UnitedNetworks Limited

INDEPENDENT ADVISER'S REPORT

Prepared by

GRANT SAMUEL & ASSOCIATES LIMITED

Auckland ▪ Sydney ▪ Melbourne

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1 Terms of the Takeover Offer

On 10 September 2002 VECTOR Limited ("Vector") announced its intention to make a full takeover offer (the "Vector Offer") to acquire all of the equity securities in UnitedNetworks Limited ("UnitedNetworks") at a price of $9.90 per ordinary share.

The Vector Offer was a result of an extensive sale process involving a number of competing bidders for the shares and/or assets of UnitedNetworks. The sale process was initiated by Aquila Inc, the parent company of UtiliCorp NZ Limited ("UNZ"). Through UNZ, Aquila Inc is the largest shareholder in UnitedNetworks with control of 70.2% of the shares on issue. Aquila Inc wishes to realise its investment in UnitedNetworks and accordingly, on 12 June 2002, requested that UnitedNetworks seek indicative bids for either:

- all of the shares in UnitedNetworks; or
- all or substantially all of the assets and business of UnitedNetworks, either as a whole or for one or more of its three regional electricity distribution networks, its gas distribution network and its broadband communication network.

The sale process for the shares or assets of UnitedNetworks was run concurrently, with final binding offers submitted on 9 September 2002. A number of bids for the shares and assets of UnitedNetworks were submitted. The key details of the preferred bid, but not the name of the preferred bidder were disclosed to Grant Samuel after all the bids had been evaluated by UnitedNetworks and its advisers. On 9 September 2002 Grant Samuel advised the independent directors that the preferred bid was within its valuation range, based on the information received up to that date. On 10 September 2002, after due consideration, the independent directors waived the Cornerstone Relationship Deed that otherwise would have prevented Aquila Inc from accepting the Vector bid, and the independent directors of UnitedNetworks determined the Vector bid afforded the best value outcome for UnitedNetworks' shareholders. Aquila Inc has advised the New Zealand Stock Exchange ("NZSE") that it has agreed to accept the Vector Offer in respect of its entire shareholding in UnitedNetworks, subject to it obtaining certain consents from its lending bank syndicate. Aquila Inc has been granted 28 days from 10 September 2002 to obtain such consents, otherwise the Vector Offer will lapse. UNZ and Aquila Inc have undertaken not to sell or agree to sell its shareholding in UnitedNetworks to any party other than Vector for a period of 150 days from 10 September 2002.

The Vector Offer is conditional upon, inter alia:

- a minimum acceptance level of 70.19% of the issued shares in UnitedNetworks. This condition can only be satisfied by the sale of UNZ's 70.2% shareholding in UnitedNetworks to Vector; and
- during the period from 1 September 2002 up to the last date on which the Vector Offer may become unconditional, UnitedNetworks will not, without Vector's prior written consent:
  - declare, pay, or make a dividend, bonus issue or other distribution of any kind (other than the interim dividend of 19 cents per share paid on 6 September 2002 and including, but not limited to, any distribution, or return of capital) upon or in respect of any shares;
  - issue or make an allotment of, or grant an option or right to subscribe for, shares, or equity securities of any class to any person, or agree to make such an issue or allotment or grant such an option or right;
  - alter its share capital or any rights, privileges or restrictions, attaching to any shares;
  - alter its constitution other than to ensure compliance with the Listing Rules of the NZSE;
  - make, or permit to be made, any new allocation to any person under any existing scheme for the purchase of shares in UnitedNetworks by employees or any other entitled person;
  - acquire, or dispose of, to agree or dispose of, or grant or agree to grant any option or equitable interest in respect of an asset, for an amount in excess of $100,000, otherwise than in the ordinary course of business;
  - create or permit to arise any encumbrance over any assets except for purchase money security interests granted in relation to assets acquired in the ordinary course of business;
  - make any material or unusual change in any material business contract, other than in the ordinary course of business;

- do anything which could result in the termination of any material business contract, or which would otherwise defeat or materially prejudice any of them (other than in the ordinary course of business);
- enter into any new material business contracts or arrangements, other than in the ordinary course of business;
- change or agree to change, the remuneration or any of the other material terms of employment of any employee except for ordinary wage or salary increases in accordance with its established review policies or commence the employment of any person at a rate of remuneration in excess of $60,000 per annum; or
- enter into any arrangement or agreement or incur any commitment or liability in connection with the business having a value or involving an amount, or providing for payments over its term which are, in excess of $100,000, or having a term of more than 12 months.

However, UnitedNetworks is permitted to enter into the sale and purchase agreements relating to:

- the sale of UnitedNetworks' eastern region electricity network to Powerco Limited ("Powerco") and Hawkes Bay Network Limited ("Hawkes Bay Network") for $785 million; and
- the sale of UnitedNetworks' central region gas distribution network to Powerco for $220 million.

These arrangements have been entered into by UnitedNetworks as a requirement of the Vector Offer. The Vector Offer is not conditional upon the asset sales being completed.

The conditions listed above are structured such that, provided UnitedNetworks complies with the conditions, Vector will be bound to effect the full takeover offer. There are no conditions that allow Vector to alter or withdraw the Vector Offer at its sole or partial discretion. Offers received by UnitedNetworks that did not conform to this format were not considered by UnitedNetworks.

Profile of Vector

Vector owns the electricity distribution network which services central and southern Auckland. Vector has approximately 260,000 customers connected to its network.

As a result of the Energy Companies Act 1992 the assets of the Auckland Electric Power Board were corporatised to form Mercury Energy Limited, owned by the Auckland Electricity Consumer Trust. The customers of Mercury Energy Limited were the income beneficiaries of the trust and the capital beneficiaries were the local Auckland councils. As a result of the Electricity Industry Reform Act 1998, Mercury Energy Limited sold its energy retailing and generation assets and the remaining electricity distribution business was renamed Vector.

The Auckland Electricity Consumer Trust continues to own Vector, with Vector's customers receiving a dividend each year in the form of a rebate off their electricity account. The Auckland Electricity Consumer Trust has announced that if the Vector Offer is successful it will continue to pay dividends to the consumers within the boundaries of the local authorities that are its capital beneficiaries.

2 Scope of the Report

2.1 Requirements of the Takeovers Code

The Takeovers Code came into effect on 1 July 2001, replacing the Companies Amendment Act 1963 and the New Zealand Stock Exchange ("NZSE") Listing Rule requirements governing the conduct of listed company takeover activity in New Zealand. The Takeovers Code seeks to ensure that all shareholders are treated equally and, on the basis of proper disclosure, are able to make an informed decision as to whether to accept or reject an offer.

The Takeovers Code specifies the responsibilities and obligations for both Vector and UnitedNetworks as "bidder" and "target" respectively. UnitedNetworks' response to the Vector Offer, known as a "target company statement", must contain the information prescribed in the Second Schedule of the Takeovers Code, and is to include or be accompanied by an Independent Adviser's Report (or summary thereof). If only a summary report is included within the target company statement, the full report must be available to UnitedNetworks shareholders for inspection upon request.

2.2 Purpose of the Report

The Vector Offer constitutes a full takeover offer under Rule 8 of the Takeovers Code. Accordingly, the independent directors of UnitedNetworks have engaged Grant Samuel & Associates Limited ("Grant Samuel") to prepare the Independent Adviser's Report required under Rule 21 of the Takeovers Code setting out an assessment of the merits of the Vector Offer to assist UnitedNetworks shareholders in forming an opinion on the Vector Offer. Grant Samuel is independent of UnitedNetworks and Vector and has no involvement with, or interest in, the outcome of the proposed acquisition of shares in UnitedNetworks by Vector.

Grant Samuel has been approved by the Takeovers Panel under the Takeovers Code to prepare the Independent Adviser's Report. The report is for the benefit of the holders of UnitedNetworks shares (other than Vector and its associated persons). The report should not be used for any purpose other than as an expression of Grant Samuel's opinion as to the merits of the Vector Offer.

2.3 Basis of Assessment

Rule 21 of the Takeovers Code requires the Independent Adviser to assess "the merits of an offer". The term "merits" has no definition either in the Takeovers Code itself or in any statute dealing with securities or commercial law in New Zealand. The Takeovers Panel has not issued guidelines as to the interpretation of the term "merits".

Under the compulsory acquisition rules of the Takeovers Code, where the 90% threshold is reached as a result of a Takeovers Code offer and 50% of the shares not held by the offeror prior to the offer commencing have been acquired as a result of the offer, the price for the remaining shares is set at the original price offered. In the context of UnitedNetworks, if the Vector Offer reaches the 90% acceptance threshold then the compulsory acquisition price for the remaining shares will be the Vector Offer price of $9.90 per share. In other circumstances the compulsory acquisition price is a cash price specified by the dominant owner and certified as "fair and reasonable" by an independent adviser. The Takeovers Code provides no guidance as to the definition of "fair and reasonable".

In Australia, the phrase "fair and reasonable" appears in legislation and the Australian Stock Exchange Listing Rules as a basis for assessing takeover and similar transactions. The terms "fair" and "fair and reasonable" are both widely used tests or frameworks for analysing corporate transactions. However, there is very little useful legal or regulatory guidance as to the meaning of these terms. The Australian approach draws a distinction between "fair" and "reasonable" in relation to takeover offers. A fair offer is one that reflects the full market value of a company's businesses and assets. A takeover offer that is in excess of the pre-bid market prices but less than full value may not be "fair" but may be "reasonable" if shareholders are otherwise unlikely in the foreseeable future to realise an amount for their shares in excess of the bid price. This is commonly the case in takeover offers where the bidder already controls the target company. In that situation, the minority shareholders have little prospect of receiving full value from a third party offeror unless the controlling shareholder is prepared to sell its controlling shareholding.

Reasonableness is said to involve an analysis of other factors that a shareholder might consider prior to accepting a takeover offer such as:

- the offeror's existing shareholding;
- other significant shareholdings;
- the liquidity of the market for the target company's shares;
- any benefits through achieving 100% ownership;
- any special value of the company to the offeror; and
- the likelihood of an alternative offer.

A takeover offer could be considered "reasonable" if there were valid reasons to accept the offer notwithstanding that it was not "fair". A fair offer will always be reasonable but a reasonable offer will not necessarily be fair.

For the purposes of this report, Grant Samuel is of the opinion that an assessment of the merits of a transaction is a broader test than "fair and reasonable" and encompasses a wider range of issues associated with a takeover offer. Grant Samuel has assessed the merits of the Vector Offer after taking into consideration the following factors:

- the estimated value of UnitedNetworks and the fairness of the Vector Offer when compared to this value;
- the likelihood of an alternative offer and alternative transactions that could realise fair value;
- the likely market price and liquidity of UnitedNetworks shares in the absence of the Vector Offer;
- any disadvantages for UnitedNetworks shareholders of accepting the Vector Offer;
- the likelihood of the Vector Offer being declared unconditional;
- the likelihood of the Vector Offer not achieving the 90% compulsory acquisition threshold and Vector not increasing its offer;
- the attractions of the UnitedNetworks business; and
- the risks of the UnitedNetworks business.

Grant Samuel's opinion on the merits of the Vector Offer are to be considered as a whole. Selecting portions of the analyses or factors considered by it, without considering all the factors and analyses together, could create a misleading view of the process underlying the opinion. The preparation of an opinion is a complex process and is not necessarily susceptible to partial analysis or summary.

2.4 Approach to Evaluation of Fairness

The Vector Offer is for all the outstanding shares in UnitedNetworks and accordingly is a full takeover offer. In Grant Samuel's opinion, the price to be paid under a full takeover should reflect the full underlying value of the company. The support for this opinion is two fold:

- the Takeovers Code's compulsory acquisition provisions apply when the threshold of 90% of voting rights has been reached. In this instance, the Takeovers Code seeks to avoid issues of premiums or discounts for minority holdings by providing that a class of shares is to be valued as a whole with each share then being valued on a pro-rata basis. In other words, the minority shareholder is to receive its share of the full underlying value. Grant Samuel believes that the appropriate test for fairness under a full takeover offer is the full underlying value, pro-rated across all shares. The underlying rationale is that it would be inconsistent for one group of shareholders, those selling under compulsory acquisition, to receive a different price under the same offer than those who accepted the offer earlier; and

- under the old takeover provisions of the NZSE Listing Rules a controlling shareholding could have been transferred to another party without a full takeover offer being made to the remaining shareholders. Under the Takeovers Code it is now a requirement that the acquisition of more than 20% of the voting rights in a "code" company can only be made under an offer to all shareholders unless the shareholders otherwise give approval. As a result, a controlling shareholding (generally accepted to be no less than 40% of the voting rights) cannot be transferred without the acquirer making an offer on the same terms and conditions to all shareholders (unless target company shareholders consent). Prior to the introduction of the Takeovers Code some market commentators held the view that where a major shareholder had a controlling shareholding, any control premium attached only to that shareholding. One of the core foundations of the Takeovers Code is that all shareholders be treated equally. In this context, any available control premium is now available to all shareholders under a takeover offer regardless of the size of their shareholding or the size of the offeror's shareholding at the time the offer is made.

Accordingly, Grant Samuel is of the opinion that not only because shares acquired under a compulsory acquisition scenario will receive a price equivalent to full underlying value, but because the control premium is now available to all shareholders, the share price under a takeover offer should be within to or exceed the pro-rated full underlying value of the company.

Grant Samuel has considered whether the Vector Offer price is fair by comparing the consideration of $9.90 per share with its estimate of the full underlying value of UnitedNetworks shares. A takeover offer consideration that falls within or exceeds a valuation range estimated on this basis is fair. The estimated value was determined by:

- assessing the ungeared valuation of UnitedNetworks' operating businesses and aggregating those values;
- adding the value of other assets; and
- deducting the net debt of UnitedNetworks.

UnitedNetworks has been valued at fair market value, which is defined as the estimated price that could be realised in an open market over a reasonable period of time assuming that potential buyers have full information. The analysis attributes the full control value to UnitedNetworks. The aggregate therefore represents the full underlying value of UnitedNetworks. The resulting value exceeds the price at which Grant Samuel expects portfolio interests in UnitedNetworks would trade in the absence of the Vector Offer.

2.5 Sources of Information

The following information on UnitedNetworks was used and relied upon, without independent verification in preparing this report:

Non public information provided by UnitedNetworks:

- monthly management accounts for the current year;
- forecasts and budgets for the year to 31 December 2002;
- UnitedNetworks' three year financial plan 2002 – 2004;
- the Information Memorandum dated 1 July 2002 for the proposed sale of shares or the assets and business of UnitedNetworks;
- due diligence information provided to the prospective purchasers of the shares and assets of UnitedNetworks, including a presentation by UnitedNetworks management;
- other confidential reports and working papers prepared in relation to the proposed sale of UnitedNetworks; and
- other confidential reports and working papers prepared by UnitedNetworks management.

Publicly available information:

- annual reports of UnitedNetworks for the years ended 31 December 1999, 2000 and 2001;
- half year reports of UnitedNetworks for the six months ended 30 June 2000, 2001 and 2002;

- disclosures reported by UnitedNetworks under the Electricity (Information Disclosure) Regulations 1999 for the years to 31 March 2001 and 2002;
- the Electricity Asset Management Plan as at 31 March 2002; and
- other information on the electricity and gas industries and publicly listed businesses operating in those sectors including annual reports, interim financial results, information disclosures, price reports, industry studies and brokers' reports, and information regarding the prospective financial performance of those businesses.

Grant Samuel has also had discussions with and obtained information from the legal and financial advisers to UnitedNetworks.

