

*Contact Energy*  
***Annual Report 2009***

# Contents

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1	Summary
2	Performance indicators
4	Chairman's review
6	Managing Director's review
10	Management discussion of financial results
24	Company overview
27	Governance
40	Remuneration report
51	Security holder information

## Financial contents

56	Financial statements
61	Notes to the financial statements
110	Audit report

## 111 Corporate directory

The 2009 Annual Meeting of Contact Energy Limited shareholders will be held at the Michael Fowler Centre, 111 Wakefield Street, Wellington on Thursday 22 October 2009, commencing at 10:30am NZDST.

The Notice of Annual Meeting and shareholder voting/proxy form have been provided separately to shareholders.

# Summary

For the financial year ended 30 June 2009

- Weather extremes, transmission constraints and reduced electricity demand combined to impact on earnings, with underlying earnings after tax of \$161 million, down from \$233 million for the 12 months to 30 June 2008
- Generators and turbines delivered for the 200 megawatt gas-fired peaking power station under construction at Stratford
- Commenced injection of natural gas into the Ahuroa natural gas storage facility near Stratford
- Continued construction of the 23 megawatt Tauhara phase one geothermal power station at Taupo
- Secured final resource consents for the company's 220 megawatt Te Mihi geothermal power station
- Continued to develop wind, hydro and geothermal generation options
- Completed the installation of more than 42,000 smart meters in Christchurch customers' houses
- Celebrated 50 years of renewable geothermal generation at the Wairakei power station with a community open day and celebration
- Raised \$550 million in Contact's first retail bond issue – the most successful issue raising in New Zealand for a non 'A' rated company
- Introduced a profit distribution plan that allows retention of cash for investment in the business
- Total distributions to shareholders equivalent to 28 cents per share, under the profit distribution plan

For more information, please visit our website at [www.contactenergy.co.nz](http://www.contactenergy.co.nz) or contact:

Investor Relations

PO Box 10742

Wellington

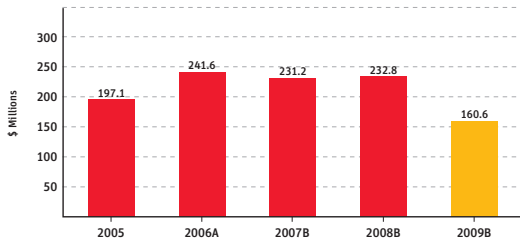
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Email: [annualreport@contactenergy.co.nz](mailto:annualreport@contactenergy.co.nz)

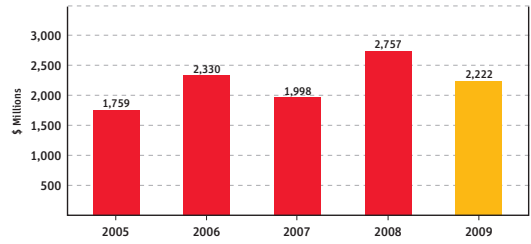


# Performance indicators

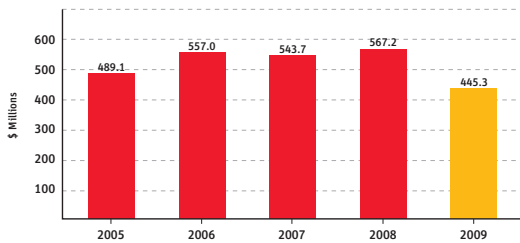
Underlying earnings for the period



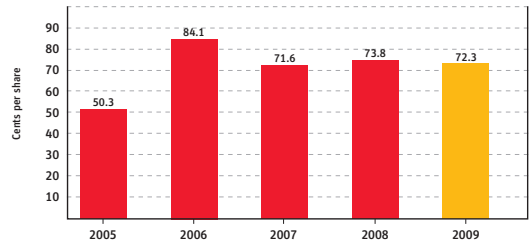
Total operating revenue



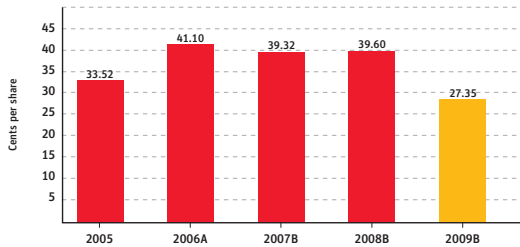
EBITDA<sup>1</sup>



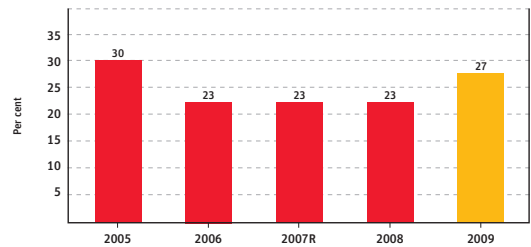
Operating cash flow per share<sup>2</sup>



