

STATEMENT OF CORPORATE INTENT
2016 - 2018

Reshaping & Delivering





18 million tonnes of freight moved each year by rail



900 freight trains each week



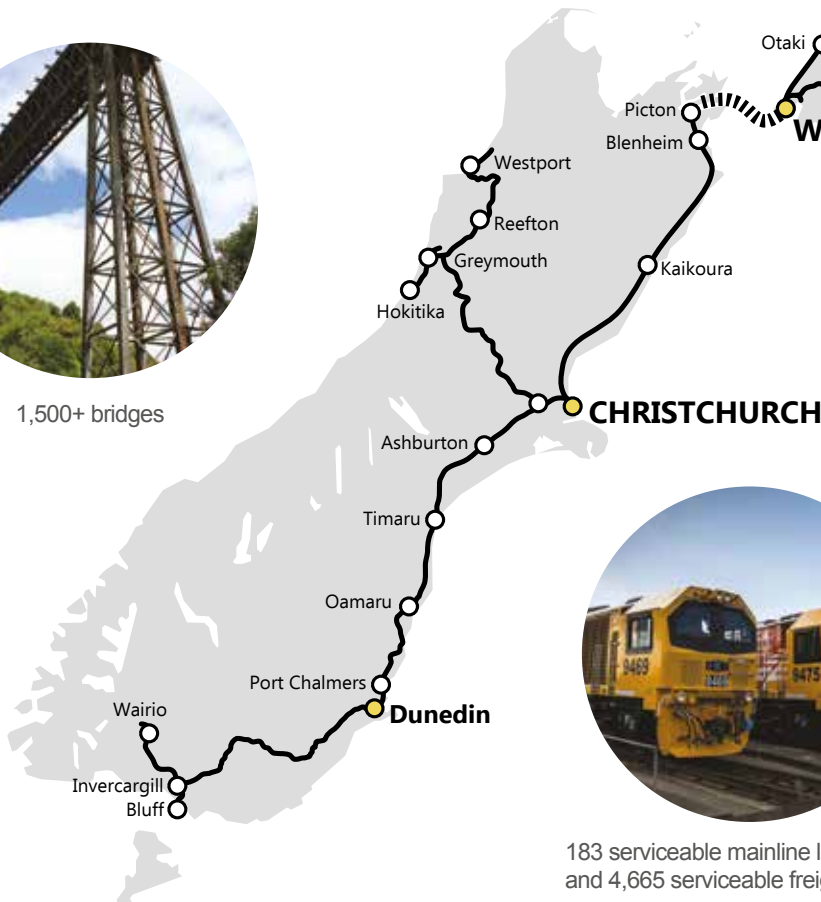
Tranz Metro provides 12 million passenger journeys per year



1,500+ bridges



Interislander carries 800,000 passengers per year



183 serviceable mainline locomotives and 4,665 serviceable freight wagons



Contents

Our story.....	4
Required information	15
APPENDIX 1: Performance Measure definitions and glossary	17



Our story

Our vision

Trusted Kiwi-owned logistics partner, growing New Zealand.

Nature and scope of the business

KiwiRail owns, operates and optimises rail and ferry transport and supply chain networks to facilitate the efficient movement of freight and passengers within New Zealand. KiwiRail is focused on providing excellent services to our customers, a Zero Harm workplace for our staff, and an improved financial position for our shareholder. We:

- Own and operate a national rail network which meets the needs of our customers
- Provide for the transport of bulk and consolidated freight
- Provide ferry services (forming the 'bridge' between the North and South Islands) for rail and road freight and for passengers and their vehicles
- Provide and support rail passenger services in metropolitan areas and long distance services for both domestic and tourist markets
- Manage and develop property holdings for rail operations and appropriate third-party land use

We are committed to an integrated transport approach in conjunction with the New Zealand Transport Agency and the Ministry of Transport.

