7. CHRISTCHURCH CITY HOLDINGS LIMITED - GROUP AND PARENT COMPANY ANNUAL REPORT

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PURPOSE OF REPORT

1. The purpose of this report is to present to the Council the audited financial statements of Christchurch City Holdings Ltd ('CCHL') for the year ended 30 June 2005, and to provide an overview of the activities and results of its subsidiary and associated companies.

CCHL ANNUAL REPORT FOR THE YEAR ENDED 30 JUNE 2005

2. Attached is a copy of the audited financial statements for the year ended 30 June 2005. The full annual report is currently with the printers, and will be distributed when available. The group recorded an improved profit compared with the previous year, and a substantial increase in equity. The following commentary is based on the Chairperson's review in the annual report:

Financial

3. The consolidated net profit after tax for the year was $66.2 million, compared with $34.2 million in the preceding year. The substantial improvement in group profitability principally relates to an improved result from Orion Group Ltd, which included a substantial gain on the sale of the majority of its shareholding in Australian listed company Energy Developments Ltd.

4. Group equity increased from $761 million to $963 million, in the main reflecting:

   - an $82 million first time revaluation by Lyttelton Port Company Ltd of its land, buildings and harbour structures;
   - an $81 million revaluation by Orion Group Ltd of its electricity distribution network; and
   - the improved group net profit after tax referred to above.

5. Further detail regarding the performance of the subsidiary companies is provided on the following pages. The group remains conservatively geared, with a net debt to net debt plus equity ratio of 26.7%.

6. The parent company's net profit after tax of $43.3 million was well ahead of the Statement of Intent forecast of $30.5 million, principally as a result of higher than budgeted dividend income from Orion Group Ltd. It was, however, lower than the $67.3 million result recorded in the preceding year, which included the receipt of an unbudgeted special dividend from Orion Group Ltd of $35 million.

7. The company paid a total dividend to the Council of $30.0 million, compared with a forecast $29.1 million.

Governance

8. The CCHL board recognises that good governance is critical to the ongoing success of the group, and this continues to be a key focal point of its activities. The operating companies must be able to conduct their businesses in a commercial manner without political interference, and part of CCHL's role is to ensure that they are able to do this.

9. The directors of CCHL and our subsidiary companies are all required to follow best practice governance, abide by the Institute of Directors Code of Conduct and comply with the Companies Act. This means that their primary legal and ethical obligation is to the interest of the company and its shareholders.

10. The Council's director appointment policy, originally recommended by CCHL to the Council and adopted in June 2003, further enhances the integrity of the director search and appointment process. A key principle of the policy is that appointments are made on merit, with a strong focus on the skill sets required for that particular position, identified in consultation with the respective board chairs. It is CCHL's intention to review this policy over the next few months on behalf of the Council, and to recommend any changes required.

Strategic direction

11. The combined assets and resources of the CCHL group mean that it has a significant role to play in the regional economy, particularly given the strategic importance of the infrastructural assets it is responsible for.

12. Last year, CCHL commenced an initiative to encourage greater co-operation between the group companies, with a view to utilising the collective strength of the group more effectively. There has been encouraging progress, with informal networks at board and management level being established and further developed. It is fair to say that there is now a greater level of understanding throughout the group of the issues and opportunities facing the various companies.

13. This year, the board commenced a project to evaluate the long-term infrastructural needs of the greater Christchurch region, through detailed consultation with business and community leaders. The results of this work are currently being considered by the board.

14. CCHL intends to use the results of this project to construct a conceptual framework enabling it to:

- assess the effectiveness of its current investments;
- identify potential gaps in the greater Christchurch region's infrastructure over the next 10 to 20 years; and
- to evaluate future investment proposals.

15. This is a major project for CCHL, and is likely to have a significant impact on the company's future direction and modus operandi. It is being performed in consultation with key stakeholders, and is expected to complement existing regional development initiatives that are currently in progress. Naturally, any significant changes in CCHL's operations will be undertaken in full consultation with the Council.

16. It is expected that the results of this strategic review will be communicated towards the end of the 2005 calendar year.

Outlook

17. The outlook for the group is positive. The subsidiary companies are trading successfully, and in many cases expanding their operations. Some, however, will need to re-invest significantly into their businesses over the next few years to meet capacity demands.