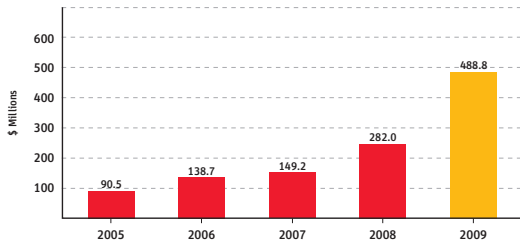
Underlying earnings per share<sup>2</sup>



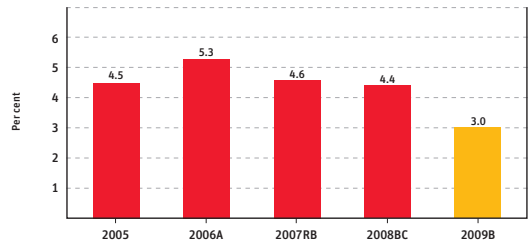
Net debt/debt+equity



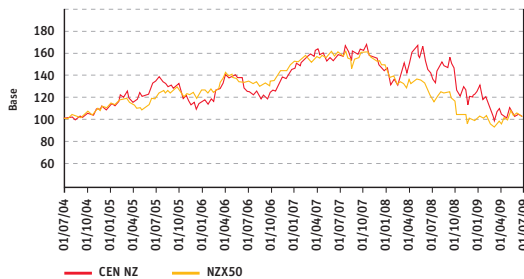
Capital and investment expenditure



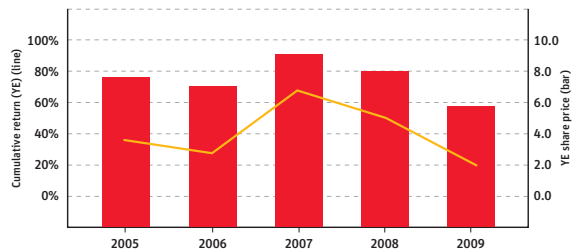
Underlying return on total assets

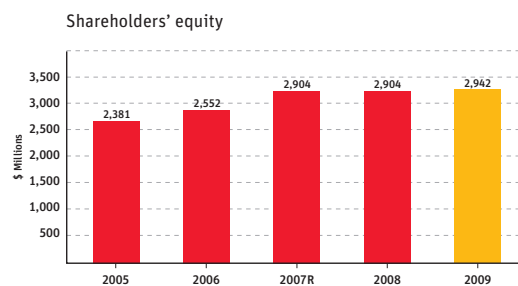
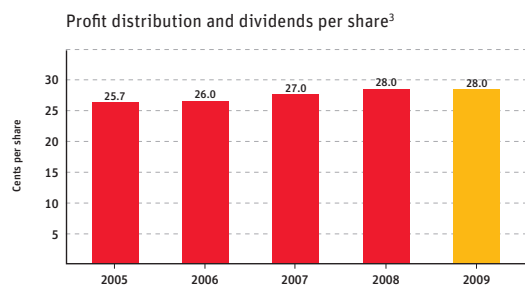
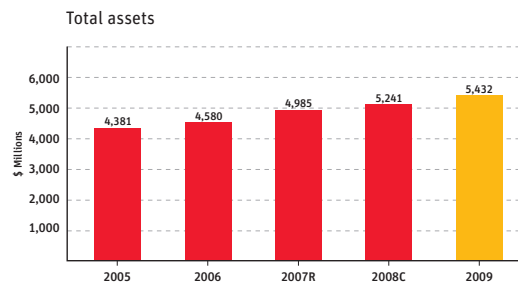
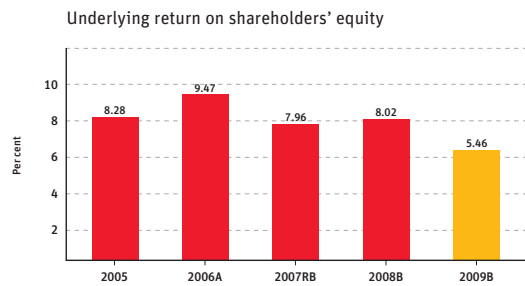
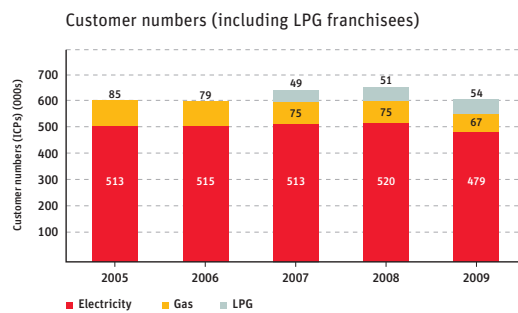
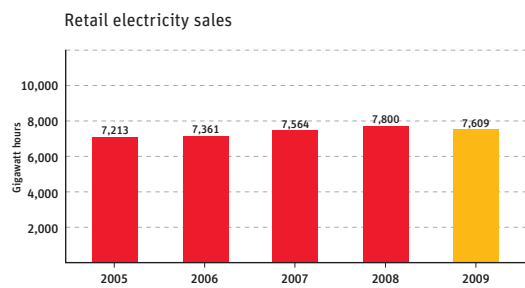
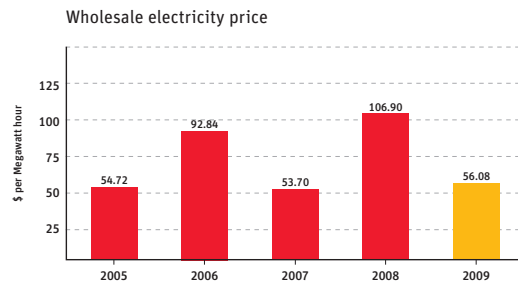
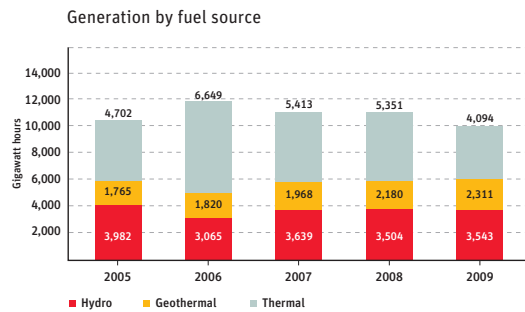


CEN relative to the NZX50



Shareholder return





## Notes to the graphs

Comparatives have been restated to reflect current period presentation where appropriate.

- The 2005 reporting period was for the nine months ended 30 June 2005 and the results of that period have been annualised where appropriate for the purposes of the above graphs; for 2006 and subsequent years the reporting period is the year ended 30 June.
- The above financial statistics, returns and ratios are based on Financial Statements prepared in accordance with New Zealand equivalents to International Financial Reporting Standards (NZIFRS).

R Denotes years in which Contact's property, plant and equipment were revalued. The revaluation affects total assets, shareholders' funds and related ratios.

A Excludes gain on disposal of subsidiaries and change in fair value of financial instruments, both net of tax.

B Excludes change in fair value of financial instruments and other significant one-off items both net of tax where appropriate.

C The 2008 total assets have been adjusted to reflect the presentational changes of financial instruments and deferred financing costs.

