

# Sustainable & Inclusive Growth for New Zealand





Diggers at work clearing a slip on the Main North Line

Front cover image: Rebecca Hauck, Rail Operator

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# Contents

<b>Who We Are and What We Do</b> .....	5
<b>Introduction</b> .....	6
<b>Nature and scope</b> .....	8
<b>Market Outlook and Economic Assumptions</b> .....	8
Sector Outlook .....	9
Earthquake Recovery and ongoing resilience .....	10
<b>Our Strategic Priorities</b> .....	11
Sustaining a Zero Harm environment .....	11
Engaging our customers and stakeholders - customer strategy .....	13
Developing operational performance .....	14
Empowering our people .....	14
Meeting financial targets .....	14
<b>How KiwiRail Creates Value</b> .....	18
<b>Aspirations and objectives</b> .....	20
<b>Required information</b> .....	25
<b>Appendix 1: Performance Measure definitions</b> .....	28
<b>Glossary</b> .....	29

## Who we are and what we do

## Our vertically integrated business model

### We connect people and communities

**32 million**

We help commuters make more than 32 million low-carbon journeys each year

**One million**

We carry more than one million tourist passengers each year

**17%**

We enable passenger growth of 17% in Auckland (2016/17)



- 3,500 km of track operated and maintained
- 6.6m sleepers, of which 48% are concrete

- Over \$1b invested in renewal and upgrade of rail network, rolling stock and property over the last five years
- Manage 18,000ha of land
- Own more than 1,500 buildings

- 3,090 signals
- 1,500 public level crossings
- 3,400 employees
- 76% union members
- 46 years - average employee age
- 45% decrease in Total Recordable Injury Frequency Rate in last three years

- 3 long distance passenger experiences between Auckland and Greymouth
- 160,000 passengers per year
- Stops at 23 towns and cities in NZ

## We keep freight moving

**18 million**

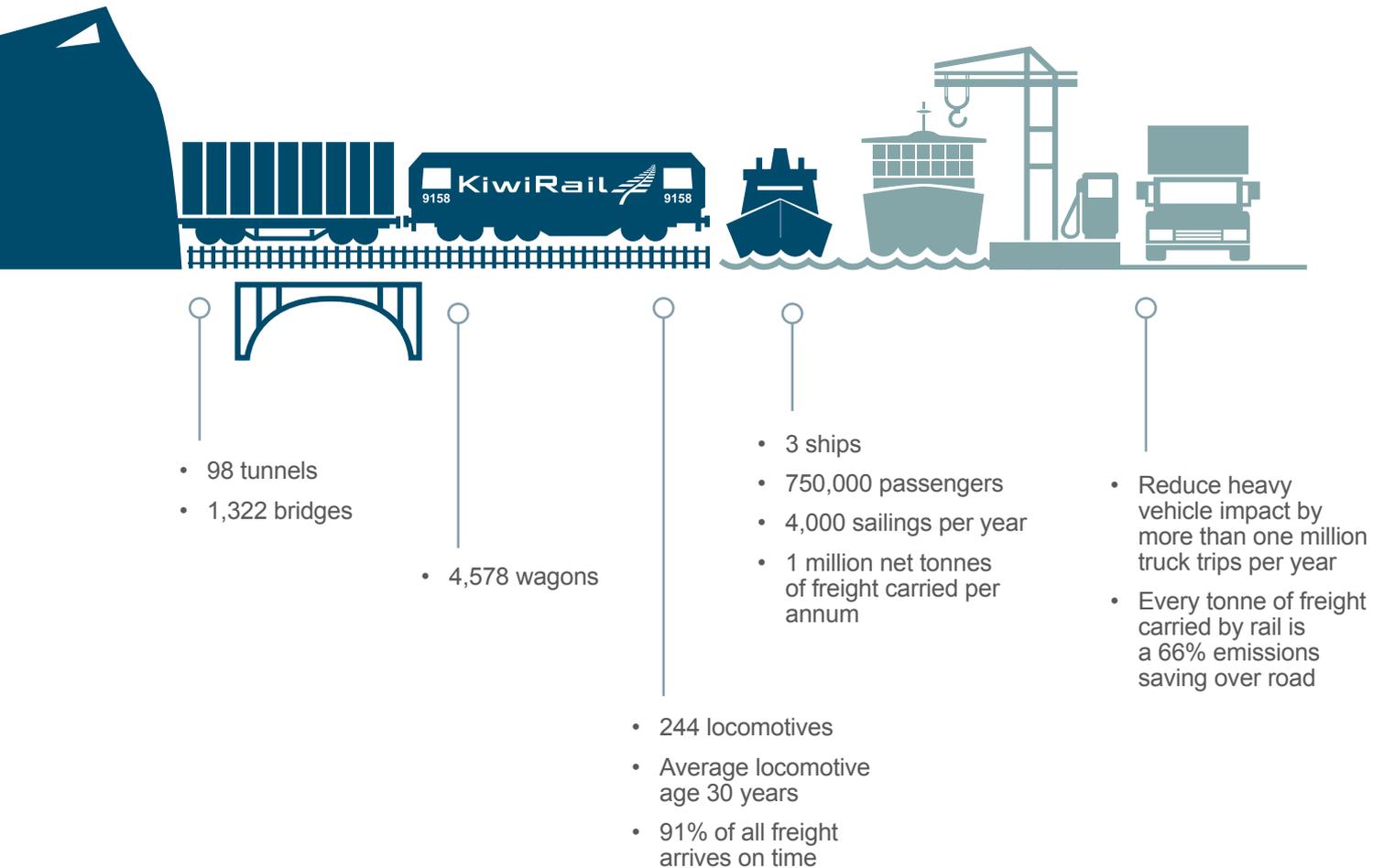
We move 18 million tonnes of freight each year

**16%**

We carry around 16% of New Zealand's total freight task (tonnes-km)

**25%**

We transport around 25% of New Zealand's exports



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## Introduction

For more than 150 years, rail has played a vital role as an enabler of economic and regional growth in New Zealand, connecting businesses, communities, importers and exporters to the world.

