2018 AGM

CEO's Address

Thank you Mr Chairman,

I would like to start by summarising our key achievements in FY18. These slide behind me will be available online at the conclusion of this meeting. First and foremost, we have done a solid job of keeping everyone safe this year. As the Chairman noted, the company is profitable with an EBITDA of $4.0m for the year. We were successful in driving more than $2m of costs out of the business year on year, and in doing so, we managed to achieve exceptional turbine availability, at over 98%.

I will start by dwelling a little on our health and safety performance. As you will appreciate, maintaining turbines is a complex and potentially hazardous business. We have a strong safe work culture on site, and internal and external audits give us confidence in our systems and processes. In FY18 we have broadened our focus to adopt new industry benchmarks, and we have outperformed against all metrics.

We completed the year with no recordable incidents. Keeping everyone safe remains our number one priority.

I would like to provide a recap of our progress over the last 18 months on the key strategic initiatives we identified in early 2017. Our curtailment regimes help to make us consistent with best practice and I have mentioned our progress in reducing costs. We have solved debate around noise emissions with the s128 process firmly behind us, and we are busy maintaining the electrical reticulation assets we purchased this time last year following your support of resolutions at the 2017 AGM. We have been very successful in working with the industry regulator, the Electricity Authority, to change both the market rules as the relate to wind energy, and in achieving interim dispensation to curtail on price. We have also been successful in managing our revenues through hedging. In early 2017 we promised you that we would get these things sorted, and that is exactly what we have done.

For FY18, we produced around 103GWh post curtailment. In the absence of curtailment our production would have been higher, but the key here is how we align production to the cost to run. That notwithstanding, FY18 was a pretty low wind year for us, underscoring the importance of financial hedging, which earnt us $450k for the year, to bring total electricity revenues to $7.6m.

Electricity price for the year was quite good at a shade under $70/MWh, which when hedging gains are included improved to around $74/MWh.

We have an ambitious work programme for the year, focussed around four workstreams. We are looking to continue to build separation between revenue and cost to run and we continue to work on our consents and in building social license to operate. While we have made big changes to our cost base we have more work to do in bedding these changes in, and we plan to continue to evolve our turbine management strategies. I will now touch on each of these initiatives in turn.

Operating separation, that being the gap between what a turbine earns in revenue and what it costs to run in parts and servicing, is profit. However, this interplay between turbine revenue and run cost is complex. To understand cost to run, in wind farming we use the short run marginal cost, which is essentially the mechanical cost per MWh. While we can calculate an average short run marginal cost for the whole wind farm (in wind farming this typically being around $15 to $20/MWh), this is in fact a continuum with a very wide spread. In relatively calm conditions when the wind direction is optimal and we have smooth laminar flows, it can cost as little as $1/MWh or $2/MWh to run a turbine. However, when we get gusty southerlies, for example, the short run marginal cost can be as high as several hundred dollars per megawatt hour. If the market price in these conditions is, say, $50/MWh, running that turbine is costing us money – this is why we have been so focussed on this issue. Clearly, curtailing turbines when cost to run is above market price is a profit imperative for a wind farmer.

However, until recently, the market rules did not permit elective curtailment on price. As I mentioned, after we undertook extensive lobbying alongside a number of gentailers, the industry regulator, the Electricity Authority, changed the wind offer rules, essentially permitting us to curtail on price. However, it was then unclear when the system operator, Transpower, would make the necessary physical changes to the wholesale market trading system. As such, we sought and received from the EA interim dispensation to curtail on price, and we commenced doing so early this year. It is still unclear when Transpower will make the required market changes, but we have this benefit right now, and we are confident it is proving effective. We also changed our control room provider recently, from Vector to Trustpower, both as it was commercial advantageous and as this better positions us ahead of these trading system changes. What this rules relief did was to permit us to put in place our three-axis curtailment strategy.

