Ausgrid

2019-24 Regulatory Proposal

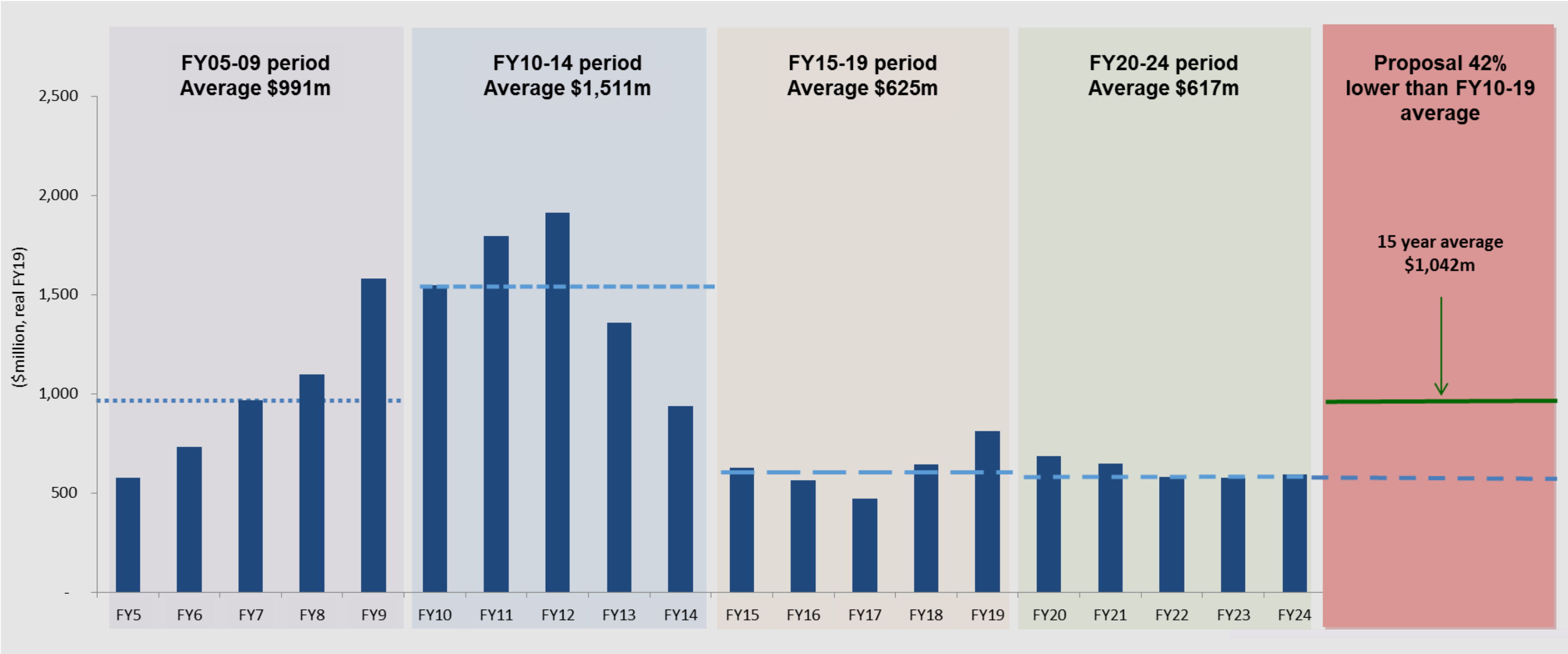
Discussion September 2018

Agenda

1. Ausgrid capex forecast is designed to be capable of acceptance
    I. Replacement capex determined by program and internally tested
    II. Augmentation capex – reflects low growth environment
    III. ICT capex – lower than all recent history
    IV. Fleet capex – reflects a return to BAU after significant fleet reduction
    V. Property capex – property sold, remaining locations to be remediated
2. Ausgrid is committed to oil-filled cable replacement
3. Capex governance at Ausgrid: driving lower forecasts
4. Ausgrid's response to stakeholder consultation
5. Non-system property capex is part of an overall strategy of optimisation
6. Proposed opex – locks in savings and includes significant efficiency

