SOUTH PORT NEW ZEALAND LIMITED

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2019 ANNUAL MEETING NZX AND MEDIA STATEMENT

Rio Tinto review warrants attention

South Port New Zealand Limited has urged the Government to recognise the risk represented by Rio Tinto's strategic review of the viability and competitive position of the New Zealand Aluminium Smelter (NZAS).

Speaking at the Port operator's Annual Meeting, South Port Chairman Rex Chapman said while there had been comment that Rio Tinto (the operator and majority shareholder in NZAS) was 'crying wolf', it would be wrong not to take the review seriously. "NZAS was well justified in arguing that it is paying too much for transmission costs."

"It must be remembered that the NZAS was built in the 1970's in conjunction with the Manapouri Power Scheme with a dedicated transmission line. The book value of the dedicated grid infrastructure was $72M in 2014."

More recently, Transpower has upgraded its infrastructure in the North Island and has spent several billion dollars doing so. It has sought to pay for this by charging all customers more. NZAS is now being charged $65-70M p.a. - almost the same as the book value of its dedicated transmission infrastructure."

As a result of this, NZAS is now operating at a very significant loss, yet is obtaining very little benefit from Transpower's recent transmission infrastructure spend.

The Electricity Authority has been undertaking a review of transmission pricing for the last ten years but it appears to be no closer to imposing a fairer model. Its latest proposal would reduce NZAS transmission costs by ~$11M p.a. but only from 2024.

"Quite apart from the serious financial impact on Invercargill and the Southland region the closure of the Smelter will still mean that the production loss at Tiwai will need to be met elsewhere in the world, most likely from a smelter that is not powered by renewable energy."

Mr Chapman clarified the position of South Port in the event of a closure of the Smelter, which represents 33% of cargo volume at Bluff.

However, South Port receives no wharfage revenue for raw material passing across the Tiwai Wharf (across the harbour from main port operations) and instead earns a fee fixed until 2043 for the wharf structure. While NZAS is an important customer, the overall contribution to South Port net profit (excluding the licence fee) is less than $2M.

Repairs cost factor for 2020

South Port has signalled that the 2019-20 annual results will reflect increased expenditure on ageing port assets to ensure critical wharf and infrastructure remains ‘fit for purpose’.

“Although we have achieved good cargo and revenue growth, the repairs and maintenance burden has increased at a greater rate,” said Rex Chapman.

In the 2019 year, South Port set net profit ($9.79M, up 1%) and revenue records, bulk cargoes contributing 87% of all tonnage and log cargoes reached 700,000 metric tonnes. Adding woodchip exports, forestry is now 31% of total bulk cargo volumes.

Container transfers increased by 25% to 48,700 TEU, after both organic growth and a sizable lift in market share.

South Port had set a 5-year target of 50,000 TEU as part of the business case supporting the purchase of a second mobile harbour crane in 2014. The Company is now close to achieving the throughput target.

A key customer, Open Country Dairy is to construct a third dryer at Awarua, Southland that will be operational from the 2020-21 season. South Port is providing warehousing for Open Country’s milk powder exports.

Forestry exports are expected to reduce in the current year; log prices have reduced because of a fall in demand in India and China.

Log prices tend to be cyclical and prices and volume are expected to improve, but the timeline is uncertain.

Recent wet weather in Southland has negatively impacted on the import of bulk fertiliser.

In an adjustment to the earlier forecast of an earnings reduction of around 5%, the Company now expects earnings will be around 10% lower. However, the Company would seek to maintain the dividend level at the current 26 cents per share.

Mr Chapman said that in 2019 South Port updated the 10-year Asset Management Plan and it includes below ground infrastructure. The Company now has a more robust plan which allows future costs to be forecast with more certainty.

A greater allocation of financial and human capital will occur over the next three years, following which such expenditure will return to a more stable state.

Mr Chapman said, “South Port recognises that social and environmental outcomes should be recorded and reported to shareholders and stakeholders, and the 2019 Annual Report includes commentary on social responsibility and the Company’s first report on emissions will benchmark decisions taken to reduce them.”

Mr Chapman noted an exploration well will be drilled by OMV in the Great South Basin this summer.

The expectation is that if there is a discovery, the geology suggests it is most likely to be gas, which can provide "important transition energy to achieving a low carbon economy."

He notes that the Interim Climate Change Committee earlier this year advised the Government not to pursue a target for 100% renewable power 2035. They stated it would be too expensive and would deliver little emissions reduction. It instead urged the Government to accelerate its efforts to electrify transport and industry."

Many major industries in Southland could convert to gas powered generation, which would result in significant reductions in carbon emissions. A gas find would also provide much needed certainty of supply "and make a positive contribution to achieving the Government's 2050 zero carbon target."

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