2.6 Limitations and Reliance on Information

The opinion of Grant Samuel is based on economic, market and other conditions prevailing at the date of this report. Such conditions can change significantly over relatively short periods of time. The report is based upon financial and other information provided by UnitedNetworks. Grant Samuel has considered and relied upon this information. Grant Samuel believes that the information provided was reliable, complete and not misleading and has no reason to believe that any material facts have been withheld.

The information provided has been evaluated through analysis, enquiry, and review for the purposes of forming an opinion as to the underlying value of UnitedNetworks. However in such assignments time is limited and Grant Samuel does not warrant that these inquiries have identified or verified all of the matters which an audit, extensive examination or "due diligence" investigation might disclose. The time constraints imposed by the Takeovers Code are tight. This timeframe restricts the ability to undertake a detailed investigation of UnitedNetworks. In any event, an analysis of the merits of the offer is in the nature of an overall opinion rather than an audit or detailed investigation. Grant Samuel has not undertaken a due diligence investigation of UnitedNetworks. In addition, preparation of this report does not imply that Grant Samuel has audited in any way the management accounts or other records of UnitedNetworks. It is understood that, where appropriate, the accounting information provided to Grant Samuel was prepared in accordance with generally accepted accounting practice and in a manner consistent with methods of accounting used in previous years.

An important part of the information base used in forming an opinion of the kind expressed in this report are the opinions and judgement of the management of the relevant enterprise. That information was also evaluated through analysis, enquiry and review to the extent practical. However, it must be recognised that such information is not always capable of external verification or validation.

The information provided to Grant Samuel included forecasts of future revenues, expenditures, profits and cash flows of UnitedNetworks prepared by the management of UnitedNetworks and, in particular, forecast earnings for the year ending 31 December 2002. Grant Samuel has relied on these forecasts for the purpose of its analysis. Grant Samuel has assumed that these forecasts were prepared accurately, fairly and honestly based on information available to management at the time and within the practical constraints and limitations of such forecasts. It is assumed that the forecasts do not reflect any material bias, either positive or negative. Grant Samuel has no reason to believe otherwise.

However, Grant Samuel in no way guarantees or otherwise warrants the achievability of the forecasts of future profits and cash flows for UnitedNetworks. Forecasts are inherently uncertain. They are predictions of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of management. The actual future results may be significantly more or less favourable.

To the extent that there are legal issues relating to assets, properties, or business interests or issues relating to compliance with applicable laws, regulations, and policies, Grant Samuel assumes no responsibility and offers no legal opinion or interpretation on any issue. In forming its opinion, Grant Samuel has assumed that, except as specifically advised to it, that:

- the title to all such assets, properties, or business interests purportedly owned by UnitedNetworks is good and marketable in all material respects, and there are no material adverse interests, encumbrances, engineering, environmental, zoning, planning or related issues associated with these interests, and that the subject assets, properties, or business interests are free and clear of any and all material liens, encumbrances or encroachments;
- there is compliance in all material respects with all applicable national and local regulations and laws, as well as the policies of all applicable regulators, and that all required licences, rights, consents, or legislative or administrative authority from any government, private entity, regulatory agency or organisation have been or can be obtained or renewed for the operation of the business of UnitedNetworks;
- various contracts in place and their respective contractual terms will continue and will not be materially and adversely influenced by potential changes in control; and
- there are no material legal proceedings regarding the business, assets or affairs of UnitedNetworks, other than as publicly disclosed.

3 Background to the Electricity and Gas Industries

3.1 Background to the Electricity Industry

Industry Structure

Deregulation of the electricity sector in New Zealand began in 1987 with the corporatisation of the state-owned monopoly electricity generator, Electricity Corporation of New Zealand ("ECNZ"). Corporatisation of the locally owned retail utilities followed through the Energy Companies Act 1992 and in 1994 Transpower (the national grid operator) was separated from ECNZ. In 1996 ECNZ was split into two state-owned enterprises, the "old" ECNZ and Contact Energy. Contact Energy is now a publicly listed company. As a result of the Electricity Industry Reform Act 1998 (the "Reform Act"), the electricity sector is now divided into three distinct parts:

- ***Retail/Generation*** - These businesses generate or purchase electricity and sell electricity to the New Zealand electricity market or end user. Retail/generation businesses are prohibited from owning or operating networks to distribute electricity to the end-use customer. The largest owners of electricity retailing businesses are Meridian Energy, Mighty River Power, Genesis Power, Contact Energy and Trustpower. Currently these five electricity retail businesses service approximately 95% of all customers in New Zealand. While electricity retailers are not obliged to be electricity generators and vice versa most retailers have now elected to generate at least some portion of the electricity they require to service their customers as a hedge against market electricity prices. The five major electricity retailers together with Natural Gas Corporation ("NGC") own the majority of New Zealand's generation assets.

- ***Transmission*** - Transmission refers to the national high voltage distribution of electricity to local low voltage networks. Transpower, which remains a state owned enterprise, owns and operates the high voltage electricity transmission system in New Zealand including a high voltage direct current link between the North and South Islands. It contracts with generators regarding the connection, dispatch and other services provided to connect generators to its network and contracts with distribution businesses regarding the connection of their local networks to the national system. As part of recent sector reforms, the Commerce Commission has been afforded the power to determine Transpower's pricing methodology and to impose price controls on it in certain circumstances.

- ***Distribution*** - electricity distribution businesses are the regional low voltage network owners which operate the cables, wires, poles, switchgear and transformers that deliver electricity from the Transpower high voltage network to the end use customer. Distribution businesses are often referred to as 'lines' or 'network' businesses. Electricity distribution businesses do not have end use customers of their own. They charge retail electricity businesses (which "own" the customer) for the service of delivering electricity from the point of purchase to the end-use customer. As at 31 August 2002 there were 28 distribution businesses ranging in size from those servicing 4,000 end use customers to UnitedNetworks, which is the largest electricity distribution business in New Zealand and services over 500,000 end use customers. Some of the distribution businesses are privately owned or listed. Others are owned through various structures but often by trusts or consortiums representing local councils or electricity consumers.

A key objective of the Reform Act and the separation of the key operating components of the electricity sector was to promote retail competition and ultimately reduce prices to the consumer.

Distribution Businesses

Distribution businesses' revenue is derived from the retail electricity businesses who use the network to sell electricity to their customers. Retailers acquire the electricity from generators and set the prices for their end customers. Accordingly, they bear the risks of movements in electricity pricing. Distribution businesses provide the "transportation" of electricity effectively on a fee for service basis, and therefore have a very different risk profile. Distribution company revenue typically comprises a fixed charge (daily or monthly) per connection on the network and a variable charge based on the quantity of electricity transported. Electricity retailers then bundle these "lines charges" into their own pricing structures to end-use consumers.

Distribution businesses' charges also include transmission although Transpower costs are often incorporated on a straight "pass through" basis. Transmission costs are usually the largest expense item for an electricity distribution company. Distribution businesses pay transmission costs to:

- Transpower – in the form of ancillary service, interconnection, connection, new investment and economic value added charges; and where they exist to
- Embedded generators – to pass on the savings in Transpower charges which accrue to the distribution company because the generator is situated within its network.

The Ministry of Economic Development calculates the line charges on each distribution network, and the average line charge in New Zealand is 6.60 cents/kWh. The table below shows the line charges for a selection of larger electricity distribution businesses:

Domestic Line Charges – Average Price (c/kWh) as at 15 May 2002	
Distribution Business and Region	**Average Price (c/kWh)**
UnitedNetworks (Northern Region)	6.52
Vector (Auckland)	5.22
WEL (Waikato)	6.51
UnitedNetworks (Tauranga)	6.75
Powerco (New Plymouth)	7.73
Powerco (Manawatu)	9.71
UnitedNetworks (Wellington)	6.59
Orion NZ (Christchurch)	5.99
Weighted Average for New Zealand	**6.60**

Source: Ministry of Economic Development

Line charges tend to vary depending on the profit requirements of the owners and on the size and density of the network. Many distributors are trust or local authority owned and have return on investment requirements that are less than those of publicly listed companies. Importantly, capital expenditure and maintenance costs tend to be lower for larger or more dense networks such as those in major urban centres.

Regulatory Regime

Electricity distribution businesses are currently subject to light-handed regulation in New Zealand. The Electricity (Information Disclosure) Regulations 1999 and its subsequent amendments require electricity distribution businesses to publicly disclose financial statements, asset values calculated using a Optimised Deprival Value ("ODV") methodology, financial performance measures, network statistics and performance measures, pricing tariffs and asset management plans. The public disclosure of such measures, particularly profitability measures such as return on investment provide industry watchdogs and the public with detailed comparative information. However there is no specific control of pricing tariffs or profitability.

In early 2000 the Government announced a Ministerial Inquiry into the electricity industry. The recommendations of the inquiry were released in June 2000 and included the rationalisation of current industry arrangements under a single self-governing structure and the introduction of a targeted form of price regulation. The Electricity Industry Bill was passed into law in August 2001 to implement the recommendations of the Ministerial Inquiry and the Commerce Commission was empowered to oversee the introduction of regulation. A targeted rather than universal form of price regulation was preferred, as operating efficiencies and profitability vary significantly between electricity distribution businesses. A key component of the targeted regulatory regime is to set thresholds against which the performance of electricity distribution businesses will be assessed. Once the thresholds have been agreed upon and set, the Commerce Commission will be able to investigate and report on any breach of the thresholds by an electricity distribution business for the purposes of determining whether it intends to regulate that business. In March 2002 the Commerce Commission released a discussion paper on regulation of electricity lines businesses indicating the four possible thresholds under consideration:

- a price efficiency threshold, being either a breach of a price path criteria and an inability to demonstrate efficiency or by benchmarking;
- a profit threshold, measured as the return on investment on the asset base. ODV is often considered to be an appropriate asset base measure;
- a sharing threshold, where excess profits due to the benefits of efficiency gains would be expected to be shared with consumers; and
- a service quality threshold, which would measure the average quality of service against appropriate standards.

The Commerce Commission has stated that its preferred approach is to focus on the price efficiency and service quality thresholds. There is understood to be some resistance to a profitability threshold because such an approach may potentially disincentivise the electricity distribution businesses to invest in their networks, undertake innovations or reduce costs. The Commerce Commission has proposed a timetable for designing and implementing the regulatory regime:

Commerce Commission – Electricity Regulation	
Stage	**Timetable**
Design and implementation of thresholds and associated supporting valuation and information disclosure aspects	By October 2003
Reporting of information for initial assessment against thresholds	For some thresholds by October 2004 For all thresholds by October 2005
Investigation of any breaches	Not defined
Implementation of any regulation measures for distribution businesses that breach a threshold and on which the Commerce Commission decides to impose targeted regulation.	Not defined

In summary, the regulatory regime governing the future of the New Zealand electricity industry is still in the process of being determined and, notwithstanding the indications of the Commerce Commission, the final outcome cannot be predicted with any certainty. The final form of the regulatory regime will impact on UnitedNetworks and all other New Zealand electricity distribution businesses.

3.2 Background to the Gas Industry

Industry Structure

The New Zealand gas industry is based around the distribution of natural gas and LPG from gas and oil fields located in the Taranaki Basin. Unlike the electricity industry, the gas industry has no regulated ownership division between gas producers, wholesalers, transmission companies, distribution companies and retailers. As a consequence a number of industry participants operate in two or more of these sectors.

The offshore Maui field is the main source of natural gas to the industry with smaller fields such as Kapuni, McKee and TAWN providing further reserves. The sale of gas in New Zealand is characterised by a set of exclusive and long term contracts between the producers of gas and a small number of downstream users or retailers. Many of these contracts contain strong "take or pay" components. The major users of gas in New Zealand are:

- Methanex, for the manufacture of methanol (approximately 40% of total gas consumption);
- Contact Energy, Genesis Power and NGC for electricity generation (approximately 35%); and
- other industrial, commercial and residential users (approximately 25%).

Gas is supplied for distribution by NGC which owns and operates about two thirds of New Zealand's 3,200 km of high pressure gas transmission pipelines. The rest of the high pressure network is owned by Maui Developments Limited and is operated by NGC. NGC provides open access natural gas transportation services to gas users, subject to capacity constraints.

Gas is reticulated across localised distribution networks in the North Island to end use commercial and residential consumers. The owners of local gas distribution networks are NGC (Northland, Auckland, Waikato, Bay of Plenty and Kapiti), Powerco (Taranaki, Central North Island and Hutt Valley) and UnitedNetworks (Auckland, Wellington, Horowhenua, Manawatu and Hawkes Bay).

Retailers of gas to end-use customers include NGC, Contact Energy and most other major electricity retailers.

Regulatory Regime

The natural gas industry has undergone a degree of reform and restructuring since the mid 1980s but not to the same extent as the electricity industry. New legislation was introduced into the gas industry in the form of the Gas Act 1992. Exclusive area franchises and price control were abandoned in favour of a comprehensive light handed disclosure regime designed to create a more contestable market. Light handed regulation consisted of three components:

- comprehensive information disclosure to facilitate monitoring of the financial and operational performance of the gas distribution businesses;
- the use of the Commerce Act 1986 to deal with anti-competitive behaviour; and
- the threat of future regulation, such as the introduction of price control, if market dominance was abused.

In March 2001 the Government announced that a review of the gas industry would be undertaken which would look at *"ensuring energy is delivered in an efficient, fair, reliable and sustainable manner to existing and potential users"*. The review recommended continued information disclosure by transmission and distribution network owners of prices, costs and asset values (based on ODV) and incorporated an indication by Government that it expects reported profits to be reasonable. An announcement from the Government formally responding to the review recommendations is expected in late 2002.

From UnitedNetworks' perspective, the value of its investment in the gas distribution business will in part be affected by the future shape of the regulatory market. While the regulatory outlook remains unclear, many market commentators believe that the most likely scenario is that the Government will accept the recommendations of the review of the gas industry as sufficient, thereby avoiding the need for greater regulatory involvement.

4 Profile of UnitedNetworks

4.1 History of UnitedNetworks

Power New Zealand Limited ("Power New Zealand") was formed in 1994 as a result of the corporatisation of the Waitemata Electric Power Board and the Thames Valley Electric Power Board, as required by the Energy Companies Act 1992. In compliance with the Reform Act, Power New Zealand elected to remain as a network electricity business and sold its retail customer base and generation businesses to TransAlta New Zealand in 1998. At the same time, Power New Zealand acquired the electricity distribution businesses of TransAlta New Zealand (covering Wellington and the Hutt Valley) and TrustPower (covering the Western Bay of Plenty, Rotorua and Taupo). Power New Zealand changed its name to UnitedNetworks in early 1999.

In May 2000 UnitedNetworks entered the gas distribution business by acquiring the natural gas distribution network of Orion New Zealand ("Orion") for $550 million. The Orion network covered Auckland, Wellington and a number of small networks in Manawatu, Horowhenua and Hawkes Bay. Orion is majority owned by the Christchurch City Council, and had acquired the gas network through its takeover of Enerco New Zealand Limited in November 1998.

In July 2000 UnitedNetworks commenced building fibre-optic networks in the Auckland and Wellington central business districts, taking advantage of a market opportunity for broadband services via fibre-optic infrastructure and the ability of UnitedNetworks to use its standby gas pipe infrastructure to carry the fibre-optic cables, thus substantially reducing the capital cost of developing the network.

In July 2001 UnitedNetworks sold its contracting field services business to Siemens Energy Services. As part of the sale, UnitedNetworks entered into a long term services contract with Siemens Energy Services for the provision of electricity and gas network maintenance and capital works.

