STATEMENT OF CORPORATE INTENT

2014-2016

This Statement of Corporate Intent has been submitted by the Board of KiwiRail Holdings Limited in accordance with Section 14 of the State-Owned Enterprises Act, 1986.
It sets out the Board's intentions and objectives to June 2016.

KiwiRail Overview

KiwiRail is a State-Owned Enterprise and the backbone of New Zealand's integrated transport network. Our vision is to be a world class mover of freight and people by rail and ships, and to be the natural choice for our customers in the markets in which we operate.

We have three key profit centres made up of several operating divisions:

Rail Freight

- **Freight** – the customer facing functions of the rail business including sales, marketing, operations, and rolling stock mechanical services.
- **Infrastructure & Engineering** – manages the rail network covering both maintenance and capital works.
- **Property** – the management of our commercial property partnerships and our internal property holdings.
- **Support Services** – finance, information systems, legal, communications, procurement and planning.

Interislander

The link between the North and South Islands for rail, trucking and passenger customers with three ferries - two rail decked and one non-rail deck.

Passenger

- **Scenic** – tourism train services the TranzAlpine, Northern Explorer, Coastal Pacific, in addition to the Capital Connection commuter train and charter services.
- **Tranz Metro** – Wellington commuter train service operated under contract for Greater Wellington Regional Council.
- **Auckland Metro** – KiwiRail provides track maintenance, train maintenance and train control services to Auckland Transport. The train services are operated by a 3rd party, Transdev, under contract to Auckland Transport.

Operations

Each week, train control operations manage the movement of:

ASSETS

- 4,000 kms track
- 198 mainline locomotives
- 4,585 freight wagons
- 2 owned, 1 leased ferry
- 4,200 staff approximately

1. Foreword

This is the first Statement of Corporate Intent (SCI) since KiwiRail was formally separated into two entities – KiwiRail Holdings Limited (a new State-Owned Enterprise, “SOE”) and New Zealand Railways Corporation (NZRC). This structural change sees the commercial operations undertaken through KiwiRail Holdings with the land assets retained in NZRC. As part of this change, the assets and liabilities of KiwiRail Holdings Limited reflect the commercial values of the business and in doing so providing a better basis for assessing financial performance. A separate SCI is prepared for NZRC.

This SCI reflects the fourth year of the KiwiRail 10 year strategic plan. The first three years of the plan show good progress towards achieving our objectives. Our rail freight operations have materially grown volume and revenue year on year, we have invested in new locomotives and wagons, completed major upgrades to the national rail network, and extended the *Aratere* to provide greater inter-island rail capacity.

Further to this we, and our transport partners, have invested significantly in improving passenger services to encourage greater usage. Major upgrades to the Auckland and Wellington networks have been completed on time and on budget. New commuter trains have been successfully introduced to Wellington and new carriages have been introduced on the long distance, tourism-focused services.

These, and other, initiatives have underpinned our business performance through a period of great uncertainty. Average group revenue growth of more than 8% per year over the last three years has been achieved in a difficult economic and operating environment. Our focus on freight – where the majority of our growth has been realised - is starting to pay real dividends.

Investment in the business comes with the expectation of progressing towards financial sustainability. To progress this we have made some tough decisions and reprioritised investment into the areas that provide the most benefit to the business. The closure of the Napier to Gisborne line, the sale of Hillside Workshops and the changes to our Infrastructure and Engineering division have been essential to ensuring the future of the organisation. Our commitment to a safe, high performance culture has not been compromised by these decisions.

Over the next three years we will continue to implement our strategy as we look to achieve financial sustainability by 2020.

2. Nature and Scope of the Business

The business activities of KiwiRail over the next three years will be:

- To own and operate a national rail network to meet the requirements of our customers
- To provide for the transport of bulk and consolidated freight
- To provide inter-island ferry services (forming the 'bridge' between the North and South Islands) for rail, road freight, and passengers and their vehicles
- To provide and/or support rail passenger services in metropolitan areas and long distance services for both domestic and tourist markets
- To manage and develop property holdings for rail operations and appropriate third party land use

3. Corporate Responsibility Commitment

KiwiRail's commitment to corporate responsibility has been defined across six impact areas:

- To be a good employer, treating our people fairly, with respect, giving them the right tools and training to work safely, and valuing their diversity. We are committed to creating a workplace that makes people want to join, stay and work to their full potential. We are committed to their safety and well-being
- We will design safety into how we do business every day, not only for our own people but also for the communities in which we operate
- To deliver to our customers what we have promised; we will listen to them and involve them in our solutions and innovations
- To work with our suppliers to develop long term partnerships based on best practice procurement methods which reflect mutually agreeable codes of conduct
- To recognise the environmental, social and economic needs of the communities we work in and endeavour to be a good neighbour. We will involve relevant communities in initiatives we implement
- To help protect the environment by better understanding, managing and measuring our environmental impacts and minimising the carbon intensity of our services. We will do this by commissioning new, more fuel efficient locomotives, increasing our focus on fuel saving behaviour and opportunities to improve efficiency, and the completion of some of the Metro Projects including Auckland metro electrification.

4. Business Outlook and Strategy

Our goal remains unchanged – to move freight and people around New Zealand in a safe, efficient and customer focused way. The platform is now well established for us to continue to grow safely and responsibly.

A market-centred approach is the foundation of our ten year strategic plan – a decade long programme of investment and innovation to ensure we can deliver the highest levels of service expected at a fair price for all our customers.

The 10 year plan is a subset of a thirty year plan needed to bring the assets to their sustainable level. The first 10 years is critical to attaining KiwiRail's financial sustainability.

We constantly monitor risks and issues in the business and put in place mitigations to these. Meeting our building standards obligations is an evolving risk against which we are developing our policies and responses. The potential financial impacts of remediation have not yet been quantified.

Key elements of our strategic plan:

ONE: Growth in Freight Volume and Revenue Quality

Independent freight studies have consistently predicted the near doubling of the freight task over the next thirty years and rail must be successful to allow this task to be efficiently moved.

Rail Freight generates over 65% of the total income of KiwiRail. Revenue is generated through the transportation of bulk commodities, import-export goods and domestic freight. Table 5.2(a) outlines our freight growth targets. We are projecting annual freight revenue in the 2016 financial year to $85m higher than 2013, representing growth of 20%, or 6% on a compound annual basis.

Put simply, our objective is not to put on more trains, but fill our existing services. This will result in increased margin flowing to our operating surplus.

We are actively engaged with our customers in the dairy, coal, port, domestic forwarding and forestry sectors ensuring we are positioned well to capture their volume growth as they grow in their markets, and in addition, regain market share as their confidence in our capability develops.

In the domestic freight sector maximising train capacity utilisation will be targeted as we continue to drive toward consistent, on time performance. We have seen many of the freight forwarders building or leasing facilities on rail land with developments in Auckland, Hamilton, Palmerston North, Wellington, Christchurch and Dunedin.

A new premier train service between Auckland and Palmerston North has been introduced adding additional capacity and improving the efficiency of freight management on our key services. For example, this has reduced the amount of "attach and detach" activity at key transit terminals (such as Hamilton and Palmerston North), thereby improving reliability.

We will continue to review our pricing structures to make sure we are fairly reflecting the costs of service and value of our offering.

Reliable rolling stock is a key element of quality customer service. The investments in locomotives, wagons and containers over recent years have been well received by our customers.

