted in domestic revenue growth of 3.3%.

The Rail result has been offset by weaker performance in other parts of the business including Interislander and Passenger which have experienced a range of challenges.

The Interislander result, compared to 2011, has been negatively affected by the planned increase in costs to replace the Aratere while she was overseas getting extended, increased fuel costs and a decline in the passenger market. The combination of these factors has led to a decrease in operating surplus of $3.2 million.

The long distance passenger service is still being negatively affected by the impact of the Christchurch earthquakes with tourist numbers approximately 30% below pre-earthquake levels and showing no real signs of growth.

The ongoing freight growth gives us confidence that our strategic plan is working, particularly as the above issues are continued to be managed appropriately.

In line with our 2012 objectives we have:

- Grown our freight volume, revenue and earnings
- Put into service the first 20 new DL locomotives in the North Island. They have travelled over two million kilometres to deliver over 15,000 freight services enabling KiwiRail to successfully deliver the requirements for the last peak freight season, a record milk season and the Ports of Auckland strike. There have been issues, as there usually are when commissioning large, newly designed, bespoke rolling stock, but they have, and are, being rectified under warranty at no cost to KiwiRail. These rectifications are now being incorporated into the design for the next 20 DLs so we can continue to upgrade our fleet capability
- Put into service 535 new flat deck wagons and 258 intermodal containers across the country
- Delivered the Metro upgrade projects on time and on budget ($1.2b). These include Developing Auckland Regional Transport (DART), Auckland Electrification Project (AEP) and EMU’s in Auckland, and the Wellington Regional Rail Project (WRRP) and Matangi’s in Wellington
- Lifted the rail network standard which is evidenced by the lift in service reliability and speed, and the reduction in temporary speed restrictions and mainline derailments
- Explored partnership opportunities for the Scenic operations
- Renegotiated our relationships with the Auckland and Wellington councils for the Metro arrangements.
Rail’s role in the New Zealand economy is very different from the days 150 years ago when trains first started running. It’s even changed significantly in the last 50 years. That means the way we plan for the future of our business must adapt to changing times and circumstances.

At its most basic, it involves focusing on the movement of freight – on rail and ferry – along KiwiRail’s routes of national significance. A secondary focus is on containing and effectively managing those parts of the business that are essentially non-commercial.

The rail industry has long investment time-frames. Locomotives and wagons have working lives of 30 years or more. Bridges and tunnels can last up to a century.

This tells us that although the normal business planning period is three years, our own planning and investment horizons must be much more distant.

The strategic plan continues to be the basis of this Statement of Corporate Intent (SCI). This plan has undergone a review to incorporate the impacts of the challenges to the business over the last two years and what we have learned in implementing our plan.

While on-going performance of all our businesses units is important, the most critical growth will continue to come from the Freight business for which reliable equipment and timekeeping is the cornerstone to success.
**Outlook**

KiwiRail is projecting freight revenue growing by an average of 6.5% per annum over the next three years due to:

- Continued commissioning of new rolling stock enabling greater capacity and reliability
- Addition of a new daily service between Auckland and Palmerston North, and new forestry services for the lower North Island
- Improving yields from general price increases via CPI adjustments and adjusting the pricing for contracts that do not meet their long run costs
- An increase in coal and other bulk mineral volumes, including an assumed increase in Solid Energy contract prices
- Additional forestry exports and revenue from new log bolsters
- Import-Export revenue increases due to the overall primary sector growth, customer decisions from where to send freight, growth in the Taranaki region, and the Christchurch recovery
- Margin improvements by further utilising existing capacity on current services and growing the yield on key trains.

We have improved the quality of our travel products with the introduction of new carriages for the Coastal Pacific service and the Aratere improvements. As the economy improves and Christchurch recovers, we predict that passenger numbers will increase. In the meantime we will continue to canvas the market to see if potential partners can improve the performance of our long distance rail service.

The Government has endorsed our revised plan and recognised the growth and improvement in the business by announcing the third appropriation of $250 million, from the original $750 million approved in 2010, in the May 2012 budget.

**Key elements of our strategic plan:**

**ONE: GROWTH IN FREIGHT VOLUME AND REVENUE QUALITY IS ESSENTIAL**

Freight is critical for KiwiRail’s journey to financial sustainability. It currently generates more than 60 percent of KiwiRail’s revenue from carrying bulk commodities, import-export goods and domestic freight. The predicted near doubling of the freight task over the next thirty years and the opportunity to continue to increase rail’s market share on some routes reinforces its importance to the business.

As shown in Table 7.2(a), in the second year of the strategic plan the Freight Group achieved year on year revenue growth of $59.1 million, a 14.8% improvement on 2011. We have targeted continued Freight revenue growth of $35.1 million (2013), $36.8 million (2014) and $23.9 million (2015) from increased volumes and a continued focus on yield improvements. This will continue to be supported by improvements in reliability and transit times, and the increased ferry capacity due to the Aratere extension.

During 2011 the Freight business took direct control of the maintenance of the KiwiRail rolling stock fleet. This ensured that the maintenance part of the business was even more closely aligned with the needs and priorities of our customers.

**ROLLING STOCK**

One of the fundamental strategies central to the transformation of the business is to introduce newer, more reliable and lower overall cost rolling stock. This is critical for improving reliability and productivity, and continuing revenue growth. New locomotives have been introduced, as well as new wagons and other equipment. Lower costs to maintain this equipment will begin to take effect in the next year and will accelerate as more new equipment is introduced.

The first two years of the strategic plan has seen $125.5 million invested in new rolling stock with:
20 DL locomotives in operation, a prototype for the second generation of DL locomotives completed, and the purchase of long lead time key components for the construction of the second batch of DL locomotives

- 535 new flat top wagons in operation
- 258 intermodal containers in operation
- 600 log bolster in operation to help cater for forestry growth.

We plan to purchase an additional 519 wagons, 35 locomotives and 360 intermodal containers over the next three years to retire out of life expired rolling stock and to meet our demand requirements.

The specific numbers of wagons and locomotives to be purchased are reported in Table 7.1(k) with the investment values included in capital expenditure forecasts reported in Table 7.2(c).

Auckland - Christchurch

While reducing transit times is still a priority for growing our domestic freight traffic, on-going discussions with our freight forwarding customers has resulted in a shift in focus to ensuring our premium freight trains reliably meet their current timetables. Our customers consider reliable on-time performance to be of more immediate importance than improving transit times.

At the same time, during the last 12 months the business has extensively reviewed the options to improve transit times via infrastructure changes. We have identified several low-cost infrastructure changes with small time benefits and these are currently underway, for example:

- Changes to North Island Main Trunk line signalling
- Minor curve easements.

We are carefully looking at where we invest our money to ensure we get the most benefit and as such it is considered more prudent to focus on initiatives that improve reliability than reduce time, for example:

- Train control upgrades in areas of low reliability
- Yard improvements to allow faster arrivals and departures and quicker throughput.

The introduction of a new premier train service between Auckland and Palmerston North for the next peak season will add additional capacity and enable the Freight business to realign the freight on its key services. This will in itself benefit train services and reduce the amount of attach and detach activity at key transit terminals (for example at Hamilton and Palmerston North), thereby improving reliability.

We are also monitoring with interest the progress of the Clifford Bay feasibility study currently being undertaken by the Ministry of Transport.

We are continuing to review the ships we require for the Interislander business and how we use them, and the land-side assets, for rail freight needs.

Two: Addressing non-performing areas of the business

Minor Lines

Minor lines that carry little or no traffic will only survive if they have proven future potential and/or an imminent anchor customer.

In July 2010 we announced the mothballing of the Stratford-Okahukura Line. We have recently signed a lease for the operation of self-drive rail carts on this line. This tourism business has meant that the line, while still effectively mothballed, will not be closed at this time.

We are continuing to assess the future of the Napier to Gisborne and North Auckland lines after a year of consultation with local communities and continued efforts to gain more freight business.

The North Wairarapa line will continue to be used as an alternative link into Wellington during North Island Main Trunk upgrade work over the next few years.

Hillside Workshops

As announced earlier in the year the Hillside Workshops business has been offered for sale. We expect the sale process to be completed by September this year. We intend to sell the business as a going concern to a purchaser who will bring other customers and capabilities to the business. Failure to sell the business will mean a further review on the future of Hillside will be made by the end of 2012.

Long Distance Passenger

During the first quarter of the 2013 financial year we expect our process to seek a partner for this business to be concluded. The result of this will determine how
this operation fits into our future structure and plans.

THREE: WE NEED TO IMPROVE AND MAINTAIN A SUSTAINABLE CONNECTED NETWORK

The national KiwiRail network extends over 4,000 km – a mixture of main lines, secondary lines and minor lines. Growing the business depends on maintaining a connected and financially sustainable network.

Our core network capital expenditure is part of the strategic plan programme outlined in Table 7.1(f).

After investing $192.0 million in 2012, we plan to invest $163.6 million in 2013, $132.1 million in 2014 and $178.0 million in 2015 in infrastructure renewals and upgrades to improve reliability and speed on the core network. As mentioned earlier this is a reduction in the original planned expenditure of approximately $200 million. The key physical outputs for that expenditure are reported in Table 7.1(j).

FOUR: INVESTING IN OUR PEOPLE AND IMPROVING PERFORMANCE

An aligned, safe and engaged workforce is critical to the successful delivery of our strategic plan. We have completed an independent review of our human resources and safety strategies and this has produced six key strategic priorities that work together to support KiwiRail’s vision and strategic plan. These interconnected themes centre on building a safe service-oriented culture that focuses engagement, performance, productivity and personal accountability and are:

- Attraction and retention (Employer of Choice/Good Employer)
- Staff engagement and leadership development
- Flexibility and capability
- Productivity and performance
- Health, safety and wellbeing
- Practices, processes and systems.

