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Committee Council
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WRC Holdings Group 2013/14 draft Statement of Intent

1. Purpose

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

2. The decision-making process and significance

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

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

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

3. Background

WRC Holdings Ltd and its 100% owned subsidiary companies, Port Investments Ltd (PIL), Pringle House Ltd (PHL), are Council Controlled Trading Organisations (CCTOs) and Greater Wellington Rail Ltd (GWRL) is a Council Controlled Organisation (CCO) as defined under the Local Government Act (LGA) 2002. Greater Wellington Transport Ltd and Greater Wellington Infrastructure Ltd are no longer included in the SOI as they have been closed and removed from the Company Register.

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

The LGA 2002 requires that a draft SCI for CentrePort and a draft SOI for WRC Holdings is provided to the shareholder by 1 March, covering the projected results for the three financial years from 1 July 2013.

The directors of WRC Holdings Ltd considered the draft SCI financials for CentrePort and draft SOI for WRC Holdings on 27 February 2013.

A letter enclosing the draft WRC Holdings SOI (incorporating the CentrePort SCI) was sent to the Chair of Greater Wellington Regional Council on 27 February (refer **Attachment 2**).

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

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

4. Statement of Intent

As noted in section 1 of this report the draft SOI for the WRC Holdings Group of Companies for 2013/14 and the following two years is attached (refer **Attachment 1**).

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

	2012/13* $000	2013/14 $000	2014/15 $000	2015/16 $000
Net profit (deficit) before tax (NPBT)	19,919	(3,856)	19,223	47,794
Net profit (deficit) after tax (NPAT)	14,528	(5,274)	13,356	33,805
Earnings before interest, tax and depreciation	54,779	33,928	56,048	86,304
Return on total assets	4.3%	0.8%	4.0%	7.3%
Return on shareholders equity	3.1%	(2.0%)	2.9%	7.3%
Shareholders equity to total assets	53.8%	51.9%	52.4%	55.3%
Dividends	2,672	1,489	1,739	1,681

* 2012/13 SOI

The following analysis compares last year’s SOI to this year’s Draft SOI, followed by a commentary on significant variances.

Contrasting these figures with last year's SOI, the changes in the key lines are as follows:

	2013/14 $000	2014/15 $000
NPBT (2012/13 SOI)	21,570	52,700
NPBT (2013/14 SOI)	(3,856)	19,223
Increase (Decrease)	(25,426)	(33,477)
Dividends (2012/13 SOI)	2,491	2,892
Dividends (2013/14 SOI)	1,489	1,739
Increase (Decrease)	(1,002)	(1,153)

NPBT - Net profit before tax

The significant reduction in profitability in the 2013/14 year is due to a number of factors. The primary factor is the accounting treatment and timing of the flow of funds for the train purchases. They do not reflect a real deterioration in financial performance. A summary of factors affecting the movements are:

Greater Wellington Rail Ltd

GWRL is showing a loss of $11.1 million compared to a profit last year of $4.9 million. This is due to the timing of the Matangi 2 project as the capital grants for this have reduced from $25 million to $11 million and are recorded as revenue in GWRL statement of Comprehensive Income

CentrePort Limited

They are reporting a similar result to the previous SCI with the exception of their accounting for derivatives. They have excluded an upward revaluation of $3 million which has reduced profitability by that amount.

Port Investments Ltd

$1m subvention receipt from CentrePort in last year's SOI is not occurring in this year's SOI. The subvention payments from CentrePort Ltd are now paid directly to Greater Wellington Regional Council as it is more tax efficient to do so.

Pringle House Ltd

PHL is showing a $2.3 million loss compared to a $689,000 profit in last year's SOI. The assumption being there is no rental income and the building is sold at a level which reduces PHL's equity to nil. The loss reflects ongoing operating costs in 2013/14 and a loss on sale in that year.

WRC Holdings Ltd

WRCH is showing a $2.9m write off on its investment in PHL in the latest SOI.

The reduction in profitability in the 2014/15 year is again due to a number of factors that follow along similar themes:

Greater Wellington Rail Ltd

GWRL is showing a profit of $5.7 million compared to a profit of $35.8 million last year. The reason is due to the timing of the Matangi 2 project as the Capital Grants for this have reduced from $56 million to $26 million and are recorded as revenue in GWRL Statement of Comprehensive Income.

CentrePort Limited

CentrePort are reporting a similar result to the previous SCI with the exception of their accounting for derivatives. They have excluded an upward revaluation of $2 million which has reduced profitability by that amount.

Port Investments Ltd

$1m subvention receipt is now paid to Greater Wellington as noted above.

Pringle House Ltd

Rental profit of $627,000 is now lost.

Dividends

The Dividends reduction in both years is impacted by the loss of the $1 million subvention receipt from CentrePort.

The relatively lower dividend decrease in 2013/14 is due to a larger saving in interest costs in that year compared to smaller forecasted savings the 2014/15 year.

5. Statement of Intent without GWRL

As can be noted above, the SOI operating result and consequential return on equity and assets is variable and is directly influenced by the capital grants, level of depreciation and deferred tax movements in GWRL.

When the financial results of GWRL are eliminated from the SOI calculations the results show more consistency, with the exception of the write down and loss from the Pringle House in 2013/14 adversely impacting the Net Profit.