1 Ausgrid capex forecast is designed to be capable of acceptance

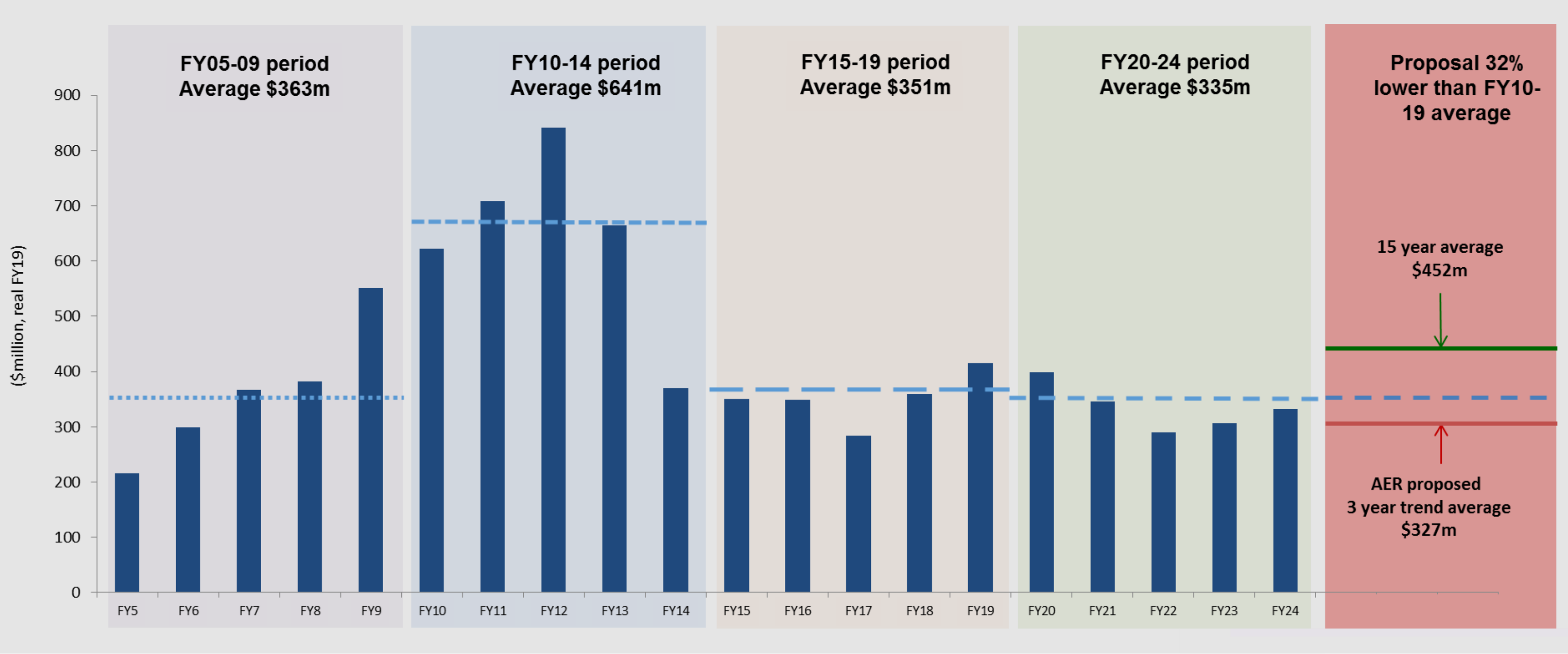
- Based on detailed bottom-up forecast of necessary capex at a program level
- Subject to significant internal governance and external consultation
- Responded to customer feedback
- Overall program consistent with actual expenditure for FY15-19
- 15 – 19 Period unusual:
  - Responding to AER decision
  - Focus on transformation; and
  - Preparation for lease transaction
- 2% labour productivity included within the forecast



- No real RAB growth per customer
- We are challenging the business to deliver the necessary program with no increase in capital expenditure allowance.

Replacement capex determined by program and internally tested

- Bottom up replacement expenditure requirements estimated with reference to:
  - Failure rates
  - Condition; and
  - Risk.
- Necessary step change in certain asset categories: consac, HDPE
- AER's repex model operates best in stable operating environments. The recent regulatory period was not a stable environment.
- Proposed capex is in line with the most recent 5 year average.



