
Fuels Update

Presentation to Investors

Taupo

27 March 2007



CONTACT

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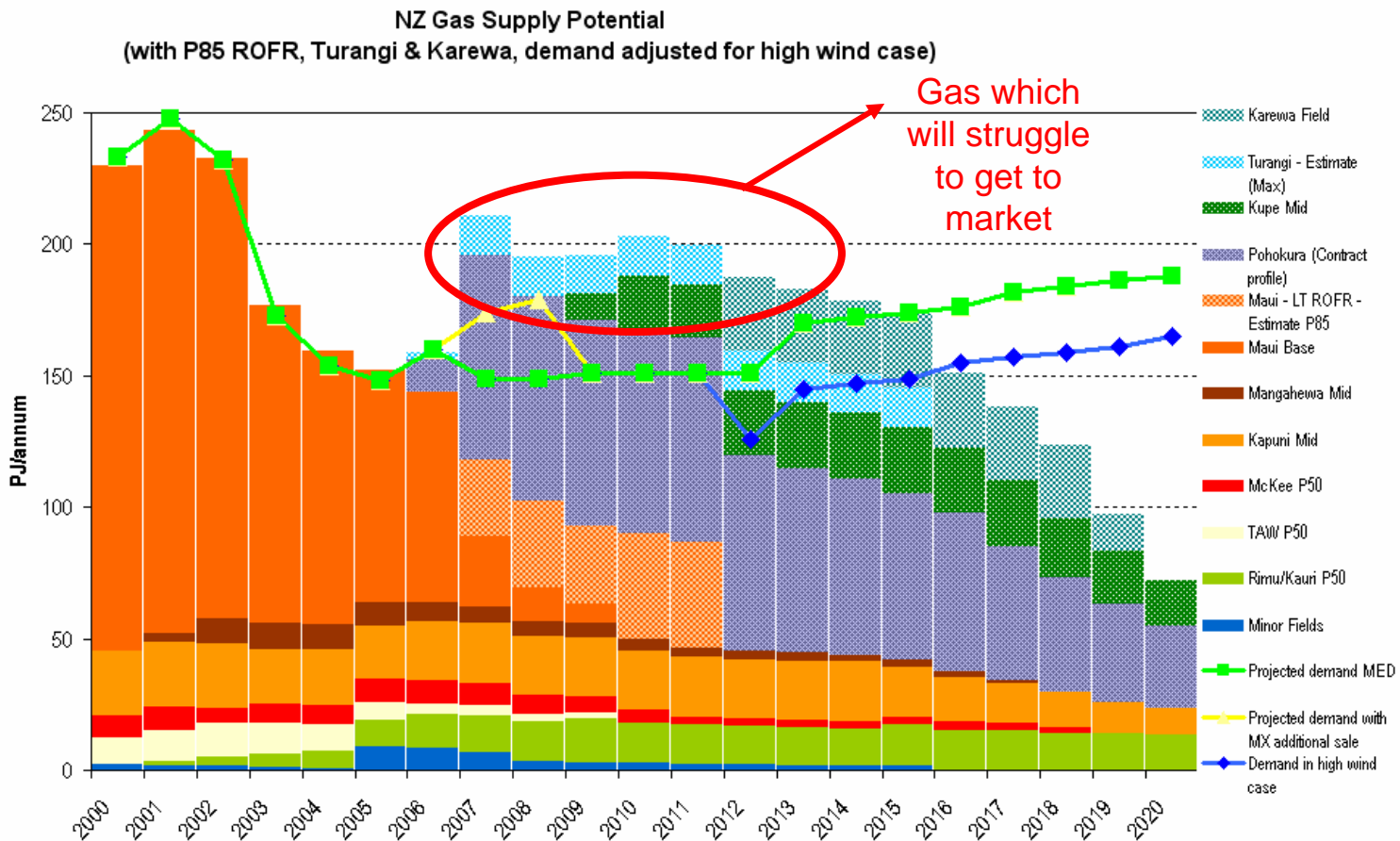
Introduction

- Presentation will cover:
 - Overview of current industry gas supply/demand
 - Current gas market issues
 - Overview of Contact's gas portfolio
 - Managing the complexity of the gas portfolio