Rail delivers up to \$1.5 billion in hidden benefits to New Zealand each year. These are benefits not recognised when undertaking a traditional “return on investment” analysis of expenditure on the rail network. They include a range of positive outcomes that would not be possible without rail, including reduced carbon emissions, less traffic congestion, fewer road-related injuries and fatalities, and reduced road maintenance costs for taxpayers.

In the 10 years since its creation, KiwiRail has been at the helm of sustainable transportation in New Zealand, providing a low-carbon alternative for freight and passengers. It has grown and adapted to meet the changing needs of its existing and new customers, and is now perfectly placed to help drive sustainable and inclusive growth for the country.

With a new Government in place in 2017, KiwiRail is set to assist new initiatives for regional growth and will look to the Government for investment to support a resilient network fit for these future plans.

The Government Policy Statement 2018 (GPS) makes provision for the improvement of rail through new urban and interregional commuter rail services and outlines a capital delivery investment phase out to FY26. Rail has a prominent focus within the GPS as an enabler of sustainable economic development, which links New Zealand’s regions and ports to export markets overseas.

KiwiRail is registered as a State-Owned Enterprise (SOE) and operates within the policy and regulatory frameworks of the State-Owned Enterprises Act 1986 (the Act). This Statement of Corporate Intent (SCI) sets out the business’ objectives and performance targets for the three years to 30 June 2021 and is submitted by KiwiRail pursuant to Section 14 of the Act.

## Nature and scope

KiwiRail is a vertically integrated infrastructure business with above and below rail operations. The organisation optimises rail and ferry transport, and supply chain networks for the efficient movement of freight and passengers within New Zealand.

It owns and operates a national rail network that transports around 25% of New Zealand’s exports per annum. Each year, it enables more than 32 million low-carbon commuter journeys on the Auckland and Wellington Metros, transports one million passengers on its world-class tourism services including its Cook Strait ferry service, and moves around 18 million tonnes of freight.

Like many rail networks around the world, KiwiRail operates an integrated model with responsibility for both the above rail operations and the below rail network. This approach is consistent with the majority of freight rail organisations and many metro train operations globally, which operate as interconnected vertically integrated businesses.

The integrated model is designed to facilitate an efficient, co-ordinated approach to design,

planning, operation and maintenance, with a primary focus on meeting the needs of customers. This model also reflects the fact that railways are interconnected systems, where there are benefits to the networks and operations teams working closely together.

Rail competes directly with road and sea operators for the transport of goods around New Zealand. To increase its market share, KiwiRail is transitioning to a customer centric operating model which uses customer insights, process evaluations and technological solutions to develop competitive opportunities for future growth.

The business is focused on providing an efficient and reliable service to customers, a Zero Harm workplace for its people, and helping to grow New Zealand sustainably. However, these aspirations are impacted by KiwiRail’s current funding model and years of underinvestment by successive Governments. To ensure customers receive more reliable services with greater capacity and resilience, and to maintain safety standards across the network, KiwiRail requires a multi-year funding model with appropriate capital investment.

# Market Outlook and Economic Assumptions

KiwiRail plays an integral role in New Zealand's economy, with exports accounting for approximately 30% of Gross Domestic Product. Each year, KiwiRail transports around 18 million tonnes of freight on its rail services and carries up to \$20 billion worth of freight value on Interislander ferries, for export or distribution around New Zealand.

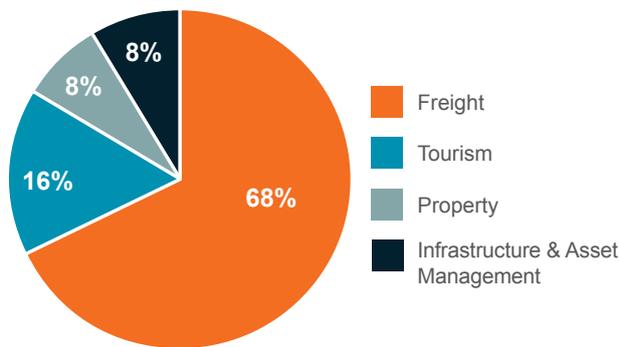
Around a quarter of KiwiRail's revenue comes from the transportation of freight to and from the international market. As a result, KiwiRail has significant exposure to the risks and uncertainties of the global economy. Global demand for key commodities has risen in recent years resulting in growth in bulk freight, forestry, and shifting imports and exports to and from ports.

New Zealand's economy is performing well and is expected to expand at an average rate

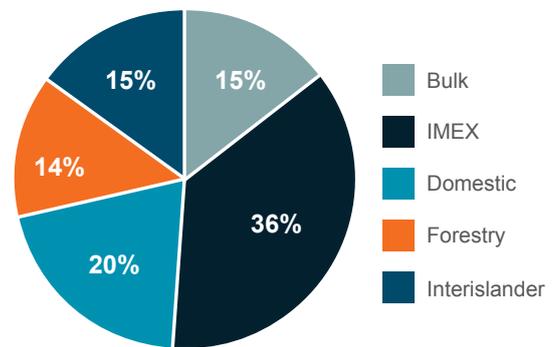
of 2.9% per year over the next five years<sup>1</sup>. An increasing population, low interest rates and government spending underpin this growth. Treasury has forecast export volume growth will strengthen over the next year and the unemployment rate will decline to around 4.0%<sup>2</sup>

New Zealand's commitment to the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) is predicted to create export opportunities in Japan, Canada, Peru and Mexico, countries which do not have free-trade agreements with New Zealand. The agreement will see the reduction and removal of tariffs over a 16-year period, and will eventually eliminate tariffs placed on wine and forestry products, and significantly reduce tariffs on dairy exports. CPTPP has the potential to deliver an estimated \$222 million of tariff savings per annum<sup>3</sup>.

**Total External Revenue by Service Line**



**Freight Trading Revenue by Sector**



The charts above show the source of KiwiRail's revenue FY17, and a breakdown of KiwiRail's freight revenue by sector. In terms of freight revenue, it is worth noting that the non-commodity driven activities are where we can have the greatest degree of influence on our market share as these activities are less susceptible to price movements caused by external factors.