We are continuing the drive to achieve a zero harm workplace across all our businesses under the guidance of the newly established role of General Manager, Safety and People.

FIVE: A COMMERCIAL FOCUS FOR METRO PASSENGER

In the last year the full implementation of the Metropolitan Rail Operating Model was achieved. This seeks to put metro rail on a sustainable basis, allow operating services to be fully contested, and ensure KiwiRail does not subsidise the operation of networks for commuter services in Wellington or Auckland. These objectives have been met by:

- Transferring ownership of KiwiRail’s Wellington-based EMU rolling stock and associated inventory, shelters and stations (other than Wellington Station), EMU maintenance facilities and associated plant and equipment to entities controlled by Greater Wellington Regional Council (GWRC)
- Negotiating track access agreements based on full cost recovery with GWRC and Auckland Transport
- Continuing to operate the Wellington metro commuter service under contract to GWRC with the combined objective of improving the customer experience. We will make a decision on whether we will bid for this contract when it is due for renewal in 2016.

KiwiRail’s focus is now on achieving our performance objectives including further improvements in on time performance and levels of customer service, leading to improved customer ratings and increasing patronage.

SIX: DRIVING PRODUCTIVITY IMPROVEMENTS

We have continued to focus on improving productivity in the past year and the investments made to date and on-going plans are expected to generate tangible improvements in performance. As highlighted in Table 7.1, examples of these include:

- Freight operating cost to revenue ratio is forecast to improve from 71% in 2011 to 61% in 2015 due to:
  - Increase in prices
  - Improved utilisation on existing services
  - Improved yield of new equipment
  - Stronger control on costs
  - Some expected benefits from exploring new technologies and practices in shunt operations.
- Freight fuel costs as a percentage of revenue is forecast to improve from 15% in 2011 to 13% in 2015 from the introduction of new more fuel efficient locomotives and new initiatives such as in-cab fuel optimisation trip metering systems
- Rolling stock maintenance cost as a percentage of freight revenue falling from 13% in 2011 to 9% in 2015 as new equipment is introduced
- Reducing rail network operating costs as a percentage of freight revenue falling from 16% in 2011 to 13% in 2015 by re-engineering infrastructure delivery through more efficient use of the labour force and how the track is accessed
- Interislander productivity will improve by optimising the number of sailings, better fuel
management and by ensuring labour costs are competitive over time, reducing the operating cost to revenue ratio from 88% in 2011 to 84% in 2015.

**SEVEN: CHALLENGING THE SUPPORT SERVICES MODEL**

This year we will complete a review of support functions (Information Systems, Human Resources, Finance, Property and Legal) to determine the most efficient manner for delivering these services across the business.

The review has focused on:

- Understanding what support functions are currently undertaken across the business
- Identifying which activities should be retained in the business and which make more sense to be operating in a centralised manner
- Focusing the business unit support on value add and strategic activities rather than transactional processes
- Aligning the cost of providing support functions to the expected financial performance of the business.

We are also in the process of developing a comprehensive financial management information system to improve data architecture, reporting efficiency and cash flow management.

As we continue to improve our rolling stock assets and rail network, we are also investing in our information technology and communication systems to help improve our levels of customer service and business efficiency. Some examples include:

- **KORMS** – Implement an efficient, reliable, sustainable, operational and customer facing technology that supports and simplifies core freight management activities
- **Yard Wagon Tag Readers** – Provisioning of Tag Readers for use in operational reporting of wagons/rail vehicle movements to the backend systems
- **Mobility** – Establishment of standards and capabilities to support emerging business unit demands in relation to mobile devices, communications and the provision of information anytime and anywhere.

**PROPERTY**

KiwiRail’s property division includes Commercial and Operational Property Management together with Commercial lease management. This business unit provides property support services to all internal business units, together with maintaining an external lease portfolio for over 3500 tenants, from commercial tenants to those with grazing rights, generating $30.0 million of revenue in 2012.

The key areas of focus for this unit are:

- New freight customer property developments
- A new strategic focus with investments being made in energy initiatives to reduce power consumption, asset management and commercial development
- A change in approach from reactive unscheduled maintenance to a more planned/scheduled maintenance and renewals plan
- Maximising the return from the property portfolio.

We are seeing strong demand from freight firms to have rail-enabled sites across the network. This has been particularly evident in Auckland, Palmerston North, Wellington, Christchurch and Dunedin, with almost $60 million expected to be invested in these sites over the next two years. These developments complement the freight objective of a modal shift from road to rail.

Table 7.2(c) includes investment capital for these commercial opportunities and other requirements.
The progress of our primary objective contained in the 10 Year Strategic Plan is the main focus for 2013-2015. We are committed to growing internal cash flow to reach self-sufficiency by 2020, while making the best use of our assets employed. New initiatives are now being implemented that will push underlying performance towards the targets set down below.

As a diverse business, KiwiRail has many reportable financial and non-financial metrics, many of which are applicable to the particular business unit. The measures reported below capture the most important drivers of the Strategic Plan.

**TABLE 7.1**

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<td>(a) Operating revenue</td>
<td>667.4</td>
<td>715.8</td>
<td>734.0</td>
<td>779.0</td>
<td>815.0</td>
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<tr>
<td>(b) Grant income</td>
<td>344.6</td>
<td>172.3</td>
<td>152.1</td>
<td>33.5</td>
<td>33.6</td>
</tr>
<tr>
<td>(c) Operating surplus before major one-off items</td>
<td>107.7</td>
<td>104.9</td>
<td>119.3</td>
<td>152.7</td>
<td>184.4</td>
</tr>
<tr>
<td>(d) Net operating surplus</td>
<td>102.6</td>
<td>77.6</td>
<td>119.3</td>
<td>146.0</td>
<td>183.4</td>
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<tr>
<td>(e) NPAT before grant income</td>
<td>(310.5)</td>
<td>(2,477.4)</td>
<td>(287.9)</td>
<td>(140.3)</td>
<td>(131.6)</td>
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<tr>
<td>(f) Strategic Plan Capital Expenditure</td>
<td>397.1</td>
<td>345.8</td>
<td>313.8</td>
<td>307.0</td>
<td>295.3</td>
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<tr>
<td>(g) Metro Project Capital Expenditure</td>
<td>261.6</td>
<td>143.6</td>
<td>124.5</td>
<td>10.2</td>
<td>0.0</td>
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<td>(h) Metro Renewals Capital Expenditure</td>
<td>16.9</td>
<td>18.5</td>
<td>24.4</td>
<td>22.7</td>
<td>24.4</td>
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<th>Key Sales Metrics</th>
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<tr>
<td>(i) Freight NTK (m)</td>
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<td>(j) Freight AVG Yield (C/NTK)</td>
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<th>Key Investment Outcomes</th>
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<tr>
<td>(k) Rolling Stock Replacement</td>
</tr>
<tr>
<td>- Wagons (no. of new units)</td>
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<td>- Locomotives (no. of new units)</td>
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<td>(l) Network Renewals</td>
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<tr>
<td>- New Sleepers Laid (000)</td>
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<td>- New Rail Laid (km)</td>
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<td>- Lines Destressed (km)</td>
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<tr>
<td>- Span Metres Replaced</td>
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<td>- Timber Piers Replaced</td>
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<td>- Culverts Replaced</td>
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<td>- Level Crossing Upgrades</td>
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<th>Customer Service Performance</th>
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<tr>
<td>(m) Freight – Premium Train (%&lt;30min)</td>
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<td>(n) Metro (%&lt;5min)</td>
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<tr>
<td>(o) Scenic (%&lt;15min)</td>
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<td>(p) Interislander (%&lt;15min)</td>
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<tr>
<td>(q) Group Labour Costs as % of Revenue</td>
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<td>(r) Freight OPEX as a % of Freight Revenue</td>
</tr>
<tr>
<td>(s) Freight fuel &amp; traction electricity costs as a % of Revenue</td>
</tr>
<tr>
<td>(t) Freight maintenance costs as a % of Revenue</td>
</tr>
<tr>
<td>(u) Interislander OPEX as a % of Revenue</td>
</tr>
<tr>
<td>(v) Interislander fuel costs as a % of Revenue</td>
</tr>
<tr>
<td>(w) Network operating costs % of Freight revenue</td>
</tr>
<tr>
<td><strong>Health and Safety</strong></td>
</tr>
<tr>
<td>(x) LTIFR (per million man hours)</td>
</tr>
<tr>
<td>(y) MTIFR (per million man hours)</td>
</tr>
<tr>
<td><strong>Staff Engagement</strong></td>
</tr>
<tr>
<td>(z) Engagement Index</td>
</tr>
<tr>
<td><strong>Corporate Responsibility</strong></td>
</tr>
<tr>
<td>(aa) GHG emissions per NTK from rail freight traction energy (gms)</td>
</tr>
</tbody>
</table>

**Note 1:** NPAT before grant income in 2012 includes an impairment loss of $2,199 million resulting from the restructure of KiwiRail’s balance sheet to value assets in line with their market value or the commercial return as described section 9 of this Statement.

**Note 2:** Strategic Plan Capital expenditure excludes major Metro projects funded by government and Metro passenger renewals funded by local authorities.