Gas Supply and Demand

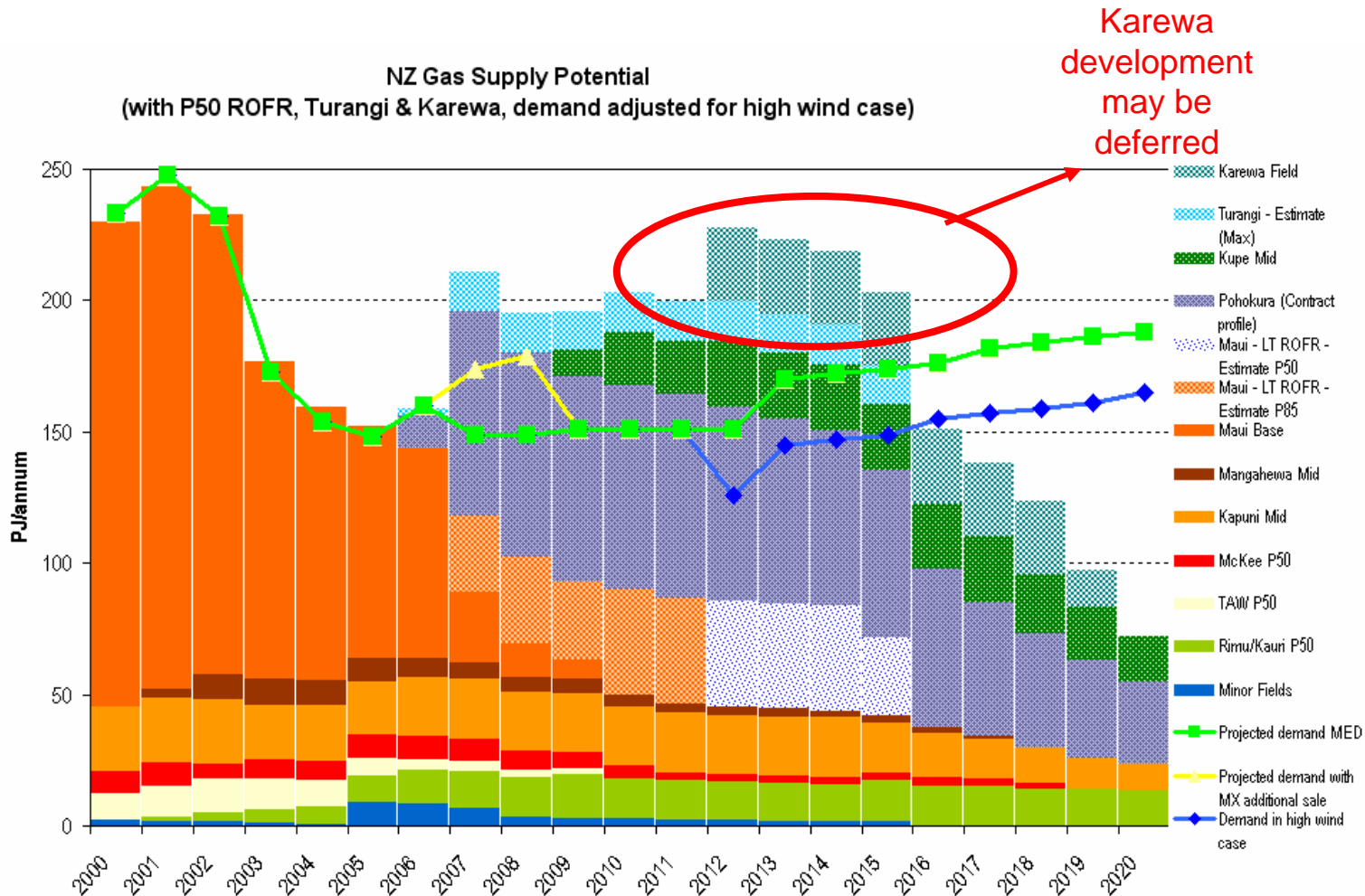
Industry gas supply and demand position

- Supply seems sufficient through to the middle of the next decade, with over supply in the short term
- The extent of renewable construction will be significant driver of demand



Industry gas supply and demand position

- If the Maui P50 gas is confirmed it is possible that the market may stay long into the next decade
- Key question remains the gap from about 2016 -18, depending on demand



Key Activities (March 2007)

Northland

The area in red is closed to PIT Petroleum permit application until further notice.
Seismic programmes will be carried out on one permit area in 2007.

Onshore Taranaki

There are well commitments on eight permits in 2007
Seismic programmes will be undertaken in five areas.

Offshore Taranaki

AWE's eight well drilling campaign commenced in late 2006.
Two other permits have well commitments in April 2007.
Remaining activity is 3D seismic acquisition in five permit areas.

East Coast

The area in red is closed to PIT Petroleum permit applications until further notice.
There are two well commitments in April 2007.
Pogo is undertaking a seismic programme.

Canterbury

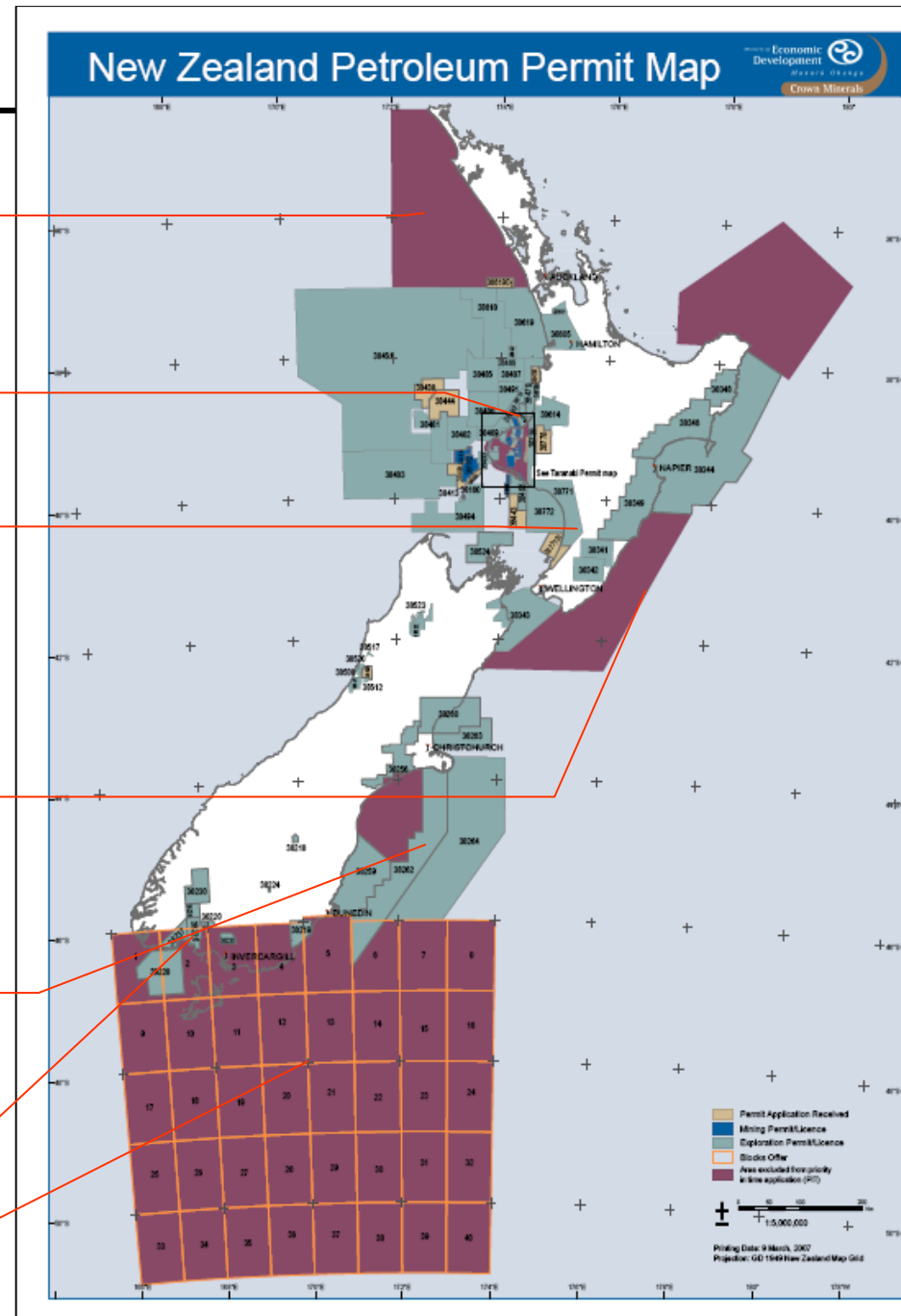
A second large offshore block was awarded (Origin) and a seismic programme expected to be carried out soon.
Cutter-1 (AWE & Tap) well plugged.