Who we are

KiwiRail:

- Keeps New Zealand moving
- Provides efficient transport flows to ports
- Connects the North and South Islands
- Leads the bulk transport agenda
- Reduces New Zealand's supply chain costs
- Takes congestion out of urban centres
- Reduces New Zealand's carbon footprint
- Develops strategic partnerships for key customers

What we do

- We move ~18 million tonnes of freight and provide 13 million passenger trips per year
- We employ 4,000 New Zealanders, 85% of whom are union members
- We have a market share of around 16% of total freight volume in New Zealand
- We transport ~30% of New Zealand's exports
- We avoid the need for the equivalent of 1.4 million truck movements a year, saving the equivalent of 470,000 tonnes of carbon dioxide a year
- We operate, maintain and improve 4,000 km of track network, nationwide



Mark Kariyawasim & Fiona Stevenson on the Northern Explorer. Photo: Doug Cole

A look back at 2014 /15

The 2014/15 financial year was essentially a year of recovery and consolidation for KiwiRail as we experienced both significant challenges and important accomplishments.

During 2014, we had to recover from the operational impacts of the loss of the Aratere ferry from service, and remediation of the asbestos discovered in the new DL locomotives. These two events, combined with downturns in the global commodity markets, created challenging operating conditions and led to revenue performance being slightly behind the previous year.

However, 2014/15 also saw some significant accomplishments as we embarked on reshaping the organisation, including:

- One KiwiRail strategy developed to deliver our customer-focused business model
- Continuing our commitment to a Zero Harm workplace with the Total Recordable Injury Frequency Rate (TRIFR) reduced by 50% over the previous financial year and Lost Time Injury Frequency Rate (LTIFR) reduced by 36%
- Increasing customer confidence, and strategic partnerships developed with key customers
- Developing take or pay contracts for key customers
- Excellent financial results for the Interislander with a 22% increase in passenger numbers and 9% revenue growth from the previous year
- Strong trading results from Scenic Journeys with 18% revenue growth from the previous year
- Operational efficiency improvements, including fuel burn improvement
- Recommissioning the Aratere in mid-2014
- A summit with the Rail and Maritime Transport Union (RMTU), Aviation and Marine Engineers' Association and New Zealand Merchant Service Guild to commence a path towards a High Performance, High Engagement relationship with our employees
- Achieving an operating margin of 13% on declining revenue through tight management of costs



Subs Narasy, Container Terminal Manager Wellington. Photo: Lindsay Keats



KiwiRail Northern Region Site Protector Paul Andrews (right) takes night team members Roger Perry (left) and Frank Seumanu through the locking-on procedure before heading out to repair a rail break at Avondale. Photo: Brendon O'Hagan

Commercial Review

The Commercial Review (the 'Review') was completed in December 2014 and was an opportunity to engage with the Government on long term funding and support for rail, and gain clarity on the most favoured network configuration. The Review examined the economics of each rail corridor and service, and provided a range of future options.

This high-level Review confirmed that it is difficult for KiwiRail to increase revenue from commodity-based sectors, and also difficult to improve productivity given the company's historical inflexible labour agreements. Additionally, given the capital-intensive nature of rail, there are implications for our future funding requirements should we retain the national

network in its entirety. The Review underlined the challenges that KiwiRail faces in reconfiguring its operations. Historic under-investment in the network only makes those challenges even larger.

After considering the range of options in the Review, KiwiRail is pleased that the Government signalled a long-term commitment to a national rail network, and committed \$400 million in funding over the next two years. However, the Government also indicated that KiwiRail must continue to drive significant efficiency and productivity improvements to reduce the level of ongoing taxpayer support required.

KiwiRail is committed to fully engaging with our staff as we continue to improve our productivity and efficiency, and to providing an increasingly high level of service to our passengers and freight customers.



“The current New Zealand Government’s investment and growing confidence in KiwiRail is a sign of an emerging understanding of the importance of rail to the New Zealand economy.”

Bruce Pledsted, Executive Chairman, Mainfreight

Keith Whittaker, Tranz Metro Mechanical Engineer. Wellington Railway Station.

True value of rail to New Zealand

Rail freight delivers a range of benefits to New Zealand which is not recognised when undertaking traditional ‘return on investment’ analysis of expenditure on the rail network. These benefits include a range of negative outcomes that rail helps to avoid such as road crashes, emissions into the environment, traffic congestion, and the costs of roading repair, maintenance and upgrades. These are considered to be factors that would otherwise incur costs for other parties in the absence of rail freight. KiwiRail is therefore keen to contribute to a debate on the value of rail, rather than only a narrow debate on the cost of rail.