**Note 3:** Year in which commitment is made to purchase rolling stock.

**Note 4:** KiwiRail Limited is in discussions with Solid Energy to achieve a proper contribution to capex on the West Coast coal route, and to agree an increase in yield. This table assumes that a satisfactory outcome is reached between KiwiRail Limited and Solid Energy in this regard, and that appropriate annual capital and maintenance plans are agreed between NZRC, KiwiRail Limited and Solid Energy in respect of the West Coast coal route.
<table>
<thead>
<tr>
<th>Reference</th>
<th>Description of Performance Measure</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) (i) (j)</td>
<td>Driving revenue, particularly in the Freight division, is critical to the success of this business plan. While KiwiRail is looking for revenue improvements across all operational business units, a step change is planned through volume and yield improvements on rail freight.</td>
</tr>
<tr>
<td>(b)</td>
<td>KiwiRail receives operating grants from the Crown to fund major metro projects and other public benefit capital items. This funding is forecast to decrease from 2013 as the metro projects near completion.</td>
</tr>
<tr>
<td>(c) (d) (e)</td>
<td>Net operating surplus growth is a critical element of the funding required to deliver the investment programme we have planned. We are looking to drive operating profitability significantly over the next three years.</td>
</tr>
<tr>
<td>(f) (k) (l)</td>
<td>The capital plan has been separated between expenditure for the core business (Rail, Interislander and Passenger) and purpose-funded major Metro project and renewals expenditure. We have outlined a number of expected deliverables for the rolling stock and network renewals expenditure. The 2012 commitment to purchase five new locomotives reflects the cost incurred to complete one prototype and purchase long-lead time componentry for the second tranche of 20 locomotives.</td>
</tr>
<tr>
<td>(g)</td>
<td>The Developing Auckland Rail Transport (DART) project was substantially completed and commissioned in 2011. However, the DART programme also included a number of other lesser tasks around platform extensions, station re-developments and track re-alignments in preparation for electrification. Most of this work is in progress or complete and will be finalised at the next Christmas 2012/13 block of line. Auckland Electrification Project (AEP) covers all the infrastructure works required to prepare the network for the commencement of EMUs (Electric Multiple Units) over the metro area from Swanson to Papakura. This includes (1) re-signalling the network which will be completed in early June 2012 apart from the work associated with DART at Christmas; (2) the construction of foundations, masts and conductors over the tracks which is at various stages of progress and will be completed by the end of August 2013; (3) re-building 24 bridges to achieve the required clearances for the conductors which will be completed in July 2012.</td>
</tr>
<tr>
<td>(h)</td>
<td>In addition to funding from Greater Wellington Regional Council (GWRC), $88.4 has now been secured from the Crown for KiwiRail to complete an extensive refurbishment of the remaining Wellington electrical traction system and an upgrade of the associated signalling over the next 8 years. Discussions are continuing with both GWRC and Auckland Transport regarding long term metro renewal and maintenance funding in parallel with performance based agreements.</td>
</tr>
<tr>
<td>(m)</td>
<td>Premium trains performance is expected to improve from 82% in 2012 to 95% in 2015 as new rolling stock is introduced to these services and track upgrades improve reliability.</td>
</tr>
<tr>
<td>(n)</td>
<td>The introduction of the Matangi fleet in Tranz Metro will provide continuous improvements to customer service to ensure a 91 percent or better on time performance target is achieved.</td>
</tr>
<tr>
<td>(o)</td>
<td>Scenic passenger growth is reliant on continued improvements in customer service to ensure a top quality tourist experience, including a 87 percent or better on time performance target.</td>
</tr>
<tr>
<td>(p)</td>
<td>The Interislander over recent years has maintained a very high standard of time reliability. In both the 2011 and 2012 financial years this was adversely affected by disruptions related to the Aratere extension and upgrade. In the latter part of the 2012 financial year Interislander’s reliability has returned to pre-Aratere extension levels creating a higher base for on-time performance at 85%. Refinements over time are expected to result in achieving a consistent on-time performance level of 90% or above.</td>
</tr>
<tr>
<td>(q) - (w)</td>
<td>Driving continued productivity improvements throughout our business is a fundamental element of the Strategic Plan and returning KiwiRail to financial self-sufficiency by 2020. Key initiatives underlying 2013 financial year productivity improvements are discussed on page 10.</td>
</tr>
<tr>
<td>(x) (y)</td>
<td>KiwiRail takes health and safety performance extremely seriously. We operate a heavy engineering transport operation that presents many risks for accident and injury. We will continue to drive the safety message and improve our workplace safety record and have our staff return home as they came to work. KiwiRail has signed up to a Zero Harm programme, with significant improvements to LTIFR (lost time injury frequency rate) and MTIFR (medical time injury frequency rate) targets over the next three years.</td>
</tr>
<tr>
<td>(z)</td>
<td>Every year KiwiRail completes a staff engagement survey. Given the importance of an engaged workforce to deliver our plan, a strong engagement result is required.</td>
</tr>
<tr>
<td>(aa)</td>
<td>As part of its corporate responsibility commitment we plan to reduce our carbon footprint by reducing greenhouse gas emissions.</td>
</tr>
</tbody>
</table>
KiwiRail has committed to providing greater segment visibility of our business. To that end, we have included key financial measures for our business units in the following table:

### TABLE 7.2

<table>
<thead>
<tr>
<th>BUSINESS UNIT SUMMARY ($m)</th>
<th>2011 Actual</th>
<th>2012 Actual</th>
<th>SCI Horizon Budget</th>
<th>2014 Plan</th>
<th>2015 Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Operating Revenue</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rail Business</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Freight</td>
<td>398.5</td>
<td>457.6</td>
<td>492.7</td>
<td>529.5</td>
<td>553.4</td>
</tr>
<tr>
<td>Infrastructure &amp; Engineering</td>
<td>27.2</td>
<td>34.2</td>
<td>33.1</td>
<td>32.9</td>
<td>34.3</td>
</tr>
<tr>
<td>Corporate &amp; Property</td>
<td>31.8</td>
<td>34.1</td>
<td>33.1</td>
<td>35.3</td>
<td>38.6</td>
</tr>
<tr>
<td></td>
<td><strong>457.5</strong></td>
<td><strong>525.9</strong></td>
<td><strong>558.9</strong></td>
<td><strong>597.7</strong></td>
<td><strong>626.3</strong></td>
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<tr>
<td>Interislander</td>
<td>122.9</td>
<td>123.9</td>
<td>126.8</td>
<td>130.5</td>
<td>135.5</td>
</tr>
<tr>
<td>Scenic1</td>
<td>21.5</td>
<td>20.3</td>
<td>2.5</td>
<td>3.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Tranz Metro</td>
<td>65.5</td>
<td>45.7</td>
<td>45.8</td>
<td>47.3</td>
<td>48.7</td>
</tr>
<tr>
<td></td>
<td><strong>667.4</strong></td>
<td><strong>715.8</strong></td>
<td><strong>734.0</strong></td>
<td><strong>779.0</strong></td>
<td><strong>815.0</strong></td>
</tr>
<tr>
<td>(b) Net Operating surplus before major one-off items</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rail Business</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Freight</td>
<td>130.7</td>
<td>149.8</td>
<td>168.0</td>
<td>196.2</td>
<td>221.2</td>
</tr>
<tr>
<td>Infrastructure &amp; Engineering</td>
<td>(38.4)</td>
<td>(38.2)</td>
<td>(48.4)</td>
<td>(50.5)</td>
<td>(52.0)</td>
</tr>
<tr>
<td>Corporate &amp; Property²</td>
<td>(14.0)</td>
<td>(23.5)</td>
<td>(26.0)</td>
<td>(24.8)</td>
<td>(21.2)</td>
</tr>
<tr>
<td></td>
<td><strong>78.3</strong></td>
<td><strong>88.1</strong></td>
<td><strong>93.6</strong></td>
<td><strong>120.9</strong></td>
<td><strong>148.0</strong></td>
</tr>
<tr>
<td>Interislander</td>
<td>19.5</td>
<td>16.3</td>
<td>19.4</td>
<td>24.3</td>
<td>27.8</td>
</tr>
<tr>
<td>Scenic1</td>
<td>(0.2)</td>
<td>(3.6)</td>
<td>2.5</td>
<td>3.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Tranz Metro</td>
<td>10.1</td>
<td>4.1</td>
<td>3.8</td>
<td>4.0</td>
<td>4.1</td>
</tr>
<tr>
<td></td>
<td><strong>107.7</strong></td>
<td><strong>104.9</strong></td>
<td><strong>119.3</strong></td>
<td><strong>152.7</strong></td>
<td><strong>184.4</strong></td>
</tr>
<tr>
<td>(c) Strategic Plan Capital Expenditure (excl. Metro)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rail Business</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Freight</td>
<td>121.4</td>
<td>84.4</td>
<td>94.9</td>
<td>101.5</td>
<td>87.7</td>
</tr>
<tr>
<td>Infrastructure &amp; Engineering</td>
<td>199.8</td>
<td>192.0</td>
<td>163.6</td>
<td>132.1</td>
<td>178.0</td>
</tr>
<tr>
<td>Corporate &amp; Property</td>
<td>26.8</td>
<td>23.7</td>
<td>46.1</td>
<td>69.4</td>
<td>22.5</td>
</tr>
<tr>
<td></td>
<td><strong>348.0</strong></td>
<td><strong>300.1</strong></td>
<td><strong>304.6</strong></td>
<td><strong>303.0</strong></td>
<td><strong>288.2</strong></td>
</tr>
<tr>
<td>Interislander</td>
<td>23.1</td>
<td>30.9</td>
<td>4.3</td>
<td>4.0</td>
<td>7.1</td>
</tr>
<tr>
<td>Scenic</td>
<td>22.4</td>
<td>14.8</td>
<td>4.9</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Tranz Metro</td>
<td>3.6</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td><strong>397.1</strong></td>
<td><strong>345.8</strong></td>
<td><strong>313.8</strong></td>
<td><strong>307.0</strong></td>
<td><strong>295.3</strong></td>
</tr>
</tbody>
</table>

**Note 1:** Scenic operating revenue and net operating surplus forecasts assume the operating business is sold in 2013, with the AK carriages leased to the new operator. If the planned sale does not proceed, Scenic is expected to generate operating deficits over the next three years.