The next three years will see further new equipment delivered as outlined in Table 5.1(k). The associated lower costs in fuel and maintenance for this equipment will begin to take effect over the next few years. This will enable us to provide further funding to upgrade the existing rolling stock.

TWO: Maintain a Sustainable Connected Network

The KiwiRail network extends over 4,000 km – a mixture of main lines, secondary lines and minor lines. Growing the business depends on maintaining a connected and financially sustainable network.

Our core network capital expenditure is part of the strategic plan programme outlined in Table 5.2(c) with a number of key output metrics in Table 5.1(l).

Through 2013 we reduced some of our network labour resource as we adjusted our network programme to ensure we lived within our means. Even with these changes, we are still expecting to invest over $474.5m in capital and $180m in operating costs on the rail infrastructure over the next three years.

An absolute bottom line is that our investment levels must ensure a safe railway is maintained for the good of our staff and customers.

Over recent years the business has extensively reviewed the options to improve transit times via infrastructure changes. Several low-cost infrastructure changes have been progressed, for example:

- Changes to North Island Main Trunk line signalling
- Minor curve easements.

We are carefully looking at where we invest our money to ensure we get the most benefit and as such it is considered more prudent to focus on initiatives that improve reliability than reduce time. These have included:

- Train control upgrades in areas of low reliability
- Yard improvements to allow faster arrivals and departures, and quicker throughput.

THREE: Investing in our People and Improving Safe, High Performance

Successful delivery of our plan will require support by a safety focussed, efficient team as we drive to be a world class operator.

An organisation-wide Health & Safety (H&S) Strategy has been developed which establishes a clear framework to deliver a safe, high performance culture, including:

- One KiwiRail H&S organisation structure.
- One KiwiRail H&S Scorecard.
- One KiwiRail Life Saving Rules.
- TalkSAFE as a One KiwiRail leadership behaviour.
- Clear and consistent One KiwiRail H&S safety messaging throughout the business.

This strategy sets out “what” KiwiRail intends to deploy to lift our internal safety performance. “How” safety improvement is delivered will be achieved in partnership with our employees and their representatives.

We will continue to educate the community about how to safely interact with our operations to help reduce the risk to themselves and our people.

FOUR: Integrated Fleet Strategy

The InterIslander team are developing a comprehensive plan to assess the future requirements of the business on the Cook Strait. This review is considering ship configuration, road bridging options for rail (to avoid the requirement for rail decked ships), freight demand, and port requirements.

We expect this exercise to be complete in late 2013 to create the blueprint for the Interislander business in the coming 10 to 20 years as the asset renewals occur. This affects all dimensions of the Cook Strait requirement – rail freight, trucks and passengers with their vehicles.

Interislander is also engaged with the Government’s feasibility study for Clifford Bay, an alternative South Island port option instead of Picton.

FIVE: A Commercial Focus for Passenger

We went to market for partners who could take on the long distance Scenic business and add value to it. We were unable to locate the right partner given the economic risks involved and as a result KiwiRail has decided to retain this business and drive it back to profitability.

All three of the long distance services are targeted as tourism experiences and that clarity has resulted in us introducing some improvements.

We have commissioned new carriages to all three services and we re-launched the Auckland to Wellington service as the Northern Explorer. We have recently announced the Coastal Pacific (between Christchurch and Picton) will be a seasonal service that will operate over the summer months each year until the market recovers sufficiently to sustain an all year round service.

The TranzAlpine (between Christchurch and Greymouth) continues to be affected by the after-effects of the Christchurch earthquakes but we expect passenger numbers to grow over the coming years as the rebuild of the city gathers momentum.

KiwiRail operates the Wellington Metro service under contract to Greater Wellington Regional Council. This contract expires in June 2016 and a decision will be made about pursuing contract renewal nearer that time.

SIX: Driving Productivity Improvements

The productivity objective is an important element of our performance strategy. We must not rely on revenue growth alone to address our financial performance and we are committed to improving on our current financial outlook. Over the past year we engaged an independent consultancy to test our planning and challenge where opportunity exists to standardise processes.

We have implemented an ideas pipeline to drive improvement initiatives across the business, with targeted benefits and timelines identified. Many of these initiatives are underway with dedicated project managers and steering committees in place. The key aim of these projects is to improve both customer service and operating efficiencies.

From this work we are continuing our efforts to drive benefits from our procurement programmes, terminal standardisation processes and front line work activities. For example, this work will give our teams more track time to do repairs and renewals.

We have also delivered restructuring benefits in the Infrastructure and Engineering, Corporate and Mechanical business units over the past two years.

SEVEN: Challenging the Support Services Model

Our support services functions are a mix of business unit owned and centrally managed teams. These cover activities such as information technology, finance, safety and human resources, insurance, communications and property management.

We have recently implemented structural changes to our finance services groups and are working across the business to ensure visibility of expenditure and outcomes of the support functions are made available to the customer facing businesses of Freight, Interislander and Passenger. From this we expect to ensure we are delivering what the business wants in a well ordered, cost efficient and considered manner.

5. Business Objectives & Performance Targets

TABLE 5.1

			SCI Horizon		
	2012 Actual	**2013 Actual**	**2014 Plan**	**2015 Plan**	**2016 Plan**
Financial Metrics ($m)					
(a) Operating revenue	715.8	727.0	769.3	797.7	816.1
(b) Grant income (metro project contributions)	172.3	181.7	72.6	26.7	16.2
(c) Operating surplus before major one-off items	104.9	108.2	120.1	143.4	160.1
(d) Net operating surplus	77.6	108.2	120.1	143.4	160.1
(e) Net Profit After Tax [1]	(2,305.1)	(174.7)	(112.4)	(119.2)	(121.5)
(f) Capital Expenditure	345.8	310.6	309.6	294.6	274.2
(g) Metro Project Capital Expenditure	143.6	149.0	26.1	-	-
(h) Metro Renewals Capital Expenditure	18.5	26.4	46.0	26.2	15.7
Key Sales Metrics					
(i) Freight Net Tonne kilometres (NTK) (m)	4,581	4,692	4,944	5,272	5,606
(j) Freight Average Yield (C/NTK)	8.00	8.20	8.37	8.40	8.42
Key Investment Outcomes					
(k) Rolling Stock Replacement [2]					
- Wagons (no. of new units)	-	360	-	175	200
- Locomotives (no. of new units)	-	20	10	10	-
(l) Network Renewals [3]					
- New Sleepers Laid (000)	105	96	83	101	104
- New Rail Laid (km)	36	25	20	17	17
- Lines Destressed (km)	242	192	180	200	200
- Span Metres Replaced	524	446	220	220	220
- Timber Piers Replaced	77	65	40	40	40
- Culverts Replaced	49	24	20	20	20
- Level Crossing Upgrades	10	8	10	10	10