## Sector outlook

Future performance of the rail freight business is largely dependent on the outlook for commodity-driven activities, the success of customers' operations and reconnecting volumes at full capacity on the Main North Line (MNL), following the Kaikoura earthquake in November 2016.

New Zealand's mining sector has spent many years in decline. However, there are indications the coal market is experiencing a resurgence as commodity prices for coking coal, needed in the steel manufacturing process, rise. There is also strong demand for coal from emerging economies such as India.

However, the global trend for "cleaner" energy, and subsequent investment, is predicted to

1. <http://www.treasury.govt.nz/budget/forecasts/hyefu2017/005.htm>  
 2. <http://www.treasury.govt.nz/budget/forecasts/hyefu2017/005.htm>  
 3. <https://www.mfat.govt.nz/en/trade/free-trade-agreements/free-trade-agreements-concluded-but-not-in-force/cptpp/cptpp-overview/>

reduce reliance on coal in the long term. In 2015, total investment in renewable power and fuels in developing countries exceeded that in developed economies for the first time<sup>4</sup>. In addition BP's Energy Outlook for 2017 forecast that global coal demand would peak in the 2020s<sup>5</sup>.

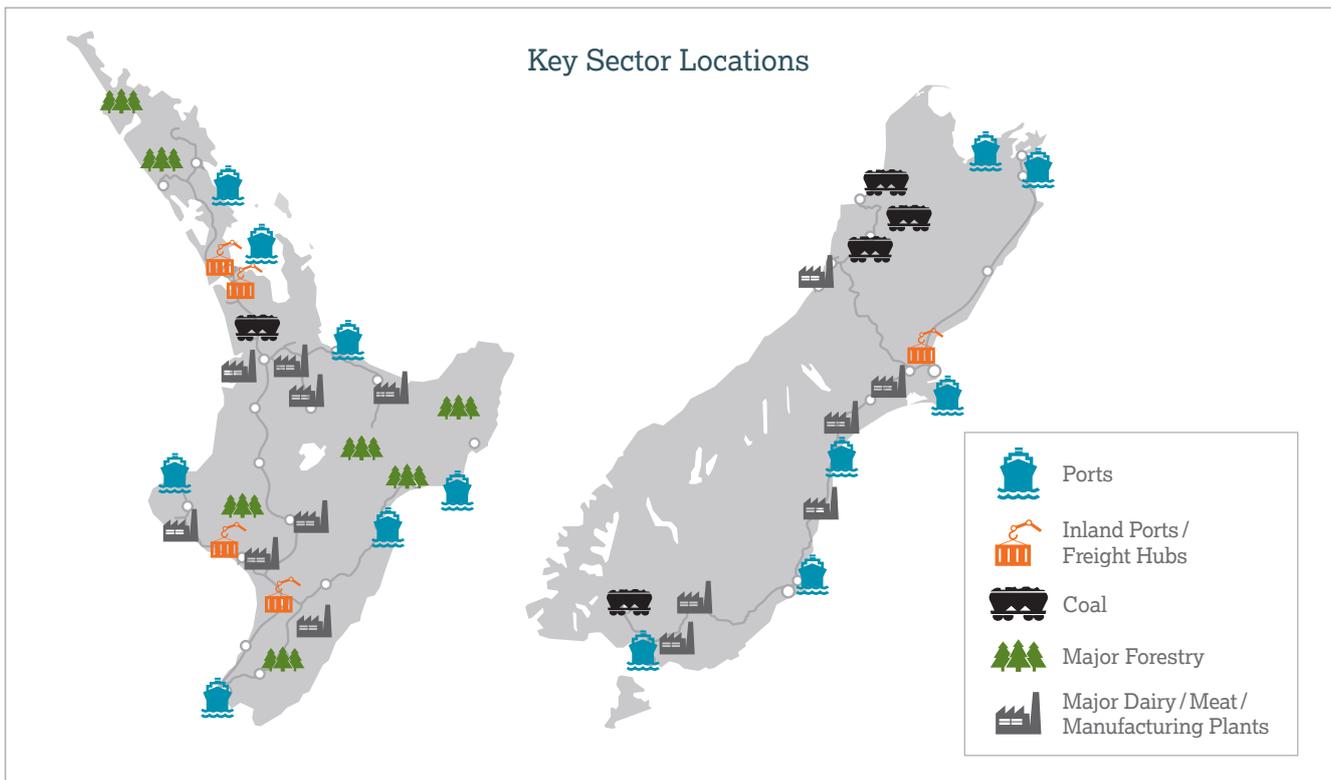
Currently, markets where dairy consumption is growing - principally China, where exports have been boosted by the 2008 Free Trade deal - are creating strong demand for New Zealand's dairy products. Once implemented, CPTPP is expected to open up the dairy market in dry and tropical countries which are unable to produce the amount of milk they consume.

Significant growth in the forestry sector is forecast in the short and long term. In the first six months of FY18, increased log volumes resulted in an 8% revenue upsurge in forestry

business for KiwiRail. Production volumes are projected to increase substantially in the next 15 years as forests planted in recent decades reach maturity. The resulting "wall of wood" should reach peak harvest by 2032.

Shipping lines continue to consolidate and invest in larger vessels. New Zealand's ports are responding to this trend by investing in infrastructure that can accommodate "big ships" including dredging, terminal infrastructure, inland ports and intermodal freight hubs.

The global trend for containerisation is evident across New Zealand's ports. By HY18, KiwiRail's growth in port revenue was up 16% on the prior year's six months to December 2017. In the same period overall container movements for New Zealand grew by 7%, reflecting the modal conversion to rail.



## Earthquake Recovery and ongoing resilience

The 7.8 Kaikoura earthquake in 2016, caused widespread damage to the Main North Line, creating 750 separate worksites, more than 90 slips and landslides and damage to 21 bridges

between Christchurch and Picton. It also resulted in loss of earnings of around \$100 million from business disruption and costs associated with recovery and resilience work.

Following the earthquake, KiwiRail partnered with the New Zealand Transport Agency in the North Canterbury Transport Infrastructure

4. <https://www.letstalkaboutcoal.co.nz/coal-globally/>

5. <https://www.bp.com/content/dam/bp/pdf/energy-economics/energy-outlook-2017/bp-energy-outlook-2017.pdf>

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Recovery (NCTIR) alliance to rebuild the line, reopening for limited freight services just 10 months after the devastating earthquake. The early reopening took trucks off the vulnerable inland routes and helped with the rebuild of the road, including the delivery of concrete blocks for sea walls along the route.