Southland Basin

L&M plans to drill up to six wells in 2007.

Great South Basin

Licensing round underway, bidding closes March 2007.

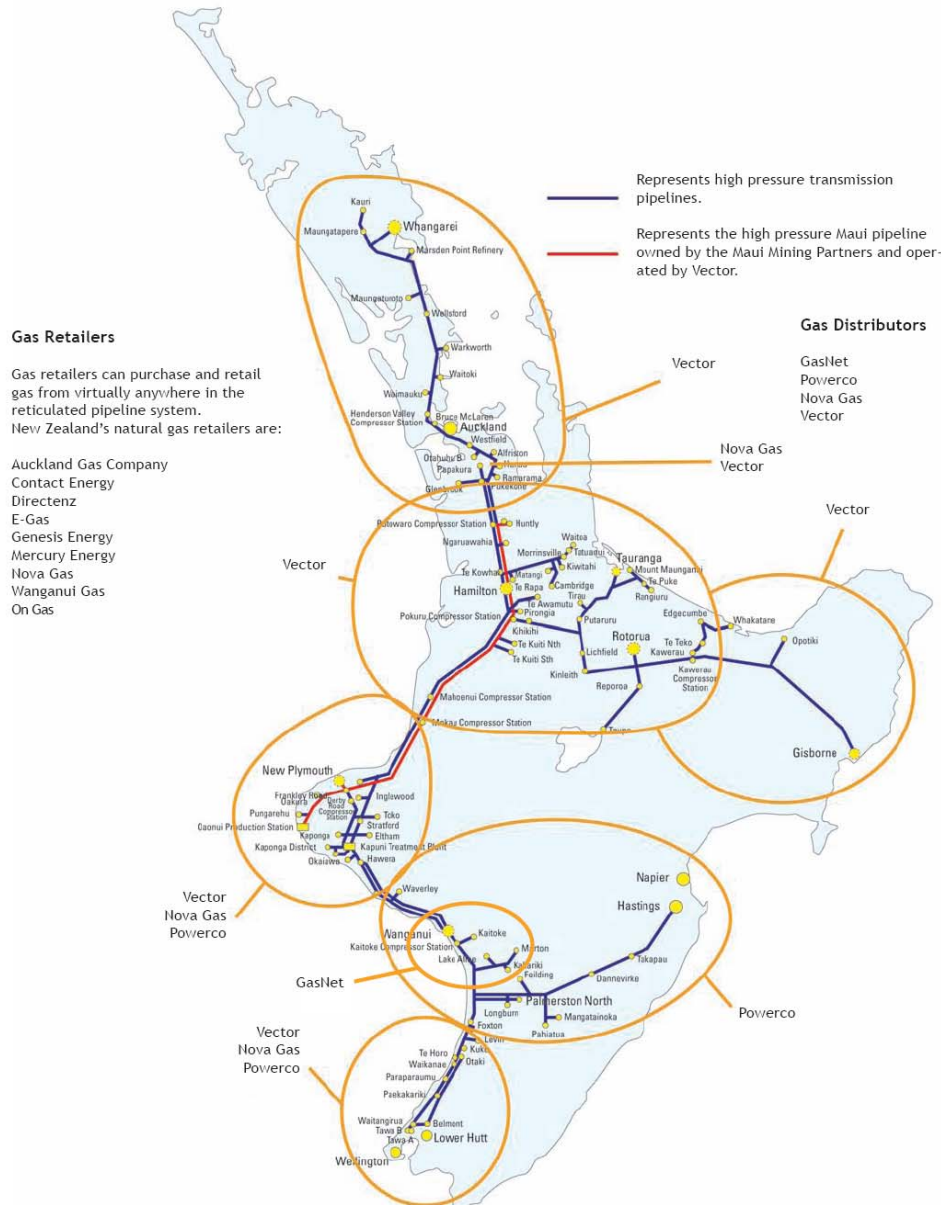


Current gas market issues

Current gas market issues

- The gas market is dominated by long term contracts and until recently there has been little drive for short term trading
- New gas fields and associated contracts have little flexibility and the transmission arrangements are more rigid
- Accordingly there is increasing need for short term trading to deal with periods of excess or shortage
- The Gas Industry Company is in the process of evaluating possible mechanisms to facilitate short term trading
 - Ranges from promoting standard contracts to development of a trading platform
 - Key issue is the cost benefit analysis associated with more sophisticated platform
 - Despite the need for short term trading there is little discretionary demand for gas
- Transmission arrangements are also creating pressure for more active short term trading
- The next few years will be challenging as the market is in a position of relative over supply