Studies in other countries, notably Australia and the United Kingdom, have attempted to capture the extent of these factors and apply costs to them. Building on the work undertaken in the ‘Back on Track: Sustainability Report 2014’ KiwiRail is seeking to undertake a similar exercise in New Zealand to inform the debate about the true value of the benefits that a national rail network brings to New Zealand.



Removing 1.4 million truck movements from our roads



Helping commuters make 24 million low-carbon journeys each year



Diverting 470,000 tonnes of carbon emissions



Avoiding 185 million litres of diesel consumption



Reducing congestion, making our roads safer



Contributing to New Zealand’s economic growth



Helping community groups, schools and sports groups to travel



Creating long-lasting two-way relationships with customers, suppliers and other stakeholders

Market outlook and economic assumptions

As an open economy and a trading nation, factors outside New Zealand affect KiwiRail. Exports account for about 30% of New Zealand's GDP, with dairy accounting for roughly one third of New Zealand's exports. Some downside risks include:

- A significant slowdown in the Chinese economy
- A slowdown in the Australian economy
- A further fall in export volumes as a possible consequence of a further fall in commodity prices

Rail competes directly with road and sea operators for the transport of goods around New Zealand. In order to increase our market share, rail needs to provide a reliable, cost-effective and consistent service to its customers. We are committed to meeting our customers' needs, and delivering against the terms of our service offerings.

KiwiRail's competitive advantage is in moving heavier goods over long distances, and we have made a conscious decision to only operate in certain markets in line with the value proposition of our service offering.

KiwiRail maintains and manages the 4,000km track network which has more than 1,500 bridges, more than 90 tunnels and more than 6 million sleepers. This network runs through often difficult terrain. The case can be made that the network provides value to New Zealand as a whole. The Crown continues to provide ongoing financial support to maintain the network. The cost of the track network is high even in areas with little demand for train services. As part of our responsibility as a State-

owned Enterprise to run our business in a commercial manner, we need to address our underperforming and costly assets.