	2012 Actual	2013 Actual	SCI Horizon 2014 Plan	SCI Horizon 2015 Plan	SCI Horizon 2016 Plan
Customer Service Performance					
(m) Freight – Premium Train (%<30min)	81%	89%	90%	90%	90%
(n) Metro (%<5min)	92%	94%	95%	95%	95%
(o) Scenic (%<15min)	85%	81%	87%	90%	90%
(p) Interislander (%<15min)	75%	85%	90%	91%	92%
Productivity Measures					
(q) Group Labour Costs as % of Revenue	38.6%	40.2%	38.5%	38.0%	37.6%
(r) Freight Operating Expenditure as a % of Revenue	67.3%	66.4%	62.9%	60.7%	59.6%
(s) Freight fuel & traction electricity costs as a % of Revenue	17%	16%	16%	14%	14%
(t) Freight maintenance costs as a % of Revenue	10%	10%	10%	9%	9%
(u) Interislander Operating Expenditure as a % of Revenue	87%	85%	82%	82%	83%
(v) Interislander fuel costs as a % of Revenue	22%	21%	21%	20%	20%
(w) Network operating costs % of Freight revenue	19%	19%	19%	18%	17%
Health and Safety					
(x) Lost Time Injury Frequency Rate (per million work hours)	6.1	5.5	n/a	n/a	n/a
(y) Medical Time Injury Frequency Rate (per million work hours)	46.9	37.6	n/a	n/a	n/a
(z) Total Harm	442	386	309	247	198
Staff Engagement					
(aa) Engagement Index	67	72	74	76	78
Sustainability					
(ab) Greenhouse Gas emissions per NTK from rail freight traction energy (gms) Abatement, infringement and enforcement notices under the Resource Management Act	32.5 0	32.5 0	32.7 0	30.0 0	30.0 0

Note 1: Net Profit After Tax in 2012 includes an impairment of $2,199 million resulting from the restructure of KiwiRail's balance sheet to value assets in line with their market value or the commercial return in accordance with the company's designation as a Profit Oriented Entity. Impairments will continue to be required in subsequent years until the commercial value of the Rail Cash Generating Unit is positive, but this will be at a substantially lower level.

Note 2: Year in which commitment is made to purchase rolling stock.

Note 3: The number of network renewal activities for the 2014 plan is expected to be below the levels in 2013. They have been set based on a thorough review of the network as part of our Asset Management Plan review. They are targeted to ensure we operate a safe and efficient rail network meeting the expectations of our customers while making optimal use of the capital available in the business. In some circumstances full replacement can be deferred, however, we will remain vigilant to ensure that maintenance activities are undertaken where needed.

Table 5.1

Reference	Description of Performance Measure
(a) (i) (j)	Driving revenue, particularly in the Freight division, is critical to the success of this business plan. While KiwiRail is looking for revenue improvements across all operational business units, growth is planned through volume and yield improvements on rail freight.
(b)	KiwiRail receives operating grants from the Crown to fund major metro projects and other public benefit capital items. This funding is forecast to decrease from 2013 as the major metro projects near completion.
(c) (d) (e)	Net operating surplus growth is a critical element of the funding required to deliver the investment programme we have planned. We are looking to drive operating profitability significantly over the next three years.
(f) (k) (l)	The capital plan has been separated between expenditure for the core business (Rail, Interislander and Passenger) and purpose-funded major Metro project and renewals expenditure. We have outlined a number of expected deliverables for the rolling stock and network renewals expenditure. The final number of locomotives purchased in the 2014 and 2015 years may change as we assess our actual requirements and finalise negotiations with our supplier.
(g)	The Developing Auckland Rail Transport (DART) project was substantially completed and commissioned in 2011. However, the DART programme also included a number of other lesser tasks around platform extensions, station re-developments and track re-alignments in preparation for electrification.
(h)	In addition to funding from Greater Wellington Regional Council (GWRC), $88.4 million was committed by the Crown for KiwiRail to complete an extensive refurbishment of the remaining Wellington electrical traction system and an upgrade of the associated signalling over the next eight years. Discussions are continuing with both GWRC and Auckland Transport regarding long term metro renewal and maintenance funding in parallel with performance based agreements.
(m)	Premium trains performance has improved from 82% in 2012 to 89% in 2013, close to our long run target of 90%, driven by new rolling stock introduced to these services and track upgrades to improve reliability.
(n)	The introduction of the Matangi fleet in Tranz Metro has assisted with continuous improvements to customer service to ensure a 91% or better on time performance target is achieved with an ultimate target of 95%.
(o)	Scenic passenger growth is reliant on continued improvements in customer service to ensure a top quality tourist experience, including an 87%, or better, on time performance target. During 2014 upgraded locomotives will be introduced to support the achievement of higher on time performance.
(p)	The Interislander over recent years has maintained a very high standard of time reliability. In both the 2011 and 2012 financial years this was adversely affected by disruptions related to the *Aratere* extension and upgrade. In the latter part of the 2012 financial year Interislander's reliability has returned to pre-*Aratere* extension levels creating a higher base for on-time performance at 85%. Refinements over time are expected to result in achieving a consistent on-time performance level of 90% or above.
(q) - (w)	Driving continued productivity improvements throughout our business is a fundamental element of the Strategic Plan and returning KiwiRail to financial self-sufficiency by 2020.
(x) (y) (z)	KiwiRail takes health and safety performance extremely seriously. We operate a heavy engineering transport operation that presents many risks for accident and injury. We will continue to drive the safety message and improve our workplace safety record so our staff return home as they came to work. KiwiRail has signed up to a Zero Harm programme, with significant improvements to safety targets expected over the next three years. After a review of our reporting metrics we believe a more appropriate measure to demonstrate our health and safety initiatives and impacts is "Total Harm". This represents the combined total number of lost time injuries and medical treatment injuries (rather than the frequency measure of injuries per million work hours previously used).
(aa)	Every year KiwiRail completes a staff engagement survey. Given the importance of an engaged workforce to deliver our plan, a strong engagement result is required.
(ab)	As part of its corporate responsibility commitment we plan to reduce our carbon footprint by reducing greenhouse gas emissions. A zero target for notices received under the Resource Management Act highlights the importance we place on complying with environmental law in our activities.

BUSINESS UNIT FORECASTS

KiwiRail has committed to providing greater segment visibility of our business. To that end, we have included key financial measures for our business units in the following table:

Table 5.2

			SCI Horizon		
	2012 Actual	**2013 Actual**	**2014 Plan**	**2015 Plan**	**2016 Plan**
BUSINESS UNIT SUMMARY ($m)					
(a) Operating Revenue					
Rail Freight					
Freight	426.9	432.5	465.6	495.4	526.4
Infrastructure & Engineering [1]	40.0	51.1	35.7	36.5	37.4
Corporate & Property	36.2	36.9	38.5	40.1	41.7
	503.1	**520.5**	**539.9**	**572.0**	**605.5**
Interislander	160.4	159.6	163.4	166.6	170.5
Scenic	20.4	20.2	20.5	22.5	24.9
Tranz Metro	45.8	43.8	46.7	48.9	50.4
Metro Maintenance	50.6	51.3	55.5	45.6	24.1
Inter-Business Unit Revenue elimination	(64.5)	(68.4)	(56.7)	(57.9)	(59.3)
Group External Revenue	**715.8**	**727.0**	**769.3**	**797.7**	**816.1**
(b) Net Operating surplus before major one-off items					
Rail Freight					
Freight	139.7	146.9	172.7	194.9	212.8
Infrastructure & Engineering [1]	(35.8)	(36.7)	(50.5)	(51.5)	(52.6)
Corporate & Property [2]	(26.6)	(34.4)	(37.4)	(36.3)	(35.2)
	77.3	**75.8**	**84.8**	**107.2**	**125.1**
Interislander	20.5	24.3	29.2	29.6	29.2
Scenic	(3.6)	(1.5)	(2.3)	(1.5)	0.3
Tranz Metro	3.9	3.9	3.5	3.7	3.8
Metro Maintenance	6.8	5.7	4.9	4.3	1.7
	104.9	**108.2**	**120.1**	**143.4**	**160.1**

			SCI Horizon		
	2012 Actual	2013 Actual	2014 Plan	2015 Plan	2016 Plan
(c) Capital Expenditure (excluding Metro projects and renewals)					
Rail Freight					
Freight	84.4	104.9	95.9	94.7	75.3
Infrastructure & Engineering	192.0	169.7	148.4	154.4	171.7
Corporate & Property	23.7	27.0	51.9	37.1	20.8
	300.1	**301.6**	**296.2**	**286.2**	**267.7**
Interislander	30.9	4.5	12.4	7.1	5.2
Scenic	14.8	4.5	1.0	1.3	1.3
Tranz Metro	-	-	-	-	-
	345.8	**310.6**	**309.6**	**294.6**	**274.2**

Note 1: The Infrastructure and Engineering business unit comprises the Network operations and mechanical workshops in Lower Hutt and Dunedin (closed in 2013).