**Note 2:** The 2011 and 2012 Corporate and Property operating deficits are not strictly comparable due to structural changes, and higher information technology and other Corporate initiative costs incurred in 2012.

**Note 3:** KiwiRail Limited is in discussions with Solid Energy to achieve a proper contribution to capex on the West Coast coal route, and to agree an increase in yield. This table assumes that a satisfactory outcome is reached between KiwiRail Limited and Solid Energy in this regard, and that appropriate annual capital and maintenance plans are agreed between NZRC, KiwiRail Limited and Solid Energy in respect of the West Coast coal route.
In May 2010 the Government announced its support for KiwiRail’s transformation with a $750 million investment in principle over the first three years of the Strategic Plan (the 2011 – 2013 financial years). The Crown’s investment, together with internally generated cash flow, funds KiwiRail’s capital investment programme.

The capital projects underlying the Crown’s 2011 and 2012 financial year investment of $500 million included:

- Extending and upgrading the MV Aratere by inserting a 30 metre section of hull structure into the middle of the ship, replacing the bow and propellers and upgrading the ship’s power supply
- Part of the Network upgrades and renewals programme
- The purchase of container flat top freight wagons and containers
- Part of the refurbishment programme for existing locomotives and wagons
- Part of the information technology and property refurbishment investment programme.

The Government has appropriated the third $250 million equity investment for the 2013 financial year, together with the conversion of $322.5 million of historic debt to equity on 16th July 2012. As discussed in section 1 of this Statement, after the review of our strategic plan we have slowed our capital investment plan over the next three years, reducing the level of equity funding required in 2013. The plan assumes we draw down $198 million of the $250 million of equity funding appropriated in 2013 (with the balance being drawn down in 2014) to fund:

- Part of the purchase of the second tranche of 20 DL locomotives, 75 wagons and 180 intermodal containers
- Part of the refurbishment programme for existing locomotives and wagons
- Part of the Network renewals and upgrade programme.

Funding Assumptions for 2014 and 2015

The financial forecasts and performance measures included in Tables 9.1 to 9.3 are based on a number of important funding and capital structure assumptions.

The plan to turnaround KiwiRail assumes the Crown invests approximately $1.1 billion to support the 10 year $3.1 billion (excluding Metro projects and renewals) capital programme. The Government has now appropriated the first $750 million of equity funding. For the balance, we have commenced discussions with the Government on funding arrangements beyond 2013. As these discussions are on-going we have prepared this Statement assuming the Crown provides $146 million in equity funding in the 2014 financial year (of which $52m has already been formally appropriated) and $122 million in 2015. However it is important to note that the Government has made no commitment to the unappropriated funding at the time this Statement was prepared. We will actively work with the Government to explore the most efficient way to meeting these funding requirements.
As a State Owned Enterprise (SOE), KiwiRail is required to report a number of specific performance measures as shown in the table 9.1.

The balance sheet and financial metrics are not typical of a SOE due to KiwiRail's heavy reliance on shareholder investment support through the first five years of the Strategic Plan before underlying earnings become positive.

Furthermore, the Group’s balance sheet valuations previously reflected the view that its assets were held for a public benefit rather than to generate a commercial return. At KiwiRail’s annual public meeting in November 2011, it was announced that a change in accounting methodology would be made to reflect a more standard commercial approach to non-land asset valuations and impairment testing. This change reflects the Shareholder’s requirement that the Group maximise cash flow generated from assets other than rail use land and will result in a much more realistic value of KiwiRail’s assets. Rail use land will continue to be held for public benefit.

After consultation between KiwiRail’s Directors and Shareholding Ministers, the Shareholder determined and publicly announced that a new company (NewCo - which will be an SOE) will be established to hold all the rail assets and liabilities currently held in the NZRC Group, excluding rail use land. It is expected that the

reorganisation will have legal effect on 1 January 2013.

As the decision by the Shareholder was made public prior to the end of the financial year, the impact is reflected in our Financial Statements as at 30 June 2012. Our assets are now valued in line with their market value or the commercial return they generate. This treatment results in a significant change from the previous Optimised Depreciated Replacement Cost (ODRC) valuation and is the reason for the $7.1 billion reduction in value of KiwiRail’s non-land assets. Of the $7.1 billion, $4.9 billion is covered by revaluation reserves, with the remaining $2.2 billion being recognised as an impairment in the Statement of Financial Performance.

A further $2.4 billion reduction in our land value at 30 June 2012 results from the normal revaluations performed by independent valuers. This reduction was covered by revaluation reserves.

Each year we will assess the value of our assets at the higher of their market value or the commercial return they generate. As the Strategic Plan does not result in a positive commercial value for the Rail business until after 2015, we have included further impairments of capital expenditure through the forecast period. This is offset partially by reduced depreciation expense on lower assets values.

1 Land used for the rail corridor and other operational purposes
### TABLE 9.1

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Total Shareholder Return</td>
<td>NA</td>
<td>-99%2</td>
<td>-7%</td>
<td>-8%</td>
<td>3%</td>
</tr>
<tr>
<td>Dividend Yield</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Dividend Payout</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>Return on Average Equity</td>
<td>0.3%</td>
<td>-28.5%</td>
<td>-3.7%</td>
<td>-2.8%</td>
<td>-2.5%</td>
</tr>
<tr>
<td>Return on Average Equity excluding IFRS fair valuation movements and asset revaluations</td>
<td>1.9%</td>
<td>-189.4%3</td>
<td>-29.2%</td>
<td>-15.8%</td>
<td>-13.8%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Average Capital Employed</td>
<td>-13.0%</td>
<td>-144.9%</td>
<td>-33.8%</td>
<td>-15.2%</td>
<td>-13.6%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>14.8%</td>
<td>10.8%</td>
<td>16.3%</td>
<td>18.7%</td>
<td>22.5%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder’s Funds to Total Assets</td>
<td>93.1%</td>
<td>81.2%</td>
<td>89.3%</td>
<td>89.3%</td>
<td>89.4%</td>
</tr>
<tr>
<td>Gearing Ratio (net)</td>
<td>3.6%</td>
<td>14.9%</td>
<td>5.6%</td>
<td>6.5%</td>
<td>6.3%</td>
</tr>
<tr>
<td>Interest Cover</td>
<td>3.5</td>
<td>2.3</td>
<td>6.4</td>
<td>7.8</td>
<td>9.6</td>
</tr>
<tr>
<td>Solvency (current assets/current liabilities)</td>
<td>0.50</td>
<td>0.33</td>
<td>0.65</td>
<td>0.61</td>
<td>0.61</td>
</tr>
</tbody>
</table>

**Note 1:** Performance measures are defined in Appendix 2.

**Note 2:** The 2012 ratio reflects the $231 million decrease in the estimated commercial value of KiwiRail compared to 2011 as discussed on page 20.

**Note 3:** The 2012 ratio reflects the impact of the $2.2 billion impairment of assets recognised in KiwiRail’s 2012 Statement of Financial Performance.

The performance targets in table 9.1 reflect the new asset values for the current NZRC Group, including rail use land and the impact of the asset impairments. As discussed above, the Shareholder intends to establish a new SOE (NewCo) to hold all the rail assets and liabilities currently held in the NZRC Group, excluding rail use land. Assets to be transferred to the new SOE include all rolling stock, tracks, railway infrastructure, ships, plant and equipment, buildings and all shares in subsidiaries. The new company will be classified as a Profit Oriented Entity (“POE”) for accounting purposes, and its assets will therefore be valued and impairment tested on a commercial basis as described above. It is expected that the Group’s rail assets and liabilities will be vested in the new company on 1 January 2013. The vesting of rail assets and liabilities will use a statutory procedure under the New Zealand Railways Corporation Restructuring Act 1990 for which the shareholder is providing its support.

