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

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Officer responsible:	As above
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PURPOSE OF REPORT

1. The purpose of this report is to comment on the audited financial statements of Christchurch City Holdings Ltd ('CCHL') for the year ended 30 June 2006, 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 2006

2. The CCHL annual report for the year ended 30 June 2006 has already been circulated. 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 $54.7 million. This compares with the $66.2 million in the preceding year that included a one-off gain by Orion on the sale of the majority of its shareholding in Australian listed company Energy Developments Ltd. Further detail regarding the performance of the subsidiary companies is provided on the following pages.

4. The group remains conservatively geared, with a net debt to net debt plus equity ratio of 32%.

5. The parent company's net profit after tax of $29.6 million was slightly under the Statement of Intent forecast of $30.6 million, principally as a result of lower dividends from Lyttelton Port Company Ltd.

6. The company performed its triennial revaluation of its equity investments as at 30 June 2006. There was an overall increase in value of $270 million, bringing the overall value of CCHL's equity investments up to $1.2 billion. The main value increases were in respect of Orion Group Ltd and Christchurch International Airport Ltd. There was, however, a decrease in the value of City Care Ltd, reflecting the difficult environment in which it is operating.

7. While it is pleasing that the value of our investments continues to grow, it creates a challenge for the group to earn a competitive return from this increased asset base.

8. The company paid a total dividend to the Council of $47.3 million, compared with a forecast $30.0 million. This included a special dividend of $17.9 million.

Governance

9. 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.

10. CCHL has a governance committee whose role is to recommend director appointments, review governance policies and ensure that good succession policies are in place for key governance positions on both the parent and subsidiary companies.

Strategic Direction

11. As signalled in CCHL's Statement of Intent, the strategic focus of the company is changing to support the Christchurch City Council's overall vision. The Council wants a future-oriented and growing niche economy that builds prosperity, and this includes an investment focus to maintain and enhance the things that make the city attractive.

12. A review by CCHL showed there were a number of infrastructure areas where significant development would be needed to secure the economy of the region. These include water, energy supply, roading and the community's access to broadband.

13. CCHL's approach is to identify where gaps exist that cannot be filled by the private sector or existing Council operations. The company will take a role in filling these gaps, whether by joint ventures, public-private partnerships, new wholly owned companies or by acting as a catalyst for development by others.

14. CCHL has no desire to replicate or compete with private sector operations, but we recognise that there will be projects which are not suitable for private sector investment. CCHL will require a sound business case to underpin any investment, but recognises that a lower rate of return, or slower path to profitability may be appropriate in some cases.

15. The company will continue to strive to achieve a good balance between commercial return and regional benefit. Achieving this balance is seen as a key role of the company.

Lyttelton Port Company Ltd

16. During the year, Lyttelton Port Company Ltd developed a strategic plan that included the need for the company to enter into strategic partnerships to achieve long-term sustainable growth and benefit to the region. The increased market power of shipping companies as a result of consolidation was, and is, seen as a strategic threat to Lyttelton Port Company.

17. As a response to this strategy, CCHL went into the sharemarket with the aim of acquiring 100% ownership in the port company, and entering into what was effectively a joint venture with a global international port operator.

18. While a takeover was not achieved, because Port Otago Ltd acquired a 15% stake during the period of the takeover offer, CCHL has increased its stake in Lyttelton Port Company Ltd from 69.0% to a very strategic 74.06%.

19. It was well within CCHL's means to outbid Port Otago for the original 10% stake that became available, but CCHL, as a Council-owned company, was not prepared to enter into what could have been an expensive bidding war for the stake.

20. These plans are now on hold, but CCHL remains committed to ensuring that the company grows in the long term, and will support the company in pursuing that aim through partnerships with the potential to strengthen our local economy.

Outlook

21. The outlook for the group is positive. The subsidiary companies are trading successfully, and in many cases expanding their operations. Some, however – in particular, Christchurch International Airport Ltd and Lyttelton Port Company Ltd – are re-investing significantly into their businesses to meet capacity demands. This could have a short-term effect on their ability to maintain previous dividend levels to CCHL.

22. Christchurch International Airport Ltd has commenced 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 includes 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.

23. As previously stated, a key focus for the CCHL board over the next few months will be developing a framework to evaluate 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

24. The following commentary is based on that contained in the CCHL annual report:

Orion Group Limited

Financial Performance

25. Orion achieved a net profit after tax for the year of $34.1 million, compared with $52.3 million in the previous year. Last year's result included a $29.3 million gain on sale of the majority of Orion's investment in Energy Developments Ltd ('EDL'), with the balance of the shares being sold in the 2006 financial year.

Network

26. 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 99.99% of the time over the last five years – the third best result in New Zealand (the two companies ahead of Orion have solely urban networks which are less vulnerable to disruption). In terms of the number of interruptions per consumer per annum, Orion was the most reliable in the country.