Note 2: During the year the structure of business support functions throughout the Group was reviewed. This resulted in a number of activities being moved into the Corporate Business Unit to centrally support operating business units. This included functions related to Finance, Safety and Training. These costs are not, at this time, recharged to business units and accordingly EBITDA is not strictly comparable between 2012, 2013 and 2014.

6. Shareholder Equity Funding

In May 2010 the Government announced its support for KiwiRail's transformation with a $750 million equity investment. By June 2013 all of this funding had been drawn on.

The capital projects underlying the Crown's first three years of investment included:

- Extending and upgrading the MV *Aratere* by inserting a 30 metre section of hull structure into the middle of the ship, replacing the bow and propellers and upgrading the ship's power supply
- Part of the Network upgrades and renewals programme
- The purchase of container flat top freight wagons and containers
- Part of the refurbishment programme for existing locomotives and wagons
- Part of the information technology and property refurbishment investment programme.

The crown has approved a further $94m equity funding for 2014 in line with our budget submission request.

Funding Assumptions for 2015 and 2016

The financial forecasts and performance measures included in Tables 5.1 and 5.2 are based on a number of important funding and capital structure assumptions.

The plan to turnaround KiwiRail's financial performance assumed the Crown invests approximately $1.1 billion to support the 10-year $3.1 billion (excluding Metro projects and renewals) capital programme. The Government has now appropriated $844 million of equity funding.

For the balance, we are continuing discussions with the Government on funding arrangements beyond 2014. As these discussions are on-going we have prepared this Statement assuming the Crown provides $122 million in equity funding in the 2015 financial year and $81 million in 2016. It is important to note, however, that the Government has made no commitment to the un-appropriated funding at the time this Statement was prepared. We will actively work with the Government to explore the most efficient way of meeting these funding requirements.

7. SOE Performance Measures

Table 7.1

SOE Performance Targets[1]	2012 Actual [2]	2013 Actual	2014 Plan	2015 Plan	2016 Plan
			SCI Horizon		
Shareholder Return Measures					
Total Shareholder Return [3]	n/a	n/a	n/a	n/a	n/a
Dividend Yield	Nil	Nil	Nil	Nil	Nil
Dividend Payout	Nil	Nil	Nil	Nil	Nil
Return on Average Equity	-28.5%	-35.7%	-19.4%	-20.9%	-22.0%
Return on Average Equity excluding IFRS fair valuation movements and asset revaluations	-189.4%	-33.8%	-21.6%	-23.3%	-24.6%
Profitability/Efficiency Measures					
Return on Average Capital Employed	-144.9%	-16.6%	-12.9%	-13.1%	-12.7%
Operating Margin	10.8%	14.9%	15.6%	18.0%	19.6%
Leverage/Solvency Measures					
Shareholder's Funds to Total Assets	81.2%	58.2%	56.1%	53.5%	49.9%
Gearing Ratio (net)	14.9%	27.1%	43.3%	48.3%	61.7%
Interest Cover	2.3	7.1	8.5	9.5	9.7
Solvency (current assets/current liabilities)	0.33	1.30	0.93	0.89	1.11

Note 1: Performance measures are defined in Appendix 2

Note 2: 2012 Performance measures reflect the KiwiRail Group structure prior to the balance sheet restructure.

Note 3: As the Commercial valuation for KiwiRail is negative, this measure is not considered meaningful.

8. Commercial Value of the Crown's Investment

The Board has used the method of discounted cash flows (DCF) to estimate the value of the KiwiRail Group as at 30 June 2013.

There has been a reduction in the commercial value related to operating free cash flows of $460 million. Over half the value erosion is directly as a consequence of reduced volume projections from Solid Energy as well as uncertainty on the renegotiation of the Solid Energy carriage contract. The balance of the reduction reflects general growth confidence risk. We will continue to seek mitigations to the downside issues and keep our shareholder informed of opportunities or associated issues.

Overall, however, the DCF Equity Value has improved on prior year by $141 million. Non-operating items of improved tax and debt position have more than offset the operating free cash flow reduction.

The change in the present value of tax payable results from a combination of reduced projected earnings and a higher tax depreciation base. The higher tax depreciation base is due partly to a change in the assets vested from NZRC (from that assumed in the prior year SCI) and partly related to new tax legislation supporting the restructure. Based on the current earnings projections, it is not expected that the Group will be tax paying in the projected earnings period.

Net Debt decreased by $351 million compared to 30 June 2012. The balance at 30 June 2013 includes $178.5 million of outstanding loans with the Government Debt Management Office compared to $498.5 million at 30 June 2012. This reduction is predominantly due to the conversion of $322.5 million debt to equity on 16 July 2012.

An increase in the risk free rate has resulted in an increase in the discount rate used in determining the DCF. The impact of this is a reduction in value of $14 million.

$m	30 June 2012	30 June 2013
Present Value of Pre-Tax Free Cash Flows	33	(427)
Less Present Value of Tax Payable on Ungeared Earnings	(250)	0
DCF Enterprise Value	**(217)**	**(427)**
Less Net Debt	(498)	(147)
DCF Equity Value	**(715)**	**(574)**

The key points about the manner in which this valuation was derived are as follows:

- The DCF methodology used to calculate the Net Present Value (NPV) of the entire KiwiRail Group includes all subsidiaries on an after tax basis.
- The DCF / NPV was based on the nominal (ie inflation-adjusted) future cash flows set out in KiwiRail's three year Business Plan, with forward projections made through years 4 to 20 consistent with the revised strategic plan.
- A terminal value of $118 million has been included.
- An annual growth assumption of 3% has been assumed in the terminal value.
- A discount rate of 9.8% has been used (as compared to 9.3% for the 2012 valuation).
- PwC has confirmed the mathematical accuracy of the calculation of the DCF valuation prior to approval of the DCF value by the Board

9. Accounting Policies

The Corporation's detailed accounting policies are set out in Appendix One: Statement of Current Accounting Policies.

10. Dividend Policy

The Strategic Plan requires significant investment over a 10-year period. A significant amount of that investment is from the Shareholder. As such KiwiRail does not expect to make any dividend payments over the period of this Statement.