1 Earnings before net interest expense, income tax, depreciation, amortisation, financial instruments and other significant items. The year ended 30 June 2006 was the first year in which changes in the fair value of financial instruments were recognised within the Income Statement in accordance with NZIFRS.

2 The number of shares used for the current and prior year comparatives in the 'underlying earnings per share' and 'operating cash flow per share' analysis has been adjusted for the impact of the bonus shares issued under the profit distribution plan (PDP).

3 The number of shares used in the 'profit distribution and dividends per share' analysis has not been adjusted for the impact of the bonus shares issued under the PDP and represents the number of ordinary shares on issue at the dividend declaration date less any shares held as treasury stock. The total distribution paid is in respect of each financial year. Prior to 2009, all distributions were fully imputed cash dividends. For the 2009 financial year the PDP operated as a non-taxable bonus issue, with any shares bought back being fully imputed cash dividends.

# Chairman's review

## Weather and transmission present challenges to performance

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The financial year ended 30 June 2009 was challenging for Contact, largely as a result of unusual weather conditions, transmission constraints, and the effects of economic recession on energy demand growth. Despite this, the company has taken important steps to strengthen its financial position and has advanced its strategy of investing for future growth.

### The full year result and contributing factors

Contact achieved Earnings Before Net Interest Expense, Income Tax, Depreciation, Amortisation, Financial Instruments and Other Significant Items (EBITDAF) of \$445.3 million, down 21 per cent from \$567.2 million in the 2008 financial year. Underlying earnings were \$160.6 million, down 31 per cent from \$232.8 million.