Table 9.2 presents NZRC Group’s balance sheet as at 30 June 2012 and a pro-forma balance sheet for the proposed new SOE assuming the value of rail use land is $3.158 billion and all trading operations are carried out by NewCo. The re-stated performance measures for NewCo are shown in table 9.3.
### TABLE 9.2

**Proforma Newco Balance Sheet ($m)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Assets</td>
<td>212</td>
<td>212</td>
<td></td>
<td>182</td>
<td>149</td>
<td>151</td>
<td></td>
</tr>
<tr>
<td>Property, Plant, Equipment &amp; Land</td>
<td>4,051</td>
<td>(3,158)</td>
<td>893</td>
<td>965</td>
<td>1,041</td>
<td>1,063</td>
<td></td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td><strong>4,263</strong></td>
<td><strong>1,105</strong></td>
<td></td>
<td><strong>1,147</strong></td>
<td><strong>1,190</strong></td>
<td><strong>1,214</strong></td>
<td></td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>206</td>
<td>206</td>
<td></td>
<td>198</td>
<td>165</td>
<td>167</td>
<td></td>
</tr>
<tr>
<td>Non Current Liabilities</td>
<td>43</td>
<td>43</td>
<td></td>
<td>36</td>
<td>33</td>
<td>35</td>
<td></td>
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<tr>
<td>Liabilities before borrowings</td>
<td>249</td>
<td>249</td>
<td></td>
<td>234</td>
<td>198</td>
<td>202</td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>554</td>
<td>554</td>
<td></td>
<td>226</td>
<td>266</td>
<td>262</td>
<td></td>
</tr>
<tr>
<td>Shareholder Equity</td>
<td>3,460</td>
<td>(3,158)</td>
<td>302</td>
<td>687</td>
<td>726</td>
<td>750</td>
<td></td>
</tr>
</tbody>
</table>

### TABLE 9.3

**Restated Performance Targets for NewCo**

<table>
<thead>
<tr>
<th>Shareholder Return Measures</th>
<th>2013 Budget</th>
<th>SCI Horizon</th>
<th>2014 Plan</th>
<th>2015 Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Shareholder Return</td>
<td>-7%</td>
<td>-8%</td>
<td>3%</td>
<td></td>
</tr>
<tr>
<td>Dividend Yield</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Dividend Payout</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
<td></td>
</tr>
<tr>
<td>Return on Average Equity</td>
<td>-27.4%</td>
<td>-15.1%</td>
<td>-13.2%</td>
<td></td>
</tr>
<tr>
<td>Return on Average Equity excluding IFRS fair valuation movements and asset revaluations</td>
<td>-29.2%</td>
<td>-15.8%</td>
<td>-13.8%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Profitability/Efficiency Measures</th>
<th></th>
<th>SCI Horizon</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Average Capital Employed</td>
<td>-33.8%</td>
<td>-15.2%</td>
<td>-13.6%</td>
<td></td>
</tr>
<tr>
<td>Operating Margin</td>
<td>16.3%</td>
<td>18.7%</td>
<td>22.5%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Leverage/Solvency Measures</th>
<th></th>
<th>SCI Horizon</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholder’s Funds to Total Assets</td>
<td>59.9%</td>
<td>61.0%</td>
<td>61.8%</td>
<td></td>
</tr>
<tr>
<td>Gearing Ratio (net)</td>
<td>31.3%</td>
<td>34.5%</td>
<td>32.9%</td>
<td></td>
</tr>
<tr>
<td>Interest Cover</td>
<td>6.4</td>
<td>7.8</td>
<td>9.6</td>
<td></td>
</tr>
<tr>
<td>Solvency (current assets/current liabilities)</td>
<td>0.65</td>
<td>0.61</td>
<td>0.61</td>
<td></td>
</tr>
</tbody>
</table>
The Board’s estimate of the DCF value of the Kiwirail Group as at 30 June 2012 is negative $715 million, a $231 million decrease on the estimated value at 30 June 2011.

<table>
<thead>
<tr>
<th>$m</th>
<th>30 June 2011</th>
<th>30 June 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Present Value of Pre-Tax Free Cash Flows</td>
<td>(30)</td>
<td>33</td>
</tr>
<tr>
<td>Less Present Value of Tax Payable on Ungeared Earnings</td>
<td>-</td>
<td>(250)</td>
</tr>
<tr>
<td>DCF Enterprise Value</td>
<td>(30)</td>
<td>(217)</td>
</tr>
<tr>
<td>Less Net Debt</td>
<td>(454)</td>
<td>(498)</td>
</tr>
<tr>
<td>DCF Equity Value</td>
<td>(484)</td>
<td>(715)</td>
</tr>
</tbody>
</table>

The key points about the manner in which this valuation was derived are as follows:

- The discounted cash flow (DCF) methodology was used to calculate a Net Present Value (NPV) of the entire KiwiRail Group, including all subsidiaries, on an after tax basis.
- The DCF / NPV was based on the nominal (i.e. inflation-adjusted) future cash flows set out in KiwiRail’s three year Business Plan, with forward projections then also made about years 4 to 20 consistent with the revised strategic plan, and a terminal value of $733 million was included in the terminal year. The growth assumption assumed in the terminal value was 2.25%.
- A discount rate of 9.3% was assumed.
- PwC has confirmed the mathematical accuracy of the discounted cash flow valuation calculations prior to approval of the DCF value by the Board.
- The $187 million reduction in estimated DCF Enterprise Value compared to 30 June 2011 reflects a $63 million increase in the present value of forecast pre-tax free cash flows, offset by a $250 million decrease relating to tax. Previously the NZRC group paid no tax due to the tax exempt status of NZRC, but under the expected reorganisation as discussed on page 17 of this Statement, NewCo will be a tax payer from about 2020 onwards.
- Net Debt increased by $44 million compared to 30 June 2011. The balance at 30 June 2012 includes $498.5 million of outstanding loans with the Government Debt Management Office. This balance has not been adjusted for the conversion of $322.5 million of this debt to equity subsequent to the valuation date (16 July 2012).
- Delivery of the Strategic Plan will result in continued improvement in the enterprise value of KiwiRail as the heavy investment in “catch-up” capital expenditure over the first five years of the plan is completed and operating surplus growth is realised.
The Corporation’s detailed accounting policies are set out in Appendix One: Statement of Current Accounting Policies.

12 DIVIDEND POLICY

The Strategic Plan requires significant investment over a 10-year period. A significant amount of that investment is from the Shareholder. As such KiwiRail does not expect to make any dividend payments over the period of this Statement.

13 REPORTING TO SHAREHOLDING MINISTERS

KiwiRail will provide to Shareholding Ministers:
- An Annual Report and Half Yearly Report in accordance with sections 15 and 16 of the State-Owned Enterprises Act 1986. These will include a statement of financial performance, a statement of financial position, a statement of cash flows and such details as are necessary to permit an informed assessment of the Corporation’s performance
- Continuous Disclosure reporting as required by the Crown Ownership Monitoring Unit (COMU)
- Regular reporting to COMU for performance monitoring during the Strategic Plan investment period
- Other information requested by Ministers in accordance with section 18 of the State-Owned Enterprises Act 1986.

14 PROCEDURES FOR SHARE ACQUISITIONS

Purchase of shares in any company or interests in any other organisation will be subject to prior agreement with Ministers in accordance with the New Zealand Railways Corporation Act 1981 and the State-Owned Enterprises Act 1986 which provides that KiwiRail may, from time to time, with the approval of the Minister of Finance, subscribe for or otherwise acquire stocks, debentures, or any interest in any company, body corporate or business.
KiwiRail expects to receive compensation from the Crown as per section 7 of the State-Owned Enterprises Act 1986 for public policy work and projects undertaken by the corporation which have a public good element or purpose and would not be undertaken on purely commercial grounds.

### REPORTING ENTITY

New Zealand Railways Corporation ("NZRC", "the Parent") is a statutory corporation established pursuant to the New Zealand Railways Corporation Act 1981 and is included within the First Schedule of the State Owned Enterprises Act 1986. The Group comprises the New Zealand Railways Corporation and its subsidiaries. The Group is domiciled in New Zealand. The Parent and the Group have been designated as a Public Benefit Entity ("PBE").

The primary objective of the Group is to establish, maintain and operate, or otherwise arrange for, safe and efficient rail, road and ferry freight and passenger transport services within New Zealand in such a way that revenue exceeds costs, including interest and depreciation; and to provide for a return on capital as specified by the Minister of Finance from time to time.

### Change of accounting designation

The Group’s balance sheet valuations previously reflected the view that its assets were held for a public benefit rather than to generate a commercial return. At KiwiRail’s annual public meeting in November 2011, it was announced that a change in accounting approach would be made to reflect a more standard commercial approach to non-land asset valuations and impairment testing. This change reflects the shareholder’s requirement that the Group maximise cash flow generated from assets other than rail corridor land. Cash generating units ("CGUs") to which the assets are allocated are therefore required to be impairment tested on the basis of the commercial returns they are forecast to generate. This has resulted in the recorded value of affected assets being significantly reduced to values supported by forecast future cash flows. This change has been accounted for as a change in assessment of assets from non-cash generating to cash generating.

After consultation between NZRC Directors and Ministers of the Crown (acting as shareholders of the Group) it has been determined by the shareholder and publically announced (27 June 2012) that the following structural changes will be made:

a) A new company (which will be an SOE) will be established to hold all the rail assets and liabilities currently held in the Group, excluding Crown land that is currently made available to the Parent of the Group under its legislation. Assets to be transferred to the new SOE include all rolling stock, tracks, railway infrastructure, ships, plant and equipment, buildings and all shares in subsidiaries. The new company will be classified as a Profit Oriented Entity ("POE") for accounting purposes, and its assets will therefore be valued and impairment tested on a commercial basis. It is expected that Group’s rail assets and liabilities will be vested in the new company early in 2013. The vesting of rail assets and liabilities will use a statutory procedure under the New Zealand Railways Corporation Restructuring Act 1990 for which the shareholder is providing its support.

b) Agreements will be entered into as required to enable the Crown land that is currently made available to the Parent of the Group to be made available to the new company to continue to fulfil its objectives as a rail operator.

c) Appropriate cash generating units will be defined for impairment testing in accordance with POE accounting guidelines to ensure transparent reporting of the performance of the
new company and to ensure the appropriate valuation of assets consistent with the commercial return they generate.