What three-axis curtailment does is to assess wind speed and turbulence intensity in real time, and each turbine solves to a market price required to run profitably. Based on the forecast price and a number of technical constraints, the turbine either runs or shuts down. Of course, actual market price may be different from final market price, and there remain significant opportunities to refine this regime.

The key question of course is whether this strategy is working. We monitor this very closely, and it is not an easy relationship to model, particularly when we are doing this to a turbine fleet that has been run hard for around seven years without the benefits of curtailment. What we can report however is that the definable directly countable savings exceed the revenue forgone by a significant margin, and this is a key contributor to our EBITDA result.

One of a number of key indicators of the success of all our operating interventions, including three-axis curtailment, is major component failure rate. The decline in the failure rate of most key components over the last three years is particularly encouraging and reflects what has been achieved by the team in recent times. As these failure rates decline, we can have confidence both in the underlying quality of the turbine platform, and in our ability to operate the fleet successfully for profit.

We are continuing to gather more data with time and we will report on our progress. Of course, what is most interesting is the inverse relationship between market price and the degree of curtailment – as market pricing improves, and it is forecast by most market commentators to steadily improve, less curtailment occurs, contributing to the bottom line.

For the last eighteen months, the company has been engaged in a genuine process to build social license to operate. Obviously, to do this we had to put an end to noise litigation. Putting voluntary curtailment in place as quickly as we could, as a new team in early 2017, was an essential first step and a real gesture of good faith. We have refined that regime twice to make it more effective for our neighbours, and it has minimal effect on revenue as it occurs in very specific non-prevailing conditions where our neighbours are located directly downwind. What all our activities around noise have done is to give us a real opportunity to engage meaningfully with our neighbours. Almost all of them support wind farming; what the company had failed to do was to appropriately manage very specific and entirely manageable effects. We're not entirely done in getting this right, but we have come a very long way.

We also recently launched a community engagement programme, where we plan to build upon our role in hosting multisport events and school visits on site to provide wider support to key community initiatives.

We see our commitment to strong social behaviours as an imperative for a major infrastructure owner. We work with the local environment, local companies and local people to generate renewable energy, and we must manage all impacts of our operations to the best of our ability. In time, this will provide us with a strong social license to operate, and in doing so will give us greater long-term optionality on our site, which will be valuable.

As we move into FY19, we remain focused on bedding in and locking down our operational performance. While we achieved a lot in FY18, a number of our key initiatives provided part year benefits only. Purchasing the electrical reticulation assets saved us around $500k for the FY18 year and headcount is down year on year from 16 to 11, and I believe our team is now largely right-sized. Our mechanical parts cost has come down significantly and we have eliminated noise litigation costs from our business.

Against this lower cost backdrop, turbine availability would be expected to suffer. However, we have been able to lift turbine availability from 96.1% to 98.4% year on year. I want to note my view that this is a direct function of initiatives put in place but also huge commitment from my exceptional team on site. At an operational level, we really have had an exceptional year.

As I mentioned, we have eliminated over $2m of costs from our business, representing a 36% year on year reduction. For an infrastructure business this represents a very significant change.

We are working on a number of initiatives to further improve operational performance. We have completed the building blocks that we hope will permit us to do this, and we are currently working on a five or six axis curtailment strategy to better refine the revenue/cost to run relationship. This will be a big focus for FY19.

Our before tax profit was $0.78m, driven off a solid EBITDA result. While we have made this business sustainably profitable on an operating basis, as you will have noted in our annual report, the market continues to be an uncertain place for an independent generator. We do however see the wholesale market continuing to evolve, and we trust that this will bring some opportunity for us.

As the Chairman has said, being a small independent wind farmer is a very hard place to be. We will continue to focus relentlessly on the operational initiatives I have outlined that will drive performance. These are important for the company but are even more relevant as we contemplated wider strategic options. Everything we have achieved over the last 18 months improves this positioning, and there is potential to leverage this work and our core assets to create further value. My team and I will do everything we can to support and maximize this value for the benefit of our shareholders.

As always, I appreciate your patience and support as we continue the journey.

Thank you.

John Worth

CEO