11. Reporting to Shareholding Ministers

KiwiRail will provide to Shareholding Ministers:

- An Annual Report and Half Yearly Report in accordance with sections 15 and 16 of the State-Owned Enterprises Act 1986. These will include a statement of financial performance, a statement of financial position, a statement of cash flows and such details as are necessary to permit an informed assessment of the Corporation's performance
- Continuous Disclosure reporting as required by the Crown Ownership Monitoring Unit (COMU)
- Regular reporting to COMU for performance monitoring during the Strategic Plan investment period
- Other information requested by Ministers in accordance with section 18 of the State-Owned Enterprises Act 1986.

12. Procedures for Share Acquisitions

Purchase of shares in any company or interests in any other organisation will be subject to prior agreement with Ministers in accordance with the New Zealand Railways Corporation Act 1981 and the State-Owned Enterprises Act 1986 which provides that KiwiRail may, from time to time, with the approval of the Minister of Finance, subscribe for or otherwise acquire stocks, debentures, or any interest in any company, body corporate or business.

13. Compensation from The Crown

KiwiRail expects to receive compensation from the Crown as per section 7 of the State-Owned Enterprises Act 1986 for public policy work and projects undertaken by the corporation which have a public good element or purpose and would not be undertaken on purely commercial grounds.

14. APPENDIX 1: Statement of Current Accounting Policies

REPORTING ENTITY

KiwiRail Holdings Limited ("KiwiRail", "the Parent") is a company domiciled in New Zealand, registered under the Companies Act 1993 and is included within the First Schedule of the State Owned Enterprises Act 1986. The Group comprises KiwiRail Holdings Limited and its subsidiaries. The Parent and the Group have been designated as a Profit Oriented Entity ("POE").

The primary objective of the Group is to establish, maintain and operate, or otherwise arrange for, safe and efficient rail, road and ferry freight and passenger transport services within New Zealand in such a way that revenue exceeds costs, including interest and depreciation; and to provide for a return on capital as specified by the Minister of Finance from time to time.

Change of accounting designation

The Group's balance sheet valuations previously reflected the view that its assets were held for a public benefit rather than to generate a commercial return. At KiwiRail's annual public meeting in November 2011, it was announced that a change in accounting approach would be made to reflect a more standard commercial approach to non-land asset valuations and impairment testing. This change reflects the shareholder's requirement that the Group maximise cash flow generated from assets other than rail corridor land. Cash generating units ("CGUs") to which the assets are allocated are therefore required to be impairment tested on the basis of the commercial returns they are forecast to generate. This has resulted in the recorded value of affected assets being significantly reduced to values supported by forecast future cash flows. This change has been accounted for as a change in assessment of assets from non-cash generating to cash generating.

After consultation between New Zealand Railways Corporation Directors and Ministers of the Crown (acting as shareholders of the Group) it was determined by the shareholder and publically announced (27 June 2012) that the following structural changes were to be made:

a) A new company, KiwiRail Holdings Limited (which is an SOE) has been established at 31 December 2012 to hold all the rail assets and liabilities currently held in the Group, excluding Crown land that is currently made available to the Parent of the Group under its legislation. Assets to be transferred to the new SOE include all rolling stock, tracks, railway infrastructure, ships, plant and equipment, buildings and all shares in subsidiaries. KiwiRail Holdings Limited is classified as a Profit Oriented Entity ("POE") for accounting purposes, and its assets are therefore valued and impairment tested on a commercial basis. The Group's rail assets and liabilities have been vested in the new company as at 31 December 2012. The vesting of rail assets and liabilities used a statutory procedure under the New Zealand Railways Corporation Restructuring Act 1990 for which the shareholder is providing its support.

b) An agreement has been entered to enable the Crown land that was previously made available to New Zealand Railways Corporation to be made available to KiwiRail Holdings Limited to continue to fulfil its objectives as a rail operator.

c) Appropriate cash generating units have been defined for impairment testing in accordance with POE accounting guidelines to ensure transparent reporting of the performance of the new company and to ensure the appropriate valuation of assets consistent with the commercial return they generate.

As the decision by the shareholder was made public prior to the end of the financial year, the impact of this decision was reflected in the Financial Statements as at 30 June 2012. The consequences of this are:

a) Fixed and Intangible Assets at 30 June 2012 are reflected in the financial statements at their recoverable amount being the higher of value in use or fair value less cost to sell, with value in use being the present value of future cash flows. Where the recoverable amount of the asset is below net book value, an impairment has been recognised. The impairment is first applied against any revaluation reserve and then against the statement of financial performance if the revaluation reserve is insufficient.

b) The following cash generating units have been established:

i) Rail Freight (which includes the Metro and Scenic businesses);

ii) Interislander; and

iii) Leased buildings.

BASIS OF PREPARATION

Statement of compliance

The financial statements have been prepared in accordance with New Zealand Generally Accepted Accounting Practice and comply with the State-Owned Enterprises Act of 1986 and New Zealand equivalents to International Financial Reporting Standards ("NZ IFRS") and other applicable financial reporting standards.

Measurement base

The financial statements have been prepared on the basis of historical cost, modified by the revaluation of certain non-current assets and certain financial instruments (including derivative instruments).

Cost is based on the fair value of the consideration given in exchange for assets at the date of the transaction.

Accounting policies are selected and applied in a manner which ensures that the resulting financial information satisfies the concepts of relevance and reliability, thereby ensuring that the substance of the underlying transactions or other events is reported.

Unless otherwise specified, all dollar amounts in these financial statements and accompanying notes are stated in New Zealand dollars and all values are expressed in millions of dollars ($m). The functional and presentation currency is New Zealand dollars.

Changes in accounting policies

As noted above the Group was formed as a result of the restructure on 31 December 2012. The accounting policies previously applied by the New Zealand Railways Corporation have also been adopted by KiwiRail Holdings Limited, with the following changes made to reflect the change from a public benefit to a profit oriented entity.

(i) Capitalisation of finance costs on acquisition of qualifying assets (see (e) below).

NATURE OF BUSINESS AND PRINCIPAL ACTIVITIES

The Group carries out the following activities:

- Manage and operate the New Zealand Rail Network
- Provide rail operators with access to the rail network
- Provide advice to the Crown on rail infrastructure issues
- Manage land on the rail corridor
- Operate interisland ferries
- Operate Wellington Metro and long distance rail passenger services
- Operate rail freight transport services in New Zealand
- Carry out engineering and mechanical services to the locomotives and other rolling stock

ESTIMATION UNCERTAINTY

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenues and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

Estimates and underlying assumptions are reviewed on an on-going basis. Revisions of accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

Asset revaluations

The remaining useful lives of property, plant and equipment represents management's best estimates of the useful lives of individual asset classes. When assets are revalued the valuers provide updated expected remaining useful lives for the assets that have been revalued.

Employee entitlements

Independent actuaries are engaged to provide the valuation of employee entitlements. Reliance is placed on the expertise of the independent actuaries to provide accurate valuations of employee benefits. The two key assumptions used in calculating this liability include the discount rate and the salary inflation factor. The discount rate is the yield on 10 year Government bonds as at the end of the financial year, which have terms to maturity that match, as closely as possible, to the estimated future cash outflows. The salary inflation factor is determined with consideration of historical salary inflation patterns.

Inventory obsolescence

Management relies on its knowledge of the business to calculate inventory obsolescence provisions. The bulk of inventory held is spare parts for rolling stock and the network. Due to the age of these assets the parts held are often old and management relies on its knowledge of the business to identify items of inventory that are truly obsolete.