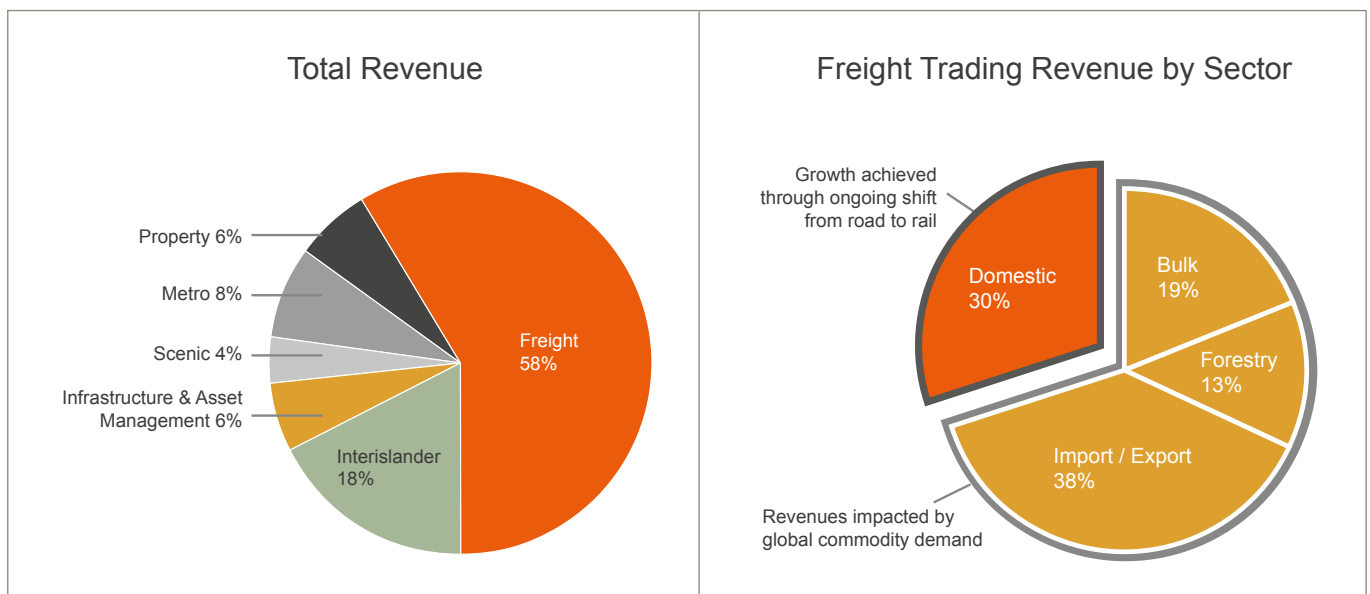
Sector outlook

Future performance of the rail freight business is largely dependent on the outlook for commodity-driven activities. The current outlook for key commodities such as coal, forestry and milk-based products is concerning as global demand has fallen, and the immediate outlook over the next three years for these commodities is challenging.

The prospects are brighter, however, for KiwiRail's other business areas. We are actively targeting both the domestic (wagon and container) and import and export (IMEX) sectors which are both forecast to grow. The move by shipping lines to use bigger cargo ships is a positive opportunity for KiwiRail as this leverages our ability to aggregate and move large volumes of freight, with speed, to and from ports.

New Zealand ports are also getting more deeply involved in New Zealand's domestic and import/export supply chain. Port investments in freight hub and inland port infrastructure, capacity commitments with KiwiRail and partnerships such as CODA (Port of Tauranga) and Netlogix (Ports of Auckland) are all influencing New Zealand's supply chain landscape.

Rail volumes have risen significantly in 2015 with CentrePort in Wellington and Port of Auckland and this growth is expected to continue in 2016.



The charts above show the source of KiwiRail's revenue, and a breakdown of KiwiRail's freight revenue by sector. In terms of our 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.



Southdown freight yard. Photo: Alex Wallace

Reshaping and delivering

Our focus for the next two years is to reshape the business to ensure we can meet our customers' needs in the most efficient and effective way possible, and deliver both financial and operational results. KiwiRail is building significant momentum for change, and the next two years will see us simplifying our business, standardising our assets, and investing in our people to help us achieve this goal.