Today, UnitedNetworks owns three distinct operating businesses:

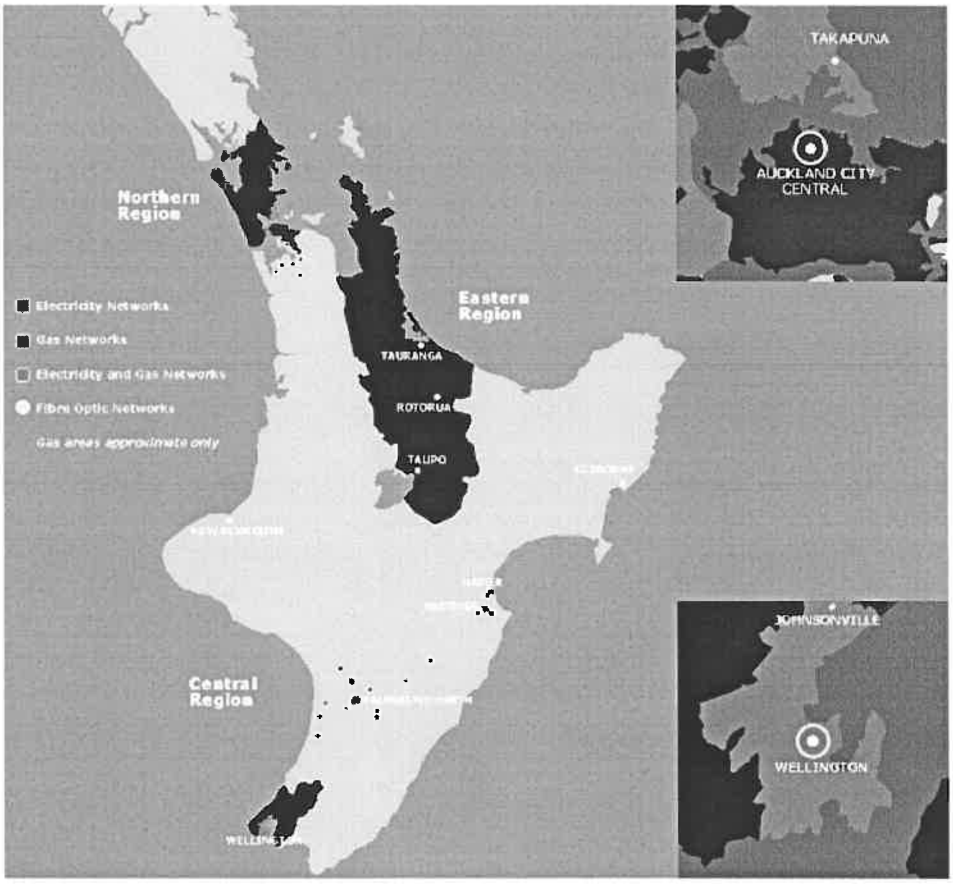
- electricity distribution networks in the Northern, Eastern and Central regions of the North Island of New Zealand;
- gas distribution networks in Auckland, Wellington and Horowhenua/Manawatu/Hawkes Bay; and
- communication networks in the Auckland and Wellington CBDs.

4.2 Profile of UnitedNetworks

4.2.1 Electricity Networks

The UnitedNetworks' electricity networks cover substantial residential areas in the North Island of New Zealand, including north and west Auckland, Coromandel, eastern and northern Waikato, western Bay of Plenty, Rotorua, Taupo, Wellington and Hutt Valley. The electricity distribution business produced approximately 80% of UnitedNetworks' total earnings for the year to 31 December 2001. UnitedNetworks electricity distribution network consists of approximately 30,000 kilometres of lines, providing electricity to approximately 500,000 electricity customers. The network density of approximately 17 connections per kilometre is high by New Zealand standards, reflecting the predominantly residential nature of the network.

The nètworks have been segmented into three distinct regions - Northern, Eastern and Central - as depicted in the following map of UnitedNetworks' assets:



Key statistics on the networks are summarised below:

UnitedNetworks – Electricity Networks				
Region	**Northern**	**Eastern**[1]	**Central**	**Total**
Financial				
ODV (as at 31 March 2002)				**$1,040.9m**
Revenue (2002 Forecast)				**$393.7m**
EBITA (2002 Forecast)				**$213.3m**
Performance				
Connections	185,928	167,470	152,637	**506,035**
System length (km)	10,248	13,961	5,812	**30,022**
Coverage area (km^2)	2,890	16,316	1,238	**20,444**
Connection density (cct/km)	18.1	12.0	26.3	**16.9**
Annual throughput (GWh)	2,140	2,501	2,192	**6,833**
Load factor	50%	69%	52%	**57%**

Source: Information Memorandum, UnitedNetworks electricity information disclosure 31 March 2002

[1] As a requirement of the Vector Offer UnitedNetworks has entered into an agreement to sell this asset.

The profile of the three electricity networks owned by UnitedNetworks is summarised in the table overleaf:

UnitedNetworks – Profile of Electricity Networks
Northern
Incorporates a substantial proportion of medium density urban dwellings in the Waitakere and North Shore cities, and significant commercial and industrial developments in Takapuna, Albany Basin, Glenfield, Henderson and Te Atatu. The northern parts of the area are predominantly rural residential apart from scattered small townships. There are no high density, high rise locations.
Eastern
The eastern region contains a mixture of rural and urban developments, and a number of major industrial customers. The largest of the industrial customers operate in the dairy and forestry sectors.
Central
The central region is characterised by high customer density in the Wellington City area, surrounded by urban developments in much of the adjoining area. Significant business and retail centres are located at Lower Hutt, Porirua, Upper Hutt, Seaview, Petone and Johnsonville.

Network Usage

The primary customers of the electricity business are the five major electricity retailers – Genesis Power, Mighty River Power, TrustPower, Contact Energy and Meridian Energy, which collectively account for over 90% of the electricity business revenues. UnitedNetworks has network access agreements with each of these major energy retailing businesses. The network access agreements provide all retailers with a generic set of terms and conditions for core gas and electricity network services ensuring a neutral platform for end-consumer choice at a retailer level. UnitedNetworks also chooses to contract directly with some larger, primarily industrial end-consumers. Electricity retailers typically own the electricity meters within their customer sites and under the network access agreements provide UnitedNetworks with data relating to connection numbers and load usage to enable UnitedNetworks to accurately invoice each electricity retailer.

Network Condition

UnitedNetworks' electricity networks range from the high density of connection and underground networks of central Wellington to the low density, "stringy" networks of the northern Coromandel. A comparison of data extracted from other electricity distribution businesses from the information disclosures required for the year to 31 March 2002 is set out in the following table:

Statistics of New Zealand's largest electricity distribution businesses

	UnitedNetworks	Vector	Orion	Powerco	The Power Co	WEL
Load Factor (%)	62.8	59.4	58.6	63.5	60.7	58.5
Loss Ratio (%)	5.6	4.5	4.9	5.9	8.5	4.9
Total Overhead (km)	19,340	3,283	5,682	14,158	7,379	3,360
Total System (km)	30,022	8,579	11,506	15,960	7,540	4,692
% underground	36%	62%	51%	11%	2%	28%
Total Load (GWh)	7,283.1	4,884.9	2,758.4	1,955.3	546.4	915.7
Total Connections	506,035	274,000	166,556	157,451	31,800	72,942
SAIDI[2] (minutes)	121.6	56.3	46.0	159.0	139.0	76.2
SAIFI[3]	2.0	1.1	0.7	2.6	2.9	1.5
CAIDI[4] (minutes)	61.0	53.9	66.0	62.5	48.3	51.2

Source: Electricity information disclosures, 31 March 2002

[2] SAIDI = System Average Interruption Duration Index, being the average number of minutes of interruption per connection for the year.

[3] SAIFI = System Average Interruption Frequency Index, being the average number of interruptions per connection for the year.

[4] CAIDI = Customer Average Interruption Duration Index, being the average number of minutes per interruption for each affected connection for the year.

UnitedNetworks has entered into a selection of national contracts for the provision of capital and maintenance field services for its electricity and gas networks. The key contracts are underpinned by annual guaranteed minimum expenditure arrangements for each year of the contract term, and afford those contract partners with exclusivity rights in respect of the functions they perform for UnitedNetworks. The guaranteed minimum expenditure on the major Siemens Energy Services contract progressively declines over the term of the contract.

Strategy

As with any electricity distribution business the opportunity to increase the size of the network is a function of new residential, commercial, industrial, resource and infrastructure developments within the network area. Encouraging development of this nature is difficult for a lines company, except to the extent that it can offer to assist with the lines construction cost. In the absence of a meaningful level of new business opportunities, many electricity distribution businesses place strong emphasis on cost control and keeping the cost of capital low, while at the same time endeavouring to maintain high standards of reliability and service. Some lines businesses have sought to capture growth opportunities and revenue streams through the provision of other services, such as gas and communications, or the growth of non-regulated revenue streams in the electricity industry.

4.2.2 Gas Networks

UnitedNetworks is New Zealand's largest low pressure gas distributor, distributing gas to approximately 50% of New Zealand's gas consumers. The gas network covers substantial residential areas of Auckland (the Northern Region), Wellington, Hawkes Bay, Horowhenua and the Manuwatu (together the Central Region). UnitedNetworks gas distribution network consists of approximately 7,284 kilometres of lines, providing gas to approximately 124,000 customers. Key statistics on the gas network are summarised in the following table:

UnitedNetworks – Gas Networks			
	Northern	**Central**[5]	**Total**
Financial			
ODV (as at 31 March 2002)			**$254.9m**
Revenues (2002 forecast)			**$67.6m**
EBITA (2002 forecast)			**$48.7m**
Performance			
Connections	65,743	58,313	**124,056**
System length (km)	4,713	2,571	**7,284**
Connection density (cct/km)	13.9	22.7	**17.0**
Annual throughput (PJ)	10.9	6.5	**17.3**
Load factor	76%	85%	**71%**

Source: Information Memorandum

UnitedNetworks largest gas customer is Contact Energy, itself the largest gas retailer in New Zealand. There is an increasing trend for electricity retailers to offer gas and electricity to their customers as a mechanism of protecting that customer base.

UnitedNetworks developed and launched the "Pure Energy" brand in 2001, which is being used as a vehicle to promote gas across all market segments. The objective behind the Pure Energy brand is to rebuild consumer awareness of gas as an alternative energy source. Stimulation of demand for gas is primarily marketing driven, and between 1998 and 2001 there was very little generic marketing of gas as an energy source, due to the effects of industry fragmentation and the constant change of ownership of gas assets.

[5] As a requirement of the Vector Offer UnitedNetworks has entered into an agreement to sell this asset.

UnitedNetworks has adopted a channel partner approach to promote the Pure Energy brand, based around working closely with gas service providers, gas appliance retailers and manufacturers to ultimately promote the increased use of gas.

UnitedNetworks' gas business is currently focused on customer retention and increasing market share by promoting the accessibility and desirability of gas as a primary or dual fuel. Penetration of gas has historically been reasonably low, with only 28% of customers in the reticulated area in Auckland connected to gas although, in the smaller Wellington market, the penetration is significantly higher at 58%.

A key identifiable risk facing gas distribution network owners is the availability of a long term gas supply for retailers of reticulated gas. Some gas reserve scenarios indicate that known gas reserves are forecast to be exhausted before 2020. This is dependent on a continuation of current consumption reserves and excludes any new discoveries.

Significant synergies can be achieved through the ownership of both electricity and gas networks. While encouraging consumers to use both electricity and gas decreases the variable component of UnitedNetworks' electricity revenue it gains an additional fixed gas line charge. Further, by reducing the demand for electricity particularly during peak load times by substituting gas as a primary source of fuel for heating and cooking can reduce and/or delay capital expenditure required to meet load growth on the electricity network.

4.2.3 Other Assets

UnitedNetworks Communications

UnitedNetworks Communications ("UNC") was launched in early 2001 to provide broadband services through a high speed fibre optic infrastructure in the Auckland and Wellington CBD markets. Fibre optic cables were inserted into the cast iron standby gas mains in both cities at a cost significantly below that of building a new network. The UNC network has a system length of 92km, and is currently connected to approximately 20% of the 640 buildings that it passes.

UnitedNetworks has adopted an open access wholesale business model for UNC, offering the network as a component or facilitator of partners' offerings, rather than selling directly to end users. UNC offers a range of connection and service options including on demand and efficient time usage alternatives.

While UNC has experienced significant growth in the levels of bandwidth traffic being carried across its network, its ability to influence bandwidth demand is limited. As with its investment in the gas industry, UnitedNetworks has adopted a "channel partner" approach to drive increased usage of its network.

Treescape

Treescape is a provider of arboricultural services with an operating presence in the larger metropolitan areas covered by UnitedNetworks' electricity network. It provides services to a broad range of customers, ranging from one-off jobs for residential customers to long term contracts with large businesses and local authorities. Treescape is 50% owned by UnitedNetworks. Treescape and UnitedNetworks have entered into a long term relationship deed and shorter term cutting contracts.

4.3 Earnings Performance

The financial performance of UnitedNetworks for the two years to 31 December 2001 and the management forecast to 31 December 2002 is summarised in the table below:

UnitedNetworks – Financial Performance ($m)			
Year to 31 December	**2000 Audited**	**2001 Audited**	**2002 Forecast**
Revenue			
Electricity	359.9	364.2	374.6
Gas	50.2	59.2	66.7
Investment income	6.0	4.2	4.7
Other revenue	42.9	26.6	15.2
Total Revenue	**458.9**	**454.2**	**461.2**
Direct Expenses	(125.1)	(105.1)	(110.5)
Indirect Expenses	(51.9)	(45.1)	(37.6)
EBITDA[6]	**281.9**	**304.0**	**313.0**
EBITDA %	61%	67%	68%
Depreciation	(54.7)	(55.7)	(54.6)
EBITA[7]	**227.1**	**248.4**	**258.4**
Amortisation of goodwill	(18.9)	(16.6)	(16.2)
EBIT[8]	**208.3**	**231.7**	**242.2**
Net interest	(95.4)	(101.9)	(91.8)
Taxation	(3.8)	(9.4)	(23.3)
Share of Associates Surplus	0.2	0.2	1.6
Minority Interest	-	-	-
Profit after taxation	**109.2**	**120.8**	**128.6**

Source: UnitedNetworks Annual Reports and management accounts (2002)

The following comments are relevant to an analysis of the financial performance of UnitedNetworks summarised in the table above:

- the forecast for the year ending 31 December 2002 includes five months of actual results to 31 May 2002 and seven months forecast for the remainder of the financial year. Trading during June, July and August 2002 has been on target with the forecast;
- the financial statements for the year to 31 December 2000 include nine months of ownership of the gas distribution business which was acquired on 1 April 2000;
- UnitedNetworks has held its electricity tariffs to the mass markets (domestic and small commercial consumers) constant over the past three years. The majority of the growth in electricity revenue through the period shown is due to the growth in total electricity connections to the network;
- the progressive reduction in other revenue reflects the sale of the contracting field services business which was sold in July 2001 to Siemens Energy Services. This business unit sale also impacts on the ongoing level of direct and indirect expenses;
- the major direct expenses are electricity transmission and ancillary service charges to Transpower. The charges for the ancillary services can have a high variable component. As of 1 April 2002, UnitedNetworks had unbundled the Transpower ancillary service charges from its standard lines charges, and it now passes on the ancillary service charge incurred each month to its electricity retail company customer base. As of the same date, UnitedNetworks also unbundled the loss rental rebates which are refunded to it by Transpower and passed on to the electricity retail businesses also apportioned by load. UnitedNetworks has made a number of changes to its pricing structures that have had the effect of reducing the volatility of

6 Earnings before interest, tax, depreciation, and amortisation of intangibles

7 Earnings before interest, tax and amortisation of intangibles

8 Earnings before interest and tax

UnitedNetworks net Transpower costs by passing the variable components of the charging regime onto the electricity retail businesses;

- amortisation relates primarily to the intangible assets arising from the acquisition of the TransAlta and Trustpower electricity networks in 1999 and the Orion gas network in 2000 which is amortised on a straightline basis over 40 years. The figure in 2001 and 2002 is net of the amortisation of the gain relating to the sale of the contracting field services business to Siemens Energy Services, which is being amortised over 7.5 years; and
- UnitedNetworks is not required to pay tax as tax depreciation on the gas and electricity networks acquired is substantially higher than accounting depreciation, and the acquisition of tax losses from UnitedNetworks parent company UNZ. However the company chooses to prepay tax in order to generate imputation credits.