18. Christchurch International Airport Ltd has recently signalled its plans for a major upgrade of its terminal facilities, providing a much needed enhancement of the major gateway into the South Island. Lyttelton Port Company has previously indicated the scope of its planned capital expenditure programme over the next few years, which will include improvements to wharves, a third container crane, berth expansion, and new container handling equipment. Orion Group Ltd's published asset management plan details the extent of its capital expenditure and maintenance programme, which averages over $40 million per annum.

19. As previously stated, a key focus for the CCHL board over the next few months will be the development of a conceptual framework for evaluating its investments in the context of the needs of the regional economy. The board will also continue to monitor industry developments, and consider and report on strategies that it considers will maintain or enhance shareholder value. This will include reviewing the current capital structure of the group.

REVIEW OF SUBSIDIARY AND ASSOCIATE RESULTS AND ACTIVITIES

Orion Group Limited

Financial Performance

20. Orion achieved a net profit after tax for the year of $52.3 million, compared with $0.2 million in the previous year.

21. The primary reason for the improved result was a $29 million gain on Orion's investment in Energy Developments Ltd ('EDL'), with the majority of the investment being sold in March 2005. In contrast, the previous year's result included a $13 million write-down of the EDL investment. The company also realised a $2.1 million gain on the sale of property.

22. The core electricity network performed well, with a net profit after tax of $33.5 million. This result was slightly ahead of the SoI forecast, but down on the previous year as a consequence of higher depreciation resulting from a revaluation of assets.

Network

23. Network reliability is a crucial aspect of Orion's performance, and its asset management plan aims to ensure that that the network remains of a high standard. Orion "kept the lights on" for 99.989% of the time over the last five years – the second best result in New Zealand.

24. Forecast capital expenditure over the next five years is some $160 million, and a further $70 million on maintenance, with priorities on meeting forecast growth in demand both in Christchurch as a result of infill housing, overall urban growth and Environment Canterbury's impending Clean Air Plan, and in rural areas to meet ever increasing loads. Equally important are the replacement of ageing equipment and enhancing system security and reliability.

Regulation

25. In 2003 the Commerce Commission introduced price and quality thresholds for all electricity distributors. However, it remains to be seen how material breaches will be dealt with. In the meantime, Orion continues to have dialogue with the Commerce Commission regarding proposed regulation of the gas pipeline industry, where the issues are similar. This discussion is relevant as the Commerce Commission continues to consider WACC, other inputs into threshold breach investigations and any resultant direct price control of the electricity network sector.

Investments

26. Orion has continued to invest, through a 60% holding in a joint venture with Meridian Energy, in Whisper Tech, a company that develops and manufactures small scale co-generation units that efficiently produce useable heat as well as electricity. Transition to mass manufacture will be a major focus for Whisper Tech over the next year. Other investments include holdings in HumanWare Group, 4RF Communications and Energetics.

Looking Ahead

27. Orion's core focus is, and will continue to be, the network and, through its asset management plan, will maintain a capital programme that allows for growth in demand. Capital expenditure over the next few years will need to increase as many of Orion's assets were installed in the 1960s and are now falling due for replacement. There will continue to be significant ongoing work with regard to regulatory developments, the outcome of which will be critical to the future of the industry. The ability to attract and retain skilled staff is also a key challenge that Orion is actively addressing.

Christchurch International Airport Limited

Financial Performance

28. The company recorded a net profit after tax of $16.5 million, compared with $14.8 million in the previous year. The airport continued to experience unprecedented growth in passenger numbers, particularly in respect of international travellers.

29. International growth has been stimulated by a combination of trans-Tasman value-based services and additional services by existing international carriers – the latter including new wide-body services to Los Angeles and Dubai, and a year-round daily service from Singapore Airlines. Additionally, Air New Zealand and Pacific Blue have commenced direct flights to Rarotonga. Domestic passenger growth has been driven by reduced airfares and a buoyant local economy.

30. Revenues increased by over 12% as a result of the above growth, with airport charges, passenger departure charges, lease rentals and concessions and vehicle parking all showing solid increases over the previous year. However, costs also increased in some areas, with growth-related labour costs, marketing incentives, repairs and maintenance and depreciation all having an impact.

31. Capital expenditure at $39.6 million was higher than average, and included an expansion of the international terminal and aprons to meet growth in passenger numbers and various property development initiatives.

Terminal Development Project

32. The growth in passenger numbers has placed significant pressure on the airport's facilities and brought to a head the need to give priority to further investment in terminal facilities.

33. Over the last few months, the company has consulted with its key stakeholders and developed a comprehensive business case for an integrated terminal development. In particular, there has been significant consultation with the company's airline customers over pricing and capital works. The company greatly values strong, trusting relationships with its business partners, and was pleased recently to confirm price stability to its airline customers for a further three years.