As the decision by the shareholder was made public prior to the end of the financial year, the impact of this decision is reflected in the Financial Statements as at 30 June 2012. The consequences of this are:

a) Fixed and Intangible Assets are reflected in the financial statements at their recoverable amount being the higher of value in use or fair value less cost to sell, with value in use being the present value of future cash flows. Where the recoverable amount of the asset is below net book value, an impairment has been recognised. The impairment is first applied against any revaluation reserve and then against the statement of financial performance if the revaluation reserve is insufficient.

b) The following cash generating units have been established:
   i) Rail Freight (which includes the Metro and Scenic businesses);
   ii) Interislander; and
   iii) Leased buildings.

The results of applying cash generating principles for the CGUs are detailed in the Financial Statements as follows:

a) The statement of financial performance reflects the value of impairments in excess of any applicable revaluation reserve.

b) The statement of comprehensive income reflects the impairments that have been applied against asset revaluation reserves.

c) Section (c) (iv) of Significant Accounting Policies details the approach to valuation and potential impairment of property, plant and equipment.

d) Section (d) of Significant Accounting Policies details the approach to valuation and potential impairment of intangible assets.

BASIS OF PREPARATION

Statement of compliance

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice and comply with the New Zealand Railways Corporations Act 1981, the State-Owned Enterprises Act of 1986 and New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable financial reporting standards as appropriate for public benefit entities.

Measurement base

The financial statements have been prepared on the basis of historical cost, modified by the revaluation of certain non-current assets and certain financial instruments (including derivative instruments).

Cost is based on the fair value of the consideration given in exchange for assets at the date of the transaction.

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

Unless otherwise specified, all dollar amounts in these financial statements and accompanying notes are stated in New Zealand dollars and all values are expressed in millions of dollars ($m). The functional and presentation currency is New Zealand dollars.

Going concern

The successful transformation of KiwiRail to a long term, self-sustaining railway business is outlined in the long term business plan presented to the shareholder in 2010 and the latest three year business case presented to the shareholder in 2012. These plans outline the support required from the shareholder to contribute to the proposed investments that will provide the opportunity to drive long term, sustainable earnings.

The shareholder has confirmed $250m of equity funding in the 2012/13 financial year. In addition, on 16th July 2012 $322.5m of debt included in current financial liabilities was converted to equity by the shareholder.

We have completed these financial statements on a "going concern" basis based on the assumption the shareholder support will continue largely in line with those plans. The shareholder has confirmed that any shareholder funding that is committed to the Group prior to the establishment of the new company will be provided to the new company once established.

Changes in accounting policies

The group and parent have applied Joint Venture accounting in the current financial year to account for an arrangement with Northland Regional Council. See note (n) below for further details. There have been no other material changes in accounting policies in the year. All other policies have been applied on a basis consistent with those used in previous periods.

NATURE OF BUSINESS AND PRINCIPAL ACTIVITIES

The Group carries out the following activities:

- Manage and operate the New Zealand Rail Network
- Provide rail operators with access to the rail network
Provide advice to the Crown on rail infrastructure issues

Manage land on the rail corridor

Operate interisland ferries

Operate Wellington Metro and long distance rail passenger services

Operate rail freight transport services in New Zealand

Carry out engineering and mechanical services to the locomotives and other rolling stock

**ESTIMATION UNCERTAINTY**

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions of accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

**Asset revaluations**

The remaining useful lives of property, plant and equipment represents management’s best estimates of the useful lives of individual asset classes. When assets are revalued the valuers provide updated expected remaining useful lives for the assets that have been revalued.

**Employee entitlements**

Independent actuaries are engaged to provide the valuation of employee entitlements. Reliance is placed on the expertise of the independent actuaries to provide accurate valuations of employee benefits. The two key assumptions used in calculating this liability include the discount rate and the salary inflation factor. The discount rate is the yield on 10 year Government bonds as at the end of the financial year, which have terms to maturity that match, as closely as possible, to the estimated future cash outflows. The salary inflation factor is determined with consideration of historical salary inflation patterns.

**Inventory obsolescence**

Management relies on its knowledge of the business to calculate inventory obsolescence provisions. The bulk of inventory held is spare parts for rolling stock and the network. Due to the age of these assets the parts held are often old and management relies on its knowledge of the business to identify items of inventory that are truly obsolete.

**CRITICAL JUDGEMENTS**

**Asset revaluations**

The Group’s land is held at fair value and other assets are carried at depreciable replacement cost. Assets are revalued on a cyclical basis by independent valuers. The valuation of land is based on “across the fence” methodology.

**SIGNIFICANT ACCOUNTING POLICIES**

The following accounting policies have been consistently applied to all reporting periods presented in these financial statements.

(a) **Consolidated financial statements**

The consolidated financial statements of the Parent and its subsidiaries include the financial statements of subsidiary companies using the acquisition method of consolidation. The acquisition method of consolidation involves adding together like items of assets, liabilities, equity, income and expense on a line by line basis from the date that control commences to the date that control ceases and eliminating all significant intra-group balances and transactions. Subsidiary companies are those entities that are controlled directly or indirectly by the Parent.

The Parent values subsidiary companies at the time of acquisition as the identifiable assets and liabilities acquired measured at the aggregate of fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Unrealised losses relating to impairment of subsidiaries are recognised in the Statement of Financial Performance.

(b) **Revenue recognition**

Revenue is measured at the fair value of the consideration received or receivable by the Parent and Group and represents amounts receivable for goods and services provided in the normal course of business once significant risk and rewards of ownership have been transferred to the buyer after eliminating the sales within the Group.

(i) Freight revenue is recognised based on the date of freight acceptance. Freight revenue also includes maintenance revenue which is recognised at the date that the maintenance service is provided.

(ii) Interislander revenue is comprised of freight revenue and passenger revenue. Freight revenue is recognised based on the date of freight
acceptance. Passenger revenue is recognised at the date of travel.

(iii) Tranz Metro and Scenic revenue is recognised at the date of travel.

(iv) Property and Corporate revenue comprises rental income, Government funding for operating expenditure and other revenue. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging the operating lease are recognised on a straight-line basis over the lease term.

(v) Infrastructure and Engineering revenue comprises track access revenue, Government funding for operating expenditure, manufacturing revenue, maintenance revenue and other revenue. Track access revenue is recognised on a straight-line basis over the term of the relevant agreement. Manufacturing revenue is recognised by reference to the stage of completion of the contract activity at the balance date, if the outcome of the contract can be reliably estimated. The stage of completion is assessed by reference to surveys of work performed. Manufacturing revenue includes revenue from design services. Maintenance revenue is recognised at the date that the maintenance service is provided.

(vi) Interest income from call and term deposits is recognised as it accrues, using the effective interest method.

(vii) Dividend income is recognised when the right to receive payment has been established.

(viii) Other sources of income are recognised when earned and are reported in the financial periods to which they relate.

(ix) Government funding received as reimbursements of operating costs are recognised as income in the period in which the funding is receivable.

(x) Government funding received as reimbursements of the costs of capital projects is recognised as income in the period in which the funding is receivable.

(xi) Grants received in respect of services provided are recognised when the requirements of the relevant grant agreement are met.

(c) Property, plant and equipment

(i) Recognition and Measurement

Property, plant and equipment asset classes consist of land, buildings, railway infrastructure, rolling stock, ships and plant and equipment.

Property, plant and equipment are shown at cost or valuation, less any accumulated depreciation. Items of property, plant and equipment in the course of construction are classified as capital work in progress. Cost includes expenditure that is directly attributable to the acquisition of the asset.

Where an asset is acquired for nil or nominal consideration the asset is recognised initially at fair value, where fair value can be reliably determined; and the fair value of the asset received less costs incurred to acquire the asset is also recognised as income in the Statement of Financial Performance.

(ii) Revaluation

Land, buildings and railway infrastructure are revalued with sufficient regularity to ensure that the carrying amount does not differ materially from fair value. Fair value is determined from market-based evidence by an external, independent valuer. Valuations are undertaken in accordance with the standards issued by the New Zealand Property Institute with the following bases of valuation adopted:

- Specialised buildings and railway infrastructure – valued using optimised depreciated replacement cost.
- Rail corridor – land associated with the rail corridor is valued based on adjacent use (‘across the fence’), as an approximation of fair value.
- Non-specialised land and buildings which could be sold with relative ease are valued at market value.

Any revaluation increase arising on the revaluation of land and buildings and railway infrastructure is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in the Statement of Financial Performance, in which case the increase is credited to the Statement of Financial Performance to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of land, buildings or track assets is charged as an expense to the Statement of Financial Performance to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

Other additions between revaluations are recorded at cost.

(iii) Disposals

Realised gains and losses arising from the disposal of property, plant and equipment are recognised in the Statement of Financial Performance in the period in which the transaction occurs. The gain or loss is calculated as the difference between the carrying amount of the asset and the sale proceeds received (if any). Any balance attributable to the disposed asset in
the asset revaluation reserve is transferred to retained earnings.

(iv) Impairment.
The carrying amounts of the Group’s non-current assets are reviewed at each reporting date to determine if there is any indication of impairment. If any such indication exists, the asset or its related cash-generating unit (CGU) will be tested for impairment by comparing its recoverable amount to its carrying amount. The recoverable amount of an asset or CGU is the higher of its value in use and its fair value less costs to sell.

Where the future economic benefits or service potential of the asset are not primarily dependent on the asset’s ability to generate net cash inflows and where the Group would, if deprived of the asset, replace its remaining future economic benefits or service potential, the value in use is the depreciated replacement cost.