4.4 Cash Flow

The cash flow statements of UnitedNetworks over the two years to 31 December 2001 and the forecast year to 31 December 2002 are summarised in the table below.

UnitedNetworks – Cash Flow Position ($m)			
Year to 31 December	**2000 Audited**	**2001 Audited**	**2002 Forecast**
EBITDA before abnormal items	**281.9**	**304.0**	**313.0**
Working capital movements and other adjustments	0.1	4.9	(11.2)
Taxation	(11.2)	(25.6)	(25.1)
Interest (net)	(97.0)	(114.4)	(91.9)
Net cash from operating activities	**173.8**	**168.9**	**184.8**
Capital expenditure	(631.8)	(69.8)	(65.5)
Proceeds from sale	1.2	71.9	2.6
Equity issue/repurchase	0.0	0.0	0.0
Net cash from investing activities	**(630.6)**	**2.1**	**(62.9)**
Dividends paid/received	(45.9)	(48.2)	(50.2)
Net increase (decrease) in cash held	**(502.8)**	**122.8**	**71.7**
Net cash - opening	**(874.2)**	**(1,377.6)**	**(1,254.7)**
Net cash - closing	(1,377.6)	(1,254.7)	(1,183.0)

Source: UnitedNetworks Annual Reports

4.5 Financial Position

The financial position of UnitedNetworks as at 31 December 2000 and 2001 and as at 30 June 2002 is summarised below:

UnitedNetworks – Financial Position ($m)			
As at	**31 Dec 2000 Audited**	**31 Dec 2001 Audited**	**30 Jun 2002 Unaudited**
Current assets			
Debtors	42.1	43.4	47.7
Inventories	10.6	1.1	0.0
Other assets	0.1	0.0	0.1
Total current assets	52.8	44.5	47.8
Current liabilities			
Creditors & accruals	(45.6)	(59.9)	(43.2)
Other (including dividend payable)	(30.7)	(13.1)	(7.3)
Total current liabilities	(76.4)	(73.0)	(50.5)
Net working capital	**(23.6)**	**(28.5)**	**(2.7)**
Fixed assets	1,365.0	1,373.6	1,366.4
Intangibles	791.6	771.4	762.9
Taxation assets	42.2	57.1	64.7
Other assets	8.5	22.0	22.5
Capital employed	**2,183.7**	**2,195.6**	**2,216.5**
Deferred gain	-	(31.8)	(28.9)
Net debt	(1,377.6)	(1,255.4)	(1,238.0)
Shareholders' funds	**806.2**	**908.5**	**946.9**
Number of Shares	*151.5*	*151.5*	*151.5*
Net assets per share (NZ$)	*5.32*	*6.00*	*6.25*

Source: UnitedNetworks Annual and Interim Reports

The following issues are relevant to analysis of the financial position of UnitedNetworks:

- intangibles arose on the acquisitions of the Orion gas distribution network and the TransAlta and TrustPower electricity networks;
- the deferred gain is a result of amortising the gain on the sale of the contracting field services business;
- the taxation assets comprise mainly prepaid tax that has arisen from the decision to attach imputation credits to dividend payments. UnitedNetworks prepays tax to create new imputation credits. This prepaid tax can be used to offset future tax payments. Prepaid tax is not subject to continuity of ownership tests and will be available to the purchaser of UnitedNetworks; and
- UnitedNetworks' debt facilities include term loans, fixed and floating rate medium term notes and New Zealand dollar denominated commercial paper programme.

4.6 Capital Structure and Ownership

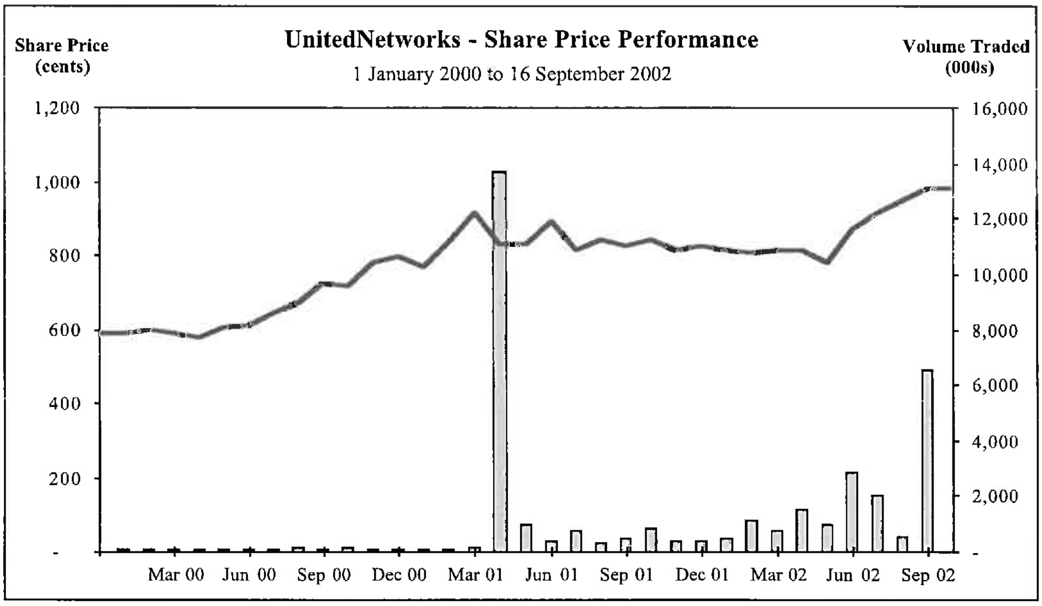
There are currently 151.5 million UnitedNetworks shares on issue. The top 20 shareholders as at 1 September 2002 are shown in the following table:

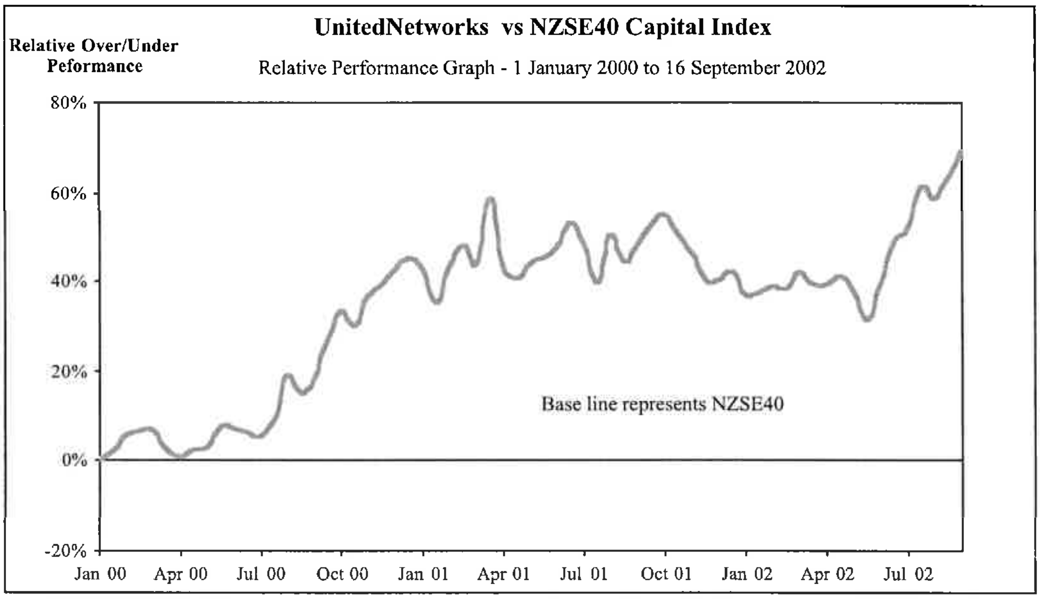
UnitedNetworks – Top 20 Shareholders as at 1 September 2002	Ordinary Shares	
	No. of Shares (000)	%
UtiliCorp NZ Ltd	106,328	70.20
UnitedNetworks Shareholders' Society Inc	16,200	10.70
UnitedNetworks Employee Share Schemes Ltd	2,490	1.64
National Nominees Ltd	2,182	1.43
Westpac Banking Corporation	1,553	1.03
Citibank Nominees (NZ) Ltd	954	0.63
NZGT Nominees Ltd	672	0.44
Trustees Executors & Agency Co. of NZ Ltd	655	0.43
Premier Nominees Ltd	565	0.37
AMP Investments Strategic Equity	560	0.37
AMP Life Ltd	542	0.36
Cogent Nominees Ltd	397	0.26
Royal & Sun Alliance Life & Disability	363	0.24
NZ Guardian Trust Co	294	0.19
Westpac Superannuation Nominees (NZ)	221	0.15
UnitedNetworks Shareholders' Society Inc	208	0.14
Guardian Assurance Ltd	186	0.12
Cogent Nominees Ltd	175	0.12
Royal & SunAlliance Nominees (NZ) Ltd	169	0.11
Public Nominees Ltd	168	0.11
Top 20	**134,880**	**89.05**
Other shareholders	16,589	10.95
Total shares issued	**151,469**	**100.00**

The UnitedNetworks Shareholders' Society is the trustee of the Waitemata Electricity Trust which holds 16.2 million shares on behalf of the trust beneficiaries until expiry of the trust on 1 July 2004. Three local authorities (Waitakere City Council, North Shore City Council and Rodney District Council) are the final beneficiaries of the trust and UnitedNetworks is the income beneficiary of the trust. The Waitemata Electricity Trust directs its income, being the dividends from the trust's UnitedNetworks shares, primarily to undergrounding projects in the local authorities' areas. A variation to the trust deed has been executed requiring the trustee to sell shares in UnitedNetworks under the Vector Offer if directed by the local authorities.

4.7 Share Price Performance

The share price history, trading volume, and price performance relative to the NZSE40 Capital Index is summarised below:





UnitedNetworks share price increased throughout the later half of 2000 after the acquisition of Orion's gas distribution network in April 2000. In April 2001 UNZ placed 13 million of its shares in UnitedNetworks on the market in order to improve liquidity. This reduced UNZ's shareholding in UnitedNetworks from 78.8% to 70.2% and increased monthly volumes traded. On 12 June 2002 UnitedNetworks announced that intended to commence a sales process and the trading price of UnitedNetworks shares subsequently rose. UnitedNetworks has continued to trade positively relative to the NZSE40 index.

5 Valuation of UnitedNetworks

5.1 Methodology

Overview

Grant Samuel's valuation of UnitedNetworks has been undertaken by aggregating the estimated market value of each of UnitedNetworks' operating businesses (the electricity networks, the gas network and the communications network) together with the value of non-trading assets and adjusting for net borrowings. The value of UnitedNetworks has been estimated on the basis of fair market value as a going concern, defined as the maximum price that could be realised in an open market over a reasonable period of time assuming that potential buyers have full information.

The valuation of UnitedNetworks is appropriate for the acquisition of the company as a whole and accordingly incorporates a premium for control. The value is in excess of the level at which, under current market conditions, shares in UnitedNetworks could be expected to trade to the extent they were freely tradeable on the sharemarket. Shares in a listed company normally trade at a discount of 15 to 25 per cent to the underlying value of the company but the extent of the discount (if any) will depend on the specific circumstances of each company.

The most reliable evidence as to the value of a business is the price at which the business or a comparable business has been bought and sold in an arm's length transaction. In the absence of direct market evidence of value, estimates of value are made using methodologies that infer value from other available evidence. There are four primary valuation methodologies commonly used for valuing businesses:

- capitalisation of earnings or cash flows;
- discounting of projected cash flows;
- industry rules of thumb; and
- estimation of the aggregate proceeds from an orderly realisation of assets.

Each of these valuation methodologies has application in different circumstances. The primary criterion for determining which methodology is appropriate is the actual practice adopted by purchasers of the type of business involved.

Capitalisation of Earnings

Capitalisation of earnings or cash flows is the most commonly used method for valuation of industrial businesses. This methodology is most appropriate for industrial businesses with a substantial operating history and a consistent earnings trend that is sufficiently stable to be indicative of ongoing earnings potential. This methodology is not particularly suitable for start-up businesses, businesses with an erratic earnings pattern or businesses that have unusual expenditure requirements. This methodology involves capitalising the earnings or cash flows of a business at a multiple that reflects the risks of the business and the stream of income that it generates. These multiples can be applied to a number of different earnings or cash flow measures including EBITDA, EBITA, EBIT or net profit after tax. These are referred to respectively as EBITDA multiples, EBITA multiples, EBIT multiples and price earnings multiples. Price earnings multiples are commonly used in the context of the sharemarket. EBITDA, EBITA and EBIT multiples are more commonly used in valuing whole businesses for acquisition purposes where gearing is in the control of the acquirer.

Where an ongoing business with relatively stable and predictable cash flows is being valued (such as UnitedNetworks), Grant Samuel uses capitalised earnings or operating cash flows as a primary reference point. Application of this valuation methodology involves:

- estimation of earnings or cash flow levels that a purchaser would utilise for valuation purposes having regard to historical and forecast operating results, non-recurring items of income and expenditure and known factors likely to impact on operating performance; and

- consideration of an appropriate capitalisation multiple having regard to the market rating of comparable businesses, the extent and nature of competition, the time period of earnings used, the quality of earnings, growth prospects and relative business risk (see 5.1.2 below).

The choice between EBITDA, EBITA or EBIT is usually not critical and should give a similar result. All are commonly used in the valuation of industrial businesses. EBITDA can be preferable if depreciation or non-cash charges distort earnings or make comparisons between companies difficult but care needs to be exercised to ensure that proper account is taken of factors such as the level of capital expenditure needed for the business and whether or not any amortisation costs also relate to ongoing cash costs. Grant Samuel has undertaken analysis in terms of both EBITDA and EBITA.

Selection of the appropriate earnings multiple is usually the most judgemental element of a valuation. Definitive or even indicative offers for a particular asset or business can provide the most reliable support for selection of an appropriate earnings multiple. In the absence of meaningful offers, it is necessary to infer the appropriate multiple from other evidence.

The primary approach used by valuers is to determine the multiple that other buyers have been prepared to pay for similar businesses in the recent past. However, each transaction will be the product of a unique combination of factors, including:

- economic factors (eg. economic growth, inflation, interest rates) affecting the markets in which the company operates;
- strategic attractions of the business - its particular strengths and weaknesses, market position of the business, strength of competition and barriers to entry;
- rationalisation or synergy benefits available to the acquirer;
- the structural and regulatory framework;
- investment and sharemarket conditions at the time; and
- the number of competing buyers for a business.

A pattern may emerge from transactions involving similar businesses with sales typically taking place at prices corresponding to earnings multiples within a particular range. This range will generally reflect the growth prospects and risks of those businesses. Mature, low growth businesses will, in the absence of other factors, attract lower multiples than those businesses with potential for significant growth in earnings.