34. This terminal development project is major, requiring significant investment, and the company will be seeking shareholder approval for this investment proposal in the near future.

Looking Ahead

35. The company is focused on its strategic objective of becoming a leader in the delivery of airport services in Australasia, and through this to become the leading regional airport for holiday travel in New Zealand. The proposed terminal development project will be a key element in achieving this goal.

Lyttelton Port Company Limited

Financial Performance

36. The company recorded a net profit after tax of $11.8 million, slightly down on the $12.0 million achieved in the previous year. While revenue increased by 7.6%, reflecting volume growth in the port's key trades – containers, coal and bulk fuel – and some price increases, there were also some increased operating costs and higher depreciation and interest.

37. The company recorded a revaluation of its land, buildings and harbour structures as at 30 June 2005, increasing equity by $86 million.

Container Trade

38. Container terminal throughput grew 10%, from 161,200 TEUs (twenty foot equivalent units) to 177,400, reflecting the securing of new business through the terminal and growth associated with a solid economic performance by the region.

39. The company has achieved a 10% gain in productivity in the container terminal, with faster ship turnaround and more consistent service being achieved. Four new Kalmar straddle carriers were acquired during the year, and in June 2005 the company placed a tender to the market for the purchase and installation of a third container crane. Additionally an exclusive agreement has been signed with Navis Corporation for the implementation of their latest generation terminal container tracking system 'N4'.

Coal

40. Coal volumes increased by 3.4% during the year, to just under 2.2 million tonnes. This was below forecast as a result of disruption to Solid Energy's Spring Creek mine and the effect of industrial action at all mines in the third quarter. A positive development was the agreement reached between Solid Energy and Toll Rail on the maintenance and development of the Midland line. The company will also be working with Solid Energy to optimise the coal operation and improve profitability.

Bulk Fuel

41. Bulk fuel volumes remained broadly consistent at 1.1 million tonnes, but were affected by a reduction in the number of ship visits. Looking ahead the company sees opportunities to enhance its position as the key strategic location for the oil companies as they seek to optimise their operations in the South Island.

Other Trades

42. Vehicle volumes reduced slightly, but remain a significant trade. The company will be developing a car terminal facility in the inner harbour. There was a severe downturn in log volumes, with challenging export conditions and punitive shipping charter rates having a negative impact. Dry bulk volumes increased by 8%, reflecting improved service, increased ship calls and a strong performance by the agricultural sector.

Looking Ahead

43. The company envisages a significant change to the port environment in New Zealand, with consolidation of shipping lines resulting in larger ships and fewer port calls. The recently-announced acquisition by Maersk Sealand of P&O Nedlloyd is a prime example of this trend. It is committed to further developing its links with exporters, importers, major shipping line customers and key transport operators to provide solutions that support Lyttelton as the most efficient route to market in the South Island.

Red Bus Limited

Financial Performance

44. The company achieved a net profit after tax of $0.33 million, down from the $1.37 million recorded in the previous year. While revenue increased from $22.9 million to $24.4 million, profitability was adversely impacted by significant fuel price increases and competitive pressures. While Red Bus was successful in winning the new Metrostar service, this entailed a significant amount of capital expenditure, resulting in increased interest and depreciation costs.

45. The company incurred some $4.8 million of capital expenditure, mainly in new vehicles required as a result of winning tenders for subsidised services.

Patronage

46. Patronage growth is one of the company's primary objectives. Patronage strengthened over the last six months on a route by route basis, possibly as a result of increasing fuel prices. However, the extensive use of the Metrocard and the discounted fares have reduced the per passenger yields.

Tenders

47. A significant portion of the company's work came up for tender in May 2005. The company was successful in retaining all of its contracts, other than one small route. The new services take effect from November 2005.

Other Aspects of Performance

48. In addition to economic performance, the company is committed to environmental and social aspects of corporate sustainability. It uses low sulphur diesel as part of its commitment to the environment – the only commercial bus operator in New Zealand to do this – and is continuing with its programme of active community support and ensuring its meets its own high standards of being a good employer.

49. The in-house training school is continuing to develop, and further expansion of Red Bus's driver training and induction programmes now provides the opportunity for staff to achieve nationally recognised driver qualifications. This has become increasingly significant in the face of industry-wide staff shortages.

Looking Ahead

50. The company was successful in winning all but one small route in the last tender round, which takes effect from November 2005. This was the last scheduled tender round until June 2009, enabling the company to consolidate its position and focus on its financial performance going forward.