Following this significant achievement, however, severe weather events disrupted services on the line, creating uncertainty for domestic freight customers. This resulted in some freight moving to road and sea.

In FY19, work will continue to bring full freight services back with the reliability customers require to commit volume. This will be a key priority for KiwiRail, completing permanent works along the line and relocating the track to provide greater network resilience. A return to full freight services and the resumption of the Coastal Pacific passenger service are expected to occur in the second half of 2018 but are dependent on seismic activity and weather events in the area.

KiwiRail continues to work closely with insurers to resolve its earthquake claim, and has received progress payments totalling \$100 million to date.

In the years ahead, KiwiRail plans to address resilience weaknesses in the Cook Strait Ferry Services link which were highlighted during the Kaikoura quake. KiwiRail is working closely with ports to develop resilient land and sea-side infrastructure in Wellington and Picton, and is considering multi-user ferry terminals in Wellington and Picton as planning to enhance the Cook Strait's resilience continues.

To strengthen the resilience of its operations, KiwiRail is developing a train control centre in Auckland to ensure freight and passengers can keep moving safely if an earthquake affects Wellington.

## Our Strategic Priorities

For three years, KiwiRail has worked to simplify its business, standardise its assets and invest in its people. This has resulted in the delivery of reliable operational freight services, world-class tourism experiences and improved financial results, meeting the commitment of the business to Government for the past three years.

To create the blueprint for the next five years of growth, KiwiRail has assembled a cross-functional strategy team spanning business units and levels in the organisation. It is crucial that the blueprint is founded in the delivery of outstanding customer service through engaged and committed employees. The team is engaging with customers, their customers and industry change agents to understand the needs of the freight market into the future. The outcome of this work will be a five year plan of service and cultural reforms for customer growth.

### Sustaining a Zero Harm environment

Ensuring people can access the rail network safely and that KiwiRail's workplaces are safe is essential to the on-going success of the business.

KiwiRail's vision is to become the leading safety and health organisation in New Zealand in practice and performance. To achieve this, it is vital that Zero Harm is at the core of the business and that KiwiRail's employees and contractors believe every accident is preventable.

Every year, KiwiRail delivers targeted initiatives to enhance the safety of its employees and worksites across the country. Core to the delivery of these initiatives are policies and procedures to provide clear leadership, expectations, targets and performance monitoring. This continued improvement resulted in a 6% decrease in Total Recordable Injuries in the first six months of FY18.

### Health and Safety Action Teams, Critical Risks and Safety Management System

In the FY19 - FY21 period, KiwiRail will continue to invest in people, safety initiatives and systems to develop procedures and initiatives to improve worksite health and safety. Training to improve safety capabilities, which encourage a proactive approach to personal safety and the safety of others, will also continue through programmes such as Just and Fair Culture training and local Health and Safety Action Teams.

## The pillars of a Zero Harm culture



In the next three years, KiwiRail will refresh its current safety, health and environment management system with a new framework that provides a consistent way of understanding and managing Zero Harm. The new system is based on international standards and best practice which clearly show who is accountable and responsible for system development, management and use. The programme will further enhance safety leadership and employee engagement throughout the organisation, through initiatives such as Safe Work Conversations.

KiwiRail has identified five Critical Risk Networks as organisational safety focus areas. These are track occupancy, Signals Passed at Danger (SPAD), tunnels, level crossings and contractor management. In the FY19 - FY21 period, KiwiRail will continue to work with experts across the business to find risk controls that reduce the business' risk exposure.

KiwiRail continues to implement leading technology solutions. In FY19, KiwiRail will work with geotech experts and Victoria University to undertake a 12-month trial that will test a new GPS monitoring system that gives advanced warning of landslides along the rail network.

### Sustainability

KiwiRail continues to build on rail's advantage as a naturally efficient mode of transport, to improve its environmental accountability. For every tonne of freight moved by rail there is a 66% carbon emission saving over road. In addition, EY's Value of Rail report released in 2017, found that New Zealand's rail services reduce carbon emissions by 488,000 tonnes a year, the equivalent of taking 87,000 cars off the road<sup>7</sup>. These are important statistics to consider when reviewing the role rail plays in supporting New Zealand's commitment to the Paris Accord, which aims to reduce emissions below 2005 levels by 30% by 2030<sup>8</sup>.

KiwiRail recognises its role in supporting New Zealand as the country progresses the global sustainable development agenda. To further support the agenda, KiwiRail has identified a subset of the United Nations' Sustainable Development Goals (SDGs) to integrate in its organisational strategy and work programme over the next three years. SDGs provide an integrated framework for addressing the world's most urgent social, environmental and economic challenges.

The SDGs identified by KiwiRail will have the most impact on the business in the short to medium term and will address climate change

7. <http://www.kiwirail.co.nz/index.php?mact=News,cntnt01,detail,0&cntnt01articleid=506&cntnt01returnid=101>

8. <http://www.mfe.govt.nz/climate-change/why-climate-change-matters/global-response/paris-agreement>

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and Industry, Innovation and Infrastructure. In the next few months KiwiRail will undertake work to validate SDG priorities with key stakeholders.

In FY19, KiwiRail will continue to progress its sustainability programme with further initiatives in sustainable procurement.

A key component of the sustainability programme is KiwiRail's collaboration with the Energy Efficiency and Conservation Authority (EECA) which is progressing the business' efficiency programmes and targets across rail and sea. KiwiRail's ground-breaking fuel efficiency programme, DAS (Driver Advisory System) saved the business 5.7 million litres of fuel in FY17. In the next 12 months, KiwiRail will investigate the use of DAS on passenger services and the installation of a similar fuel efficiency programme on the Interislander ferries in partnership with EECA.

All areas of the organisation will work to meet KiwiRail's 73.5 gigawatt hours (GWh) energy saving target by 2020, an increase on the initial 20 GWh target which was reached just eight months after the agreement was made in November 2016.