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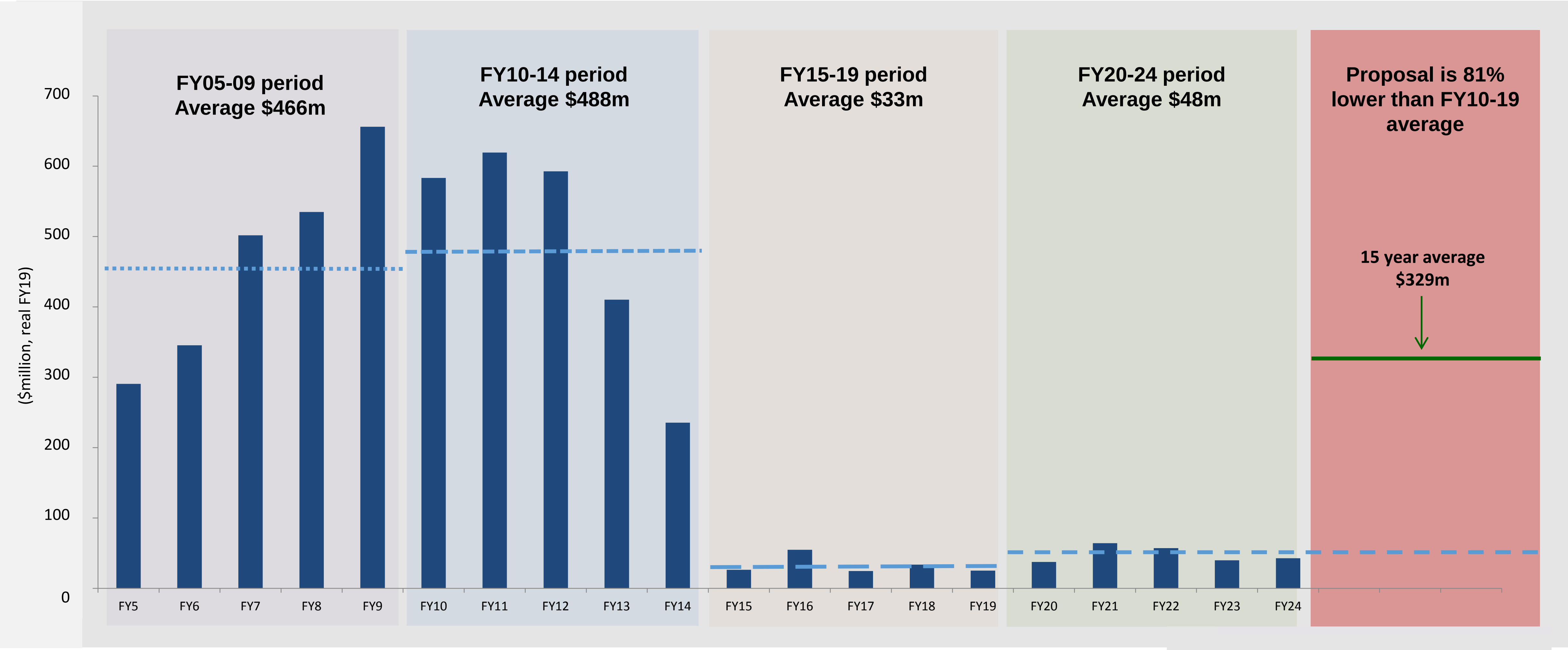
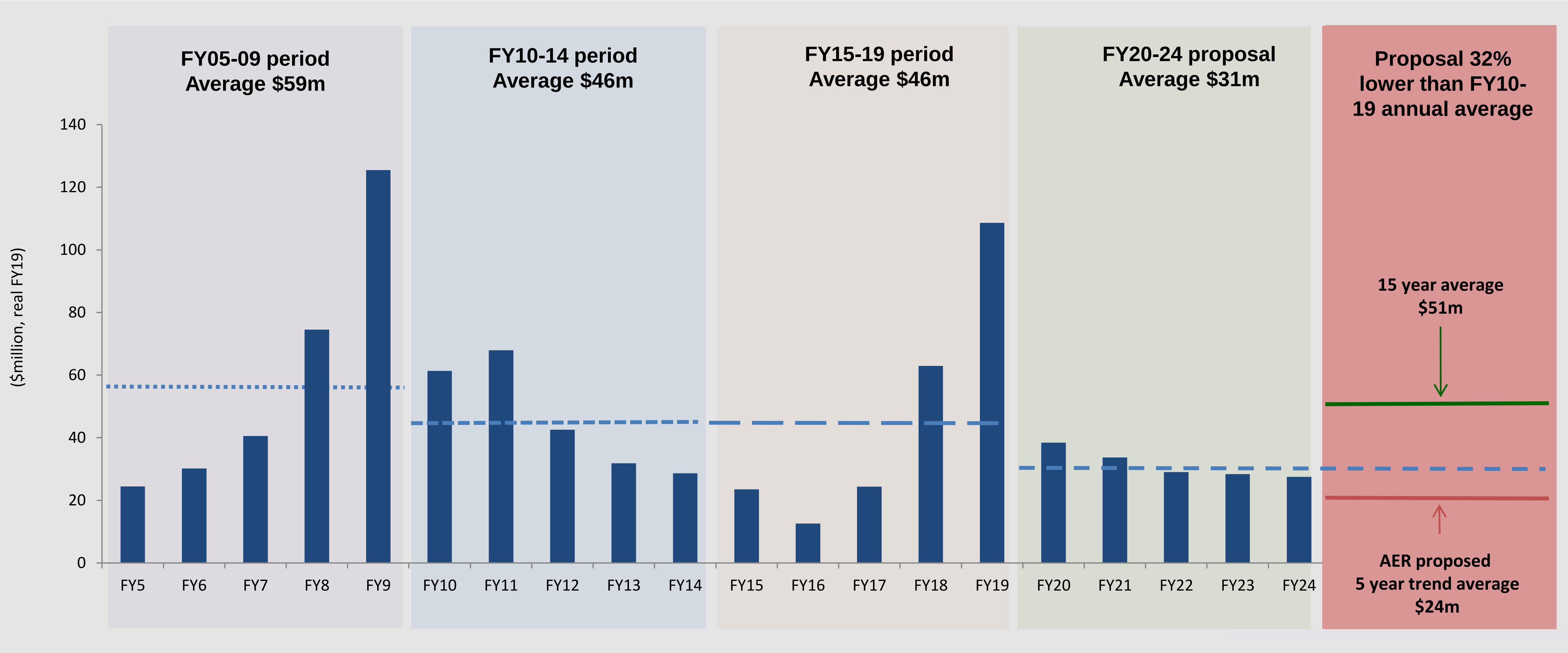