An alternative approach used by valuers is to review the multiples at which shares in listed companies in the same industry sector trade on the sharemarket. This gives an indication of the price levels at which portfolio investors are prepared to invest in these businesses. Share prices reflect trades in small parcels of shares (portfolio interests) rather than whole companies. To convert sharemarket data to meaningful information on the valuation of companies as a whole, it is market practice to add a "premium for control" to allow for the premium which is normally paid to obtain control through a takeover offer. This premium in terms of equity values (ie. share prices) is typically in the range 20 to 35 per cent (but is lower based on ungeared values).

The premium for control paid in takeovers is observable but caution must be exercised in assessing the value of a company or business based on the market rating of comparable companies or businesses. The premium for control is an outcome of the valuation process, not a determinant of value. Premiums are paid for reasons which vary from case to case and may be substantial due to synergy or other benefits available to the acquirer. In other situations premiums may be minimal or even zero. It is inappropriate to apply an average of 20 to 35 per cent without having regard to the circumstances of each case. In some situations there is no premium. There are transactions where no corporate buyer is prepared to pay a price in excess of the prices paid by institutional investors through an initial public offering.

The analysis of comparable transactions and sharemarket prices for comparable companies will not always lead to an obvious conclusion as to which multiple or range of multiples will apply. There will often be a wide spread of multiples and the application of judgement becomes critical. Moreover, it is necessary to consider the particular attributes of the business being valued and decide whether it warrants a higher or lower multiple than the comparable companies. This assessment is essentially a judgement.

Discounted Cash Flow

Discounting of projected cash flows has a strong theoretical basis. It is the most commonly used method for valuation in a number of industries, including mining, and for the valuation of start-up projects where earnings during the first few years can be negative. Discounted cash flow ("DCF") valuations involve calculating the net present value of projected cash flows. The cash flows are discounted using a discount rate which reflects the risk associated with the cash flow stream. Considerable judgement is required in estimating future cash flows and the valuer generally places great reliance on medium to long term projections prepared by management. In addition, even where cash flow forecasts are available for up to, say, ten years, the terminal or continuing value is usually a high proportion of value. Accordingly, the multiple used in assessing this terminal value becomes the critical determinant in the valuation (ie. it is a "de facto" cash flow capitalisation valuation). The net present value is typically extremely sensitive to relatively small changes in underlying assumptions, few of which are capable of being predicted with accuracy, particularly beyond the first two or three years. The arbitrary assumptions that need to be made and the width of any value range mean the results are often not meaningful or reliable. Notwithstanding these limitations, discounted cash flow valuations are commonly used in valuing industrial companies and can at least play a role in providing a check on alternative methodologies, not least because explicit and relatively detailed assumptions as to expected future performance need to be made. In this case, they can capture some of the critical issues such as price cyclicality, capital expenditure timing and variations in the regulatory regime. Grant Samuel has also utilised a discounted cash flow analysis in determining its value for the electricity and gas networks owned by UnitedNetworks.

Realisation of Assets

Valuations based on an estimate of the aggregate proceeds from an orderly realisation of assets are commonly applied to businesses that are not going concerns. They effectively reflect liquidation values and typically attribute no value to any goodwill associated with ongoing trading. Grant Samuel has not utilised this approach to value UnitedNetworks.

Industry Rules of Thumb

Industry rules of thumb are commonly used in some industries. These are generally used by a valuer as a "cross check" of the result determined by a capitalised earnings valuation or by discounting cash flows, but in some industries rules of thumb can be the primary basis on which buyers determine prices.

The Electricity Act 1992 requires the assets of distribution businesses to be valued for information disclosure purposes on a biannual basis. The valuation methodology required for this purpose is known as the optimised deprival value. The ODV methodology seeks to value the network distribution assets at the level at which the business can be sustained in the long term. The methodology incorporates a valuation based on the engineering optimisation of the network and its components after allowing for depreciation and is based on the value to the company of being deprived of the asset. The actual valuation methodology is defined in the Ministry of Economic Development "Handbook for Optimised Deprival Valuation of Electricity Line Businesses".

The primary role of ODV valuations is to provide a mechanism to measure the appropriateness of the line charges charged by the distribution businesses. Distribution businesses that have consistently high earnings relative to their ODV may have their pricing structures investigated and mandatorily reduced. This test is effectively a measure of the rate of return earned by the distribution businesses. The Commerce Commission has recently initiated an inquiry into prices set by electricity line businesses and Transpower. The inquiry is being conducted with the objective of assessing whether some form of price control is necessary in the industry. The Commerce Commission is also reviewing the basis upon which line business assets should be valued, including whether ODV is the best and most appropriate valuation methodology.

In 2002 the Commerce Commission undertook an extensive review of all ODV valuations. The review resulted in an ODV valuation for UnitedNetworks of $1,041 million. The average ODV for the 29 lines businesses operating in New Zealand as at 31 March 2002 was approximately $155 million.

In the case of the electricity industry a Value/ODV multiple is regarded as a significant and important benchmark and a primary valuation methodology. Grant Samuel has considered a Value/ODV analysis in forming its view on value. However, a standard or uniform multiple would be inappropriate as there will typically be significant variation in underlying value drivers such as growth potential, capital intensity and relative earnings capacity (return on assets). It must be recognised that rules of thumb such as Value/ODV are usually relatively crude and prone to misinterpretation.

Summary

The approach adopted by Grant Samuel was to compare and consider the valuation ranges suggested by each of three separate methodologies (capitalisation of earnings, discounted cash flow and ODV) as well as the acquisition cost (where the assets were recently acquired). Having regard to all of these benchmarks, Grant Samuel selected its preferred (or consensus) valuation range for each business.

5.2 Valuation of UnitedNetworks

Grant Samuel has valued the equity in UnitedNetworks in the range of $1.37 to $1.59 billion, equivalent to $9.02 to $10.48 per share. This value represents Grant Samuel's assessment of the full underlying value of UnitedNetworks and includes a premium for control. A summary of Grant Samuel's valuation of UnitedNetworks is set out below:

UnitedNetworks – Summary of Value ($m)

	Section	Valuation Range	
		Low	High
Electricity networks	5.3	1,955	2,125
Gas networks	5.4	540	585
Communications networks	5.5	5	8
Value of business operations		2,500	2,718
Other assets	5.5	79	83
Net borrowings	5.6	(1,213)	(1,213)
Equity value of UnitedNetworks		1,366	1,588
Shares on Issue (million)		151.5	151.5
Value per Share		**$9.02**	**$10.48**

The valuation implies the following overall multiples of earnings, assets and ODV for UnitedNetworks:

UnitedNetworks - Implied overall Value Parameters

	Range	
	Low	High
Year ended 31 December 2001		
EBITDA	8.5	9.2
EBITA	10.4	11.3
Year ending 31 December 2002		
EBITDA	8.2	8.9
EBITA	10.0	10.8
Net assets at 30 June 2002	1.4	1.7
Net tangible assets at 30 June 2002	7.4	8.6
ODV at 31 March 2002 (gas and electricity only)	1.9	2.1

Grant Samuel believes that these parameters are reasonable having regard to:

- the specific attributes of UnitedNetworks. It owns a portfolio of high quality electricity and gas distribution assets. It is the largest electricity and gas network operator in New Zealand by a substantial margin and has exposure to a number of the higher growth regions in New Zealand;

- UnitedNetworks has exposure to the highest growth market in the country (for residential demand) being the North Shore and the western suburbs of Auckland. The Eastern region has pockets of high growth such as Tauranga, but other areas of the region such as Thames Valley and Rotorua have more subdued prospects. The Central region has only a modest growth outlook;
- UnitedNetworks has a high level of capital expenditure relative to its EBITDA (impacting on free cash flows). The rural nature of a large part of the network necessitates relatively high level of ongoing capital expenditure. However, a significant proportion of capital expenditure also results from the growth in new connections. The concentrated nature of the Central region means ongoing capital expenditure requirements are much lower than for the other two regions;
- UnitedNetworks is exposed to the possibility of future price control in both the electricity and gas markets, although the timing of the implementation of any such regulation and whether it will have an impact on UnitedNetworks is not yet known;
- the evidence from recent comparable acquisitions in the sector, both domestically and internationally, and from comparable listed companies in New Zealand and overseas;
- current equity market and economic conditions; and
- the regulatory environment.

UnitedNetworks provides a near necessity service. One of the most important drivers of value is the form of the future regulatory regime for electricity and gas in New Zealand. There is currently considerable uncertainty about the final form of that regime and its implications for tariff pricing and earnings of all of the participants. In Grant Samuel's opinion, any acquirer of UnitedNetworks would apply an element of discount (either explicitly or implicitly) to reflect the risks to UnitedNetworks' future earnings and cash flows from potential adverse changes to the regulatory regime.

In forming its view on value, Grant Samuel has assumed a continuation of the current "light handed" regulatory regime, with tariffs to be based on benchmark pricing and other factors such as service quality rather than a set of strict and standardised return on investment criteria. Grant Samuel considers this to be the most likely outcome of the Commerce Commission deliberations, but it must be recognised that there are a range of alternative less favourable outcomes which could eventuate. The final form of the regulatory regime will depend among other things on political issues and the overall cost of electricity to the consumer over time. In this respect the balance of risks in the valuation is on the downside. The value would be lower in a less favourable regulatory environment. It is unlikely that the tariff pricing could be increased materially above current levels. A range of regulatory environment scenarios was incorporated in the discounted cash flow analysis undertaken by Grant Samuel.

5.3 Electricity Networks

5.3.1 Summary

Grant Samuel has valued UnitedNetworks' electricity networks in the range $1,955 to $2,125 million. This range represents Grant Samuel's overall judgement having regard to the values derived from applying the different valuation methodologies:

UnitedNetworks – Value of Electricity Networks ($m)		
Methodology	Range	
	Low	High
Capitalisation of EBITDA	$1,948	$2,069
Capitalisation of EBITA	$1,988	$2,186
Discounted Cash Flow	$1,950	$2,106
Multiple of ODV	$1,928	$2,140
Preferred value	**$1,955**	**$2,125**

5.3.2 Capitalisation of Earnings

Market Evidence from Comparable Listed Companies

Grant Samuel has calculated multiples for comparable electricity distribution companies within New Zealand. Although there now are 28 lines businesses, only UnitedNetworks, Horizon Energy Distribution ("Horizon") and Powerco are listed on the NZSE:

Electricity Networks - Comparable Listed Company Multiples				
Company	**EBITDA Multiple**		**EBITA Multiple**	
	Historic	**Forecast**	**Historic**	**Forecast**
New Zealand				
Powerco	9.4	9.0	14.0	13.5
Horizon	8.1	nc	9.6	nc
New Zealand Average	**8.8**	**9.0**	**11.8**	**13.5**
Australia Average	9.1	8.1	11.9	10.6
United Kingdom Average	10.7	8.6	14.5	11.8

When considering the data in the above table the following points should be considered:

- the listed company multiples are based on share prices as at 16 September 2002 except Powerco which is based on a price at 6 September 2002. Further details on the comparable listed companies is contained in Appendix 1. The share prices, and therefore multiples, do not include a premium for control. Shares in a company normally trade at a discount to the underlying value of the company as a whole; and

- there are few New Zealand listed companies which are purely electricity distribution businesses and none with the size of network owned by UnitedNetworks. Powerco owns both electricity and gas distribution networks, but it is substantially smaller than UnitedNetworks and its electricity networks service predominantly rural areas (Taranaki, Manawatu and Wairarapa). Horizon is solely an electricity distributor but its network, which services the western Bay of Plenty, is also substantially smaller than that owned by UnitedNetworks.

- International electricity network companies have also been considered but New Zealand's unique regulatory framework means that considerable caution must be applied in utilising international data. In particular:

  - other jurisdictions allow electricity businesses to be both distributors and retailers resulting in substantially different risk profiles. As a pure electricity distributor UnitedNetworks has a very low risk profile as it has no direct exposure to variability in costs of generating electricity or any consequential impact on retail margins;
  - tariff regimes vary widely with countries such as Australia operating a regime that effectively caps the return on assets that an electricity distributor can earn; and
  - interest rates, tax rates, economic conditions and growth profiles may vary significantly.

Market Evidence from Comparable Acquisitions

The table below sets out multiples implied by recent acquisitions of electricity lines businesses in New Zealand. Further detail on these transactions is contained in Appendix 2:

Electricity Networks – Comparable Transactions

Target	Acquirer	Value ($m)	EBITDA Multiple		EBITA Multiple	
			Historic	Forecast	Historic	Forecast
TransAlta	UnitedNetworks	590	8.4	nc	10.5	nc
TrustPower	UnitedNetworks	485	12.8	nc	17.1	nc
Wairarapa Electricity	Powerco	83	10.9	nc	11.0	nc
Central Electric	Dunedin Electricity	127	21.9	nc	42.1	nc
Horizon	BOP Electricity Trust	52	7.5	nc	8.9	nc
Otago Power	Consortium	109	17.6	17.9	22.0	23.2

In reviewing the multiples in the above table the following points should be considered:

- with the exception of the recently completed Otago Power acquisition, all of the above transactions occurred in 1998 or 1999 following the introduction of the Reform Act requiring the separation of distribution or retail/generation activities; and

- All of the above transactions were asset sales except the sale of UnitedNetworks investment in Horizon. The purchaser benefits from a "step up" in the asset base and the consequent increase in depreciation deductions. Accordingly the stated prices (and therefore the implied multiples) are above what they may be on a "net" basis or if the transaction was effected as a company sale. There is usually a significant difference in value to a vendor depending on whether the purchaser acquires an electricity network asset or the shares in the company owning the asset. Most electricity network assets have an average life of around 40 years, however the tax depreciation rate for assets is 7.5% diminishing value. This results in most networks having a low tax book value relative to the sale value, leaving the vendor with a significant tax liability due to the amount of depreciation recovered.

Assessment for UnitedNetworks

Based on the evidence set out above and having regard to the specific attributes of the individual regional networks, Grant Samuel selected the following multiples as being appropriate to apply to adjusted earnings for the year ending 31 December 2002:

Electricity Networks – Selected Earnings Multiples

	Northern	Eastern	Central
EBITDA	8.0-8.5	8.0-8.5	8.0-8.5
EBITA	10.5-11.5	10.0-11.0	9.5-10.5

These multiples result in value ranges of $1,948 to $2,069 million (capitalisation of EBITDA) and $1,988 to $2,186 million (capitalisation of EBITA).

The EBITDA multiples are the same for each region but these each reflect different offsetting considerations. Northern is the highest growth market but has the highest level of capital expenditure (relative to EBITDA) and therefore lower free cash flows. In contrast, Central has the lowest capital expenditure requirements and the highest free cash flows but its growth outlook is the weakest. These capital expenditure issues are neutralised at the EBITA level. Accordingly, the selected EBITA multiples are different for each region primarily reflecting the different growth profiles.

The earning levels used in the valuation were based on the forecast to 31 December 2002 adjusted to reflect the impact of potential tariff reductions particularly in the Central region.

5.3.3 Discounted Cash Flow

Grant Samuel has developed cash flow models to forecast the future cash flows for each of the three regional electricity networks. The cash flows have been forecast for the period to 31 December 2012 on an ungeared nominal basis after allowing for notional corporate tax. The primary assumptions used in developing the DCF models are outlined below:

- ***Growth*** - In recent years UnitedNetworks has seen connection growth of approximately 2.5% and load per connection growth of approximately 2.8%. Grant Samuel has used different growth rates for each type of network in each region and due to UnitedNetworks' combination of fixed and variable tariffs, different rates for connection growth and load per connection. UnitedNetworks is a regionally diverse company with its electricity, and to a lesser extent its gas networks, exposed to different economies across the North Island. This regional diversity ensures that the company's overall cash flows are less volatile due to regional economic impacts such as a downturn in farming or variable growth rates in the major metropolitan centres. In each of UnitedNetworks' three regions the total number of connections is growing at a faster rate than the total electricity volume or load growth. High connection growth in north and west Auckland, and in and around Tauranga reflects the number of new homes being developed in these areas. As a residential customer has a lower load requirement than a commercial customer, UnitedNetworks load per connection is expected to progressively decline.