## Engaging our customers and stakeholders - customer strategy

KiwiRail partners closely with customers to drive a competitive, commercially-focused business which supports New Zealand's sustainable and inclusive growth through reduced supply chain costs and by contributing to regional economies.

In FY18, the business began to reshape its domestic market offering. This work will continue into FY19 with new commercial agreements implemented on key corridors, including Auckland to Christchurch, to ensure the business receives a fair return for its services while remaining a competitive option compared with road.

In recent years, KiwiRail has experienced strong growth in the import/export sector. Rail's ability to aggregate and move large volumes of freight with speed, has resulted in successful partnerships with ports. In the FY18 HY result, port revenue grew 16%, well above average port growth of 8%.

In the FY19 - FY21 period, KiwiRail will continue to work closely with port partners to move large volumes of freight at speed and connect New Zealand businesses to export markets. KiwiRail is ideally placed to deliver logs as the "Wall of Wood" comes on stream, and is working with forestry operators and ports to enable rail hubs in appropriate locations. KiwiRail's log wagon fleet has grown by 40% since 2011, with former container wagons being 'recycled' at the end of their lives into wagons for forestry.

## Regional development

The Labour-led Government has signalled its strong support for rail as an enabler of regional growth and has funded a number of projects through its Provincial Growth Fund (PGF).

There are opportunities to establish new rail-enabled Regional Economic Zones for forestry, dairy and other customers with the Fund providing for three feasibility studies at Taranaki, Southland and Kawerau. KiwiRail will work closely with customers, local government and other stakeholders to plan the optimal freight transport system for these areas.

PGF funding of \$5 million will enable the reinstatement of the Napier to Wairoa line for forestry products, taking up to 5,700 trucks a year off the road and growing a regional hub in Wairoa for the handling of logs. Funding of \$3 million has been allocated to upgrade the Whanganui-Castlecliff rail line to allow mainline locomotives to support customers, including Open Country Dairy and Wellington's CentrePort.

All projects aim to reduce carbon emissions, create an easy flow for the export and domestic markets and improve road safety by easing congestion. All these things support New Zealand's growing economy.

## Tourism

The Ministry of Business, Innovation and Employment's tourism forecasts show annual international visitor expenditure increasing 52.1% to \$15.3 billion by 2023<sup>9</sup>. In the next three years, "The Great Journeys of New Zealand", the umbrella brand covering KiwiRail's passenger rail and ferry services, will continue to leverage its position as an operator to remote tourism locations and to boost regional economies through its connected journey strategy. It will also target emerging tourism markets, including Japan and China.

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9. <http://www.mbie.govt.nz/info-services/sectors-industries/tourism/tourism-research-data/international-tourism-forecasts/documents-image-library/forecasts-2017-report-final.pdf>

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## Developing operational performance

For KiwiRail to remain competitive against road freight forwarders it must maintain its customers' confidence. The most effective way to achieve this outcome is to provide customers with a consistent and reliable service.

### On Time Performance

Achieving operational performance through asset reliability and On Time Performance is key for customers deciding to put freight on to rail. However, KiwiRail's progress in this area is hindered by decades of under investment which resulted in deferred maintenance and infrastructure investment, ageing rolling stock, mothballed lines and slower rail services. Ultimately, this reduces rail's competitiveness against road.

KiwiRail is working closely with the Labour-led Government on achieving long-term, appropriate funding which will offer greater capacity for customers through investments in the rail network, new rolling stock and smart technology. KiwiRail is transitioning to a service-led operating model to ensure that these future investments successfully meet customers' needs.

### Rolling stock reliability strategy (Project Nexus)

KiwiRail's rolling stock capital requirements can no longer be deferred as many assets are at the end of their useful lives. For instance, the average age of a locomotive in the South Island fleet is 46 years old. Extending maintenance on assets of this age requires a greater number of inspections, and the locomotives experience a greater rate of failure impacting on KiwiRail's customer promise. Typically, the useful life of a locomotive is 30 years.

KiwiRail's Asset Renewal Plan for rolling stock aims to address the effects of underinvestment by establishing long-term fleet requirements that will increase the availability and reliability of its services, while maximising efficiencies and returns. Maintaining or improving the current 91% On Time Performance average for rail freight customers will require investment in new assets, overhauling existing assets to prolong their working life, and decommissioning assets at the end of their useful life. Over the next three years, KiwiRail's priority is the renewal plan and to obtain Government support for an investment programme to reduce the average age of KiwiRail's locomotives, from 30 years to 15 years by 2030.

KiwiRail has formed Project NEXUS to evaluate smart rolling stock assets and emerging technologies to better the business' diagnostics, operational performance and maintenance processes. These, in turn, boost end-to-end delivery times, improving customer experience. The project will investigate super maintenance depots in key locations and will rejuvenate facilities and rolling stock to better the reliability of services.

### Integrated planning

KiwiRail is transitioning to a vertically integrated operating model that is customer-centric, service-led and primed for growth. The first step in this process has been to develop a model that will provide a single approach to KiwiRail's asset planning, availability, reliability, operational safety and people development across the business. As the first step in this process, KiwiRail's executive team has been restructured to bring the Network Services, Rolling Stock and Operations business units under a single Chief Operations Officer to ensure a complete organisation-wide focus on integrated planning for the benefit of customers.

### Inter-island Resilient Connection Project (iRex)

The Inter-island Resilient Connection Project will define KiwiRail's long-term ferry fleet strategy. Work is underway to assess future market demands, trends and customer requirements to determine the number of ships KiwiRail should operate, the size of those ships and their capabilities for the next 30 years. The project will ensure KiwiRail meets future requirements, capacity demands and that it provides resilient land infrastructure to support continuity of service for customers in a seismic event. Work will continue throughout FY18 on the future direction of the Interislander fleet.

### Digital

If technological disruptions in KiwiRail's business are not addressed efficiency gains will slow, improvements to the reliability of assets will stall, and rail will be outpriced by road and shipping logistic companies which adopted emerging technologies.

KiwiRail is investigating global best practice and opportunities to enhance the customer experience through an intelligent transport network that provides deeper insights into KiwiRail's operations and customers' needs. This includes smart data options that monitor the health of rolling stock and provide live-tracking of goods for customers.

