



Aurizon Holdings Limited
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ASX Market Announcements
ASX Limited
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BY ELECTRONIC LODGEMENT

13 March 2018

Aurizon Network's Response to QCA UT5 Draft Decision

Please find attached announcement for release to the market.

Kind regards

A handwritten signature in black ink, appearing to read "D. Smith", with a horizontal line underneath.

Dominic D Smith
Company Secretary

ASX Announcement

Date: 13 March 2018

Aurizon Network's Response to the QCA UT5 Draft Decision

Aurizon Network has [submitted its response](#) to the Queensland Competition Authority's (QCA) Draft Decision on Aurizon Network's 2017 Draft Access Undertaking (2017 DAU).

The submission acknowledges a range of positions taken by the QCA in its Draft Decision, however Aurizon Network believes the QCA fundamentally fails to recognise the commercial and regulatory risks Aurizon Network undertakes in operating the Central Queensland Coal Network (CQCN).

The submission addresses in detail each of Aurizon Network's key concerns with the QCA Draft Decision (released on 15 December 2017), including:

- > the overall reasonableness of the QCA's proposed Maximum Allowable Revenue (MAR) of \$3.893 billion, a reduction of \$1 billion from the MAR originally proposed by Aurizon Network. Illogically, the QCA has asserted that the UT5 MAR should be lower than the current access undertaking (UT4).
- > a Weighted Average Cost of Capital (WACC) of 5.41%. The QCA has recommended that the CQCN should earn the lowest regulated return of any recent decisions for major regulated infrastructure assets in Australia. By way of comparison, the ACCC recommended only eight months earlier a WACC of 6.3% for the Hunter Valley Coal Network.
- > the QCA's \$104 million reduction in the maintenance allowance, when it expects Aurizon Network to maintain an asset base which is 20% larger than in the UT4 regulatory period and that will rail an additional 130 million tonnes or 15% more than current volumes.

A summary of the key changes from Aurizon's 2017 DAU (submitted on 30 November 2016) and Aurizon's Response (12 March 2018), together with building blocks for the revised MAR, is outlined in the two tables below. The revised MAR of \$4.757 billion for FY2018-FY2021 is a reduction of \$135 million from the \$4.892 billion MAR Aurizon Network put forward in the 2017 DAU.

Aurizon maintains the very strong view that the proposed rate of return of 5.41% does not promote the economically efficient operation of, use of and investment in, the CQCN; nor does it appropriately recognise the operational and other risks associated with the CQCN, in particular, exposure to international demand and coal prices.

The submission provides further detailed analysis, building upon the work done in the 2017 DAU, and takes an evidence-based approach in responding to each of the building blocks of MAR in the QCA Draft Decision. Aurizon Network's response proposes a WACC which, principally due to changes in market conditions, is 0.25% higher than its original submission but in real terms (taking account of revised inflation forecasts) is almost 1% lower than under the original submission.

Aurizon Network's response also identifies fundamental errors and miscalculations made by the QCA and its consultants that ultimately underpin the significantly reduced maintenance allowance of the Draft Decision. Aurizon Network continues to stress that the Draft Decision's position on maintenance, focusing on the lowest cost rather than maximising supply chain throughput by using flexible, commercially appropriate practices, does not represent 'efficient' practice and does not reflect what customers and the broader supply chain are demanding.

Next steps

Aurizon Network continues to consult directly with its customers and supply chain partners on the range of issues contained in the Draft Decision. This includes regular updates on operational and network capacity impacts that are the result of Aurizon Network progressively implementing operational and maintenance practices that are aligned with the Draft Decision. Aurizon Network cannot wait for the Final Decision because it will have retrospective application from 1 July 2017. The QCA has yet to provide a timeframe for delivery of the Final Decision.

Given Aurizon's level of concern and the implications for the Queensland coal supply chain, Aurizon continues to consider the full range of potential responses.

The tables below summarise Aurizon Network's position on the MAR building blocks for the UT5 regulatory period. A comparison is made between these values and the QCA's Draft Decision and Aurizon Network's originally submitted UT5 position.

Table 1. Building Block – Aurizon Network's response to QCA Draft Decision (\$m) compared to the Aurizon Network 2017 Draft Access Undertaking and the QCA Draft Decision.

Building Blocks	Aurizon Network UT5	QCA Draft Decision	Aurizon Network Response to Draft Decision	Rationale for variance between Aurizon Network's Response and original Aurizon Network submission (2017 DAU)
Return on Capital (WACC)	1,592	1,289	1,677	Proposed nominal WACC increased from 6.78% to 7.03% as a result of changed market rates and an updated placeholder averaging period. Note: while the nominal WACC has increased, the real WACC (which has been adjusted for inflation) decreases from 5.49% to 4.62%.
Depreciation (less Inflation)	1,141	899	936	Revised the 10-year forecast rate of inflation from 1.22% to 2.30%, reflecting changes to market rates and revised methodology.
Maintenance Cost	921	817	928	Uses FY17 as base year in line with QCA's DD, adjusted for anomalies and is based upon maintenance practices designed to minimise supply chain disruptions.
Operating Cost	855	743	867	Uses FY16 as the base year in line with the QCA's DD, with revised allocation of costs, for example, Information Technology.
Tax	329	140	300	Revised estimate of Gamma to 0.31 (from 0.25) in line with Australian Tax Office statistics.
Total MAR	4,838	3,888	4,708	
Capital Carryover	54	5	49	
Total adjusted MAR	4,892	3,893	4,757	
Tariff \$/net tonne	\$5.36	\$3.86	\$4.90	

Table 2. Building Block – parameters – Aurizon Network’s response to QCA Draft Decision

WACC parameter	UT5 submitted	UT5 QCA DD	UT5 Response to DD
Risk free rate	2.13%	1.90%	2.76%
Avg period	June 2016	June 2017	January 2018*
Capital structure (% debt)	55%	55%	55%
Market risk premium	7.0%	7.0%	7.5%
Asset beta	0.55	0.42	0.55
Equity beta	1.0	0.73	0.967
Debt risk premium	2.47%	2.00%	1.64%
Debt issuance & hedging costs	0.262%	0.233%	0.20%
Gamma	0.25	0.46	0.31
Return on equity	9.13%	6.99%	10.01%
Return on debt	4.86%	4.13%	4.6%
Post-tax nominal (vanilla) WACC	6.78%	5.41%	7.03%
Rate of Inflation	1.22%	2.37%	2.30%
Post Tax Real (vanilla) WACC	5.49%	2.97%	4.62%

* Aurizon Network proposes that the averaging period be updated to a date closer to the QCA making its Final Decision

Link

[Aurizon Network Response to QCA Draft Decision on the 2017 Draft Access Undertaking](#)

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