Gas transmission arrangements



- From Oct 2005, the Maui gas pipeline has been available for transmission of non Maui 367 gas (known as open access)
- Gas is transmitted from Oaonui along the Maui pipeline to welded points
- Two of these key points are Frankley Road and Rotowaro
- These are points of connection with the Vector transmission system for further delivery of gas south and north of the Maui pipeline
- While these are both high pressure transmission pipelines they have quite different arrangements and commercial terms of access

Overview of Maui open access arrangements

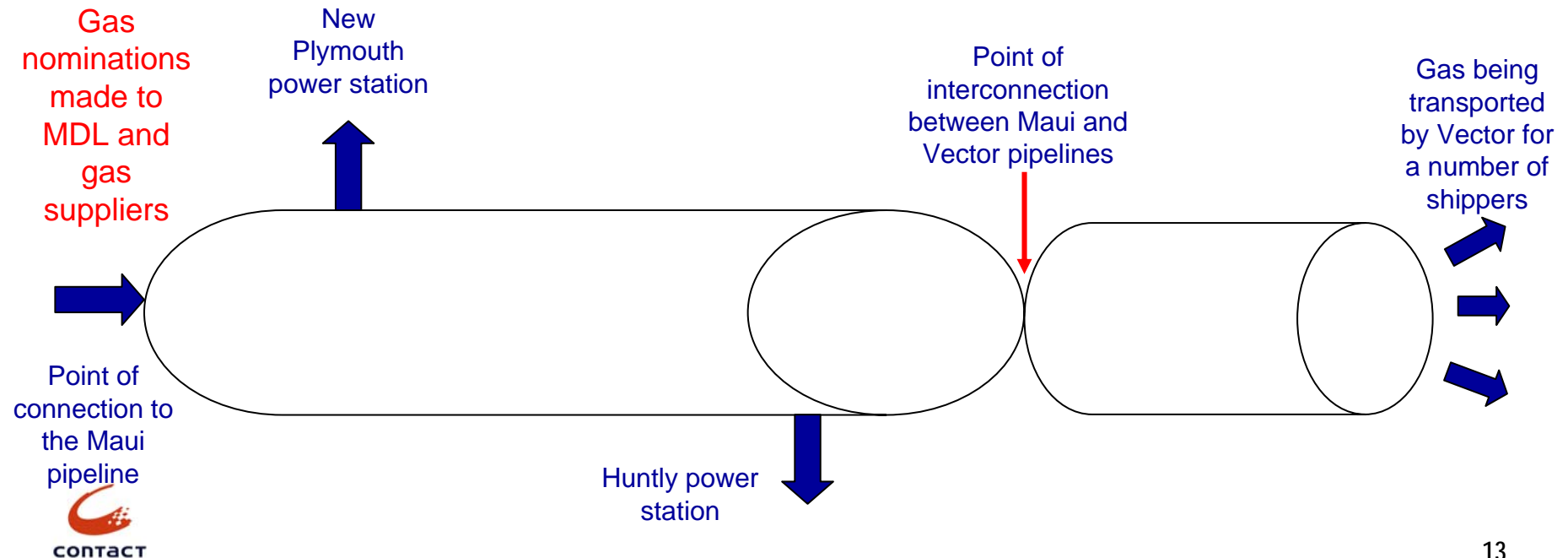
- Open access is the opening up of the Maui pipeline to allow non Maui 367 gas to be transported
 - Maui 367 gas is “delivered” – it therefore does not attract transportation charges
 - Maui 367 gas has priority rights to the available capacity in the Maui pipeline each day – transportation charges consist of two tariffs (9.6c/GJ and .1149c/GJ/km)
- Open access has been implemented through a code which applies to all users of the pipeline
- Apart from the Maui 367 gas the code does not confer capacity rights on users – available capacity is provided on a daily basis based on nomination
- The regime requires daily balancing of gas receipts and deliveries, and charges can be incurred if shippers exceed certain tolerances. Current mismatch prices are \$3.50/GJ (positive mismatch) and \$15/GJ (negative mismatch)
- Imbalance is determined by the difference between gas flows and nominations at welded points (ie the points at which the pipeline is connected to offtake points)
- This is relatively simple for certain points on the pipeline (power stations such as New Plymouth and Huntly)
- Imbalance at the Vector welded points is much more complicated since the gas flows at those points represent gas being flowed on behalf of all Vector’s transmission customers. Accordingly any charges allocated to Vector must then be passed through to Vector’s customers under Vector’s transmission arrangements

Overview of Vector gas transmission arrangements

- Unlike the Maui system Vector's transmission arrangements are based on capacity rights
 - Contact has long term fixed price transmission contracts for each of the power stations – these were recently amended to allow for the consequences of open access such as the pass through of charges incurred by Vector at the welded points with the Maui system
 - A separate arrangement with Vector applies to retail gas customers which enables Contact to book capacity on an annual basis
- Essentially the users of the Vector pipeline have rights to use the capacity they have booked and generally pay a fixed payment (and for certain contracts, a variable charge based on throughput)
- Unlike the Maui open access system there is currently no nomination regime for daily gas flows which makes it difficult to allocate gas flows on a daily basis - however, nominations are being introduced for the power stations from the beginning of April and expect to be introduced for retail arrangements from 1 October
- Further, the Vector arrangements are not codified so there is no assurance that all users have the same terms and conditions
- Given the lack of nominations on the Vector regime and an inability to measure quantities downstream, at present Vector is not able to identify on a daily basis which party or parties is responsible for the daily imbalances which arise on the Maui system; instead they use month end reconciliations to try and allocate the costs of imbalance
- This makes it relatively challenging for shippers to manage mismatch on the Vector pipeline