The value in use for cash-generating assets and cash-generating units is the present value of expected future cash flows.

If an asset’s carrying amount exceeds its recoverable amount the asset is impaired and the carrying amount is written down to the recoverable amount. For revalued assets the impairment loss is treated as a revaluation decrease (see c(ii) above).

For assets not carried at a revalued amount, the total impairment loss is recognised in the Statement of Financial Performance.

Plant and equipment, motor vehicles, leasehold improvements and equipment under finance leases are stated at cost less accumulated depreciation and impairment. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of the acquisition.

(v) Renewals
Expenditures, including inventory, relating to track renewals, ballast, formation upgrading, and major overhauls of rolling stock are capitalised as fixed assets. Repairs and maintenance costs are expensed through the Statement of Financial Performance as incurred.

(vi) Depreciation
Depreciation is charged on a straight line basis at rates that will allocate the cost or valuation of the asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter. In determining an asset’s useful life, consideration is given to its expected usage, its expected wear and tear, technical or commercial obsolescence, and legal or similar limits on its use.

Depreciation is provided on freehold buildings, railway infrastructure, rolling stock, ships and containers, plant and equipment, but excludes land.

Depreciation on revalued buildings and track assets is charged to the Statement of Financial Performance. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the asset revaluation reserve, net of any related deferred taxes, is transferred directly to retained earnings.

For assets that are revalued, any difference between the depreciation on the revalued asset value and the depreciation based on the original cost is transferred from the asset revaluation reserve to retained earnings.

The average depreciable lives for major categories of property, plant and equipment are as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Useful life</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure</td>
<td></td>
</tr>
<tr>
<td>Tunnels &amp; bridges</td>
<td>75 - 200 years</td>
</tr>
<tr>
<td>Track &amp; ballast</td>
<td>40 – 50 years</td>
</tr>
<tr>
<td>Overhead traction</td>
<td>20 – 80 years</td>
</tr>
<tr>
<td>Signals &amp; communications</td>
<td>15 – 50 years</td>
</tr>
<tr>
<td>Buildings</td>
<td>35 – 80 years</td>
</tr>
<tr>
<td>Rolling stock and ships</td>
<td></td>
</tr>
<tr>
<td>Wagons &amp; carriages</td>
<td>5 - 30 years</td>
</tr>
<tr>
<td>Locomotives</td>
<td>5 - 23 years</td>
</tr>
<tr>
<td>Ships</td>
<td>20 years</td>
</tr>
<tr>
<td>Containers</td>
<td>10 years</td>
</tr>
<tr>
<td>Plant and Equipment</td>
<td></td>
</tr>
<tr>
<td>Plant &amp; equipment</td>
<td>5 – 35 years</td>
</tr>
<tr>
<td>Motor vehicles</td>
<td>5 – 10 years</td>
</tr>
<tr>
<td>Furniture &amp; fittings</td>
<td>5 years</td>
</tr>
<tr>
<td>Office equipment</td>
<td>3 - 5 years</td>
</tr>
</tbody>
</table>

(d) Valuation of intangible assets
Intangible assets comprise software applications which have a finite useful life and are recorded at cost less accumulated amortisation and impairment.

Intangible assets are recognised initially at cost. Intangible assets with a finite useful life are amortised on a straight-line basis over their estimated useful lives, which were 3 to 5 years for all reporting periods.
(e) Net Finance Costs
Borrowing costs – Interest expense on borrowings is recognised in the Statement of Financial Performance using the effective interest rate method.

Other finance costs include interest expense on finance leases and the net change in fair value of derivative financial instruments.

As a public benefit entity the Group has elected not to capitalise borrowing costs on capital projects.

(f) Inventories
Inventory comprises items that are used in the maintenance and operation of the rail network, fuel, passenger consumable items, and items used in the manufacture of assets for sale to external parties. Inventory is not held for trading purposes with the exception of consumable cafeteria supplies held on the rail and ferry passenger services.

Inventory is recorded at the lower of cost and current replacement cost. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventory to its present condition and location. Cost is calculated on the weighted average method.

(g) Leases
Operating leases
Operating leases are defined as leases under which substantially all the risks and rewards of ownership of the applicable asset or assets remain with the lessor. Operating lease payments and receipts are recognised in the statement of financial performance in accordance with the pattern of benefits derived or received.

Finance leases
Leases in which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Finance lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The interest expense component of finance lease payments is recognised in the Statement of Financial Performance using the effective interest rate method. Assets acquired by way of a finance lease are included in property, plant and equipment, initially at an amount equal to the lower of its fair value and the present value of the future minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

(h) Income tax
The parent is exempt from income tax as a public authority. All subsidiaries of the Parent are taxpayers. The accounting policies applied in respect of the subsidiaries are as follows:

Income tax expense comprises both current and deferred tax. Income tax expense is charged or credited to the Statement of Financial Performance, except when it relates to items charged or credited directly to equity, in which case the tax is charged to equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at reporting date and any adjustments to tax in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the carrying amounts used for taxation purposes.

The amount of deferred tax provided is based on the expected manner of realisation of the asset or settlement of the liability, using tax rates enacted or substantively enacted at each reporting date. Deferred tax assets and liabilities are not discounted.

A deferred tax asset is recognised in the financial statements for all deductible temporary differences and for the carry forward of unused tax losses and unused tax credits only to the extent that it is probable that future taxable surpluses will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Unrecognised deferred tax assets are reassessed at each balance sheet date.

(i) Goods and services tax (GST)

All items in the financial statements are presented exclusive of GST, except for receivables and payables, which are presented on a GST inclusive basis. Where GST is not recoverable as an input tax it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the Statement of Financial Position.

Cash flows are included in the statement of cash flows on a net basis in respect of GST. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, IRD, are classified as operating cash flows.

(j) Provisions
Provisions are recognised when the Group has a present or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are measured at the present value of the expenditure expected to be
required to settle the obligation.

If the effect of the time value of money is material, provisions are determined by discounting the future cash flows. Where discounting is used, the increase in the provision for the passage of time is recognised as a finance cost.

(k) ACC Partnership Programme

The New Zealand Railways Corporation, Ontrack Infrastructure Limited and KiwiRail Limited belong to the ACC Partnership Programme whereby each company accepts the management and financial responsibility for employee work related accidents. Under the programme the employer is liable for all its claims costs for a period of four years up to a specified maximum. At the end of the four year period a premium is paid to ACC for the value of residual claims, and from that point the liability for on-going claims passes to ACC.

The liability for the ACC Partnership Programme is measured annually by independent actuaries using actuarial techniques at the present value of expected future payments to be made in respect of the employee injuries and claims up to the reporting date. Consideration is given to anticipated future wages and salary levels and experience of employee claims and injuries. Expected future payments are discounted using market yields on secondary market Government bond yields at balance date with terms to maturity that match, as closely as possible, the estimated future cash outflows.

(l) Employee entitlements

Provision is made for benefits accruing to employees in respect of annual leave, retiring leave, long service leave and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

The provision for retiring leave, long service leave and sick leave is calculated on an annual basis by independent actuaries.

Provisions made in respect of employee benefits expected to be settled within twelve months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within twelve months are measured on an actuarial basis at the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Employee entitlements to salaries and wages, annual leave, long service leave and other similar benefits are actuarially valued on an annual basis and are recognised in the Statement of Financial Performance when they accrue.

(m) Contributions to superannuation plans

Certain employees are members of defined contribution schemes and the Group contributes to those schemes. A defined contribution scheme is a plan under which the employee and the Group pay fixed contributions into a separate entity. The Group has no legal or constructive obligation to pay further contributions in relation to employee service in the current and prior periods. The contributions are recognised as labour and related costs in the Statement of Financial Performance when they are due.

(n) Joint Venture

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. The Group is party to a joint venture arrangement with Northland Regional Council. For these jointly controlled operations the Group recognises in its financial statements the Group's share of the assets, liabilities, revenues and expenses using the proportional consolidation method. This represents a change in accounting policy from the prior year as the impact of accounting for the arrangement in this way was not previously considered to be material to the financial statements.

(o) Financial assets

Financial assets comprise cash and cash equivalents, trade receivables and derivative financial assets. Derivatives are measured at fair value through profit and loss unless they are hedge accounted. Trade receivables are classified as loans and receivables and are carried at amortised cost using the effective interest method. Loans and receivables are not discounted due to their short-term nature.

Financial assets are recognised and derecognised on the trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs except for those financial assets classified as at fair value through profit or loss which are initially measured at fair value.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, call deposits and other investments with an initial term of less than 3 months.

Impairment of financial assets

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at each balance date. Financial assets are impaired...
where there is objective evidence that, as a result of one or more events that have occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment has been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of a doubtful debt provision. When a trade receivable is uncollectible, it is written off against the doubtful debt provision. Subsequent recoveries of amounts previously written off are credited to the Statement of Financial Performance. Changes in the carrying amount of the doubtful debt provision are recognised in the Statement of Financial Performance.

(p) Financial liabilities
Financial liabilities are classified as either financial liabilities at ‘fair value through profit or loss’ or ‘at amortised cost’.

Payables
Payables are recognised when the Group becomes obliged to make future payments resulting from the purchase of goods and services. Payables are initially measured at fair value and subsequently measured at amortised costs using the effective interest rate method.

Borrowings
Borrowings are initially measured at fair value, net of transaction costs. Borrowings are subsequently measured at amortised cost using the effective interest rate method, with the interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for more than 12 months after the balance sheet date.