### Property

KiwiRail manages one of the country's largest landholdings. In the next three

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years, the business will continue to drive commercial outcomes from lease and license arrangements across its property portfolio. The business will also continue to secure and protect the active rail portfolio through acquisition or disposal of land where this will improve the network and remove safety risk for current or future rail.

In FY19, KiwiRail will continue to work with operational staff to undertake site master planning to define a future focused operational footprint to improve its operational yards. Investigations into new leasing opportunities will also be undertaken to support growing industries and regional growth.

## Empowering our people

Frontline engagement is fundamental to the success of KiwiRail's business. The High Performance High Engagement programme (HPHE), which commenced in 2015, continues to transform KiwiRail's operations. A joint project with KiwiRail's union partners, HPHE empowers frontline staff to find solutions to the challenges facing the business while raising productivity, improving safety, and enhancing performance.

In the FY19 – FY21 period, KiwiRail will continue to align with unions on strategic priorities to drive productivity and efficiency gains. In the next 12 months, HPHE projects to address train optimisation and mechanical workforce development will be implemented; delegates and managers will continue to receive HPHE training and KiwiRail will begin to roll out HPHE 2.0. The second stage of the programme will equip managers with the skills required to implement site-specific processes that will further boost productivity and safety.

### Workforce development

KiwiRail's learning programmes identify key areas of development, enabling staff to improve their performance and to expand on their current skill set. Leadership development programmes, such as the literacy and numeracy course Back to Basics, will continue throughout FY19 - FY21. In the next 12 months, e-learning platform KiwiRail Learning Exchange (KLE) will be developed to further support employees and contractors.

KiwiRail remains committed to being an inclusive workplace that attracts and retains a diverse workforce. In FY19, KiwiRail's Diversity and Workforce Planning Committee will establish initiatives to lift the profile and number of women in the workplace, while its mentoring programme, due for delivery in 2018, will offer guidance to younger members of KiwiRail's workforce. The Graduate

Programme will continue into FY19, with a second class scheduled for enrolment in July 2018.

## Meeting financial targets

As a State-Owned Enterprise, KiwiRail operates as a profit-oriented entity with shareholder support required for below-rail infrastructure including tracks, bridges and tunnels.

KiwiRail has met its shareholders' expectations for the past three years and is on track to meet its full year operating surplus of \$30-\$50 million in FY18. KiwiRail is on track to deliver efficiency and productivity savings of \$7 million in FY18, building on savings of \$45 million in the past two years.

### Productivity and efficiency measures

In the next 12 months, KiwiRail will drive further productivity improvements that centre on improving labour efficiencies through HPHE, workforce planning, decreasing material spend, and consolidating rolling stock. In the FY19 - FY21 period, KiwiRail will continue its focus on delivering its targets in line with the expectations of Shareholding Ministers.

### Rail Review

In Budget 2017, the then government committed to a Rail Review to assess KiwiRail's operating structure and long-term capital requirements. KiwiRail welcomes the Review and believes it is an opportunity to highlight rail's role in an integrated transport system and to examine the wider benefits of transporting freight by rail.

KiwiRail believes it is critical to resolve the matter of long-term funding so the business can best deliver on the Government's objectives for rail. This funding model impacts on KiwiRail's ability to make cost-effective choices, or to plan, procure and operate its services with an efficiency that can support strategic partnerships. Multi-year funding would also enable the business to provide a sustainable future for rail as a freight transporter that delivers for customers, through overdue capital investment in rolling stock for freight and tourism ventures and upgrades for maintenance facilities, ships and Cook Strait terminal assets.

As the Rail Review progresses in FY19, KiwiRail will continue to work closely with the Ministry of Transport, Treasury and the New Zealand Transport Agency to ensure rail remains an integral part of the solution to New Zealand's transport needs.

# How KiwiRail creates value



Facilitating efficient flows to/ from ports

Delivering world class tourism experiences

Providing a sustainable transport alternative and reducing emissions\*

Connecting people and places by enabling commuter journeys



# and freight

## Our outcomes:



Reliable



Sustainable



Valuable

## Our values:



\*Around 16% of all total freight task carried, under 1% of all transport emissions

## Aspirations and objectives

The upcoming Review of Rail is critical to resolve the matter of long-term funding to ensure a sustainable future for rail delivering services to customers for the benefit of New Zealand. A commitment to a longer-term sustainable funding model would recognise KiwiRail's strategic role in the future of integrated transport, and provide greater certainty for staff and customers to support effective strategic partnerships and enable cost-efficient planning.

With appropriate funding mechanisms in place, KiwiRail will be well positioned to drive economic growth in cities and regions, reduce carbon emissions and support sustainable and inclusive growth by moving people and freight on rail.

For the following metrics to work effectively KiwiRail requires its minimum capital budget and the implementation of a multi-year funding model.

### Objective:

- Sustaining a Zero Harm Environment

### Aspiration:

- To be the leading safety and health organisation in New Zealand in practice and performance
- Improve Zero Harm performance to Australasian best-practice levels
- Provide consistent risk based Health and Safety standards
- Ensure KiwiRail is recognised as a sustainability leader

### Our FY19 - FY21 focus:

- Build on risk-based systems and worker participation to deliver a step change for Health and Safety performance
- Reduction in Total Recordable Injuries
- Meet EECA's 73.5 gigawatt hours (GWh) energy saving target by 2020

	2018	2019	2020	2021
Sustaining a Zero Harm Environment	Forecast	Plan	Plan	Plan
Safe Work Conversation	-	1 per person /per month	1 per person /per month	1 per person /per month
Total Recordable Injuries	140	105	79	59
SPAD As	23	16	10	7
Safe Working Irregularities	291	203	142	100
Derailments - Mainline	5	5	5	5
Derailments - Terminal	83	62	46	35
GHG emissions per NTK (gms)	26.19	25.92	25.66	25.41
Truck Avoidance (m)	1.1	1.2	1.2	1.3

**Objective:**

- Meeting our financial targets

**Aspiration:**

- Long-term funding mechanism and sustainable operating model in place
- Improve operating surplus as a percentage of revenue to EBITDA 15%