The nomination regime

- Contact makes nominations each day for gas to be injected into the Maui pipeline
- These nominations also address which point on the pipeline the gas is to be shipped to
- If the gas taken at the points nominated is different from that actually taken an imbalance arises
- Gas which flows through the point of interconnection with the Vector system represents the aggregate nominations of a number of shippers
- Currently there is no means to know which party is responsible for imbalance which arises at the Vector points of connection at the time the imbalance arises



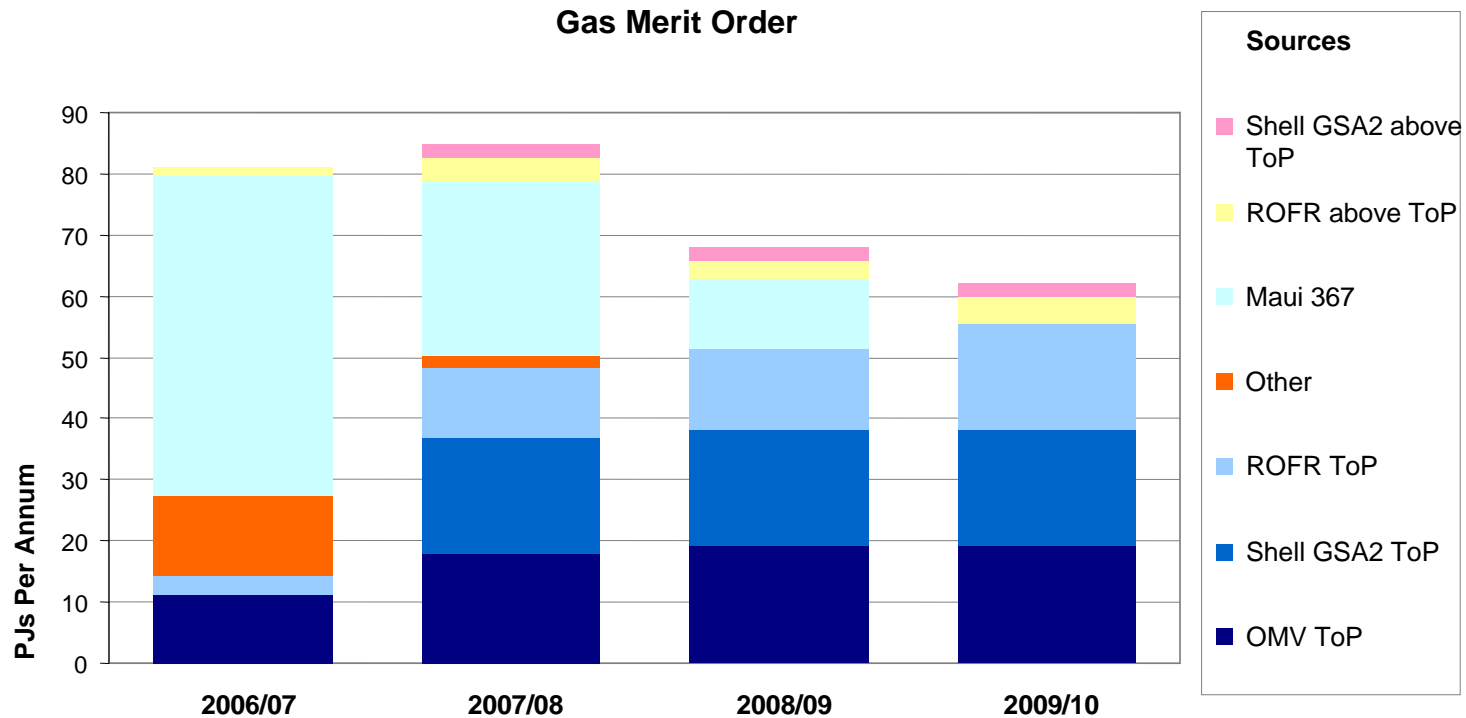
Implications of the transmission regime for Contact

- The market is still adapting to the new regimes but the implications of the move toward daily balancing allied with the lack of field and contract flexibility are already being experienced
- Contact has spent considerable effort in ensuring that our nominations are accurate and we can manage deviations from nominations
- Nevertheless, gas users are facing not only the increase in cost associated with the introduction of transmission charges on the Maui pipeline, but also emerging costs associated with imbalance charges based on daily balancing
- This requires increased focus on the accuracy of nominations, not only under gas contracts but also transmission (both in terms of the aggregate of gas to be transported and to which points on the pipeline)