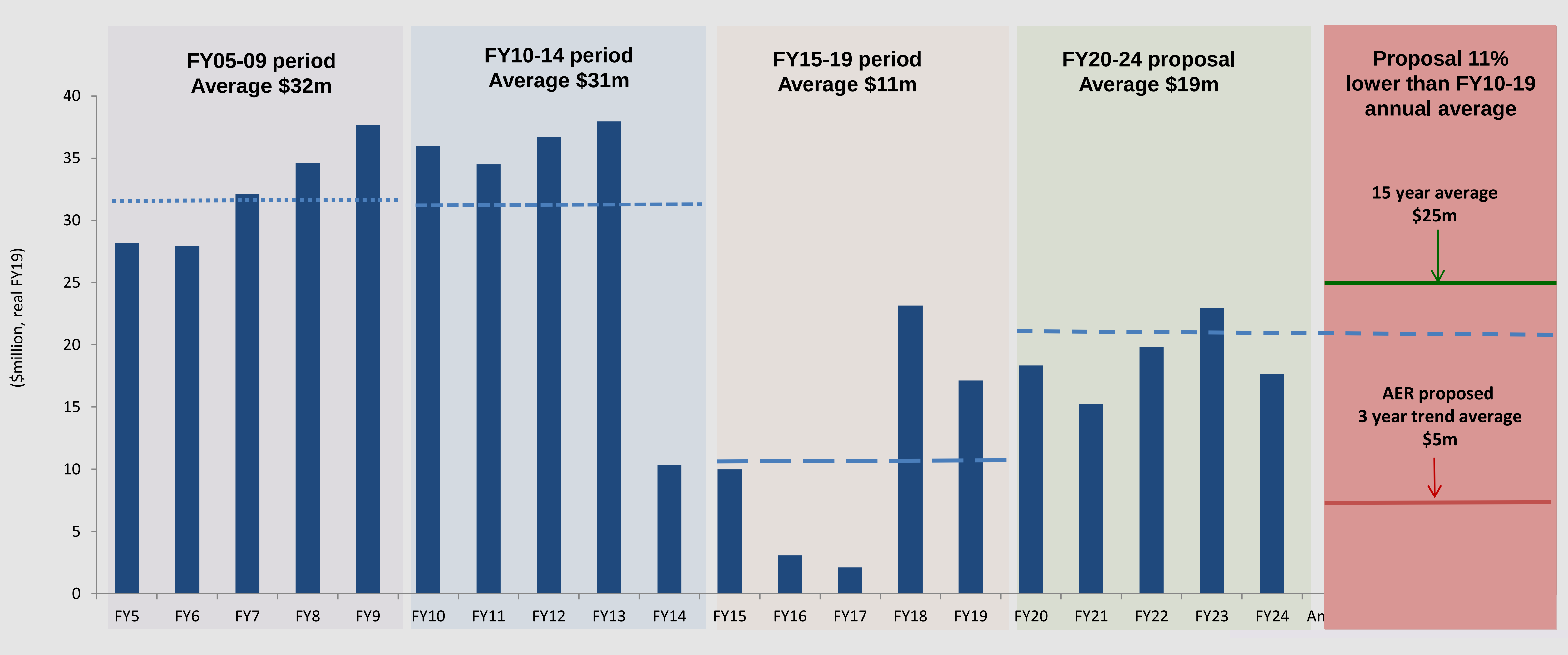
Augmentation capex – reflects low growth environment