The key drivers of the reduction in EBITDAF were:

- a decrease in net contribution from electricity as a result of high electricity purchase costs to service retail customers in the South Island in the first quarter, and a significant drop in generation revenue over the remainder of the year due to a combination of low wholesale prices, transmission constraints (which limited hydro generation) and some unplanned thermal generation outages
- a 25 per cent per unit increase in gas costs and a loss of gas supply flexibility following the roll-off of gas supply contracts from the Maui field.

While the period was challenging and the full year result disappointing, Contact took a number of significant decisions over the financial year – supported by the company's strong financial position – that will enable us to restore valuable flexibility of fuel supply and generation. This positions the company well to continue to grow and deliver value to shareholders, as well as making a significant contribution to New Zealand's long term energy security.

### Distribution to shareholders

Notwithstanding the full year result, Contact's Board of Directors resolved to hold the 2009 final distribution to shareholders at the equivalent of 17 cents per share, made under the company's profit distribution plan, which was introduced during the 2009 year. Under the plan, all shareholders receive distributions in the form of bonus shares, with the option to have those shares, or a portion of them, bought back by Contact for cash as a fully imputed dividend. As a consequence, shareholders have the choice between retaining shares and/or receiving cash.

The decision to maintain the distribution level was based on the expectation that the company's financial performance will return to normal trends. Any reoccurrence of extreme hydrology, transmission constraints, adverse government policy changes or a prolonging of the economic recession could impact Contact's financial performance in the near to medium term. To the extent such impacts do occur, the company would be unlikely to maintain distributions at this year's level.

### Financial position

Over the year, Contact undertook a number of steps to enhance the company's financial strength, including issuing \$550 million of fixed rate unsecured, unsubordinated retail bonds – after seeking to raise \$300 million and closing well oversubscribed – and implementing the profit distribution plan, which enabled \$50 million of cash to be retained in the business in respect of the interim distribution. The capital raised by the bond issue and the profit distribution plan are being used to fund investments in new generation projects and the Ahuroa natural gas storage facility.

During the financial year, Contact also increased and extended the terms of its bank facilities, and as at 30 June 2009 had \$685 million of undrawn bank facilities.

At the end of the 2009 financial year, Contact's net debt stood at \$1,124.2 million. With a gearing of net debt to net debt plus equity of 27 per cent, Contact's financial strength continues to position the company well in terms of navigating the complexity of the current economic circumstances and executing growth options when economic conditions are conducive.

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### **Governance**

There have been a number of changes to the Contact Board over the year. In March 2009, highly respected company director Sue Sheldon joined the Board as an independent director, and Contact's Chief Executive, David Baldwin, was appointed to the Board as Managing Director.

At the end of the financial year Tim Saunders retired from the Contact Board as an independent director. With the exception of a two year period, Tim has been involved in Contact's governance since the company was first formed and has made a significant contribution to building the company. On behalf of the Board, I thank Tim for his contribution and commitment and wish him all the best for the future.

### **Outlook**

When the country emerges from recession, increasing demand for energy will require new sources of generation to be built in order to maintain security of supply. This will create upward pressure on electricity prices to support investment in new generation.

Contact is well placed to support New Zealand's requirement for new generation. Over the coming year, Contact's capital expenditure is forecast to exceed the \$490 million invested over the last year (almost double the level of capital expenditure in the previous year) as the company continues to execute its strategy of investing in projects that both restore portfolio flexibility and expand geothermal generation.



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**Grant King**  
Chairman

# Managing Director's review

## Navigating complexity

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### Introduction

While Contact has always faced earnings fluctuations as a result of weather and managed that risk through our geographic and fuel diversity, the confluence of extreme weather conditions and other external factors impacted Contact's result for the financial year ended 30 June 2009.

Key among the factors influencing the result was the loss of pole one of the High Voltage Direct Current (HVDC) transmission system, which constrained the company's ability to manage the volatility associated with fluctuations in hydrology. This occurred in a year that saw both extremes of drought and deluge in the South Island, where Contact's hydro assets are located.

During the severe winter drought in the South Island, transmission constraints north of Wellington and across the HVDC prevented Contact from transmitting thermal generation from the North to the South Island, requiring the company to purchase very high priced power from the market to meet South Island customer demand.