City Care Limited

Financial Performance

51. The company recorded a net profit after tax of $1.5 million, down from the $1.8 million recorded in the previous year. The reduction principally reflects exceptional cost increases, particularly energy, materials, labour and occupation costs that were not able to be recovered during the year, and increased financing costs resulting from the company's continued expansion. The company has addressed these cost increases by restructuring the Auckland branch and, where possible, a review of contract pricing and revenues. The company has also secured some new contracts that will impact fully in the 2005/06 year, and has stabilised its occupation costs.

52. Revenue continued to grow significantly, from $62.7 million last year to $82.3 million, reflecting acquisitions and the securing of new contracts.

53. Equity increased to $15.2 million, in part reflecting a $2.5 million issue of redeemable preference shares to CCHL. A further $2.5 million of shares has been issued but not yet paid.

Growth

54. The company has continued to expand through acquisitions and the securing of new contracts. In November 2004, it acquired the business of Local Construction, a Christchurch-based civil and roading contractor. Other smaller acquisitions included Telsys, a Tauranga industrial electrical contractor and Taranaki Road Boring, a directional drilling specialist.

55. The company was also successful in securing a number of new contracts during the year, including a contract to maintain all of Tauranga City's sports fields and 40% of their parks, and a maintenance contract for almost 1,000 rental properties owned by Dunedin City.

Sale of Waste Management Business

56. Shortly after balance date, the company sold its waste management business to Christchurch City Council, with operational staff being transferred on their existing conditions of employment. The majority of the consideration for the sale consisted of the transfer to the company of around seven hectares of land off Springs Road, where the company intends to re-locate within the next two years.

Staff

57. The company continued its commitment to excellence in the way it recruits, trains and retains motivated and skilled staff, as this is the main way in which it can differentiate itself from its competitors.

58. It has extended its pre-apprentice programme, involving the employment of long term unemployed youth, in association with WINZ, and commenced a similar programme in Tauranga. To date, 78 new staff have entered City Care employment via this initiative.

59. The company has also introduced a behaviour-based workplace initiative targeting a 25% decrease in lost time accidents over each of the next two years.

Looking Ahead

60. The company will continue to seek to maintain and grow its relationship with its primary customer Christchurch City Council through service improvements and productivity gains. It will also focus on developing its contracting base throughout New Zealand as a means of obtaining critical mass and experience that enables it to improve existing service levels and compete for new work as contracts come up for tender.

Selwyn Plantation Board Limited

Financial Performance

61. The net result for the year was a deficit of $1.8 million, compared with a $2.9 million surplus in the previous year. The deficit arose as a result of a downward revaluation of the company's forests, with $4.6 million of that reduction in value being reflected in Selwyn Plantation Board Ltd's statement of financial performance.

62. Ignoring the impact of the revaluation adjustment, the net operating surplus before tax was $3.2 million, compared with $3.4 million in the previous year. Given the difficult trading conditions facing the company this is considered to be a creditable result, although it was boosted by a $0.8 million profit on the sale of land.

63. Domestic sawmill demand remained steady, but export log sale prices remained at historical lows throughout the year as a result of the high NZ$ v US$ exchange rate and record high ocean freight rates.

64. The company harvested a total of 191,208 tonnes, including third party contract harvesting, down 7% on the previous year.

Land Strategy

65. The company has previously referred to its strategy of removing land covenants from its plains land, and in October 2004 this was achieved. This provides a significant opportunity to realise additional value from land that was traditionally used for forestry purposes, but did not produce quality timber.

66. The company has embarked on a process to clear the majority of the plains land, while at the same time ensuring that its soil structure and productive capability is retained. Subsequent to balance date, the company sold 3,386 hectares of its plains land.

Asset Valuation

67. The company undertook an internal valuation of the forest estate, resulting in a 38% decrease in value to $15.6 million. This reduction primarily reflected the difficult export conditions referred to above, and a slight weakening in domestic log grade prices.

68. The company's land and buildings were independently valued at $38.9 million. This, combined with the value of the property intended for sale, represents an increase in value over the previous year of 38%. This value increase arose from the release of covenants on the plains land and a general increase in land values.

Looking Ahead

69. In line with the company's strategy to maximise value from its plains land, all harvesting in the current financial year will be restricted to the plains forests. This will present challenges in terms of log grade mix and reduced sales revenue, but overall is expected to produce the best value for shareholders.

RECOMMENDATION

That the information be received.