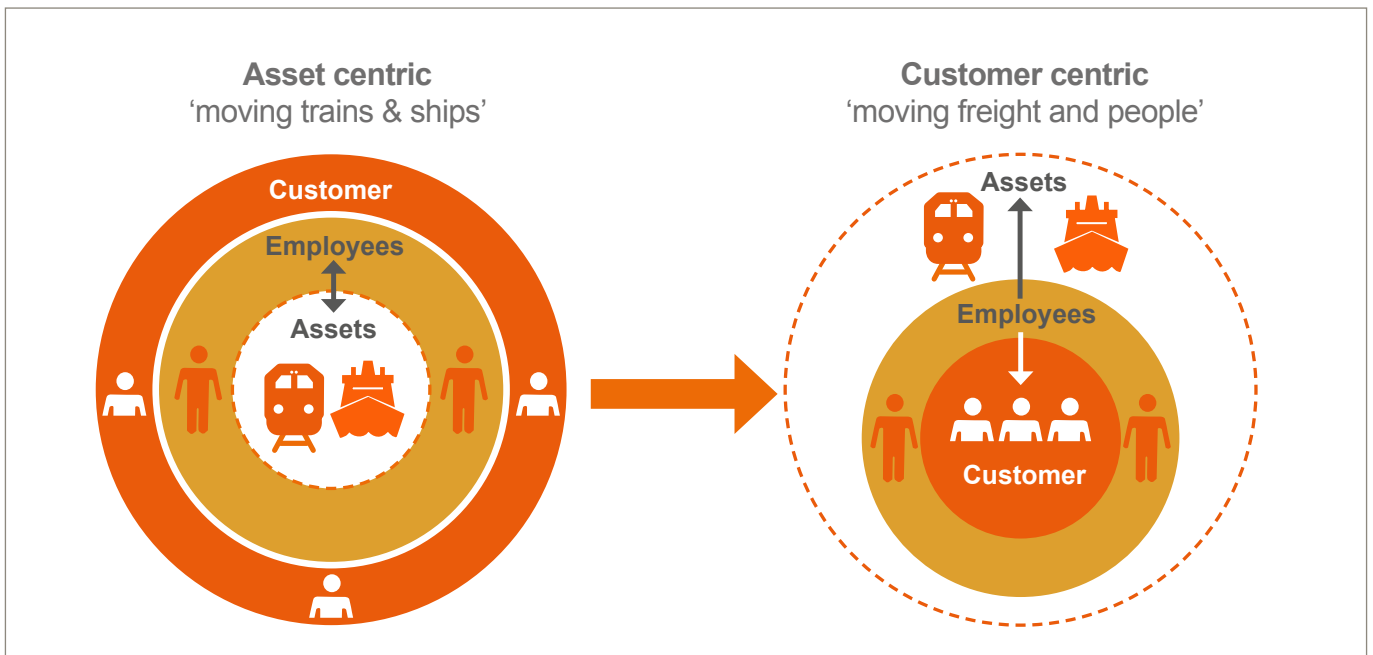
Sustaining a Zero Harm environment

We are fully committed to the safety of our people, with a strong emphasis on achieving and sustaining a Zero Harm environment. We intend to build on our credible performance in this area over the last 12 months, with Zero Harm performance being a proxy for leadership in our organisation.

Engaging our customers and stakeholders

We have established the 'One KiwiRail' strategy to become more customer-centric, based on the premise that we don't move trains and ships, we move freight and people. This new focus helps to make the needs of the customer paramount in everything we do. We are committed to helping make our customers competitive in their markets, being easy and reliable to do business with, and seamlessly bundling our rail, ferry, infrastructure and property services. Core to our strategy is the development of intermodal services which enable us to improve the utilisation of our assets across our customer base. We will actively pursue opportunities with our customers to help us build this intermodal strategy.

We intend to work more collaboratively with the NZ Transport Agency and Ministry of Transport to ensure that KiwiRail is an integral part of the solution to New Zealand's transport needs.



Delivering operational performance

In order to deliver our operational performance, we are simplifying our operating model and standardising our assets. We will have a sharp focus on reducing the cost of operations through productivity and efficiency initiatives. We will also be looking carefully at uneconomic areas of our business and assessing our options, which could range from different funding partnerships, to exiting uneconomic corridors or services.

Within KiwiRail's Property operations, the focus is on continuing to review and rationalise the company's property portfolio. KiwiRail will seek improved leasing arrangements to generate market-aligned returns from the property portfolio, as well as property development and sales initiatives where these make commercial sense.