- ***Tariffs*** - The form of the future regulation of the industry means that it is unlikely that UnitedNetworks will be able to increase electricity tariffs for the foreseeable future. Grant Samuel has therefore considered a number of scenarios involving price decreases either across UnitedNetworks' electricity networks or across selected regions.

- ***Transmission Charges*** - Transmission charges are predominantly based on load and demand. Grant Samuel has assumed transmission charges will increase in line with load growth.

- ***Other Costs*** - All other costs are forecast to grow in line with inflation which is assumed to be 2.5%. Taxation has been calculated at the corporate tax rate of 33%.

- ***Capital Expenditure*** - Grant Samuel has assumed capital expenditure to be in line with UnitedNetworks' ten year Asset Management Plan. UnitedNetworks is forecasting approximately $53 million of capital expenditure annually on the network. This is in excess of the annual accounting depreciation of the network, which in the current year is forecast to be approximately $48 million. Some of the excess capital expenditure reflects the growth of the network, while other expenditure is for asset replacement, maintenance of the quality of supply and safety improvements.

- ***Discount Rate*** - The discount of rate 7.8% has been based on a weighted average cost of capital ("WACC") using a cost of equity calculated using the Capital Asset Pricing Model ("CAPM").

- ***Terminal Value*** - The terminal value was calculated using the perpetuity formula, based on the discount rate and a long term growth rate for cash flows.

The DCF models establish a range of values for the electricity networks of $1.95 to $2.10 billion using a number of assumptions as to growth rates and tariffs. Discounted cash flow analysis is heavily dependent on the assumptions adopted and the net present value is typically sensitive to small changes in assumptions.

5.3.4 Multiple of ODV

Market Evidence

A summary of the Value/ODV multiples for transactions involving the sale of lines networks is shown in the table below. Further detail on these transactions is contained in Appendix 2:

Electricity Networks – Comparable Transactions			
Target	**Acquirer**	**ODV ($ m)**	**Multiple of ODV**
TransAlta	UnitedNetworks	319	1.9
TrustPower	UnitedNetworks	241	2.0
Wairarapa Electricity	Powerco	61	1.4
Central Electric	Dunedin Electricity	64	2.0
King Country Energy	Waitomo Energy	27	0.9
Wairoa Power	Eastland Energy	12	1.3
Horizon	BOP Electricity Trust	66	1.4
Otago Power	Consortium	109	2.1
Average			**1.6**

In analysing the ODV multiples the following factors need to be considered:

- while selected transactions listed in the table above implied multiples close to 2.0 times ODV, these transactions involved substantially smaller networks than UnitedNetworks, and/or reflected transactions completed in the late 1990s. Larger networks have tended to sell at higher multiples of ODV than smaller networks; and

- the ODV multiple implied by the King Country Energy transaction is lower than the other transactions. The transaction essentially involved a swap between King Country Electricity and Waitomo Energy Services with Waitomo Energy Services selling its retail and generation assets to King Country Energy at the same time as it acquired the network.

Grant Samuel has not considered the Value/ODV multiples from overseas transactions as these are heavily dependent upon the nature of the regulatory regime prevailing in each market.

Assessment for UnitedNetworks

Having regard to the evidence set out above and the specific attributes of each regional network, Grant Samuel selected different multiples for each of UnitedNetworks' three regional networks:

Electricity Networks – Selected ODV Multiples		
Northern	**Eastern**	**Central**
1.8-2.0	1.7-1.9	2.0-2.2

The multiples result in a value range of $1,928 to $2,140 million. The multiples are different for each region. The Eastern region warrants lower multiples to reflect the rural nature of much of the area resulting in low earnings relative to capital investment and high capital expenditure relative to EBITDA and ODV. Conversely, the Central region warrants higher multiples to reflect the benefits of the compact geography of the Wellington market. A compact catchment area enables a smaller relative investment in the network and generates a higher return on the assets employed (well above the other two regions). Similarly, relative capital expenditure is much lower. While the Value/ODV multiple is slightly above that implied by the 1998 acquisition, Grant Samuel believes this is appropriate and is justified by the improving operating performance, despite the weak growth outlook for the Wellington region.

5.4 Gas Network

5.4.1 Summary

Grant Samuel has valued UnitedNetworks' gas network in the range $540 to $585 million. This range represents Grant Samuel's overall judgement having regard to the values derived from applying the different valuation methodologies:

UnitedNetworks – Value of Gas Network		
Methodology	**Value Range ($m)**	
	Low	**High**
Capitalisation of EBITDA	539	567
Capitalisation of EBITA	535	560
Discounted Cash Flow	524	650
Multiple of ODV	517	568
Preferred Estimate	**540**	**585**

5.4.2 Capitalisation of Earnings

Market Evidence from Comparable Listed Companies

The table below sets out the multiples implied by selected listed companies that own gas networks:

Gas Networks – Comparable Listed Company Multiples				
Company	**EBITDA Multiple**		**EBIT Multiple**	
	Historic	**Forecast**	**Historic**	**Forecast**
New Zealand				
Powerco	9.4	9.0	14.0	13.5
Natural Gas Corp	6.1	7.6	10.8	12.4
New Zealand Average	**7.1**	**7.6**	**10.2**	**12.4**
Australia Average	9.7	8.8	12.2	11.1
United Kingdom Average	9.6	8.4	13.3	11.8

When considering the above information, the following points should be noted:

- the listed company multiples are based on share prices on 16 September 2002 except Powerco which is based on a price at 6 September 2002. Further details on the comparable listed companies is contained in Appendix 1. The share prices, and therefore multiples, do not include a premium for control. Shares in a company normally trade at a discount to the underlying value of the company as a whole;

- there are no companies listed in New Zealand which are solely gas distributors. Powerco owns both electricity and gas networks, while NGC operates across the gas industry with both gas transmission and distribution networks, retail gas customers and electricity generation operations; and

- international companies have also been considered but New Zealand's unique regulatory framework means that considerable caution must be applied in utilising international data. In particular, tariff regimes vary widely with countries such as Australia operating a basis that effectively caps the return on capital/assets that a distributor can earn and interest rates, tax rates, economic conditions and growth profiles may vary significantly.

Market Evidence from Comparable Acquisitions

The table below sets out multiples implied by recent acquisitions of gas distribution businesses in New Zealand and overseas. Further details on these transactions are contained in Appendix 2. Data from "off market" acquisitions is often not available and, similar to the position with comparable listed companies, considerable caution needs to be applied in reviewing international transactions.

Gas Network – Comparable Transactions						
Target	Acquirer	Price (m)	EBITDA Multiple		EBIT Multiple	
			Historic	Forecast	Historic	Forecast
New Zealand						
Enerco	Southpower	NZ$484	9.9	9.2	13.1	12.7
Orion	UnitedNetworks	NZ$550	nc	8.0	nc	11.2
New Zealand Average			**9.9**	**8.6**	**13.1**	**12.0**
Australia						
Envestra	Share float	A$910	nc	16.8	nc	24.3
AllgasEnergy	Energex	A$250	14.5	14.2	nc	21.6
Australia Average			**14.5**	**15.5**	**nc**	**23.0**
United Kingdom						
Lattice	Share float	£11,391	6.3	nc	8.8	nc

Assessment for UnitedNetworks

Based on the evidence set out above and having regard to the specific attributes of UnitedNetworks' gas network, Grant Samuel selected the following multiples as being appropriate to apply to the earnings for the year ending 31 December 2002:

Gas Network – Selected Earnings Multiples	
	Range
EBITDA	9.5-10.0
EBITA	11.0-11.5

These multiples result in value ranges of $539 to $567 million (capitalisation of EBITDA) and $535 to $560 million (capitalisation of EBITA). Since its acquisition of the gas network, UnitedNetworks has sought to improve the low growth in connections within the reticulated area both through improved product branding and by targeting new subdivisions of the introduction of gas services. The network has modest expenditure requirements to maintain the network, but network extensions are expensive.

5.4.3 Discounted Cash Flow

Grant Samuel has developed a cash flow model to forecast the future cash flows for the gas network. The cash flows have been forecast for the period to 31 December 2012 on an ungeared nominal basis after allowing for notional corporate tax. The primary assumptions used in developing the discounted cash flow model are outlined below:

- ***Growth*** - Due to the nature of electricity and gas as sources of energy varying growth rates for each has been assumed. Gas is viewed as a luxury item and becomes a substitute for electricity where loads are sufficiently large to justify the connection costs. Connection growth tends to fluctuate with advertising spend. Connection growth is forecast to be between 3% and 4% annually assuming current levels of advertising cost. As most connections are expected to be residential and therefore consume less than the average gas customer, volume per customer growth is estimated to be negative – between -2.5% and -1.0%.

- ***Tariffs*** - Cost savings have been achieved by UnitedNetworks across its gas network due to integration with its electricity business leading to earnings increases in this business. Therefore, Grant Samuel has taken a "no price increase" view across UnitedNetworks' gas network on the basis that regulation in the gas distribution sector is likely to follow the precedents being set by the electricity distribution sector.

- ***Other Costs*** - All other costs are forecast to grow in line with inflation which is assumed to be 2.5%. Taxation has been calculated at the corporate tax rate of 33%.

- ***Capital Expenditure*** - Grant Samuel has assumed capital expenditure to be in line with UnitedNetworks' ten year Asset Management Plan for 2002. UnitedNetworks is forecasting approximately $19.3 million of annual capital expenditure on the network. This is in line with the annual accounting depreciation of the network, which is approximately $19.0 million per annum.

- ***Discount Rate*** - The discount rate of 7.8% has been based on a WACC, using a cost of equity capital calculated using the CAPM.

- ***Terminal Value*** - The terminal value was calculated using the perpetuity formula, based on the discount rate and a long term growth rate for cash flows.

Assessment for UnitedNetworks

The DCF models establish a range of values for the gas network of $524 to $650 million. Discounted cash flow analysis is heavily dependent on the assumptions adopted and the net present value is typically sensitive to small changes in assumptions.

5.4.4 Multiple of ODV

Market Evidence

A summary of the transactions involving the sale of gas distribution networks is shown in the table below. Further detail on these transactions is contained in Appendix 2:

Gas Network – Comparable Transactions

Target	Acquirer	Price ($m)	Multiple of ODV
Enerco	Southpower	484	1.5
Orion	UnitedNetworks	550	2.1
AGL	Powerco	118	2.3
Average			2.0

Grant Samuel has not considered the Value/ODV multiples from overseas transactions or listed companies as these are heavily dependent upon the nature of the regulatory regime prevailing in each market.

Assessment for UnitedNetworks

Having regard to the evidence set out above and the specific attributes of UnitedNetworks' gas network, Grant Samuel has selected the multiples of 2.0 – 2.2 as being appropriate to apply to the ODV. The multiples result in a value range of $517 to $568 million. The Value/ODV multiple is similar to that implied by the 2000 acquisition. Grant Samuel believes this is appropriate and is justified by the modest improvements in operating performances, and the inherent difficulties in growing the connection base of the network.

5.5 Other Assets

5.5.1 UnitedNetworks Communications

Grant Samuel has valued UNC in the range $5.0 to $7.5 million. The UNC network has some inherent advantages. Development costs were low by comparison with the competing networks of the major telecommunications companies as UnitedNetworks was able to utilise the standby gas pipeline network which avoided the need for expensive trench digging and conduit laying. The network can be built out further continuing to use the standby gas network. The ongoing operating cost burden also benefits from these savings. However:

- the network is expected to continue to be loss making at the EBITDA level in 2002;
- the business currently has only a small number of customers;
- the business has no capacity to bundle services and must rely on channel partners to develop a customer base. The wholesale, open access business model is logical but largely unproven; and
- technological developments mean that the capacity of all fibre networks is much greater than previously specified. None of the other competing networks is likely face any form of capacity constraints in the foreseeable future.

While the UNC business clearly has potential and may develop over time into a profitable venture, it is unlikely that any significant value could be realised at the current point in time. The communications sector is depressed with little sign of any imminent upturn and there are very few buyers. There may be some interest from one of the operators of competing networks at least to get hold of the existing customers, but this not certain.

The estimated value is judgemental. Grant Samuel does not believe it would be meaningful to try to estimate a value based, for example, on a discounted cash flow analysis, as any projections that underlie the analysis would not be reliable.

5.5.2 Other Assets and Investments

Other assets total $79.1 to $83.2 million and comprise:

- as at 31 August 2002, UnitedNetworks had prepaid corporate tax of $43.0 million. This prepayment and a further prepayment due in March 2003 of $16.8 million against future tax liabilities would remain following any change of control in United Networks. Based on UnitedNetworks' tax profile, this prepayment could be expected to be utilised within the next four years assuming no other tax initiatives and no change in the assets. The proposed sale of the Eastern electricity network and gas networks in the lower half of the North Island by UnitedNetworks will result in a substantial liability for depreciation recovered. The prepaid tax asset, which will as a result of the proposed sale be approximately $60 million by March 2003, will be substantially used up to offset this liability. This asset has been valued at its face value;
- in total UnitedNetworks' Employee Share Schemes hold approximately 2.6 million shares in UnitedNetworks. No entitlements to shares have currently been issued to any executives under any schemes and UnitedNetworks is therefore entitled to any value from the shares. This holding has been valued at between $23.1 and $26.9 million at the relevant valuation levels;
- UnitedNetworks' 50% interest in Treescape;
- approximately $1.4 million cash to be received from the wind up of two joint ventures; and
- surplus properties with an estimated market value of approximately $1 million.

5.6 Net Borrowings

Net borrowings are based on net borrowings as at 31 August 2002 adjusted for:

- the payment of the interim dividend on 6 September 2002; and
- forecast operating cash flows for September and October 2002.

6 Evaluation of the Merits of the Vector Offer

6.1 The Vector Offer is Fair

In Grant Samuel's opinion the full underlying value of UnitedNetworks shares is in the range of $9.02 to $10.48 per share. The value is for 100% of UnitedNetworks and includes a premium for control. As the Vector Offer of $9.90 per share falls within Grant Samuel's value range it is fair.

The Vector Offer represents relatively high multiples of earnings and ODV. It also represents a premium of 29% to the closing price of $7.66 per share on 11 June 2002, being the day prior to the announcement that UnitedNetworks would be seeking offers for the shares or all or substantially all assets of the business. The premium for control of 29% is broadly consistent with the premiums for control observed in takeovers of other listed companies. The premium should also be considered in the context of the following:

- UnitedNetworks has enjoyed a strong sharemarket performance in the last two years, reflecting its delivery of earnings growth (primarily from cost savings and integration benefits from its acquisitions) and an expectation of further growth through additional opportunities; and
- relative to the scale of the overall business, the level of cost savings and synergies available to potential acquirers of UnitedNetworks may be relatively limited. This factor tends to limit the extent of any premium for control.