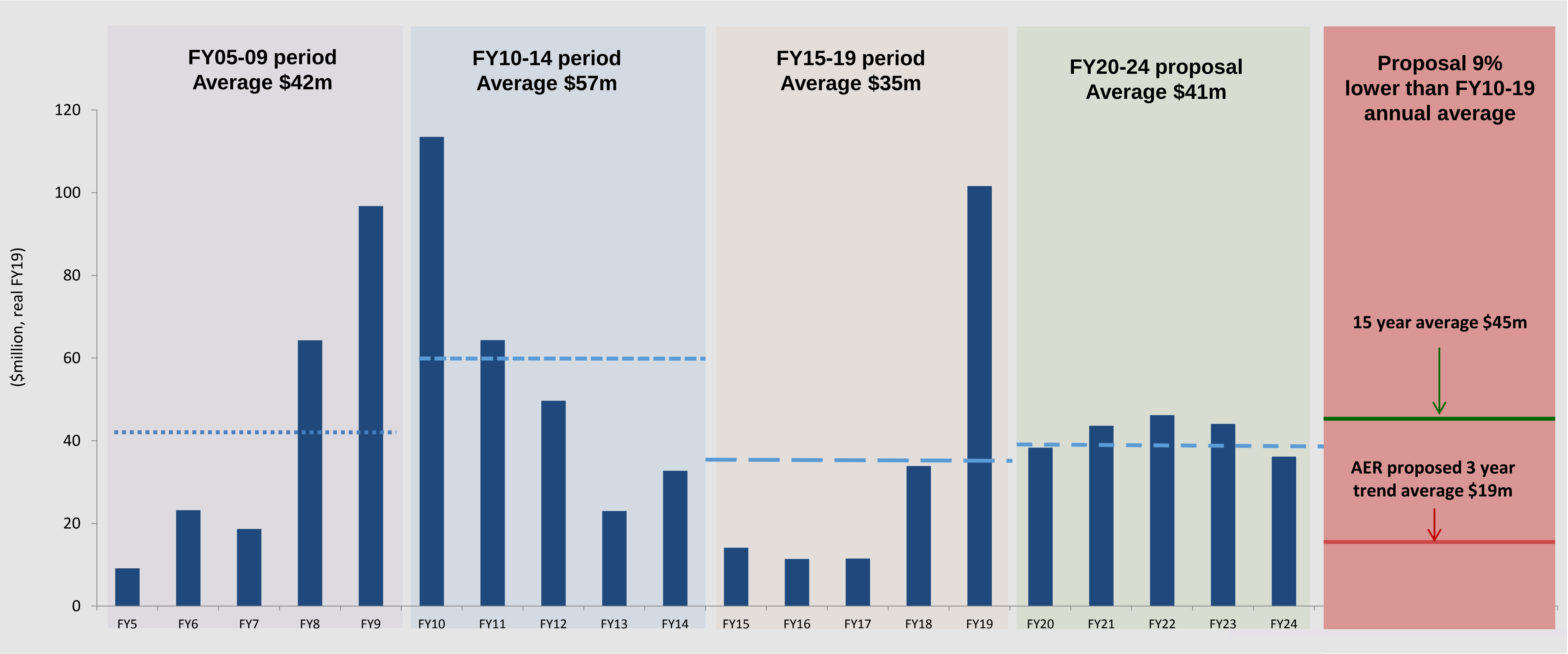
ICT capex – lower than all recent history