**Our FY19 - FY21 focus:**

- Improve operating surplus as a percentage of revenue to more than 15%
- Maximise capital efficiency

	2018	2019	2020	2021
Meeting our financial targets	Forecast	Plan	Plan	Plan
Operating Surplus (\$m)	40-60	55-75	80-100	95-115
Operating Margin (%)	7-10	9-12	12-15	13-16
Capital Expenditure - net of grants (\$m)	273	298	375	393
<b>Property</b>				
Weighted Average Lease Term (WALT %)	4	4	5	6
Yield (%)	6	7	7	7

*Forecasts for the FY19-21 period are influenced by the challenging circumstances we face as a result of the November 2016 earthquake.*

*The revenue forecast over the FY19-21 period reflects the continued uncertainty KiwiRail faces in the Domestic market and the Interislander and Coastal Pacific passenger market as the business recovers from this significant event. A key assumption for FY19 is the Main North Line remains open but continues to operate under restrictions and the Coastal Pacific will return to service.*

*Given the fixed nature of KiwiRail's cost base, any domestic revenue lost will have a significant impact on its EBITDA. These uncertainties are reflected in the forecasts, resulting in lower estimated revenue over the SCI period.*

*For KiwiRail to best deliver on Government objectives for rail, multi-year funding certainty is critical to support effective strategic partnerships and to enable cost-efficient planning.*

**Objective:**

- Empowering our people

**Aspiration:**

- Best in class staff engagement measures
- Highly Engaged and Productive Team

**Our FY19 - FY21 focus:**

- Address challenges of attracting and retaining talent in a competitive market, given KiwiRail's ageing workforce
- Ensure the organisation has the right people with the right skills, in the right place at the right time
- Transition to a more diverse workforce to meet the requirements of the business environment

	2018	2019	2020	2021
Empowering our people	Forecast	Plan	Plan	Plan
Employee Net Promoter Score	0	5	10	12

**Objective:**

- Engaging our customers and stakeholders

**Aspiration:**

- Sustainable and inclusive customer growth
- Align Shareholder and the New Zealand public on KiwiRail's purpose
- Ensure the Value of Rail is well understood by customers and the New Zealand public

**Our FY19 - FY21 focus:**

- Develop customer insights to identify organisational strengths and develop competitive opportunities for future growth
- Increase the capacity and resilience of the Cook Strait Ferry Services
- Ensure digital strategy is aligned to support business growth strategy
- Assist the Government initiative of lifting levels of productivity within regional communities
- Work with stakeholders to ensure the Rail Review delivers a successful outcome for New Zealand

	2018	2019	2020	2021
Engaging our customers and stakeholders	Forecast	Plan	Plan	Plan
Revenue (\$m)	594-614	640-660	670-690	689-709
Freight trading growth (%)	(2)-1	8-10	8-10	3-5
GTK (m)	7,651	8,295	8,933	9,091
Revenue as a percentage of FTE	18	19	19	20
Revenue as a percentage of NTK	15	15	15	16
Revenue as a percentage of KM of track	18	18	19	20
Passenger trading growth (%)	9	8	3	2
Property revenue growth (%)	6	4	5	5

**Objective:**

- Delivering operational performance

**Aspiration:**

- Efficient, reliable and integrated rail operations
- On Time Performance above 90%
- Total cost of operations less than 85% of revenue

**Our FY19 - FY21 focus:**

- Optimise assets through standardisation and investment
- Invest in network facilities and rolling stock to enable efficient and reliable services
- Alignment with unions on strategic priorities to drive productivity / efficiencies
- Integrated long-term train planning to ensure the organisation is able to drive productivity and efficiencies through the planning of people, locomotives and wagons

	2018	2019	2020	2021
<b>On Time Performance (%)</b>	<b>Forecast</b>	<b>Plan</b>	<b>Plan</b>	<b>Plan</b>
- Freight Trains - Premium	87	90	92	93
- % Interislander services to advertised sailings	99	99	99	99
<b>Operating Costs</b>				
Operating costs as a percentage of revenue	90-93	88-91	85-88	84-87
Total staff costs as a percentage of operating costs	50	47	48	48
Operating costs as a percentage of NTK	14	14	13	13
<b>Network Renewals</b>				
- New sleepers laid (000)*	64	81	65	75
- New rail laid (km)*	20	29	20	30
- New turnouts*	37	30	35	35
Availability of all locomotives (%)	91	92	92	92
Wagon availability (%)	89	92	95	95
Total Capital Expenditure as a percentage of revenue*	45	46	55	56
Total Capital Expenditure as a percentage of NTK*	7	7	9	9
Total Capital Expenditure as a percentage of KM of track*	8	8	11	11

\* Excludes South Island MNL rebuild and Provincial Growth Fund Project

## Required information

	2018	2019	2020	2021
	Forecast	Plan	Plan	Plan
<b>Shareholder Return Measures</b>				
Total Shareholder Return	n/a	n/a	n/a	n/a
Dividend Yield	Nil	Nil	Nil	Nil
Dividend Pay-out	Nil	Nil	Nil	Nil
Return on Average Equity (%)	(73)	(49)	(29)	(25)
<b>Profitability/Efficiency Measures</b>				
Return on Average Capital Employed (%)	(49)	(34)	(20)	(18)
Operating Margin (%)	7-10	9-12	12-15	13-16
<b>Leverage/Solvency Measures</b>				
Shareholder's Funds to Total Assets (%) (closing equity/total assets)	55	56	60	64
Gearing Ratio (net) (%) (net debt/closing equity)	38	29	23	17
Interest Cover (operating surplus/net finance costs)	3.6	4.5	6.3	7.2
Solvency (current assets/current liabilities)	0.69	1.08	0.98	1.00

Note that to provide meaningful comparatives, the above ratios assume that additional funding will be received as equity

### Accounting Policies

KiwiRail's detailed accounting policies can be found here:

<http://www.kiwirail.co.nz/media/publications>

### Dividend Policy

KiwiRail is focused on improving financial sustainability and reducing the need for taxpayer support. However, a significant amount of investment will be required from the Shareholder for the foreseeable future. As such, KiwiRail does not expect to make any dividend payments over the period of this SCI.