Overview of gas portfolio

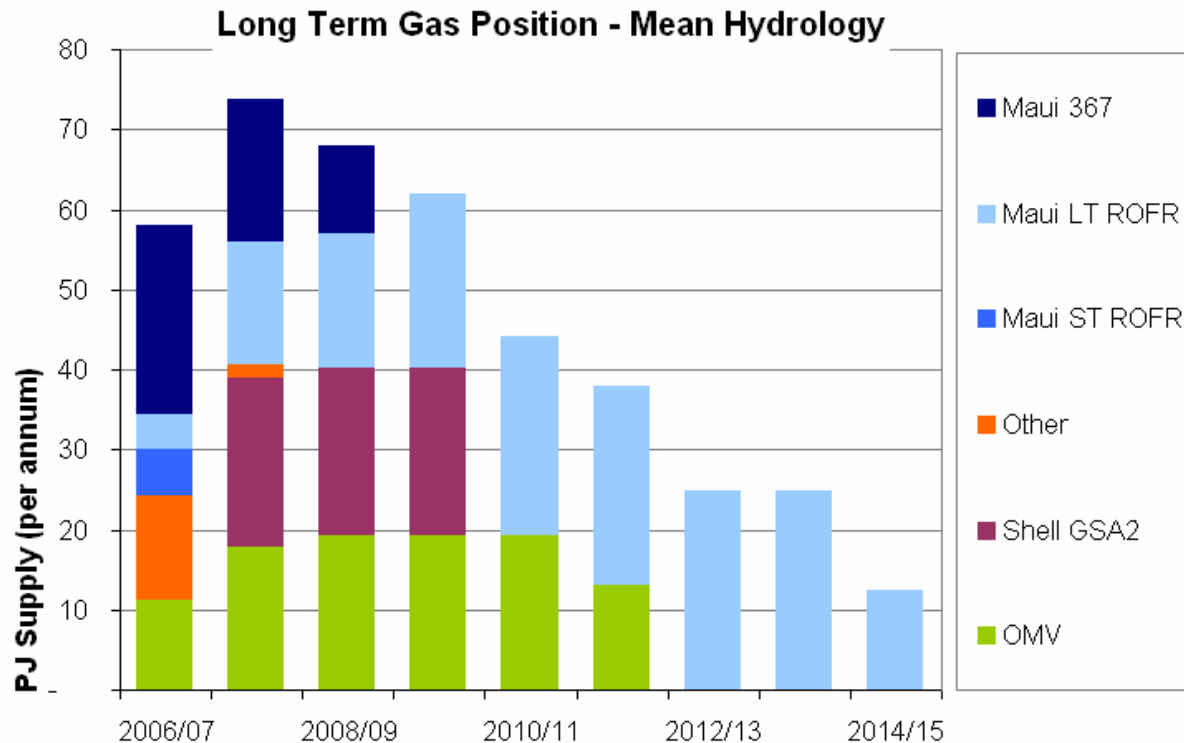
Characteristics of core gas contracts

- The utilisation of gas is increasingly complex as each contract has different constraints and value
- This graph illustrates total gas available in each year (not all of this must be used) and represents the least flexible to the most flexible sources. As Maui 367 is used less is available to be taken in the remaining period to June 2009
- Some of this gas can be viewed as discretionary and therefore may not be used
- Maui gas is assumed to be available to take in any year and therefore available gas reduces as it is used



Overview of gas portfolio

- Demand is based on a mean year view for hydrology and therefore actual takes can vary
- Illustrates the process of transition from the relative dominance of Maui 367 to increasing utilisation of Maui ROFR and Pohokura gas from OMV and Shell (GSA2)
- The demand includes a contract beginning 1 October 2007 with a large user which was essentially a sale to move some excess gas acquired in the short term under the ROFR arrangements



Future gas requirements

- The process of contracting for gas to fill the gap beyond 2010 is underway
- The Pohokura joint venture participants have been keen to get the field operational and the offshore wells tied in before seriously engaging in follow on discussions
- A key element in the contracting strategy is the role of Otahuhu C and the likely investment programme for renewables in the New Zealand market
- Wind and geothermal will inevitably be base load generation and assumptions about the extent of investment will have an effect on the future role of thermal generation
- If thermal generation is required to become more flexible to provide back up for renewable sources the role of gas will have to change
- These factors will need to be taken into account in approaching any future contracting
- Based on the current supply/demand picture Contact feels confident that the market has sufficient domestic gas to around 2015

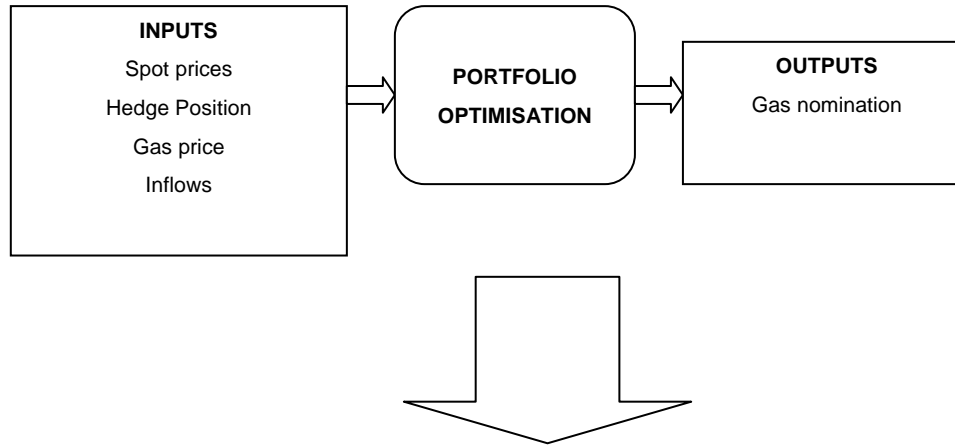
Managing the Complexity of the Fuel Portfolio

Changes to portfolio optimisation

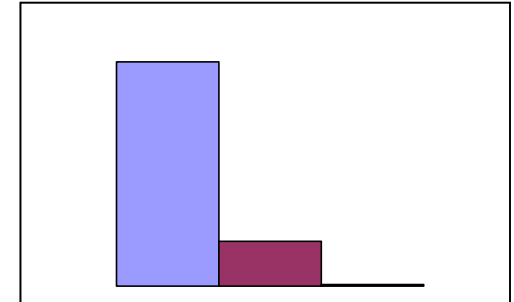
- The historical Maui flexibility enabled Contact to adopt an optimisation strategy where thermal operation was unconstrained (in either direction) by fuel supply
- Moving forward that flexibility reduces, producing a range of possible thermal operation
- In the short term the constraining factor will be the minimum contractual quantities which must be paid for, and in some circumstances, taken delivery of
- That change in operating strategy requires the following
 - a means of valuing the opportunity cost of gas
 - a portfolio that can manage the reduced flexibility
 - incorporation of that added complexity into earnings volatility measures