SIGNIFICANT ACCOUNTING POLICIES

The following accounting policies have been consistently applied to all reporting periods presented in these financial statements.

(a) Consolidated financial statements

The consolidated financial statements of the Parent and its subsidiaries include the financial statements of subsidiary companies using the acquisition method of consolidation. The acquisition method of consolidation involves adding together like items of assets, liabilities, equity, income and expense on a line by line basis from the date that control commences to the date that control ceases and eliminating all significant intra-group balances and transactions. Subsidiary companies are those entities that are controlled directly or indirectly by the Parent.

The Parent values subsidiary companies at the time of acquisition as the identifiable assets and liabilities acquired measured at the aggregate of fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Unrealised losses relating to impairment of subsidiaries are recognised in the Statement of Financial Performance.

(b) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable by the Parent and Group and represents amounts receivable for goods and services provided in the normal course of business once significant risk and rewards of ownership have been transferred to the buyer after eliminating the sales within the Group.

(i) Freight revenue is recognised based on the date of freight acceptance. Freight revenue also includes maintenance revenue which is recognised at the date that the maintenance service is provided.

(ii) Interislander revenue is comprised of freight revenue and passenger revenue. Freight revenue is recognised based on the date of freight acceptance. Passenger revenue is recognised at the date of travel.

(iii) Tranz Metro and Scenic revenue is recognised at the date of travel.

(iv) Property and Corporate revenue comprises rental income, Government funding for operating expenditure and other revenue. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging the operating lease are recognised on a straight-line basis over the lease term.

(v) Infrastructure and Engineering revenue comprises track access revenue, Government funding for operating expenditure, manufacturing revenue, maintenance revenue and other revenue. Track access revenue is recognised on a straight-line basis over the term of the relevant agreement. Manufacturing revenue is recognised by reference to the stage of completion of the contract activity at the balance date, if the outcome of the contract can be reliably estimated. The stage of completion is assessed by reference to surveys of work performed. Manufacturing revenue includes revenue from design services. Maintenance revenue is recognised at the date that the maintenance service is provided.

(vi) Interest income from call and term deposits is recognised as it accrues, using the effective interest method.

(vii) Dividend income is recognised when the right to receive payment has been established.

(viii) Other sources of income are recognised when earned and are reported in the financial periods to which they relate.

(ix) Government funding received as reimbursements of operating costs are recognised as income in the period in which the funding is receivable.

(x) Government funding received as reimbursements of the costs of capital projects is recognised as income in the period in which the funding is receivable.

(xi) Grants received in respect of services provided are recognised when the requirements of the relevant grant agreement are met.

(c) Property, plant and equipment

(i) Recognition and Measurement

Property, plant and equipment asset classes consist of buildings, railway infrastructure, rolling stock, ships and plant and equipment.

Property, plant and equipment are shown at cost or valuation, less any accumulated depreciation. Items of property, plant and equipment in the course of construction are classified as capital work in progress. Cost includes expenditure that is directly attributable to the acquisition of the asset.

Where an asset is acquired for nil or nominal consideration the asset is recognised initially at fair value, where fair value can be reliably determined; and the fair value of the asset received less costs incurred to acquire the asset is also recognised as income in the Statement of Financial Performance.

(ii) Revaluation

Buildings and railway infrastructure are revalued with sufficient regularity to ensure that the carrying amount does not differ materially from fair value. Fair value is determined from market-based evidence by an external, independent valuer. Valuations are undertaken in accordance with the standards issued by the New Zealand Property Institute with the following bases of valuation adopted:

- *Specialised buildings and railway infrastructure* –valued using optimised depreciated replacement cost.
- *Non-specialised buildings* which could be sold with relative ease are valued at market value.

Any revaluation increase arising on the revaluation of buildings and railway infrastructure is credited to the asset revaluation reserve, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense in the Statement of Financial Performance, in which case the increase is credited to the Statement of Financial Performance to the extent of the decrease previously charged. A decrease in carrying amount arising on the revaluation of buildings or railway infrastructure assets is charged as an expense to the Statement of Financial Performance to the extent that it exceeds the balance, if any, held in the asset revaluation reserve relating to a previous revaluation of that asset.

Other additions between revaluations are recorded at cost.

(iii) Disposals

Realised gains and losses arising from the disposal of property, plant and equipment are recognised in the Statement of Financial Performance in the period in which the transaction occurs. The gain or loss is calculated as the difference between the carrying amount of the asset and the sale proceeds received (if any). Any balance attributable to the disposed asset in the asset revaluation reserve is transferred to retained earnings.

(iv) Impairment.

The carrying amounts of the Group's non-current assets are reviewed at each reporting date to determine if there is any indication of impairment. If any such indication exists, the asset or its related cash-generating unit (CGU) will be tested for impairment by comparing its recoverable amount to its carrying amount. The recoverable amount of an asset or CGU is the higher of its value in use and its fair value less costs to sell.

Where the future economic benefits or service potential of the asset are not primarily dependent on the asset's ability to generate net cash inflows and where the Group would, if deprived of the asset, replace its remaining future economic benefits or service potential, the value in use is the depreciated replacement cost.

The value in use for cash-generating assets and cash-generating units is the present value of expected future cash flows.

If an asset's carrying amount exceeds its recoverable amount the asset is impaired and the carrying amount is written down to the recoverable amount. For revalued assets the impairment loss is treated as a revaluation decrease (see c(ii) above).

For assets not carried at a revalued amount, the total impairment loss is recognised in the Statement of Financial Performance.

Plant and equipment, motor vehicles, leasehold improvements and equipment under finance leases are stated at cost less accumulated depreciation and impairment. In the event that settlement of all or part of the purchase consideration is deferred, cost is determined by discounting the amounts payable in the future to their present value as at the date of the acquisition.

(v) Renewals

Expenditures, including inventory, relating to track renewals, ballast, formation upgrading, and major overhauls of rolling stock are capitalised as fixed assets. Repairs and maintenance costs are expensed through the Statement of Financial Performance as incurred.

(vi) Depreciation

Depreciation is charged on a straight line basis at rates that will allocate the cost or valuation of the asset over its expected useful life to its estimated residual value. Leasehold improvements are depreciated over the period of the lease or estimated useful life, whichever is the shorter. In determining an asset's useful life, consideration is given to its expected usage, its expected wear and tear, technical or commercial obsolescence, and legal or similar limits on its use.

Depreciation is provided on freehold buildings, railway infrastructure, rolling stock, ships and containers, plant and equipment, but excludes land.

Depreciation on revalued buildings and track assets is charged to the Statement of Financial Performance. On the subsequent sale or retirement of a revalued property, the attributable revaluation surplus remaining in the asset revaluation reserve, net of any related deferred taxes, is transferred directly to retained earnings.

For assets that are revalued, any difference between the depreciation on the revalued asset value and the depreciation based on the original cost is transferred from the asset revaluation reserve to retained earnings.

The average depreciable lives for major categories of property, plant and equipment are as follows:

Category	Useful life
Infrastructure	
Tunnels & bridges	75 – 200 years
Track & ballast	40 – 50 years
Overhead traction	20 – 80 years
Signals & communications	15 – 50 years
Buildings	35 – 80 years
Rolling stock and ships	
Wagons & carriages	5 – 30 years
Locomotives	5 – 23 years
Ships	20 years
Containers	10 years
Plant and Equipment	
Plant & equipment	5 – 35 years
Motor vehicles	5 – 10 years
Furniture & fittings	5 years
Office equipment	3 – 5 years

(d) Valuation of intangible assets

Intangible assets comprise software applications which have a finite useful life and are recorded at cost less accumulated amortisation and impairment.