Fleet capex – reflects a return to BAU after significant fleet reduction



Property capex – property sold, remaining locations to be remediated
(see net capex)



Ausgrid is committed to oil-filled cable replacement

NSW EPA

DOC18/649694, EF13/5501

Mr Sebastian Roberts
General Manager
Networks (Opex and Reset Coordination)
Australian Energy Regulator
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Dear Mr Roberts

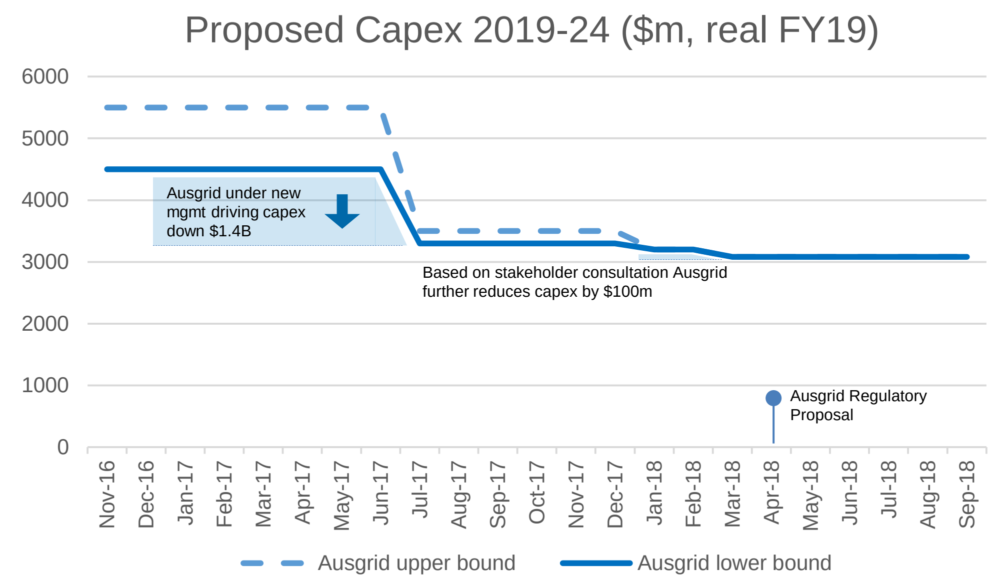
REPLACEMENT OF FLUID-FILLED UNDERGROUND TRANSMISSION CABLES

I am writing to you regarding Ausgrid's proposal to gradually replace fluid-filled underground transmission cables.

The NSW Environment Protection Authority (EPA) acknowledges that Ausgrid is committed to a risk-based strategy to progressively decommission and replace its fluid-filled cables as outlined in its Environmental Management Strategy Underground Transmission Cables (EMS 300) dated 4 October 2017. The EPA considers Ausgrid's commitments to be essential to it meeting its ongoing obligation to reduce any potential discharges to land and water of substances likely to cause harm to the environment.

- We have an agreement with the Environmental Protection Authority (EPA)
- We have an obligation to reduce oil leakages by 50% every regulatory period
- The EPA has confirmed the nature of this agreement to the AER
- It appears this is insufficient to provide the AER confidence that the cable replacements will be undertaken
- The program:
  - Has been subject to cost benefit analysis; and
  - Reflects the shared understanding with the EPA of the appropriate replacement rate.

Capex governance at Ausgrid: driving lower forecasts



- Ausgrid's Board and the new management team sought to develop a capex proposal capable of acceptance
- Initial capex forecast $4.5-5.5B tabled in November 2016:
  - Shared with the Customer Consultative Committee (CCC); and
  - Subject to internal scrutiny and challenge
- Revised capex forecasts $3.3-$3.5B tabled with senior management in July 2017
- Further challenge resulted in a capex forecast at the time of extended stakeholder consultation of $3.2B in January 2018
- Responding to stakeholder consultation Ausgrid reduced capex proposed to $3.1B in April 2018, as well as responding to several other areas of customer interest.

Key governance timeline

2016
22 Nov
CCC meeting.
Ausgrid tabled initial repex of $3.2 to $4.2B. Corresponds to total capex of $4.5-$5.5B

2017
4 April
Stakeholder Regulatory Working Group workshop.
Discussion of sustainability, key issues and drivers for capex.

2017
25 July
Stakeholder workshop consultation on initial forecasts for 2019-24 period.
Capex of $3.3-$3.5B tabled, with $1.9-$2B repex.

2017
25 Sept
Board / RREC endorse principles of affordable, reliable, sustainable to underpin proposal

2018
January
Board / RREC approve Stakeholder Consultation Document

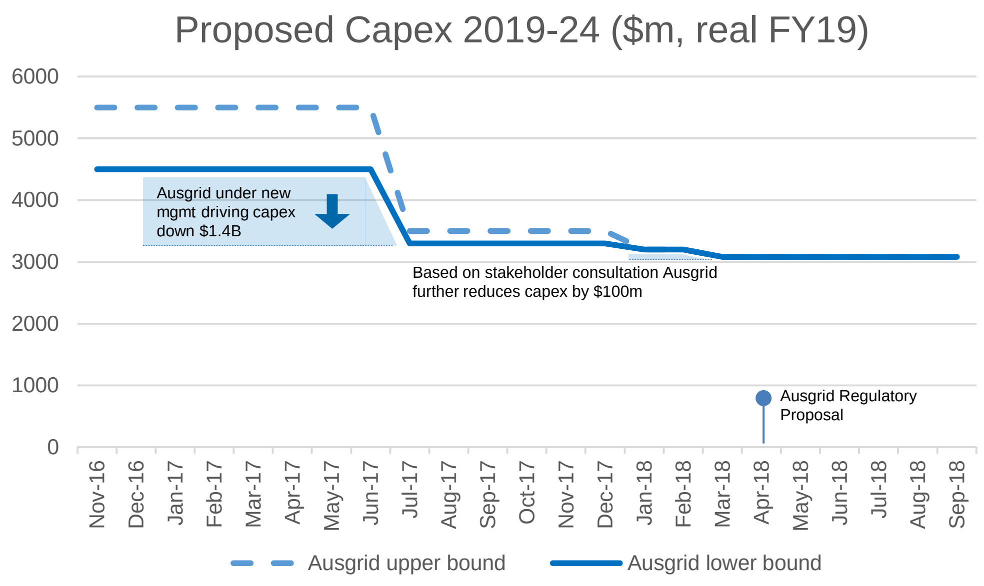
2018
February
Extension and Deep-dive stakeholder consultations.
Capex of $3.2B tabled.