Empowering our people

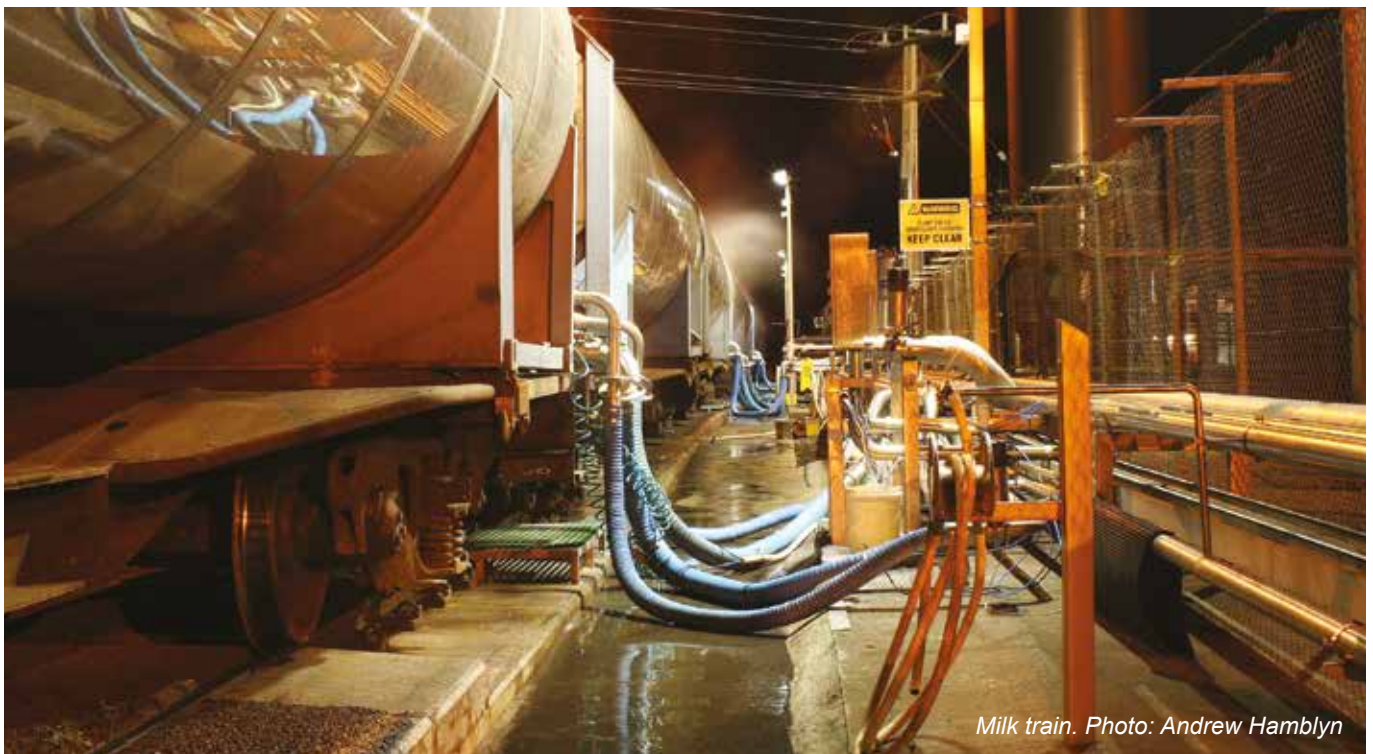
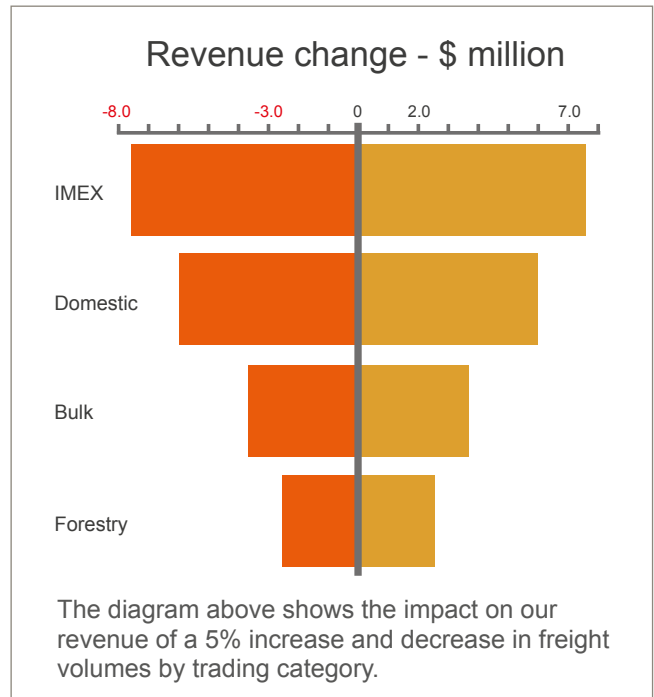
All our staff have a part to play in helping to deliver our strategic objectives. A key tool for lifting the company's performance will therefore be the development and implementation of a High Performance, High Engagement culture within KiwiRail. We are implementing this strategy to ensure all staff are increasingly focused on output and performance, and are empowered to identify changes to improve performance.

Meeting our financial targets

In line with the clear expectations of shareholding Ministers, the executive and management teams are also committed to improving KiwiRail's financial position to reduce the amount of taxpayer support in future.