	2013/14 $000	2014/15 $000	2015/16 $000
Net profit (deficit) before tax (NPBT)	7,238	13,547	13,253
Net profit (deficit) after tax (NPAT)	2,714	9,269	8,935
Earnings before interest, tax and depreciation	16,533	22,846	22,439

Return on total assets	4.6%	6.5%	6.3%
Return on shareholders equity	0.2%	4.2%	3.7%
Shareholders equity to total assets	48.0%	46.8%	48.0%
Dividends	1,489	1,739	1,691

It also should be noted that CentrePort provides the Council with subvention payments and these amount to around $1 million per year plus a guarantee fee on its debt which is around $400,000 per year, adding these on increases the return on equity by about 0.8% per annum.

6. Detailed Operating Budgets

The draft operating budgets were provided to WRC Holdings Limited Director for the companies within the WRC Holdings Group. The commentary on these budgets, including the key assumptions and significant changes from last year's budgets are discussed below.

6.1 Pringle House Ltd (PHL)

Last year's SOI had assumed business as usual but with $10,000,000 of equity injections to fund remedial work to bring the Regional Council Centre (RCC) up to earthquake code.

This year's accounts are significantly different as the assumption is the RCC will be vacated by 30 June 2013 and have no tenants and be disposed of at 30 June 2014 at a cost that makes the value of equity in PHL equal to zero.

The decision on disposing of the RCC, and Greater Wellington Regional Council terminating its lease at no benefit to PHL, are assumptions at this junction and are used for planning purposes only.

Overall, the 2013/14 PHL budget shows a net loss of $482,500 after payment of overhead costs and operating expenses of $320,00 to keep the RCC safe and secure while the disposal process is contemplated.

The loss on sale of $1.87 million reflects the difference between the valuation at 30 June 2012 of $6.4 million plus any capital works, less a forecasted sale price of $4.58 million. The sale price is a hypothetical figure which allows for all assets and liabilities in PHL to be met, leaving zero equity. The market value of the building is subject to any sale process.

6.2 Port Investments Ltd (PIL)

The projected dividends from CentrePort (PIL's share) are forecast beginning in 2013/14 to be $3.462 million, $3.769 million and $3.846 million for the 3 years respectively.

No subventions receipts are forecast to be received directly from CentrePort, rather these are now paid directly to Greater Wellington Regional Council. While of little impact to the council, the payment directly impacts the reported profitability of the WRC Holdings Group.

The dividend from CentrePort is based on CentrePort's SCI projections from 2012/13 which see a pay out of between 41% and 43% of net profit after tax. This compares to their policy of paying out between 40% and 60%.

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

6.3 Greater Wellington Rail Ltd (GWRL)

GWRL holds rolling stock and other related rail assets such as stations. It has recently completed the purchase of 48 two car Matangi train units from Rotem Mitsui in South Korea with the last contractual payment for these scheduled in 2013/14.

Capital expenditure of $19 million is forecasted for the 2013/14 year increasing to $47.5 million in 2014/15 and peaking at $103 million in 2015/16. The bulk of which is driven by the purchase of a further fleet of Matangi trains.

These capital projects are funded by a combination of equity and grant revenue in GWRL. This split is determined by the funding GWRC receives from Government, and from loans GWRC raises, with the latter funded by equity and the former by grant revenue both in GWRL, with funds received from GWRC for both.

The grant revenue from GWRC creates a significant deferred tax liability. This is because the capital grants are treated as income and if the trains were sold, a tax liability would arise, however, the depreciation expense over future years will offset this liability.

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

The statement of comprehensive income shows an increasing net operating surplus influenced directly by the increasing level of capital grant till 2015/16.

In the early years of the 10 year projections capital grants are high, leading to higher deferred tax charges. As time progresses depreciation increases leading to bigger losses and a reversal of the deferred tax adjustment to an income.

The balance sheet has equity contributed up until 2015/16 for the second fleet of the Matangi trains. The deferred tax liability reduces over time reflecting a greater depreciation charge than capital grants.

6.4 WRC Holdings Ltd (WRCHL)

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

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

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

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

Dividends payable by WRCHL increase from $1.5 million in 2013/14 to $1.7 million in 2014/15 and reduce to $1.68 million in 2015/16, reflecting the rise in dividend from CentrePort via PIL offset by a rise in interest rates (which lowers the profits in PIL).

7. CentrePort

CentrePort is showing an increasing then flat level of profitability with projected profit after tax forecast $10.2 million for the 2013/14 year moving to $11.0 and $11.1 million for the 2014/15 and 2015/16 years respectively.

Dividend is $4.5 million for 2013/14 and increasing to $4.9m for 2014/15 and to $5 million for 2015/16 of which 10/13th's or 76.9% is PIL share.

Performance indicators and other related information from CentrePort's Statement of Corporate Intent is incorporated into this draft SOI.

8. Changes to the wording in the SOI since 2012

3.20 Activities of the Group - Changes to PHL, GWRL

4.1.3. PHL performance targets redone

4.1.4 GWRL performance targets redone

4.1.6 Note GWIL & GWTL have been closed

9. Recommendations

That the Council:

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

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

*(3) **Receives** the draft Statement of Intent of WRC Holdings Group for 2013/14 and forwards any comments or recommendations to the directors of WRC Holdings Ltd for their consideration.*

Report prepared by:	Report approved by:
Mike Timmer Treasurer	Bruce Simpson Chief Financial Officer

Attachment 1: WRC Holdings Group – 2013/14 Draft Statement of Intent

Attachment 2: Copy of letter to Chair, Greater Wellington Regional Council