2018
March
Post consultation – Ausgrid agrees to further $100m capex reduction.

2018
April
Board / RREC approval Regulatory Proposal for submission. Total capex forecast of $3.08B

Stakeholder
Board

4 Ausgrid's response to stakeholder consultation



Ausgrid changed the following in response to stakeholder consultation **before** submitting our proposal:

- **Reversed** capital contribution policy change resulting in reduced capex of $25m
- **Reduced** depreciation revenues by $100m
- **Reduced** depreciation for Type 5 and 6 metering resulting in $37m in reduced cost
- Identified an additional capex deferral of $69m through new demand management initiatives
- Net outcome was a **1.3% reduction** compared to FY15-19 capex

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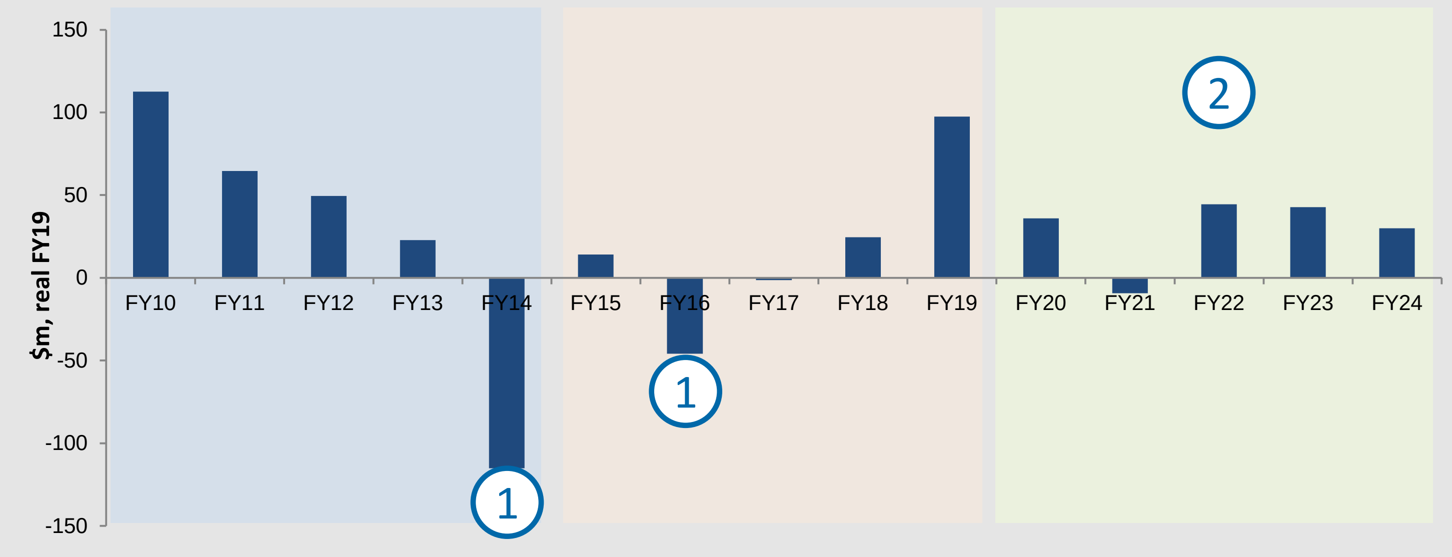
Non-system property capex is part of an overall strategy of optimisation

Net Property Capex = Capex – Disposals ($real FY19)