When the situation reversed in the spring and the southern hydro lakes rapidly filled, transmission constraints in the lower South Island, combined with the loss of electricity demand from the Tiwai Point aluminium smelter, forced Contact to spill more than 400 gigawatt hours of potential generation – enough to power more than 40,000 homes for a year – as the transmission system could not take any additional generation.

At the same time, the anticipated changes to Contact's gas supply arrangements also impacted the business. As well as gas being more expensive, current contractual arrangements also limit the company's ability to vary the amount of gas Contact takes throughout the year. During periods of high hydro inflows and low wholesale prices in the year to 30 June 2009, gas supply inflexibility constrained the company's ability to reduce higher-priced thermal generation. This lack of gas supply flexibility is being addressed through Contact's investment in an underground gas storage facility at Ahuroa – a first for New Zealand – which will be operational from mid 2010.

While the financial result for the year to 30 June 2009 was disappointing, significant progress was made in a number of important areas that position Contact well to execute its growth strategy over the coming months and years.

### Strategy for growth

Contact's strategy for new generation development is to pursue a range of options across the major fuel types – thermal, geothermal, wind and hydro – that we can execute at the right time to suit the changing operating environment. This way, we can develop the lowest cost generation options first, ensuring the best outcomes for shareholders and New Zealand.

### Geothermal

Among those available options in the current environment, Contact's priority is geothermal generation investment, given its current costs relative to other generation options and Contact's expertise in geothermal development. In the year to 30 June 2009, we made pleasing progress on a number of key geothermal developments:

- Construction of Contact's \$100 million, 23 megawatt Tauhara phase one geothermal binary plant is on track, with commissioning of the plant expected around mid 2010 (on time and within budget).
- In September 2008, final resource consents were granted for Contact's 220 megawatt Te Mihi geothermal power station.
- Development of Contact's proposed Tauhara phase two power station, a geothermal plant of up to 240 megawatts, was advanced.

The sequencing and timing of both the Te Mihi and Tauhara phase two projects is dependent on a number of factors including electricity demand growth, credit conditions, carbon policies, currency rates and resource consents. Consents exist for the operation of the Wairakei power station until 2026, enabling Contact to appropriately time the Te Mihi development to achieve optimal value.

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## Gas

Contact's investment in a 200 megawatt fast-start gas-fired peaking power station and a gas storage facility will be key to restoring some of the operational flexibility lost through the end of the Maui gas contract, the increasing exposure to fixed take or pay, high-cost gas supply contracts and the decommissioning of the company's gas-fired New Plymouth power station.

The Ahuroa gas storage project, a \$250 million development, will enable Contact to switch off its gas-fired baseload power stations when market conditions do not support them running, and store the gas for later use.

Contact's \$250 million gas-fired peaking power station at Stratford will enable us to respond to increasing levels of volatility in electricity demand peaks that result in price volatility.

## Wind

As part of Contact's strategy to secure generation development options across the range of key fuel sources, the company continues to advance resource consent applications for two wind farms – one in the Waikato and the other in southern Hawke's Bay – for development when economic conditions support them.

## Hydro

In Contact's view, new hydro projects will be required in New Zealand's medium to long term energy future, especially if the country is to meet its climate change obligations and avoid the need to import thermal fuels.

Following a review of plans inherited when Contact was formed, Contact began engaging with local communities in April 2009 on four options for new hydro development on the Clutha River, with a view to selecting a preferred option for further development. The process of community engagement, together with engineering design and review, and the consenting of an eventual option will take some time, but will be in step with the country's need for new large-scale hydro development towards the end of the next decade.

Contact also holds resource consents for the 17 megawatt hydro power station at the Lake Hawea control gates and will continue to review the economic feasibility of this project for development.

## Creating an environment that is conducive to investment

The extent to which Contact's generation growth options can be executed, and the benefits for shareholders and New Zealanders realised, is dependent on a number of factors, including transmission investment, regulatory certainty and acceptance of the need for prices to rise appropriately over time to support new generation investment. Contact is committed to working with stakeholders in all these areas to positively contribute to an environment that is conducive for investment.

## Transmission

Investment in the national transmission grid is urgently required to ensure the electricity market can operate optimally and play its role in delivering the efficiencies required to meet public expectations around reliability of supply and the prices end-consumers pay for electricity.

As the events of the 2009 financial year have clearly demonstrated, a key priority is the replacement of pole one of the HVDC by April 2012 (by what is known as pole three) to enable electricity to be moved freely between the North and South Islands.