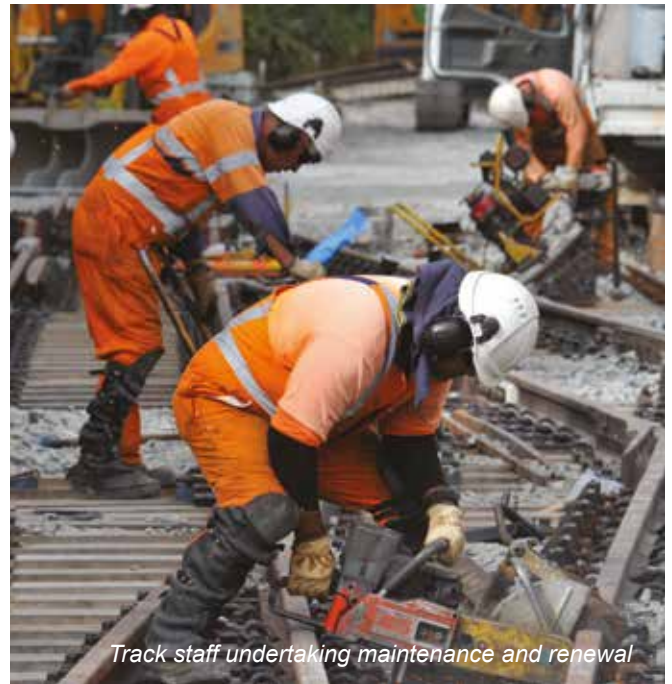
We are forecasting an operating profit range of \$83 - \$92 million for the 2015/16 year. This is lower than the Commercial Review forecast, reflecting the challenging current outlook for core commodities markets. Our reliance on these markets means our Group revenue is now forecast to be \$702 - \$710 million. Our forecast operating profit remains sensitive to volume and price pressures in key markets.

The impact of these revenue challenges on 2015/16 means we are aggressively focusing on a programme of targeted initiatives to reduce costs and increase productivity within the business.



Our strategic objectives and performance measures

During 2014/15, and following on from the Commercial Review, we implemented a 'Back to Basics' performance framework across the organisation. As a result, we have identified five strategic objectives, each underpinned by a number of initiatives, to help us move to where we want to be. As these objectives are fundamental to achieving our strategy, this is how we will measure ourselves when assessing our performance. The objectives and performance measures are outlined below.



Aspiration:
Improving Zero Harm performance to Australasian best practice levels

Objective:
Sustaining a Zero Harm Environment

Our focus:

- Broaden our understanding and mindset of Zero Harm
- Continued reduction in injuries, with a minimum reduction rate of 30% per year
- Reduction in carbon emissions of 3% per year

	2015	2016	2017	2018
	Forecast	Plan	Plan	Plan

Key performance measures

LTIFR	8.8	6.2	4.3	3.0
TRIFR	16.7	11.7	8.2	5.7
GHG emissions per NTK (gms)	31.5	30.3	29.4	28.5

Aspiration:

- Best in class customer loyalty measures
- Deep understanding of the true value of rail to New Zealand

Objective:
Engaging our customers and stakeholders

Our focus:

- Strategic partnerships with our key customers
- Profitable growth in defined markets
- Clearly defined service offerings to customers
- Collaborate with the NZ Transport Agency and Ministry of Transport on integrated land transport initiatives

2015	2016	2017	2018
Forecast	Plan	Plan	Plan

Key performance measures

	2015	2016	2017	2018
	Forecast	Plan	Plan	Plan
Rail Freight Customers - Net Promoter Score	(5)	(1)	5	5
Commercial Vehicle Customers - Net Promoter Score	2	5	10	15
Interislander - Net Promoter Score	33	35	37	40
Scenic Journeys - Net Promoter Score	63	64	65	66
Tranz Metro - Customer satisfaction (%)	92	93	94	94



Aspiration:

- On-time performance above 90%
- Total cost of operations less than 85% of revenue

Objective: Delivering operational performance

Our focus:

- Simplify the operating model
- Further improve on-time performance
- Optimise assets through standardisation and investment
- Reduce the cost of operations through productivity and efficiency initiatives

2015 Forecast	2016 Plan	2017 Plan	2018 Plan
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Key performance measures

Ontime Performance (%)

- All Freight Trains	93	94	94	94
- Freight Premium Trains	79	82	86	90
- TranzMetro	93	94	94	94
- % Interislander services to advertised sailings	98.5	99	99	99
Fuel litres per GTK	5.6	5.5	5.5	5.4
Operating costs as a percentage of revenue	87	88	85	85

Network Renewals

- New Sleepers Laid (000)	82	82	85	77
- New Rail Laid (km)	20	13	21	19
- Lines De-stressed (km)	126	153	153	139



Aspiration: Best in class staff engagement measures

Objective:
Empowering our people

Our focus:

- Build a High Performance High Engagement culture
- Grow leadership capability and retain key talent
- Simplify and standardise our working practices

