

# KIWIRAIL 2014 ANNUAL RESULTS BRIEFING

Friday 29 August 2014

EMBARGOED UNTIL 12PM – FRIDAY 29 AUGUST 2014

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## 2014 OVERVIEW

- 2014 was a challenging year for KiwiRail. Leading into it, the company had had steady growth in the three years prior.
- The operating surplus reached \$108M in 2013 and on the back of that, solid growth was budgeted for the 2014 financial year.
- There were then two unexpected and high profile events.
  - The first was the loss of a propeller on the Aratere.
  - The second was asbestos contamination in our new freight locomotives.
- This was frustrating as the 2014 year had started off well: the freight business was set to exceed its revenue and profit targets for the year.
- On 5 November 2013 the Aratere lost her starboard propeller. Within 8 weeks the Stena Alegra was secured as a replacement. However, it did not have Aratere's rail capacity.
- Aratere has been and continues to be critical to New Zealand's freight movement. She provides 45% of our Cook Strait capacity, and provides an interisland service at critical times of the day for freight customers.
- In the third quarter asbestos containing materials were found in 40 new DL Freight locomotives. They had to be taken out of service to have the asbestos carefully removed.
- The temporary loss of 20% of KiwiRail's locomotive fleet put added strain on the freight business in the second half of the financial year.
- Finally, there was a slowdown in export logging and dairy volumes from April to June this year as the prices for those goods fell on international markets. The company's bulk, dairy and import / export customers make up 40% of revenue, so any movement there impacts on the bottom line.
- As a result of all these factors, the operating surplus in 2014 fell over 28% from 2013 to \$77.5M. 2014 was extremely frustrating for KiwiRail, our customers and our stakeholders. However the company is determined to recover and continue its growth programme.
- While the financial side of the business is very important, KiwiRail has also been intensifying and refreshing its focus on safety. There has been a 45% year on year drop in total injuries but there is a long way to go to be best in class.
- KiwiRail is cautious about the outlook for 2015. While the economy is solid in some sectors, it's patchy in the core commodity sectors that make up 40% of the company's revenue.

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## CROWN SUPPORT

- The ongoing support of the Crown as shareholder has been and continues to be important.
- Including 2015, the total invested by the Crown since 2010 exceeds \$1 billion, excluding any investment in metro passenger transport.
- Most of the Crown's contribution was as part of the turnaround plan which started in 2011.
- There has also been one-off additional support in the 2014 year for loss of earnings from the Aratere outage.
- KiwiRail has made good use of that money in combination with the company's own contributions. However years of under-investment, coupled with unexpected events in the first 4 years of that plan, means getting the business financially sustainable is still a significant challenge.
- The Global Financial Crisis, Pike River, the Christchurch Earthquakes and the two events this year have all had a material impact on KiwiRail's operating surpluses.
- To achieve the company's long term goals is going to require partnering with our customers, our shareholder and transport agencies to build an integrated game plan.

## REVENUE

- The bulk of KiwiRail's 2014 revenue was derived from freight (64%), Interislander (16%) and passenger services such as Scenic Journeys(7%).
- Between 2013 and 2014 freight revenue was steady at just over \$460 million. There was an almost 5% decline in the bulk business segment and over 2% decline in import export freight.
- On the other hand domestic freight grew by over 6%, a real achievement considering the Aratere outage and one that indicates strong customer support for rail in a tough year.
- Interislander passenger revenue was down over 9% because of the Aratere, but some of that was made up for by a nearly 2% increase from commercial vehicle freight.
- Tranz Metro, which is our passenger transport business in Wellington, and our Scenic Journeys operation both performed well.
- So in the circumstances, holding the overall revenue at \$724M, close to the 2013 level of \$727M, was an acceptable outcome.

## EXPENSES

- As noted, the operating surplus was down 28%. Since revenue was steady, the difference is in the expenses for 2014:
  - Greater maintenance and reduced capital expenditure
  - Costs of seismic work across our 1500 building portfolio
  - Wage and salary increases (av 2% across 4000 staff)

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- There were on-off costs in 2014. These were primarily the lease of the Stena Alegra, the cost of the asbestos disruption and insurance receipts for our Christchurch properties.

## **ARATERE RESUMES 3 SAILINGS, TUES-FRI**

- KiwiRail is making good progress removing asbestos from our DL locomotives. We will be able to meet the demands of the upcoming peak season.
- And from this week the Aratere has resumed three sailings a day from Tuesdays to Fridays. She had been reduced to two sailings a day since returning from Singapore.

## **CONTINUING INVESTMENT**

- Despite the setbacks in 2014, KiwiRail continued its ongoing investment in the business using both Crown money and our own.
- In 2011, at the start of the turnaround plan, the company was faced with ageing infrastructure and ageing rolling stock.
- The strategy was and still is to modernise and refresh our fleet of rolling stock, and upgrade our network. Since that time we've acquired 40 new generation DL locomotives.
- It's the first time in 35 years that the business has bought new locomotives.
- One new DL loco can move the same freight as 100 trucks. That's a lot of congestion off our motorways and many tonnes fewer of carbon emissions. So Government and KiwiRail investment in these assets makes real economic sense.
- KiwiRail has also invested in new container flat wagons to which modules can be attached depending on whether timber, milk, coal or steel is being freighted.
- Lead times for new rolling stock procurement have been shortened so we're now much more responsive to market changes.
- The company is steadily replacing or upgrading bridges so they can carry heavier trains.
- Passing loops have been extended and train control systems upgraded to allow more frequent freight services.
- These combined government and company investments improve reliability and on-time performance which are the key value drivers for a supply chain and passenger transport business like ours.
- Examples of the impact they are having include improved on time performance since 2009 for freight and Interislander; improving track quality; journey times shortening or staying shorter and a significant fall in disruptions from minor incidents and derailments.

## **BUSINESS CHANGES**

- All these trends are positive, but the bottom line is that we cannot rely on revenue growth alone to get us to a sustainable position.

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- To improve our performance and continue to grow we need a more cost-effective and efficient business model.
  - Our focus will be on improving asset and labour productivity, making processes more efficient and delivering consistent on time performance for our customers.
  - This can only be achieved by the company operating as a single business across New Zealand.
  - To kick this off we've started an internal "Back to Basics" programme and we're also reviewing all parts of the business including our initial turnaround plan assumptions.

## **FREIGHT AND MARKET TRENDS**

- There are major changes taking place that will impact over the longer term. The second national freight demand study was published by the Ministry of Transport in March 2014.
- It showed that up to 2042, commodity freight is expected to increase by about 70-75 percent in terms of tonnes lifted and in terms of tonne-kms transported. And rail's predicted share of that increased tonnage is significant. It's a big increase on the current flows, an annual average increase of about two percent.
- On top of this our big exporters are trying to improve their competitiveness and reduce their carbon footprints.
- Bigger ships into New Zealand's ports will change freight flows and the intermodal freight hubs that are emerging across the country will lead to more integrated transport options.
- So the landscape is changing. We have a key role to operate and optimise our transport rail system to enable export, domestic and passenger patronage growth.
- We're now working closely with Treasury, the Ministry of Transport and the New Zealand Transport Agency to review our forward plans in light of these trends and the need to create a sustainable rail business.
- We have therefore commenced a comprehensive review of our operations. It's our intention to improve the performance of the rail business in a way that realises economic benefits for New Zealand.

## **SUMMARY**

- 2014 has been a tough year but we're determined to improve.
- In 2015, we'll be partnering with our customers and stakeholders to support their growth.
- We'll be working hard to improve our safety performance and reduce cost and waste.
- We will review our strategy to align with market and freight trends.