27. Forecast capital expenditure over the next ten years is over $30 million per annum, with approximately a further $18 million per annum to be spent on maintenance. Priorities are 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

28. Orion continues to commit significant time and resource into regulatory issues, as it is critical that regulation does not reduce incentives for lines companies to innovate and invest in their networks. Orion has worked closely with the Commerce Commission, the Electricity Commission and the Ministry of Economic Development as the regulatory framework is developed. It has also worked with the Electricity Networks Association to seek more flexibility around electricity distributors' ability to own generation and buy financial hedges to manage revenue and operating risks.

Investments

29. In 2003, Orion decided to reduce its level of investment in technology companies and return to "core business". Since that time it has withdrawn from several investments – notably EDL – and continues to seek appropriate divestment opportunities. In July 2006 Orion sold the majority of its stake in Whisper Tech, a company that develops and manufactures small scale co-generation units, to Meridian Energy. Also subsequent to balance date, in August 2006 Orion sold its shares in Energetics Pty Ltd as part of a competitive trade sale process.

30. Current investments include holdings in HumanWare Group and 4RF Communications.

Christchurch International Airport Limited

Financial performance

31. The company recorded a net profit after tax of $15.2 million, compared with $16.6 million in the previous year. The reduction in profitability was a consequence of a combination of flat passenger numbers and increased operating costs in the areas of maintenance and utility services, compliance, market stimulation incentives and the terminal development project.

32. Passenger numbers through the airport were fewer than forecast as a result of a number of factors, including a poor snow season in July/August 2005, a reduction in routes by airlines, the high New Zealand dollar and increasing domestic airfares. Nevertheless, total numbers were broadly comparable with 2005 – a record year.

33. Total revenues increased by 4.6% as a result of improved commercial revenue outcomes rather than volume growth.

Terminal Development Project

34. Past 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. During the year, after extensive consultation with its key stakeholders and the development of a comprehensive business case, the company announced a major terminal development project.

35. The total development, at an approximate cost of $200 million, is planned for completion in 2009 and will provide significantly improved operations for airlines and enhance services and facilities for customers and users of the airport campus in such areas as vehicle parking, retail, food & beverage, baggage and passenger flows and efficiency of check in and easy transfer. The first stage of the development was the awarding of a tender for a new 600 space, 4 level car parking building complex which commenced construction in March 2006 and is due for completion in the last quarter of this calendar year. In support of this initiative a new $250 million debt finance programme was established to meet the ongoing development needs of the company.

Marketing

36. The company has positioned itself and Christchurch as a profitable route for the short haul leisure market, particularly for value based airlines. Pacific Blue already operates from Christchurch as their New Zealand base of operations and during the year the company secured Christchurch as the New Zealand base of operations for Jetstar on their launch into the New Zealand market.

37. The company places a great deal of emphasis on joint venture marketing campaigns to create new demand for travel to Christchurch as a gateway to the South Island.

Lyttelton Port Company Limited

Financial Performance

38. The company achieved a 5.3% increase in earnings before interest, taxation, depreciation and amortisation (EBITDA) for the 12 months ended 30 June 2006. EBITDA rose to $28.4 million, with net profit after tax at $10.1 million, down on the $11.8 million achieved in the previous year.

39. The reduced profit reflected a significant increase in depreciation expense following a first time revaluation of the company's land, buildings and harbour structures as at 30 June 2005, increased operating costs and higher interest costs as a result of the company's capital expenditure programme. Once the previous year's result is normalised for depreciation, net profit after tax was lightly up on the previous year.

40. Revenue increased significantly during the year, from $66.5 million to $79.3 million, reflecting $10 million of additional revenues associated with the purchase of NZ Express in November 2005, and increases in container and coal volumes.

Capital Expenditure and Maintenance

41. Capital expenditure totalled $18 million for the year, including the installation of a new Liebherr crane, scheduled to be operational from October 2006, which will increase the company's capacity to three container cranes. Three additional straddle carriers have also been ordered, and upgrade work carried out to components of the Cashin Quay wharf structures. The company is also planning for capital expenditure of $10.8 million for an upgrade of the oil berth.

42. The company spent $10 million on maintenance of infrastructure assets during the year, primarily involving wharves, plant, pavements and reticulation. In a move toward a more proactive maintenance regime, the company plans to spend $12.3 million for each of the next two years before reducing back to more regular planned maintenance levels.

Trade Volumes

43. The following table summarises volumes in the company's key trades:

	2006	**2005**	**% change**
Containers (through container terminal) (TEUs)	187,400	177,400	5.6%
Total international and domestic containers (TEUs)	208,700	208,600	0.0%
Coal exports (tonnes)	2,505,100	2,156,100	16.2%
Bulk fuel (tonnes)	1,104,500	1,135,300	(2.7%)
Motor vehicles (units)	44,300	51,800	(14.5%)
Logs (tonnes)	100,000	17,500	471.4%
Dry bulk (tonnes)	539,844	623,600	(13.4%)

Red Bus Limited

Financial Performance

44. The company achieved a net tax paid profit of $0.8 million, up from $0.3 million in the previous year. The primary reasons for the improved result were the retention of existing services during the 2005 ECan tender round and a 25% bus fare increase in November 2005.