Intangible assets are recognised initially at cost. Intangible assets with a finite useful life are amortised on a straight-line basis over their estimated useful lives, which were 3 to 5 years for all reporting periods.

(e) Net Finance Costs

Borrowing costs – Interest expense on borrowings is recognised in the Statement of Financial Performance using the effective interest rate method.

Other finance costs include interest expense on finance leases and the net change in fair value of derivative financial instruments.

Where borrowing costs, including interest and finance costs, are incurred in the acquisition of a qualifying asset, they are capitalised into the cost of the asset acquired.

(f) Inventories

Inventory comprises items that are used in the maintenance and operation of the rail network, fuel, passenger consumable items, and items used in the manufacture of assets for sale to external parties. Inventory is not held for trading purposes with the exception of consumable cafeteria supplies held on the rail and ferry passenger services.

Inventory is recorded at the lower of cost and current replacement cost. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventory to its present condition and location. Cost is calculated on the weighted average method.

(g) Leases

Operating leases

Operating leases are defined as leases under which substantially all the risks and rewards of ownership of the applicable asset or assets remain with the lessor. Operating lease payments and receipts are recognised in the statement of financial performance in accordance with the pattern of benefits derived or received.

Finance leases

Leases in which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Finance lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The interest expense component of finance lease payments is recognised in the Statement of Financial Performance using the effective interest rate method. Assets acquired by way of a finance lease are included in property, plant and equipment, initially at an amount equal to the lower of its fair value and the present value of the future minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

(h) Income tax

Income tax expense comprises both current and deferred tax. Income tax expense is charged or credited to the Statement of Financial Performance, except when it relates to items charged or credited directly to equity, in which case the tax is charged to equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at reporting date and any adjustments to tax in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the carrying amounts used for taxation purposes.

The amount of deferred tax provided is based on the expected manner of realisation of the asset or settlement of the liability, using tax rates enacted or substantively enacted at each reporting date. Deferred tax assets and liabilities are not discounted.

A deferred tax asset is recognised in the financial statements for all deductible temporary differences and for the carry forward of unused tax losses and unused tax credits only to the extent that it is probable that future taxable surpluses will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Unrecognised deferred tax assets are reassessed at each balance sheet date.

(i) Goods and services tax (GST)

All items in the financial statements are presented exclusive of GST, except for receivables and payables, which are presented on a GST inclusive basis. Where GST is not recoverable as an input tax it is recognised as part of the related asset or expense.

The net amount of GST recoverable from, or payable to, the Inland Revenue Department (IRD) is included as part of receivables or payables in the Statement of Financial Position.

Cash flows are included in the statement of cash flows on a net basis in respect of GST. The GST components of cash flows arising from investing and financing activities, which are recoverable from, or payable to, IRD, are classified as operating cash flows.

(j) Provisions

Provisions are recognised when the Group has a present or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are measured at the present value of the expenditure expected to be required to settle the obligation.

If the effect of the time value of money is material, provisions are determined by discounting the future cash flows. Where discounting is used, the increase in the provision for the passage of time is recognised as a finance cost.

(k) ACC Partnership Programme

KiwiRail Holdings Limited and KiwiRail Limited belong to the ACC Partnership Programme whereby each company accepts the management and financial responsibility for employee work related accidents. Under the programme the employer is liable for all its claims costs for a period of four years up to a specified maximum. At the end of the four year period a premium is paid to ACC for the value of residual claims, and from that point the liability for on-going claims passes to ACC.

The liability for the ACC Partnership Programme is measured annually by independent actuaries using actuarial techniques at the present value of expected future payments to be made in respect of the employee injuries and claims up to the reporting date. Consideration is given to anticipated future wages and salary levels and experience of employee claims and injuries. Expected future payments are discounted using market yields on secondary market Government bond yields at balance date with terms to maturity that match, as closely as possible, the estimated future cash outflows.

(l) Employee entitlements

Provision is made for benefits accruing to employees in respect of annual leave, retiring leave, long service leave and sick leave when it is probable that settlement will be required and they are capable of being measured reliably.

The provision for retiring leave, long service leave and sick leave is calculated on an annual basis by independent actuaries.

Provisions made in respect of employee benefits expected to be settled within twelve months, are measured at their nominal values using the remuneration rate expected to apply at the time of settlement.

Provisions made in respect of employee benefits which are not expected to be settled within twelve months are measured on an actuarial basis at the present value of the estimated future cash outflows to be made by the consolidated entity in respect of services provided by employees up to the reporting date.

Employee entitlements to salaries and wages, annual leave, long service leave and other similar benefits are actuarially valued on an annual basis and are recognised in the Statement of Financial Performance when they accrue.

(m) Contributions to superannuation plans

Certain employees are members of defined contribution schemes and the Group contributes to those schemes. A defined contribution scheme is a plan under which the employee and the Group pay fixed contributions into a separate entity. The Group has no legal or constructive obligation to pay further contributions in relation to employee service in the current and prior periods. The contributions are recognised as labour and related costs in the Statement of Financial Performance when they are due.

(n) Joint Venture

A joint venture is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. The Group is party to a joint venture arrangement with Northland Regional Council. For these jointly controlled operations the Group recognises in its financial statements the Group's share of the assets, liabilities, revenues and expenses using the proportional consolidation method. This represents a change in accounting policy from the prior year as the impact of accounting for the arrangement in this way was not previously considered to be material to the financial statements.

(o) Financial assets

Financial assets comprise cash and cash equivalents trade receivables and derivative financial assets. Derivatives are measured at fair value through profit and loss unless they are hedge accounted. Trade receivables are classified as loans and receivables and are carried at amortised cost using the effective interest method. Loans and receivables are not discounted due to their short-term nature.

Financial assets are recognised and derecognised on the trade date where the purchase or sale of a financial asset is under a contract whose terms require delivery of the financial asset within the timeframe established by the market concerned, and are initially measured at fair value, net of transaction costs except for those financial assets classified as at fair value through profit or loss which are initially measured at fair value.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, call deposits and other investments with an initial term of less than 3 months.

Impairment of financial assets

Financial assets, other than those at fair value through profit or loss, are assessed for indicators of impairment at each balance date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that have occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment has been impacted. For financial assets carried at amortised cost, the amount of the impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables where the carrying amount is reduced through the use of a doubtful debt provision. When a trade receivable is uncollectible, it is written off against the doubtful debt provision. Subsequent recoveries of amounts previously written off are credited to the Statement of Financial Performance. Changes in the carrying amount of the doubtful debt provision are recognised in the Statement of Financial Performance.

(p) Financial liabilities

Financial liabilities are classified as either financial liabilities at 'fair value through profit or loss' or 'at amortised cost'.

Payables

Payables are recognised when the Group becomes obliged to make future payments resulting from the purchase of goods and services. Payables are initially measured at fair value and subsequently measured at amortised costs using the effective interest rate method.

Borrowings

Borrowings are initially measured at fair value, net of transaction costs. Borrowings are subsequently measured at amortised cost using the effective interest method, with the interest expense recognised on an effective yield basis. The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for more than 12 months after the balance sheet date.