### Information to be provided 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 Company's performance

- Continuous Disclosure reporting as required By Treasury's Commercial Operations Team
- Regular reporting to Treasury's Commercial Operations Team 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.

### Significance

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

- Any substantial expansion of activities of those described in this statement
- Any substantial capital (or equity) investment, and
- Any other significant transactions.

### Procedures for share acquisition

KiwiRail will consult with Shareholding Ministers on the subscription for, or sale of,

shares in any company or equity interests in any other organisation which are material, involve a significant overseas equity investment, or are outside the scope of KiwiRail's core business.

### 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 company which have a public good element or purpose and would not be undertaken on purely commercial grounds.

### Commercial Valuation of the Crown's investment

The Board have used the method of discounted cash flows (DCF) to estimate the value of the

KiwiRail Group as at 30 June 2018.

There has been an increase in the commercial value related to operating free cash flows of \$4m. This reflects an increase in operating surplus as KiwiRail continues to recover from the November 2016 Kaikoura earthquake with improved financial projections as a result of higher revenue growth compared with previous years.

Based on the current earnings projections, it is not expected that the Group will be tax paying in the projected earnings period. The present value of tax payable on ungeared earnings is, therefore, zero.

\$m	30 June 2018	30 June 2019
Present Value of Pre-Tax Free Cash Flows	(1,593)	(1,589)
Less Present Value of Tax Payable on Ungeared Earnings	0	0
DCF Enterprise Value	(1,593)	(1,589)
Less Net Debt	(192)	(208)
DCF Equity Value	(1,785)	(1,797)

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 (i.e. inflation-adjusted) future cash flows set out in this SCI, with forward projections made through years 4 to 7 aligned to KiwiRail's capital requirements, and years 8 to 20 consistent with the Commercial Review undertaken in 2014
- A terminal value of zero has been assessed
- A risk free rate of 4.5%\* and discount rate of 9% has been used (same as the 30 June 2017 valuation)
- PwC has confirmed the mathematical accuracy of the calculation of the DCF valuation prior to approval of the DCF value by the Board

### The Value of Rail to Aotearoa

It is important to note that the commercial valuation indicated above does not reflect

the valuable externalities which rail provides. These externalities were considered in EY's 2016 Value of Rail report. The approach taken in assessing the value of rail was to model the effects on the road network if there was no rail network.

The EY report estimated the total value of rail to the New Zealand economy to be \$1.47 billion - \$1.54 billion per annum from just four quantitative areas:

- Reduced congestion
- Reduced greenhouse gas emissions
- Improved safety outcomes – reduced costs of safety incidents like death and injuries
- Reduced road maintenance and upgrades

The value excludes further qualitative benefits from rail, such as connectivity, land use and resilience benefits which would significantly increase the value of rail.

On this analysis the value of rail is highly likely to far exceed the annual direct government investment in the existing network.

\* Risk free rate used is consistent with PwC approach to take a series of longer-term forward one year yields

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## Appendix 1: Performance Measure definitions & glossary

### Definitions of SOE Performance measures

<b>Dividend Payout</b>	Proportion of net operating cash flows paid out as a dividend to the shareholder after allowance is made for capital maintenance
<b>Dividend Yield</b>	The cash returned to the shareholder as a proportion of the value of the company
<b>Gearing ratio (net)</b>	Net Debt divided by Total Equity
<b>Interest cover</b>	Operating Surplus divided by net Interest Expense on Borrowings
<b>Operating Margin</b>	Operating surplus divided by Total Revenue
<b>Return on Average Capital Employed</b>	EBIT divided by Total Average Equity before Revaluation Reserve and Interest bearing liabilities
<b>Return on Average Equity</b>	NPAT divided by Total Average Equity before Cashflow Hedge Reserve
<b>Shareholder's Funds to Total Assets</b>	Total Equity divided by Total Assets
<b>Solvency</b>	Current Assets divided by Current Liabilities
<b>Total Shareholder Return</b>	Commercial Value less Commercial Value plus dividends paid less equity injected divided by Commercial Value

## Glossary

<b>EBIT</b>	Earnings before interest and tax
<b>GHG</b>	Greenhouse Gas
<b>GTK</b>	Gross Tonne Kilometre
<b>Line de-stressing</b>	De-stressing rail is a process undertaken to minimise the risk of the rail line buckling in hot conditions
<b>Net Promoter Score</b>	Net Promoter Score (NPS) derives from asking your employees or customers ‘How likely are you to recommend ‘company name’ to a friend or colleague?’ and basing that on a scale of 0-10. Scores of 9 or 10 are classed as promoters, scores of 7 or 8 are classed as passive, and scores of 0 to 6 are classed as detractors. The NPS is then calculated by subtracting the percentage of “Detractors” from the percentage of “Promoters” providing a score between -100 and 100
<b>NPAT</b>	Net profit after tax
<b>NTK</b>	Net Freight Tonne Kilometre
<b>Operating Surplus</b>	Net surplus (revenue minus expenditure) excluding significant items before foreign exchange, interest, taxation, depreciation, amortisation, impairment, grant income and fair value adjustments.
<b>SPAD A</b>	Signal Passed At Danger - A category "A" SPAD is a SPAD where a stop signal indication (and any associated preceding cautionary indications) was displayed correctly, in sufficient time for the train to be stopped safely at the signal
<b>TRIFR</b>	Total Recordable Injury Frequency Rate. A recordable injury is defined as a lost-time injury, any injury requiring medical treatment, or any instance where an injury prevents a return to work on normal duties for a period of one day/shift or more Total recordable injury frequency rates are the number of total recordable injuries within a given period relative to the total number of hours worked in the same period
<b>Operating Surplus</b>	Net surplus (revenue minus expenditure) excluding significant items before foreign exchange, interest, taxation, depreciation, amortisation, impairment, grant income and fair value adjustments.
<b>SPAD A</b>	Signal passed at danger. A category "A" SPAD is a SPAD where a stop signal indication was displayed correctly, in sufficient time for the train to be stopped safely at the signal.
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