2015	2016	2017	2018
Forecast	Plan	Plan	Plan

Key performance measures

Employee Engagement Net Promoter Score	N/A	(15)	(5)	5
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Aspiration:

- Decreasing reliance on taxpayer funding
- Long-term funding model in place

Objective:
Meeting our financial targets

Our focus:

- Improve contribution margin to 28%
- Improve operating surplus as a percentage of revenue to 15%
- Maximise capital efficiency

2015	2016		2017	2018
Forecast	Plan (Low)	Plan	Plan (High)	Plan

Key performance measures

Revenue (\$m)	721	701	703	710	729	750
Contribution Margin (%)	26	25	26	26	27	28
Operating surplus (\$m)	91	83	85	92	108	116
Operating Surplus as % of Revenue	13	12	12	13	15	15
Capital Expenditure - net of grants (\$m)	249	280	282	282	319	271

Required information

	2015	2016	2017	2018
	Forecast	Plan	Plan	Plan
Shareholder Return Measures				
Total Shareholder Return	N/A	N/A	N/A	N/A
Dividend Yield	0	0	0	0
Dividend Payout	0	0	0	0
Return on Average Equity (%)	(33)	(43)	(57)	(53)
Profitability/Efficiency Measures				
Return on Average Capital Employed (%)	(22)	(30)	(37)	(35)
Operating Margin (%)	13	13	15	15
Leverage/Solvency Measures				
Shareholders' Funds to Total Assets (%)	55	56	53	51
Gearing Ratio - net (%)	33	28	37	32
Interest cover	7.3	6.9	8.4	9.3
Solvency (current assets/current liabilities)	1.09	1.36	1.21	1.24

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.

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 has used the method of discounted cash flows (DCF) to estimate the value of the KiwiRail Group as at 30 June 2015.

There has been a reduction in the commercial value related to operating free cash flows of \$287 million. This reflects the reduction in operating surplus projections as a result of lower revenue growth projections 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.

There has been a decrease in the discount rate of 0.5% as a flow on effect from the risk free rate* lowering from 4.75% to 4.0%. The impact of this is a reduction in value of \$60m.

\$m	30 June 2014	30 June 2015
Present Value of Pre-Tax Free Cash Flows	(1,088)	(1,375)
Less Present Value of Tax Payable on Ungeared Earnings	0	0
DCF Enterprise Value	(1,088)	(1,375)
Less Net Debt	(206)	(170)
DCF Equity Value (commercial valuation)	(1,294)	(1,545)

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 operating plan, with forward projections made through years 4 to 20 consistent with the Commercial Review undertaken in 2014.
- A terminal value of zero has been assessed.
- A discount rate of 9% has been used (as compared to 9.5% for the 2014 valuation).
- PwC has confirmed the mathematical accuracy of the calculation of the DCF valuation prior to approval of the DCF value by the Board

*Risk free rate taken from PwC "Appreciating Value" March 2015

APPENDIX 1: Performance Measure definitions and glossary

Definitions of SOE Performance measures

Total Shareholder Return	$(\text{Commercial Value}_{\text{end}} \text{ less Commercial Value}_{\text{beg}} \text{ plus dividends paid less equity injected}) \text{ divided by Commercial Value}_{\text{beg}}$
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

Glossary

Contribution Margin	Revenue less fixed and variable costs, expressed as a percentage of revenue
EBIT	Earnings before interest and tax
GHG	Greenhouse Gas
GTK	Gross Tonne Kilometre
Line De-stressing	De-stressing rail is a process undertaken to minimise the risk of the rail line buckling in hot conditions.
LTIFR	Lost Time Injury Frequency Rate. A lost-time injury is defined as an occurrence that results in time lost from work of one day/shift or more, permanent disability or a fatality. Lost-time injury frequency rates are the number of lost-time injuries within a given period relative to the total number of hours worked in the same period.
Net Promoter Score	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.
NPAT	Net profit after tax
NTK	Net Freight Tonne Kilometre
Operating Surplus	Net surplus (revenue minus expenditure) before interest, taxation, grant income, derivatives fair value change and gross fair value adjustments.
TRIFR	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

Statement

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 2018.

*Front cover: Catherine Baker, Train Manager / Service Manager
TranzAlpine and Coastal Pacific. Photo: Brendon O'Hagan.*