(q) Derivative financial instruments and hedging activities
The Group uses derivative financial instruments within predetermined policies and limits in order to manage its exposure to fluctuations in foreign exchange, commodity and interest rate risks. The Group does not engage in speculative transactions or hold derivative financial instruments for trading purposes.

To manage this exposure the Group uses the following derivative financial instruments:
- Foreign exchange forward contracts and options
- Interest rate swaps
- Fuel commodity hedges

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into (the trade date). Any transaction costs are expensed immediately. The derivative financial instruments are subsequently re-measured to fair value. The method of recognising the resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument, and, the nature of the item being hedged.

Gains and losses, and movements in fair values of derivative financial instruments not in hedging relationships are recognised in the Statement of Financial Performance as follows:
- Foreign exchange forward contracts and options excluding contracts relating to fuel purchases – as part of ‘Foreign exchange and commodity net gains and losses’
- Interest rate swaps – as part of ‘Net finance costs’
- Fuel related foreign exchange forward contracts and fuel commodity hedges – as part of ‘Operating expenses’

The risk management objectives and strategy for undertaking various hedge transactions is covered by the Group Treasury Policy. The Group documents, at the inception of the transaction, the hedging relationship between hedging financial instruments and the hedged items. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives used in the hedging transaction are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of derivative financial instruments is classified as a non-current asset or liability when maturity of the hedged item exceeds 12 months. It is classified as a current asset or liability when the maturity of the hedged item is less than 12 months.

Cash flow hedges
Changes in the fair value of derivative financial instruments designated as cash flow hedges are recognised in the statement of comprehensive income and the cash flow hedge reserve within equity to the extent that the hedges are deemed effective. To the
extent that the hedges are ineffective for accounting, changes in fair value are recognised in the Statement of Financial Performance in Foreign exchange and commodity net gains and losses.

If a derivative financial instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, or the designation of the hedge relationship is revoked or changed, then hedge accounting is discontinued. The cumulative gain or loss previously recorded in the cash flow hedge reserve remains there until the forecast transaction occurs. If the underlying hedged transaction is no longer expected to occur, the cumulative, unrealised gain or loss recognised in the cash flow hedge reserve with respect to the derivative instrument is recognised immediately in the Statement of Financial Performance.

Where the hedge relationship continues throughout its designated term, the amount in the cash flow hedge reserve is transferred to the carrying value of the asset when it is recognised.

(r) Foreign currency translation
Foreign currency transactions are translated to New Zealand currency at the exchange rates ruling at the transaction date.

Monetary assets and liabilities in foreign currencies at balance date are translated at exchange rates ruling at balance date. All exchange differences arising on the translation of monetary assets and liabilities in foreign currencies, whether realised or unrealised, are recognised in the Statement of Financial Performance, except when deferred in equity as qualifying cash flow hedges.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items in a foreign currency that are measured based on historical costs are translated using the exchange rate at the date of the transaction.

COMPARATIVES
Certain comparatives have been reclassified to correspond with the current year presentation as follows:

Net losses on land sales – these were previously classified as operating expenses, however the sale of land is not part of the normal trading of the Group and therefore the gains or losses on these transactions are now shown outside of operating surplus. The 2011 comparatives have been restated accordingly.

NEW STANDARDS ADOPTED
The Group has adopted the following new and amended NZ IFRSs as of 1 July 2011:

- IFRIC 13 Customer Loyalty Programmes (amended 2010) became effective for reporting periods beginning on or after 1 January 2011. The revised standard clarifies that the fair value of award credits takes into account the amounts of discounts or incentives that otherwise would be offered to customers that have not earned the award credits. This change has not had a material impact of the consolidated financial results of the Group as award programmes is a relatively small part of the business of the Group.

- NZIAS24 Related Party Disclosures (revised 2009) became effective for reporting periods beginning on or after 1 January 2011. The revised standard requires further disclosures of certain transactions with related parties. These disclosures have been made in note 27 Related Party Transactions.

- NZFRS44 Additional Disclosures became effective for reporting periods beginning on or after 1 July 2011. The standard requires certain additional disclosures specific to New Zealand. All applicable disclosures required by the standard have previously, and will continue to be included in the Group’s financial statements.

- Harmonisation Amendments became effective for reporting periods beginning on or after 1 July 2011. These amendments have not had any material impact on the consolidated financial results of the Group.

NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED
The following standards and amendments were available for early adoption but have not been applied by the Group in the preparation of these financial statements:

- NZIFRS 9 Financial Instruments (revised 2010) is the first standard issued as part of a wider project to replace NZIAS39 and is effective for reporting periods beginning on or after 1 January 2013. The revised standard amends measurement categories for financial assets. It is not expected to have any impact on the consolidated financial results of the Group.
Definitions of SOE Performance Targets

Total Shareholder Return: \( \frac{\text{Commercial Value}_{\text{end}} - \text{Commercial Value}_{\text{beg}} + \text{dividends paid} - \text{equity injected}}{\text{Commercial Value}_{\text{beg}}} \)

Solvency: \( \frac{\text{Current Assets}}{\text{Current Liabilities}} \)

Dividend Yield: The cash returned to the shareholder as a proportion of the value of the company.

Dividend Payout: Proportion of net operating cash flows paid out as a dividend to the shareholder after allowance is made for capital maintenance.

Return on Average Equity: \( \frac{\text{NPAT}}{\text{Total Average Equity before Cashflow Hedge Reserve}} \)

Return on Average Capital Employed: \( \frac{\text{EBIT}}{\text{Total Average Equity before Revaluation Reserve and Interest bearing liabilities}} \)

Operating Margin: Operating surplus after one-off items and gross fair value adjustment divided by Total Revenue

Shareholder’s Funds to Total Assets: \( \frac{\text{Total Equity}}{\text{Total Assets}} \)

Gearing ratio (net): \( \frac{\text{Net Debt}}{\text{Total Equity}} \)

Interest cover: \( \frac{\text{Operating Surplus before net Fair Value Adjustments}}{\text{Interest Expense on Borrowings}} \)

Solvency: \( \frac{\text{Current Assets}}{\text{Current Liabilities}} \)

Supporting Financial Definitions

Average Capital: Total equity before revaluations averaged over opening and closing equity for the period

Average Equity: Total equity averaged over opening and closing equity for the period.

EBIT: NPAT before interest, taxation, grant income, derivatives fair value change and gross fair value adjustments.

IFRS Fair Value Adjustment: The value of financial derivatives movement recognised in the Profit and Loss Statement net or gross of taxation.

Net Debt: Face value of borrowings less cash and cash equivalents.

Net Profit after Tax (NPAT): Reported net profit after taxation

One-off items: Items that because of their nature or incidence should be adjusted in order to assist understanding of the underlying business performance.

Total Assets: Current assets plus current liabilities

Total Equity: Total shareholder’s funds including share capital, retained earnings, revaluation and cashflow hedge reserves.
The terms share and subsidiary have the same meanings as in section 2 of the State-Owned Enterprises Act 1986.

1. The Corporation shall ensure at all times that:
   ■ Control of the affairs of every subsidiary of the Corporation is exercised by a majority of the Directors of that subsidiary; and
   ■ A majority of the Directors of every subsidiary of the Corporation are persons who are also Directors of the Corporation, Executives of the Corporation, Executives of a subsidiary of the Corporation, or who have been approved by the shareholding Ministers for appointment as Directors of the subsidiary.

2. Without consulting shareholding Ministers, neither the Corporation nor its subsidiaries shall sell or otherwise dispose of, whether by single transaction or any series of transactions, and whether by a sale of assets or shares, the whole or any part of the business, if:
   ■ That which is to be sold, or disposed of, is valued at more than five percent of the Shareholder’s equity in the Corporation; or
   ■ The sale or disposal will materially reduce the nature and scope of the business as recorded in Section 3 of the Statement of Corporate Intent.

APPENDIX 3: SUBSIDIARIES AND ASSOCIATED COMPANIES

KiwiRail will consult with its Shareholding Ministers on matters that would have a material effect on the scale, scope, financial return or risk of the activities of the Corporation or its subsidiaries, including:
(a) Any substantial capital (or equity) investment
(b) The sale or disposal of the whole or any substantial part of the corporation or its subsidiaries
(c) Any substantial expansion of activities outside the scope of its business as defined in Section 3 of the Statement of Corporate Intent
(d) Any other significant transactions.

APPENDIX 4: CONSULTATION
DIRECTORS
Chair
Deputy Chair
Directors

John Spencer, CNZM
Paula Rebstock, CNZM
Bob Field, ONZM
John Leuchars
Rebecca Thomas
Kevin Thompson
Mark Tume

EXECUTIVE TEAM
Chief Executive
General Manager KiwiRail Freight
General Manager Corporate & Finance
General Manager KiwiRail Infrastructure & Engineering
General Manager Safety & People
General Manager Interislander
General Manager KiwiRail Passenger

Jim Quinn
Iain Hill
David Walsh
Rick van Barneveld
Mathew Ballard
Thomas Davis
Deborah Hume

Bankers

Bank of New Zealand
North End Branch, 100 Lambton Quay Wellington
P.O. Box 1596, Wellington 6140

Auditors

Stephen Lucy, Audit New Zealand
On behalf of the Auditor-General
L8, St Paul’s Square, Wellington
Private Bag 99, Wellington 6140

Registered office

L4, Wellington Railway Station,
Bunny Street, Wellington 6011

FURTHER INFORMATION
For assistance, publications or information concerning KiwiRail please visit our website at www.kiwirail.co.nz or contact:

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