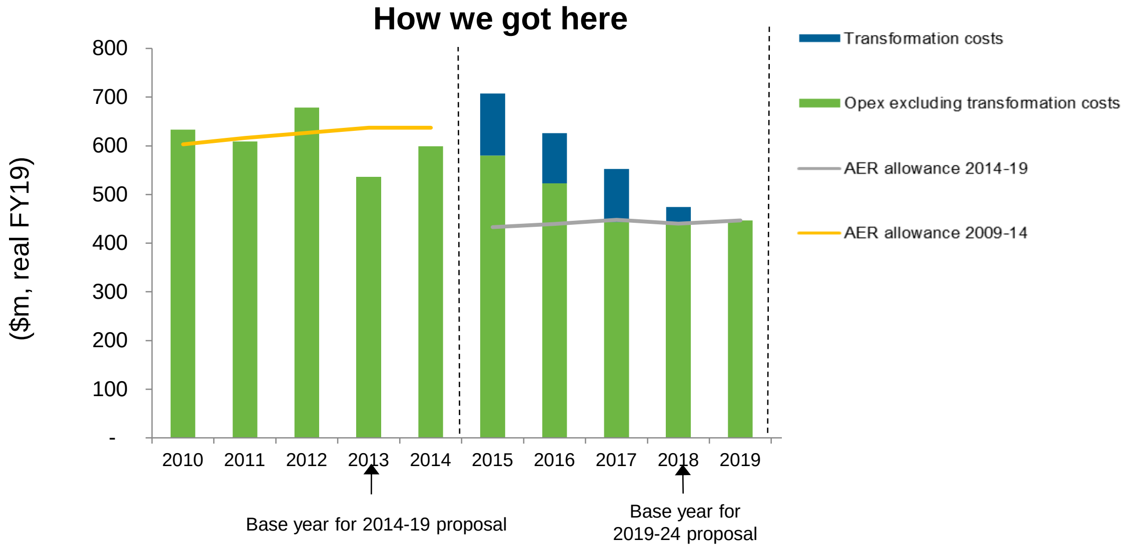


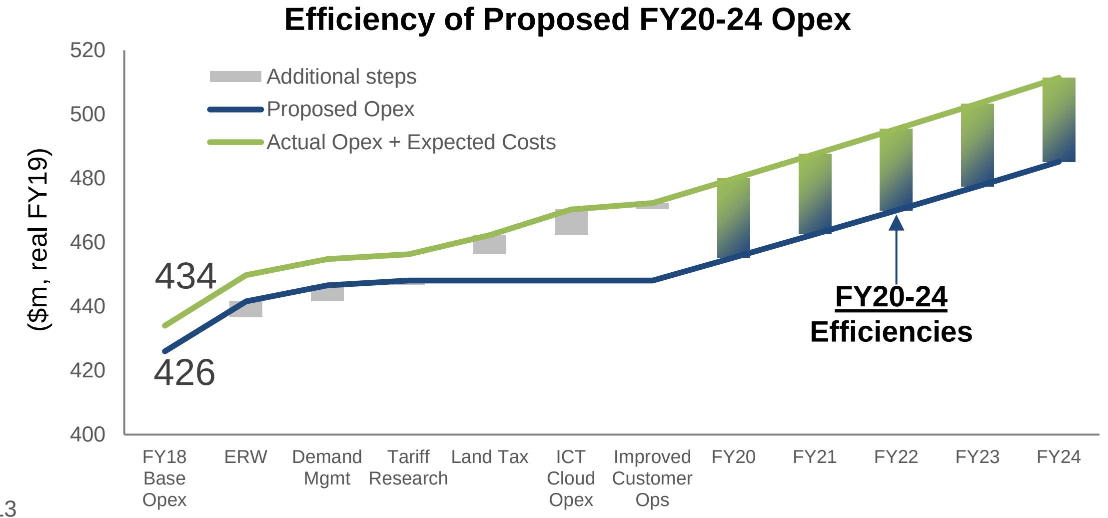
- FY20-24 non-system property capex is part of an overall strategy of portfolio optimisation:
- 1 We have sold property, which will benefit customers by $57m over FY20-24. Property sales to date have led to an opening non-system land RAB of -$57m. This is returned to customers over FY20-24.
- 2 We are seeking to refurbish / renew remaining sites over FY20-24, to ensure compliance and mitigate risks (such as asbestos).

The impact of Ausgrid's non-network property strategy, including past and forecast land disposals + forecast property capex over FY20-24, is a reduction to revenue allowances.

$nominal	Total FY20-24
Revenue impact of negative land RAB + Proposed FY20-24 Capex	-$54m
Revenue impact ($/customer)	-$30

Proposed opex – locks in savings and includes significant efficiency





- $100m (20%) base year savings to date from FY15 to FY18
- As agreed, Ausgrid has used the AER's base step trend approach
- However, the business did not achieve the target base year opex of $426m – our actuals for FY18 were $434m
- This means we are committing to opex $8m (2%) per annum lower than our current level of operating expenditure
- In addition we are committing to absorb further costs from:
  - increased land tax;
  - ICT cloud and cyber security opex; and
  - improving customer operations.
- Evidence shows businesses often face operational cost rises after periods of significant transformation
- There has been little sector wide productivity improvement.