The role of generation in managing flexibility

Optimised for Electricity Market Only

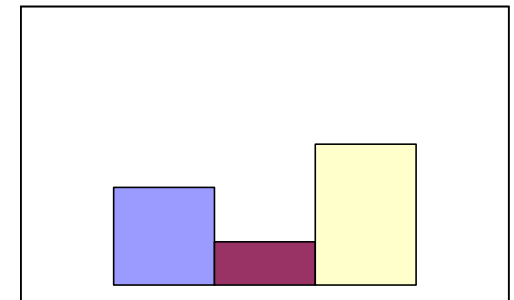
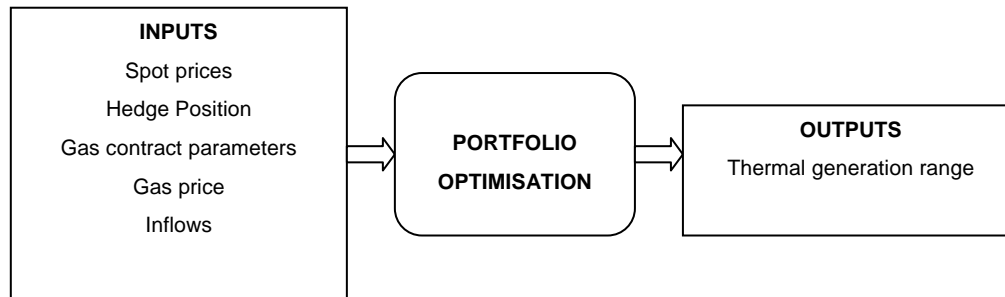