In considering the fairness of the Vector Offer, it is also important to recognise that:

- the process that has led to the Vector Offer is likely to have resulted in the offer representing the full underlying value of shares in UnitedNetworks. UnitedNetworks has:

    - run a formal structured sale process, inviting all likely potential bidders to participate;
    - invited bids for both the company as a whole or for the separate constituent businesses (including the three regional electricity networks and the gas network on a separate basis);
    - invited a number of short listed parties to undertake detailed due diligence on UnitedNetworks. These parties are believed to have been provided with all of the information an acquirer could reasonably expect to receive;
    - allowed sufficient time for bidders to evaluate the information and arrange the necessary funding;
    - provided a "level playing field" for bidders in that they were all asked to submit final and virtually unconditional[9] offers on the same date and in the same form; and
    - offered the maximum level of certainty to the winning bidder allowed under the Takeovers Code. Aquila Inc agreed that if there was a satisfactory offer, it would undertake at the time of announcement to accept that offer.

  The Vector Offer was the highest offer received at the end of the process. Accordingly, in Grant Samuel's view, it is highly likely that the Vector Offer represents the maximum price able to be achieved for UnitedNetworks in the current economic and market conditions and regulatory environment. This process results in a high level of confidence that the offer price of $9.90 per share is fair. In fact, it is arguably more compelling than a single valuer's subjective estimate;

- the fair value of UnitedNetworks at the current time reflects the significant uncertainty attaching to the future regulatory regime for UnitedNetworks' electricity and gas distribution networks. This uncertainty is included in the price of UnitedNetworks shares on the stockmarket and would have been factored into the prices offered by the potential acquirers; and

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[9] The offer was allowed to be conditional on achieving a minimum acceptance level of 70.19%, a condition which will be achieved through the acceptance of the offer by UNZ.

- value can only be properly judged in the context of current circumstances. The price of $9.90 per share is considered fair in today's circumstances. It could be that, by waiting for some period, a better price could be achieved for UnitedNetworks as a result of more certainty in the regulatory regime. On the other hand regulatory changes, if any, may be less favourable than anticipated. Any future price would also reflect the future operating performance of UnitedNetworks and the outlook and equity market conditions at the time. These may or may not be as strong as they are at present.

6.2 Other Merits of the Vector Offer

In assessing the other merits of the Vector Offer, Grant Samuel considered the following factors:

- for practical purposes the Vector Offer is unconditional. The only condition of consequence, the 70.19% minimum acceptance condition, is almost certain to be met. UNZ has a shareholding in UnitedNetworks of 70.2% at the time of the Vector Offer and has control of UnitedNetworks. UNZ has announced that it intends to accept the Vector Offer in respect of its entire shareholding in UnitedNetworks subject only to the consents from Aquila Inc's lending syndicate, and UNZ is contractually bound not to accept any other offer for a period of 150 days;

- there are significant impediments to an alternative offer. It is possible, albeit unlikely, that an alternative and higher offer than the Vector Offer could be made for the shares in UnitedNetworks. To be successful any new offer would require either:

  - Vector to agree to sell the shareholding in UnitedNetworks that it proposes to acquire as a result of the Vector Offer, which will at least be the 70.2% shareholding currently held by UNZ. Grant Samuel regards this as a remote prospect; or
  - Aquila Inc's banks not to consent to the sale of the UnitedNetworks shares in which case the Vector Offer will lapse. Aquila Inc is undertaking a restructuring of its investments globally and the sale of the UnitedNetworks shareholding is an integral part of that process. In Grant Samuel's opinion it is very unlikely that Aquila Inc's banks will not consent to the sale, particularly in view of the 150 day constraint;

- the only other significant shareholder in UnitedNetworks other than UNZ is the UnitedNetworks Shareholders' Society as trustee of the Waitemata Electricity Trust with approximately 10.7% of the shares. The trust deed of the Waitemata Electricity Trust has been amended to require the UnitedNetworks Shareholders' Society to sell shares to the Vector Offer if instructed to do so by the three local authorities which are the final beneficiaries of the trust. As at the date of this report, none of the three local authorities have indicated their intentions with regards to the shareholding. However, the fact that they have amended the trust deed to allow a sale indicates a willingness to consider any offer made;

- if Vector also acquires UnitedNetworks Shareholders' Society's 10.7% shareholding and if approximately half of the remaining shareholders accept the Vector Offer, Vector will achieve the 90% threshold and will be able to effect compulsory acquisition. If insufficient shareholders accept the offer (or if UnitedNetworks Shareholders' Society does not accept the offer), Vector will not achieve the 90% threshold and UnitedNetworks will remain a listed company controlled by Vector. In these circumstances there are substantial implications for those shareholders that do not accept the Vector Offer:

  - liquidity of UnitedNetworks shares is likely to be adversely affected. As of the close of business on 13 September 2002, UnitedNetworks has permitted Vector to acquire further shares in UnitedNetworks on or off the market. In addition there will probably be some shareholders that accept the Vector Offer. Therefore, the size of the total public pool of shareholders (the free float) will reduce. UnitedNetworks' inclusion in indices such as the NZSE40 is not a certainty;
  - there is no guarantee that Vector would maintain the current level of dividends paid by UnitedNetworks;

- unless a revised or eventual "mop-up" bid is widely anticipated, UnitedNetworks shares are likely to subsequently trade at levels well below the Vector Offer of $9.90 per share. In the three months prior to the announcement of the sale process for UnitedNetworks, its shares traded in the range of $7.60 to $8.31 per share with a weighted average daily closing price over the period of $8.08 per share. The trading price could be further impacted by the reduced liquidity, index inclusion or exclusion and any change in dividend policy;
- remaining shareholders will be exposed to risks associated with future performance of the UnitedNetworks business and the future state of equity markets; and
- there would be a prospect of a subsequent "mop-up" bid. Such bids can often be at a significant premium. However there is no certainty that such a bid would occur.

■ if Vector is not successful in achieving the 90% threshold at its offer price it may or may not choose to increase its offer. If Vector chooses to increase its offer the increased value will be available to all shareholders including UNZ even if they have already accepted the $9.90 per share offer. A strategy for minority shareholders (including UnitedNetworks Shareholders' Society) may be to resist the Vector Offer so that if Vector does not appear likely to be able to achieve 90% it will be "forced" to increase its offer to more than $9.90 per share to ensure it can get to 100% ownership. Acquisition of 100% is likely to be Vector's preferred outcome. It makes most sense in terms of integration with its own business, financing and in a number of other respects. However this strategy carries substantial risks. While it may be desirable, there is no evidence that Vector must obtain 100% of UnitedNetworks. The offer is only conditional on 70.19%. Vector may be content to leave UnitedNetworks as a separate listed company under its control. In any event, even if it did want 100%, Vector may be content to "creep" towards the 90% threshold over time by buying a further 5% per annum or by making partial takeovers. Assuming the UnitedNetworks Shareholders' Society accepts the offer, it would take Vector less than two years to reach the 90% threshold (and probably considerably less). The share price in that period is likely to be below the Vector Offer of $9.90 per share. Other factors to be considered in pursuing such a strategy are:

- if UnitedNetworks Shareholders' Society accepts the Vector Offer it would be necessary for more than half of all remaining shareholders not to accept the offer to prevent the 90% threshold being reached. This may be difficult to achieve given the fairness of the offer price; and
- the Vector Offer follows an extensive sale process and a final negotiation between Vector and UnitedNetworks. It is unlikely that there is much scope for any further increases in the offer price.

■ there are a number of synergies that Vector would expect to be able to realise if the Vector Offer is successful. It is always an open issue as to the extent that the value of such benefits is shared between the bidder and the target shareholders. Grant Samuel believes that the offer price of $9.90 per share reflects an element of the synergies likely to be available to Vector. The open, competitive process should have ensured that the winning bidder has "paid away" (through the offer premium) synergies at least to the extent of the synergy benefits common to all parties bidding;

■ some shareholders of UnitedNetworks may have been issued their shares at the time of the Power New Zealand (now UnitedNetworks) share issue to electricity customers in the Waitemata or North Shore regions of Auckland or the Coromandel. The sale of the company to Vector or indeed any other party may result in increases in line charges over time at higher levels than have historically been imposed by UnitedNetworks. However, as previously stated, the Commerce Commission is in the process of assessing whether any price control mechanisms are necessary in the industry and given UnitedNetworks' current levels of profitability reported in its information disclosures there is little opportunity for increasing prices without attracting the attention of the Commerce Commission. Further, Vector is owned by a consumer trust and has historically reported lower levels of profitability than UnitedNetworks. Vector has also been one of few distribution businesses which has reduced line charges to consumers;

- all shareholders of UnitedNetworks are able to share the benefits of the sales process undertaken by the company at the request of Aquila Inc/UNZ. By inviting a range of parties to undertake due diligence and therefore running a competitive process with "informed" potential purchasers, the offer of $9.90 per share by definition represents a "market price" for a full takeover. Further, Aquila Inc, the parent company of UNZ has agreed to pay all of UnitedNetworks' costs of the sale process which will be substantial. If they were to be paid by UnitedNetworks it is likely to have resulted in a lower offer price;

- acceptance of the Vector Offer will realise cash for shareholders. For those shareholders wishing to have an equity investment in the electricity and gas distribution sectors there are very limited other comparable investment opportunities in New Zealand. There are no other listed companies offering the same scale, diversity or exposure to high growth regions as that offered by UnitedNetworks. To this extent, shareholders may be disadvantaged by accepting the offer; and

- the $785 million being paid by Powerco and Hawkes Bay Network for the Eastern region electricity network represents a multiple of ODV of 1.9 times and the $220 million being paid by Powerco for the Central region gas network represents a multiple of ODV of 2.1 times. The Eastern region electricity transaction is at the upper limits of Grant Samuel's estimate of value for this asset and the Central region gas network transaction is at the mid-point of the ODV multiple range selected to value that asset. The sale of these two networks will result in a substantial amount of tax depreciation recovered to UnitedNetworks. This will give rise to a tax liability of approximately $80 million to UnitedNetworks. The new owners of the respective networks should as a consequence of the asset purchases be able to claim depreciation on the full purchase price of the assets. It is likely that the purchase price being paid for each network reflects the tax liability that will arise as a result of the sale by UnitedNetworks and the benefit of higher depreciation value to the purchasers.

6.3 Acceptance or Rejection of the Vector Offer

As with any equity investment there are risks associated with the market in which the company operates. The electricity industry is considered attractive to investors because of its perceived lower risk and reasonably consistent earnings growth.

Acceptance or rejection of the Vector Offer is a matter for individual shareholders based on their own views as to value and future market conditions, risk profile, liquidity preference, portfolio strategy, tax position and other factors. In particular, taxation consequences will vary widely across shareholders. Shareholders will need to consider these consequences and, if appropriate, consult their own professional adviser.

7 Qualifications, Declarations and Consents

7.1 Qualifications

Grant Samuel and its related companies provide financial advisory services to corporate and other clients in relation to mergers and acquisitions, capital raisings, corporate restructuring, property and financial matters generally in Australia and New Zealand. One of its activities is the preparation of company and business valuations and the provision of independent advice and expert's reports in connection with mergers and acquisitions, takeovers and capital reconstructions. Since its inception in 1988, Grant Samuel and its related companies have prepared more than 200 public expert or appraisal reports.

The persons responsible for preparing this report on behalf of Grant Samuel are Michael Lorimer, BCA, CA, Simon Cotter, BCom, DipAppFin, Stephen Wilson M.Com (Hons) CA FSIA and Nicola Taplin BE (Chem), DipBus. Each has a significant number of years experience in relevant corporate advisory matters.

7.2 Disclaimers

It is not intended that this report should be used or relied upon for any purpose other than as an expression of Grant Samuel's opinion on the merits of the proposed transaction. Grant Samuel expressly disclaims any liability to any UnitedNetworks shareholder that relies or purports to rely on this report for any other purpose and to any other party who relies or purports to rely on this report for any purpose.

This report has been prepared by Grant Samuel with care and diligence and the statements and opinions given by Grant Samuel in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading. However, no responsibility is accepted by Grant Samuel or any of its officers or employees for errors or omissions however arising in the preparation of this report, provided that this shall not absolve Grant Samuel from liability arising from an opinion expressed recklessly or in bad faith.

7.3 Independence

Grant Samuel does not have at the date of this report, and has not had within the previous two years, any shareholding in or other relationship with UnitedNetworks that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the proposed transaction. Grant Samuel had no part in the formulation of the proposed transaction. Its only role has been the preparation of this report and its summary.

Grant Samuel will receive a fixed fee for the preparation of this report. This fee is not contingent on the outcome of the proposed transaction. Grant Samuel will receive no other benefit for the preparation of this report. Accordingly, Grant Samuel considers itself to be independent for the purposes of the Takeovers Code.

7.4 Information

Grant Samuel has obtained all information, which it believes is desirable for the purposes of preparing this report, including all relevant information which is or should have been known to any Director of UnitedNetworks and made available to the Directors. Grant Samuel confirms that in its opinion the information provided by UnitedNetworks and contained within this report is sufficient to enable UnitedNetworks shareholders to understand all relevant factors and make an informed decision, in respect of the proposed transaction.

7.5 Declarations

UnitedNetworks has agreed that to the extent permitted by law, it will indemnify Grant Samuel and its employees and officers in respect of any liability suffered or incurred as a result of or arising out of the preparation of this report. This indemnity will not apply in respect of the proportion of liability found by a court to be attributable to any conduct involving negligence or wilful misconduct by Grant Samuel. UnitedNetworks has also agreed to indemnify Grant Samuel and its employees and officers for time spent and reasonable legal costs and expenses incurred in relation to any inquiry or proceeding initiated by any person except where Grant Samuel or its employees and officers are found to have been negligent or engaged in wilful misconduct in which case Grant Samuel shall bear such costs.

Advance drafts of this report (and parts of it) were provided to UnitedNetworks. Certain changes were made to this report as a result of the circulation of the draft report. However, there was no alteration to the methodology, conclusions or recommendations made to UnitedNetworks shareholders as a result of issuing the drafts.

Grant Samuel's terms of reference for its engagement did not contain any term which materially restricted the scope of this report.

7.6 Consents

Grant Samuel consents to the issuing of this report in the form and context in which it is to be included in the information to be sent to UnitedNetworks shareholders. Neither the whole nor any part of this report nor any reference thereto may be included in any other document without the prior written consent of Grant Samuel as to the form and context in which it appears.

7.7 Other

The accompanying letter dated 19 September 2002 and attached appendices form part of this report.

GRANT SAMUEL & ASSOCIATES LIMITED
19 September 2002

Grant Samuel + Associates

Appendix 1
Sharemarket Ratings or Selected Comparable Listed Companies

Sharemarket Ratings of Selected Comparable Listed Companies						
Company	Year End	Market Capitalisation	EBITDA Multiple		EBITA Multiple	
			Historic	Forecast	Historic	Forecast
New Zealand		**NZ$m**				
Powerco	31 Mar	$413.7	9.4	9.0	14.0	13.5
Natural Gas Corp	30 Jun	$1,061.6	6.1	7.6	10.8	12.4
Horizon	31 Mar	$95.0	8.1	nc	9.6	nc
New Zealand Average			**7.9**	**8.3**	**11.4**	**13.0**
Australia		**A$m**				
Australian Pipeline Trust	30 Jun	$602.7	nc	9.4	12.1	11.6
Australian Gas Light	30 Jun	$3,817.7	8.5	7.4	11.6	10.2
AlintaGas	31 Dec	$646.4	nc	8.0	nc	9.9
United Energy	31 Dec	$1,081.9	8.1	7.5	12.7	11.2
GasNet	31 Dec	$249.7	10.8	10.4	13.1	12.8
Australian Average			**9.1**	**8.5**	**12.3**	**11.1**
United Kingdom		**UK£m**				
National Grid	31 Mar	£8,130.8	13.6	9.6	19.0	14.1
Scottish & Southern Energy	31 Mar	£5,606.2	7.9	7.6	10.0	9.4
Centrica	31 Dec	£7,723.0	7.4	6.9	10.8	9.5
Lattice	31 Mar	£6,159.3	nc	9.5	nc	14.4
United Kingdom Average			**9.6**	**8.4**	**13.3**	**11.8**
Total Average			**8.9**	**8.4**	**12.4**	**11.7**

It should be noted that:

- the listed company trading multiples are based on share prices on 16 September 2002, except Powerco which is based on 6 September 2002. The share prices, and therefore the multiples, do not include a premium for control. Shares in a company normally trade at a discount to the underlying value of the company as a whole;

- the balance dates vary across the selection of comparable listed companies, not all of which have the same financial year end as UnitedNetworks. To the extent that different market conditions apply, caution needs to be exercised in comparing the implied earnings multiples over different financial periods; and

- forecast multiples are based on various brokers reports, where more than one brokers report has been available, the average multiple has been shown in the above table.