45. The company invested $4.4 million in new vehicles during the year to deliver the urban bus services won during the 2005 tender round. The majority of older high floor buses were sold during a fleet rationalisation review.

46. Revenue grew from $24.4 million last year to $28.6 million this year although Red Bus patronage overall fell by 4.6% through the loss of the Parklands services. Overall Christchurch bus patronage has grown 2.5% in the last twelve months.

47. Fare revenue per passenger and contract payments per passenger have both increased since the previous year. These increases were largely offset by additional service running costs associated with operating higher timetable frequencies for the 2005 urban service contracts and significantly higher fuel prices.

Operations

48. Red Bus was successful in retaining the low emission inner city shuttle bus service with Christchurch City Council for a five-year term.

49. Aging cash handling machines were replaced by new machines to reduce processing time for drivers and to prepare for the introduction of new coins in July 2006.

50. The After Midnight Express service expanded with an additional service bringing the total to five inner city to suburb services on Saturday and Sunday mornings.

Staff

51. Low unemployment, strong competition in the labour market and growth in the driver numbers required to deliver services provided a significant recruitment challenge for Red Bus this year. The combination of contract renegotiation with Environment Canterbury, establishment of an expanded training school and a comprehensive recruitment campaign has achieved a major turnaround with a full staff complement at year-end, low staff turnover and positive staff morale. Red Bus currently has 455 employees.

52. The company's driver training programme complies with National qualification standards. Since the programme's beginning, 86 new drivers and 144 existing drivers have completed their National certificates this year.

City Care Limited

Financial Performance

53. The company recorded a net profit after tax of $3.3 million, including a non-recurring capital gain of $2.3 million on the sale of the refuse business. Ignoring the capital gain, the adjusted profit is down compared with the $1.5 million recorded in the previous year. The reduction principally reflects margin pressures arising from increasing direct costs, in particular fuel and bitumen, that have not been able to be recovered from the company's longer term contracts.

54. Revenue continued to grow significantly, from $82.3 million last year to $99.3 million, mainly reflecting the full impact of the Local Construction Ltd acquisition in the previous year and also general business growth.

55. Equity increased from $15.2 million to $20.7 million, principally as a result of a $2.3 million land revaluation and the one-off $2.3 million capital gain referred to above.

Growth

56. The company has continued to expand through acquisitions and the securing of new contracts. Key amongst these was the Christchurch City Council Northern roading network maintenance contract – a major win enabling the company to re-enter the roading maintenance business after being out of that sector for a number of years.

57. Other contract wins included the remaining parks maintenance contracts for Tauranga City Council and the Metrowater fire hydrant maintenance. The latter contract, together with the rolling over of the North Shore City Council parks contracts and Manukau Water pumps maintenance contracts, greatly improve the viability of the Auckland branch.

Human resources

58. There have been significant changes in the company's management team, with a new CEO and CFO being appointed during the year following the unexpected resignations of their predecessors.

59. A new Leadership Team was established during the year to enable a greater number of managers to contribute more fully to City care's direction.

60. During the year the company successfully introduced a "Behave Safe" programme – a massive undertaking in training all 800 staff in the ethos and mechanics of this behavioural-based health and safety system. The company continues to operate its award-winning pre-apprenticeship work skills programme. Despite these and other initiatives, a national shortage of skilled labour has led to a relatively high staff turnover rate, which the company continues to battle.

Selwyn Plantation Board Limited

Financial Performance

61. The net result for the year was a net profit after tax of $3.7 million, compared with a $1.8 million deficit in the previous year. The result for the year included a gain on sale of land of $8.4 million, but also a downward revaluation of the company's forests of $6.4 million. Last year's result also included a forest revaluation decrement of $4.6 million.

62. Ignoring the impact of asset sales and revaluation adjustments, the net operating surplus before tax was $1.8 million, compared with $2.4 million in the previous year. Given the difficult trading conditions facing the company, and its strategy of harvesting only plains timber, this is considered to be an acceptable result.

63. Domestic sawmill demand remained steady, but export log sale prices remained at historical lows for most of the year as a result of the high NZ$ v US$ exchange rate and record high ocean freight rates. New building regulations and quality standards have created a marketing challenge and a negative effect on average sale price per tonne.

Land Strategy

64. In accordance with the company's previously signalled strategy to covert its plains forest land to an alternative land use, it 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. Several hundred hectares had been converted by balance date, with several hundred more in various stages of conversion.

65. Earlier in the year, the company sold 3,386 hectares of plains land situated between the Selwyn and Rakaia rivers.

Asset Valuation

66. An external valuation of the forest estate resulted in a 41% decrease in value to $9.2 million. This reduction primarily reflected weakened future log sale prices following the introduction of new building industry quality standards, but also the lower area of forested land and a higher discount rate.

67. The total of land and buildings, land conversion costs and properties intended for sale (which have not been revalued) is $43.9 million, a decrease of 7% over the previous year, reflecting the sale of the South plains land.

RECOMMENDATION

It is recommended that the information be received.