Wider upgrading of the grid – in which there has been no major investment since the 1980s – is also critical to ensuring that the transmission system can deliver electricity from new sources of generation to end-consumers and cope with increased load. Positive advances in this area include Transpower's enhancements to regional transmission capacity in Southland by the end of this calendar year.

I will continue to participate as a member of the HVDC Procurement Advisory Group and to support Transpower's project to replace pole one of the HVDC, in addition to supporting Transpower's efforts to strengthen and hasten transmission investment across the network.

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### Regulatory certainty

Certainty in key areas of policy is a necessary precondition of any investment decision. Notwithstanding this, Contact continues to support workable improvements to the efficient operation of the electricity market and is participating fully in the Ministerial Taskforce review of the sector. In particular, Contact supports the Government's commitment to streamlining regulatory functions to enable more efficient oversight of the sector and improvements to the transmission investment process.

Securing resource consent for a power station – particularly a renewable wind farm or hydro power station – remains challenging. While there should always be a careful independent consideration of a project's impacts and benefits, Contact supports the focus of the current review of the Resource Management Act and the development of a Government Policy Statement that places greater weight on the benefits of renewable projects.

While the emissions trading scheme has been delayed from a 1 January 2010 implementation date for the stationary energy sector, the introduction of a carbon pricing regime remains highly likely. Contact believes an emissions trading scheme remains the most appropriate way to price carbon and to shift investment decisions in new generation from thermal to renewable technologies.

Contact remains well positioned to capitalise from opportunities in a carbon pricing environment.

### Pricing to support investment

Without appropriate investment in new generation, there will likely be greater demand for electricity than available supply from around 2014 onwards. This will have significant impacts on individuals as well as businesses and industries that are the bedrock of New Zealand's economy, particularly in terms of reliability of supply.

However, while electricity is an essential part of our lives, its value is only obvious when it is not there, and it is therefore generally taken for granted. In this context, there is consistently strong resistance from consumers and other stakeholders to electricity price increases. Like others in the industry, we have a role to play in better articulating the rationale for electricity price increases and communicating the value of electricity, so that the retail market is priced not only competitively but also realistically to support new investment.

### Our people

Our people's health and safety is of paramount importance in maintaining the highest standards of operational excellence. Contact performed well in the 2008 financial year in terms of health and safety, but this performance has slipped in the 2009 financial year, which is not acceptable to us. In this context, a key priority for the current financial year is new or improved initiatives to foster the company's health and safety culture and rigorous target setting and reporting on all relevant measures. More detailed information on Contact's health and safety performance can be found in Contact's 2009 **Sustainability Report**, available on the company's website.

### Our customers

Last year, our customers made it clear they perceived a link between price increases and a proposed increase to the fee pool from which directors are paid, which was not acceptable to them. The result was a loss of retail customers over the course of the year, which was a major disappointment for everyone at Contact that we are working hard to reverse.

We have been focused on rebuilding the trust and confidence of our customers by providing a range of new offers such as fixed price plans and the two winter price freeze for certain areas, in addition to the usual outstanding customer service from our dedicated team across New Zealand.

### Our communities

We recognise that like others in this industry, Contact has a relatively large footprint, particularly in terms of our impact on communities where we have generation interests. In this context, we are committed to development and operational excellence, and we give back to national and local communities in ways that are meaningful to them.

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A highlight for this financial year was the 50th anniversary celebrations for Contact's Wairakei power station, the first geothermal plant of its kind anywhere in the world. As well as hosting a series of community events, Contact commissioned a large sculpture to be gifted to the Taupo community to mark the 50 year milestone and the special relationship between the people of the Taupo region and geothermal energy. For more detailed information on Contact's social and environmental performance, please see our **Sustainability Report**, available on the company's website.

### **Conclusion**

A number of the factors that contributed to the financial result for the year ended 30 June 2009 – hydrology, wholesale prices and electricity demand – are now moving back towards more normal patterns.

Supported by the important steps taken to strengthen the company's financial position in the year to 30 June 2009, we remain focused on completing and commissioning the Ahuroa gas storage and Stratford peaker projects to restore operational flexibility, continuing to develop other growth options, attracting and retaining retail customers and fostering Contact's health and safety culture.

It's been a tough year for Contact but I'm proud to lead such a talented and committed team, and I would like to thank the Board and everyone at Contact for their considerable efforts in navigating the company through a challenging period. I'm excited about Contact's future and I'm looking forward to working with all of our stakeholders as we work to accomplish our goals.



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**David Baldwin**  
Managing Director