Powerco

Powerco originally serviced the Wanganui district. In 1998 it merged with Taranaki Energy based in New Plymouth and acquired the Wairarapa electricity lines network. In March 2000 the company merged with CentralPower, which owned the electricity network servicing the Palmerston North, Manawatu and northern Wairarapa districts. In June 2001, Powerco acquired AGL's gas distribution network in the Hutt Valley and Porirua. Powerco is New Zealand's third largest energy distribution company by number of connections served, with 10% of the country's electricity connections and 25% of gas connections, and second largest distribution company based on network length.

Natural Gas Corporation

Natural Gas Corporation ("NGC") owns and operates New Zealand's 2,600 kilometre gas transmission system and 2,400 kilometres of gas distribution network throughout the North Island. NGC also retails natural gas and LPG to over 100,000 customers throughout the North Island and owns a 400MW gas-fired power generation plant in the North Island and a 30MW hydro-power generation plant in the South Island. However, on 20

August 2002 the company announced its intention to divest its retail and generation assets and has initiated a sales process for those assets. In September 2000, NGC completed its acquisition of the electricity and gas retailer, TransAlta New Zealand. As a result of an unhedged electricity purchase position NGC was adversely affected by the hydro electricity shortage in the winter of 2001. Between Jun and August 2001, NGC exited electricity retailing operations by selling its electricity customers to Genesis Energy and Meridian Energy. The financial impact on NGC was significant. Since July 1999 NGC has been 66% owned by AGL.

Horizon Energy Distribution

Horizon Energy Distribution ("Horizon") is the line company formed from Bay of Plenty Electricity Limited (formerly the Bay of Plenty Electric Power Board) after it sold both its supply business to a joint venture comprising Todd Energy Limited and Pacific Hydro Limited. Horizon Energy Distribution Limited (Horizon) is engaged principally in the operation of an electricity distribution network throughout the Eastern Bay of Plenty region of New Zealand. It conveys 590 GWh per annum of electricity to over 23,000 consumers over 2,300 kilometres of lines spread throughout the 8 400 km^2 area. The Company has been listed on the NZ Stock Exchange since 1994 and is owned by approximately 3,000 shareholders; the principal shareholder being the Eastern Bay Energy Trust, which owns 77% of the Company's shares.

Australian Pipeline Trust

The Australian Pipeline Trust is the major ASX listed natural gas pipeline company in Australia with interests in over 7,000 kilometres of pipeline infrastructure, which it acquired from AGL in June 2000. AGL holds a 30% unit holding in the trust with another 10% being held by Petronas Australia, an original equity partner with AGL in the Moomba to Sydney pipeline. Petronas is the national petroleum company of Malaysia. The trust has a number of options for expansion, including the acquisition of minority interests in existing pipelines.

Australian Gas Light

Australian Gas Light ("AGL") is one of the largest retailers and energy infrastructure owner/operators in Australia. The principal activities of the company are the sale of gas and electricity, operation of natural gas and electricity distribution systems, extraction and sale of LPG, investments in gas industries (including overseas) and realisation of property and property-related assets. AGL's network comprises of 22,534 kilometers of gas distribution pipes and an electricity network covering 950km2 in Victoria. In response to the changing regulatory landscape, AGL commenced a major restructure of its business including the floating of its transmission pipeline assets into the listed Australian Pipelines Trust and the establishment of a specialised infrastructure asset management company, Agility. AGL also owns 66% of NGC.

AlintaGas

AlintaGas is Western Australia's principal natural gas retailer and distributor. The company's distribution network, AlintaGas Networks, delivers to approximately 60% of WA households gas through a 11,100km network of pipelines and has an industrial, commercial, residential customer base which totals over 400,000 customers. AlintaGas has experienced two years of rapid growth, but the current market consensus appears to be that the company is maturing and becoming a utility with limited growth prospects.

United Energy

In 1994 the distribution and retail business of the State Electricity Commission of Victoria was divided into five corporatised entities. United Energy was the first of these entities to be privatised and the company was listed on the Australian Stock Exchange in 1998. United Energy's core distribution business encompasses an electricity distribution network covering parts of Melbourne, where it serves more than 570,000 customers. In addition, United Energy also manages the gas distribution of Multinet Gas serving more than 625,000 customers. United Energy offers other energy retailers a range of back office services including metering, billing, credit and collection and call centre. United Energy also owns 66% of Uecomm, which supplies bandwidth to customers for data and video transmission and has significant ongoing capital requirements. United Energy recently divested retail operations and essentially a distribution company with defensive and predictable earnings.

GasNet

The GasNet Australia Trust through its wholly owned subsidiary company GasNet Australia (Operations) Pty Ltd owns and maintains a pipeline network of 1,930 kilometres. The network traverses much of Victoria and has over 100 offtakes to most of Victoria's cities and regional centres. The annual throughput is typically in excess of 200 petajoules. As well as its pipeline network, GasNet also owns and operates a liquefied natural gas storage and vaporisation facility, compressor stations and other facilities including metering, monitoring, control and communication systems. GasNet's Victorian transmission operations generate 85% of the company's total revenue.

The National Grid Group
The National Grid Group ("National Grid") is an international networks business. Its principal activities are the ownership, operation and development of a regulated high-voltage transmission network in England and Wales. Following the acquisition of businesses in the US over the last two years, National Grid is now owner and operator of electricity transmission and distribution networks serving approximately 3.2 million electricity customers and 0.5 million gas customers in the north-eastern US. In addition to electricity businesses, the National Grid has communications interests, a 32.5% economic interest in Energis, an IT and communications solutions provider, and joint ventures in Poland and Latin America. It also has wholly owned infrastructure services businesses in the UK and the US. On 22 April 2002, National Grid announced a recommended merger of equals, with Lattice to create an international energy delivery group, National Grid Transco plc. The transaction is subject to shareholder and regulatory approvals both in the UK and US.

Scottish & Southern Energy
Scottish and Southern Energy is an integrated energy company with operations in Scotland, southern England and Wales. The company is one of the UK's largest energy suppliers, serving some 4 million electricity customers and 1 million natural gas customers. Scottish & Southern manages Britain's largest electricity distribution network. In addition, the company has more than 6,700 MW of generating capacity, and has an energy trading and marketing subsidiary. In response to energy deregulation in the UK, Scottish and Southern is expanding through acquisitions. It is also moving into communications and building fibre-optic networks in northern Scotland and southern England.

Centrica
Centrica is the UK's largest gas supplier, providing gas to 13.4 million households under the British Gas and Scottish Gas brands. It also has substantial electricity assets. After emerging from the 1997 British Gas split with the rights to the British Gas brand, Centrica has branched into other areas; financial services, electricity (where it serves 5.4 million customers) and communications services. The company offers consumer guides and credit cards under the Goldfish name and home and motor insurance and roadside services through its subsidiary, Centrica's Automobile Association. Over the past few years, Centrica has been delivering on its customer and business growth targets through acquisitions, rather than organic growth. Since 1999, the company has spent over £2.5 billion on acquisitions. Centrica's strategy has been to reinvest cash generated by its UK energy supply businesses in new growth businesses. There is speculation however that Centrica could be over paying for new businesses and that these businesses fail to perform.

Lattice Group
Lattice Group ("Lattice") was formed through the de-merger from BG plc in 2000. The vast majority of Lattice's turnover is generated through its subsidiary, Transco. Transco is the monopoly operator and owner of the Great Britain gas transmission and distribution system, previously owned by its former public entity British Gas. Transco transports gas for approximately 60 customers known as gas "shippers". Gas is received at seven coastal terminals and transported via 6,400km of high-pressure pipelines and 275,000km of lower pressure (local transmission) and distribution pipelines to the meters of industrial, commercial and domestic customers and to third party gas transportation systems. Transco is responsible for development and maintenance of the pipeline system. In addition, Lattice owns a number of ancillary businesses, including SST which builds, leases and operates sites for the base stations and radio masts needed by mobile telephone operators and 186k, which owns and manages a fibre-optic network of nearly 2,000 kilometres connecting 20 centres of demand in the UK. Unlike National Grid, Lattice has not expanded internationally, and has focused on efficiency improvements within its regulated gas transportation system and developing telecom infrastructure using existing gas-related infrastructure.

Appendix 2
Market Evidence from Comparable Transactions

Selected Transaction Evidence								
Date[10]	**Target**	**Acquirer**	**Price**	**EBITDA Multiple**		**EBITA Multiple**		**ODV Multiple**
				Historic	**Forecast**	**Historic**	**Forecast**	
Electricity Networks New Zealand								
			NZ$m					
Nov 98	TransAlta	UnitedNetworks	$590	8.4	nc	10.5	nc	1.9
Nov 98	TrustPower	UnitedNetworks	$485	12.8	nc	17.1	nc	2.0
Dec 98	Wairarapa Electricity	Powerco	$83	10.9	nc	11.0	nc	1.3
Feb 99	Central Electric	Dunedin Electricity	$127	21.9	nc	42.1	nc	2.0
Apr 99	King Country Energy	Waitomo Energy	na	nc	nc	nc	nc	0.9
Apr 99	Wairoa Power	Eastland Energy	na	nc	nc	nc	nc	1.3
Nov 99	Horizon	BOP Electricity Trust	$52	7.5	nc	8.9	nc	1.4
Jun 02	Otago Power	Consortium	$109	17.6	17.9	22.0	23.2	2.1
New Zealand Average								**1.6**
Gas Networks								
New Zealand			**NZ$m**					
Nov 98	Enerco	Southpower	$484	9.9	9.2	13.1	12.7	1.5
Apr 00	Orion	UnitedNetworks	$550	nc	8.0	nc	11.2	2.1
Jul 01	AGL	Powerco	$118	nc	nc	nc	nc	2.3
New Zealand Average				**9.9**	**8.6**	**13.1**	**12.0**	**2.0**
Australia			**A$m**					
Aug 97	Envestra	Share float	$910	nc	16.8	nc	24.3	nc
Jul 98	Allgas Energy	Energex	$250	14.5	14.2	nc	21.6	nc
Australia Average				**14.5**	**15.5**	**nc**	**23.0**	**nc**
United Kingdom			**UK£m**					
Oct 00	Lattice	Share float	£11,391	6.3	nc	8.8	nc	nc

The following information should be taken into account regarding these transactions:

- In November 1998 TransAlta announced the sale of its electricity lines network to UnitedNetworks for $590 million and at the same time was to purchase UnitedNetworks energy retail business and shortly afterwards its 52% shareholding in the Rotokawa Geothermal Generation Project. The purchase price paid by UnitedNetworks for the TransAlta lines network represented a multiple of ODV of 1.85;

- In November 1998 TrustPower announced the sale of its electricity lines network to UnitedNetworks for $485 million. The purchase price represented a multiple of ODV of 2.0;

- In December 1998 South Eastern Utilities announced the sale of Wairarapa Electricity's electricity lines network to Powerco for $82.5 million. At the same time South Eastern Utilities sold its electricity retail customers and electricity generation assets. The price paid suggests a multiple of 1.3 times ODV;

- Central Electric sold its electricity lines network to Dunedin Electricity in February 1999 in a tender process for $127 million. It is understood that both Orion and UnitedNetworks were also bidding. The price paid represented a multiple of ODV of 2.0;

[10] Date of announcement of the transactions

- In April 1999 King Country Energy sold its electricity lines network to Waitomo Energy Services, which has been renamed The Lines Company. At the same time Waitomo Energy Services sold its energy and generation assets to King Country Energy. The shareholding Trusts took a 10% shareholding in the other company. The sale price of the King Country network represented a multiple of ODV of 0.9. The nature of this transaction meant that the multiple of ODV was probably below that which could have been achieved in an open market transaction;

- Wairoa Power sold its lines business to Eastland Energy in April 1999. The purchase price was not disclosed however Grant Samuel understands that the price represented a multiple of ODV of approximately 1.3 or approximately $15 million;

- In November 1999 UnitedNetworks sold its 52.3% shareholding in Horizon to the Bay of Plenty Electricity Consumer Trust for $27.4 million. This price implied a multiple of ODV of 1.4. The sale proposal included provision for the Trust to pay UnitedNetworks a termination fee of $5.2 million relating to cancellation of the current Shareholders' Agreement between it and the Trust. In addition UnitedNetworks retained certain pre-emptive rights over the Trust's investment in Horizon for a period of 5 years;

- The Southland Consortium (being Electricity Invercargill and The Power Company) together with Marlborough Lines purchased the assets of Otago Power on 14 June 2002 for $109 million and the company was subsequently wound up. Otago Power had an ODV of $52.7 million as at 31 March 2001;

- In November 1998 Southpower, the majority shareholder of Enerco New Zealand ("Enerco") made a takeover offer for the company at $5.60 per share. It then increased the offer to $5.70 per share. Enerco owned gas distribution networks in Auckland, Wellington, Horowhenua, Manawatu and Hawkes Bay, retailed gas to some industrial customers and to some small gas exploration and electricity generation investments. Enerco had approximately 107,000 connections to and transported approximately 17.4PJ gas across its gas network. As at 30 September 1998 the network had an ODV of $303.2 million;

- In April 2000 Orion (formerly Southpower) sold the gas distribution assets, which it had acquired through its takeover of Enerco in late 1998, to UnitedNetworks. UnitedNetworks were the highest bidder in a formal sales process. At this time the network had 117,000 connections, and transported 16.2PJ of gas in the year to 31 March 1999. As at 31 March 1999 the ODV of the network was $267 million;

- In June 2001 Powerco acquired the New Zealand gas distribution assets of AGL for $118 million. The network serviced 26,000 gas consumers in the Hutt Valley region. AGL was required to sell the assets to secure Commerce Commission approval to allow its 66% subsidiary NGC to acquire TransAlta New Zealand. AGL had acquired the same assets in March 1999 from TransAlta New Zealand when it divested its distribution business (electricity to UnitedNetworks and gas to AGL);

- In August 1997 Boral announced the sale of its natural gas distribution network which reticulates gas to approximately 300,000 customers in South Australia to Envestra for approximately A$890 million. Envestra subsequently listed with Boral holding a 20% shareholding;

- Queensland state owned electricity company Energex acquired Allgas Energy for $23 per share after a protracted battle for control involving Boral and Texas Utilities. Energex is the largest of the Queensland electricity companies. The acquisition was viewed by many commentators as a means for Energex to protect its electricity retailing operations from a serious competitor. Boral withdrew from the bidding process after the Australian Competition and Consumer Commission would not allow the company to merge its business with that of Allgas Energy; and

- Lattice Group ("Lattice") was split from BG Group (formerly British Gas) in October 2000. Lattice is the owner of Transco, the owner and operator of Great Britain's gas transmission and distribution system. Each BG Group shareholder was given one share in Lattice. Shares commenced trading at £1.50 and closed on the first day at £1.47 per share.