(q) Derivative financial instruments and hedging activities

The Group uses derivative financial instruments within predetermined policies and limits in order to manage its exposure to fluctuations in foreign exchange, commodity and interest rate risks. The Group does not engage in speculative transactions or hold derivative financial instruments for trading purposes.

To manage this exposure the Group uses the following derivative financial instruments:

Foreign exchange forward contracts and options

Interest rate swaps

Fuel commodity hedges

Derivative financial instruments are initially recognised at fair value on the date a derivative contract is entered into (the trade date). Any transaction costs are expensed immediately. The derivative financial instruments are subsequently re-measured to fair value. The method of recognising the resulting gain or loss depends on whether the derivative financial instrument is designated as a hedging instrument, and, the nature of the item being hedged.

Gains and losses, and movements in fair values of derivative financial instruments not in hedging relationships are recognised in the Statement of Financial Performance as follows:

Foreign exchange forward contracts and options excluding contracts relating to fuel purchases– as part of ‘Foreign exchange and commodity net gains and losses’

Interest rate swaps – as part of ‘Net finance costs’

Fuel related foreign exchange forward contracts and fuel commodity hedges – as part of ‘Operating expenses’

The risk management objectives and strategy for undertaking various hedge transactions is covered by the Group Treasury Policy. The Group documents, at the inception of the transaction, the hedging relationship between hedging financial instruments and the hedged items. The Group also documents its assessment, both at hedge inception and on an on-going basis, of whether the derivatives used in the hedging transaction are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of derivative financial instruments is classified as a non-current asset or liability when maturity of the hedged item exceeds 12 months. It is classified as a current asset or liability when the maturity of the hedged item is less than 12 months.

Cash flow hedges

Changes in the fair value of derivative financial instruments designated as cash flow hedges are recognised in the statement of comprehensive income and the cash flow hedge reserve within equity to the extent that the hedges are deemed effective. To the extent that the hedges are ineffective for accounting, changes in fair value are recognised in the Statement of Financial Performance in Foreign exchange and commodity net gains and losses.

If a derivative financial instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, or the designation of the hedge relationship is revoked or changed, then hedge accounting is discontinued. The cumulative gain or loss previously recorded in the cash flow hedge reserve remains there until the forecast transaction occurs. If the underlying hedged transaction is no longer expected to occur, the cumulative, unrealised gain or loss recognised in the cash flow hedge reserve with respect to the derivative instrument is recognised immediately in the Statement of Financial Performance.

Where the hedge relationship continues throughout its designated term, the amount in the cash flow hedge reserve is transferred to the carrying value of the asset when it is recognised.

(r) Foreign currency translation

Foreign currency transactions are translated to New Zealand currency at the exchange rates ruling at the transaction date.

Monetary assets and liabilities in foreign currencies at balance date are translated at exchange rates ruling at balance date. All exchange differences arising on the translation of monetary assets and liabilities in foreign currencies, whether realised or unrealised, are recognised in the Statement of Financial Performance, except when deferred in equity as qualifying cash flow hedges.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items in a foreign currency that are measured based on historical costs are translated using the exchange rate at the date of the transaction.

NEW STANDARDS ADOPTED

The Group has adopted the following new and amended NZ IFRS as of 1 July 2012:

- *NZ IAS 1 Presentation of Financial Statements* (revised 2011) amends the presentation of items in the statements of financial performance and comprehensive income. The changes came into effect for financial reporting periods beginning on or after 1 July 2012. The changes do not impact the way that items of comprehensive income are accounted for, only their presentation in the financial statements. The adoption of this standard has not had any material impact on the consolidated financial result of the Group.

NEW STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

The following standards and amendments were available for early adoption but have not been applied by the Group in the preparation of these financial statements:

- *NZIFRS 9 Financial Instruments* (revised 2010) is the first standard issued as part of a wider project to replace NZIAS39 and is effective for reporting periods beginning on or after 1 January 2013. The revised standard amends measurement categories for financial assets. It is not expected to have any impact on the consolidated financial results of the Group.

15. APPENDIX 2: SOE Performance Measure Supporting Definitions

Definitions of SOE Performance Measures

Total Shareholder Return	(Commercial Value$_{end}$ *less* Commercial Value$_{beg}$ *plus* dividends paid *less* equity injected) *divided by* Commercial Value$_{beg}$
Solvency	Current Assets divided by Current Liabilities
Dividend Yield	The cash returned to the shareholder as a proportion of the value of the company.
Dividend Payout	Proportion of net operating cash flows paid out as a dividend to the shareholder after allowance is made for capital maintenance.
Return on Average Equity	NPAT divided by Total Average Equity before Cashflow Hedge Reserve
Return on Average Capital Employed	EBIT divided by Total Average Equity before Revaluation Reserve and Interest bearing liabilities
Operating Margin	Operating surplus after one-off items and gross fair value adjustment divided by Total Revenue
Shareholder's Funds to Total Assets	Total Equity divided by Total Assets
Gearing ratio (net)	Net Debt divided by Total Equity
Interest cover	Operating Surplus before net Fair Value Adjustments divided by Interest Expense on Borrowings
Solvency	Current Assets divided by Current Liabilities

Supporting Financial Definitions

Average Capital	Total equity before revaluations averaged over opening and closing equity for the period
Average Equity	Total equity averaged over opening and closing equity for the period.
EBIT	NPAT before interest, taxation, grant income, derivatives fair value change and gross fair value adjustments.
IFRS Fair Value Adjustment	The value of financial derivatives movement recognised in the Profit and Loss Statement net or gross of taxation.
Net Debt	Face value of borrowings less cash and cash equivalents.
Net Profit after Tax (NPAT)	Reported net profit after taxation
One-off items	Items that because of their nature or incidence should be adjusted in order to assist understanding of the underlying business performance.
Total Assets	Current assets plus non-current assets
Total Equity	Total shareholder’s funds including share capital, retained earnings, revaluation and cashflow hedge reserves.

16.APPENDIX 3: Subsidiaries and Associated Companies

The terms share and subsidiary have the same meanings as in section 2 of the State-Owned Enterprises Act 1986.

1. The Corporation shall ensure at all times that:
   - Control of the affairs of every subsidiary of the Corporation is exercised by a majority of the Directors of that subsidiary; and
   - A majority of the Directors of every subsidiary of the Corporation are persons who are also Directors of the Corporation, Executives of the Corporation, Executives of a subsidiary of the Corporation, or who have been approved by the shareholding Ministers for appointment as Directors of the subsidiary.
2. Without consulting shareholding Ministers, neither the Corporation nor its subsidiaries shall sell or otherwise dispose of, whether by single transaction or any series of transactions, and whether by a sale of assets or shares, the whole or any part of the business, if:
   - That which is to be sold, or disposed of, is valued at more than five percent of the Shareholder's equity in the Corporation; or
   - The sale or disposal will materially reduce the nature and scope of the business as recorded in Section 3 of the Statement of Corporate Intent

17.APPENDIX 4: Consultation

KiwiRail will consult with its Shareholding Ministers on matters that would have a material effect on the scale, scope, financial return or risk of the activities of the Corporation or its subsidiaries, including:

(a) Any substantial capital (or equity) investment
(b) The sale or disposal of the whole or any substantial part of the corporation or its subsidiaries
(c) Any substantial expansion of activities outside the scope of its business as defined in Section 3 of the Statement of Corporate Intent
(d) Any other significant transactions.