flexibility source



■ Gas Nomination ■ Stored Water ■ Thermal Range

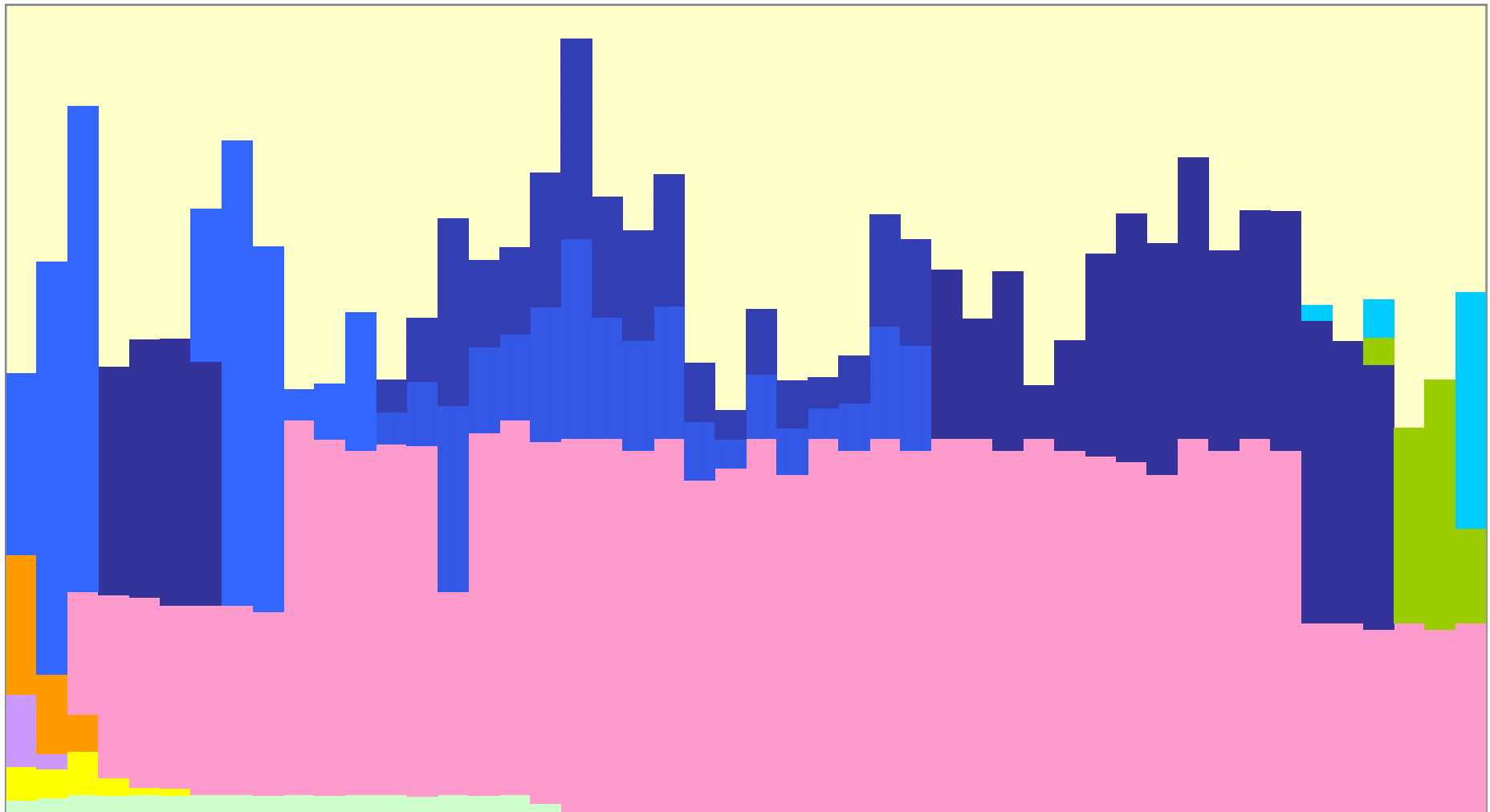
Optimised for Energy Portfolio



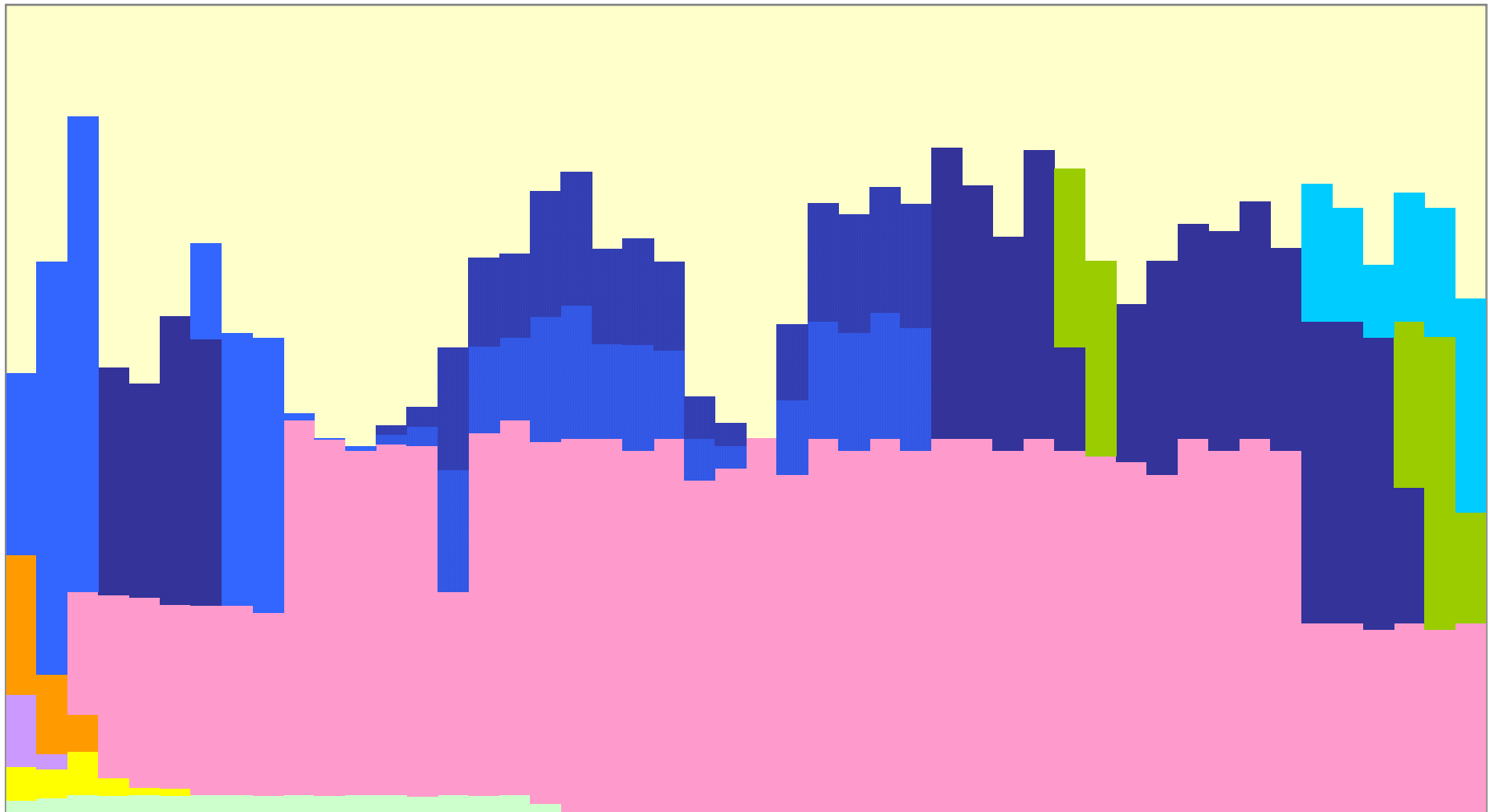
Optimisation techniques

- Like any storage modelling, the objective is to derive the opportunity cost of gas, by calculating the option value of gas retained in the reservoir for future use
- This modelling is already being used by Contact, on national hydro storage, to derive fundamental short term forward electricity prices
- Further complexity derives from the fact that each gas contract has different contractual terms, so the reservoir, for optimisation purposes, is not a homogeneous product
- The aim is to develop an opportunity cost for each contract
- Using those values, we derive optimal combinations of various contracts against historical hydrological sequences

Gas profile for one hydrological sequence



Gas profile for a different hydrological sequence



Consequences for Portfolio Management

- In order to manage the transfer of flexibility from fuel supply to thermal generation, the portfolio needs to be at higher hedge levels than previously targeted over the next 3 years
- Ideally this is achieved through further gas sales, however that market remains well supplied and at margins below the netback achieved in electricity contracts
- Higher electricity hedging levels provide greater flexibility around running thermal plant at lower electricity market prices when the opportunity cost of gas is very low
- This is being achieved by maintaining high levels of financial contracts and by extending the size and duration of the commercial contract (TOU) portfolio.
 - note this is partly responsible for Contact's retail volumes increasing despite slightly lower customer numbers
- The New Plymouth Power Station, as a physical option for the portfolio, plays an important role in allowing higher hedge targets without significant increase in risk
 - during the next 2 years whilst significant flexible MDQ (367 gas) remains
 - as an alternative gas sink for CCGT outages and opportunistic running of cheap spot gas
 - as a fuel oil generator

Earnings Volatility

- The increase in hedge levels and the constraints on fuel do however have some consequences for earnings volatility
- The indications are that we will perform strongly through a large range of hydrological conditions but may now be adversely affected by extreme events at either end of the spectrum
 - The first half year results for 06/07 were similar to 05/06 although hydrological circumstances were significantly different
 - Very wet years will drive the opportunity cost of gas below the financial cost
 - Once access to incremental daily delivery (MDQ) becomes more limited the ability to take advantage in very dry years lessens
- Earnings distribution has changed through time from
 - asymmetric with a long right hand tail that was consistent with Contact performing well in dry year scenarios
 - to
 - more symmetrical as hedge levels increased towards the 85% level but where dry years were still the main drivers of outperformance
 - to
 - still symmetrical but where extreme hydrological events at either end of the spectrum are potential drivers of lower performance

Conclusion

- The gas market is in a period of transition as new gas fields come on line and the industry beds down new transmission regimes
- The market is relatively long gas in the next few years but still faces some uncertainty about the extent of reserves beyond the middle of the next decade
- The extent of renewable generation construction will have a significant impact on the role gas will play in the longer term
- In the shorter term Contact will face some challenging periods as inflexible gas contracts conflict with other generation options