Five Year Plan for the South Australian Natural Gas Distribution Network

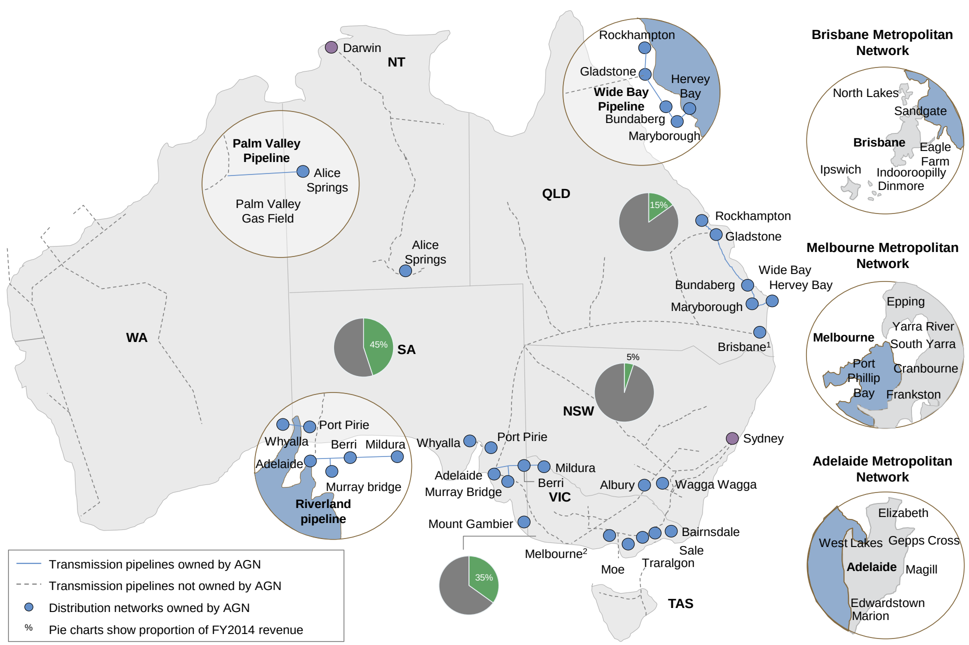
13 August 2015

Agenda

- Who we are
- Our vision and performance
- Stakeholder engagement
- Expenditure
- Demand forecasts
- WACC and cash flow
- Customer impact
- Stakeholder feedback
- Conclusion

Who we are

- Australian Gas Networks (AGN) is one of Australia's largest gas distributors:
  - Servicing 1.2 million customers across most states and territories
  - Including the Melbourne, Adelaide and Brisbane central business districts
- Owned by the Cheung Kong Group since 2014



AGN's is one of Australia's largest gas distributors

Our vision: To be the leading gas distributor in Australia

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Delivering for Customers

- Public safety
- Reliability
- Customer service

A Good Employer

- Safety
- Employee engagement
- Skills development

Sustainably Cost Efficient

- Doing the work within industry benchmarks
- Delivering profitable growth

Achieving top quartile performance on our targets

2016 to 2021: High service levels, lower prices, increased investment

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	Which means…	2011 – 2016 Actuals/Estimates	2016 – 2021 Targets
Delivering for Customers	▪ Public safety ▪ Reliability ▪ Customer service	▪ Emergency calls: 90% answered in 10 seconds ▪ Leaks: 95% attended in 2 hours; 100% repaired in Leakage Management Plan (LMP) ▪ Mains survey: 100% compliance with LMP ▪ Average 15 interruptions to 5+ customers per annum ▪ Around 38,000 new connections ▪ Stakeholder engagement program	▪ Maintain high performance levels ▪ Improve network resilience ▪ Support customer growth (more than 35,000 new connections) ▪ Plans informed by stakeholder engagement ▪ Strengthened performance incentives
A Good Employer	▪ Safety ▪ Employee engagement ▪ Skills development	▪ 2014 Lost Time Injury Frequency Rate (LTIFR): 1.3 per million hours ▪ Increase in employee and contractor numbers: 434 in 2011, 648 in 2014	▪ Continuous improvement: – LTIFR less than 1.0 per million hours – Restricted duties rate: less than 15 days – Implementation of employee engagement program (to be confirmed) – Training and compliance monitoring
Sustainably Cost Efficient	▪ Doing the work within industry benchmarks ▪ Delivering profitable growth	▪ 100% cast iron mains replacement delivered (1,070 km) ▪ Commenced plastic pipe replacement (100 km, not in benchmarks) ▪ Expanded network to Tanunda and McLaren Vale ▪ Outperformance: 9% operating expenditure, 12% capital expenditure ▪ 6% volume underperformance	▪ Complete cast iron mains replacement (862 km) ▪ Continued selective replacement of plastic pipes (411 km) ▪ Lower network tariffs in real terms – 11% upfront price reduction ▪ Step-out network growth

We will deliver increased investment and lower prices

Robust stakeholder engagement supports our plan

Jul-14 — Nov-14 — Jan-15 — Aug-15

Ongoing communications with key stakeholders

Strategy Phase

- Developed Scoping Paper
- Established Reference Groups
- Liaised with key stakeholders (internal and external)
- Developed engagement strategy (overarching and SA-specific)
- Launched stakeholder website

Research Phase

- 4 workshops with residential and business customers
- 1 workshop with advocacy groups
- 10 interviews with retailers, consumer advocacy groups and large users
- Online survey

Implementation Phase

- Internal and external engagement on insights
- Developed and released *Insights and Implementation* report for consultation
- Developed Access Arrangement (AA) Proposal
- Gave preview to AER (May)

Ongoing Engagement

- Engage on AA Proposal
- Report on the effectiveness of previous engagement
- Incorporate learnings into strategy
- Quarterly meetings with Reference Groups
- Ongoing engagement with stakeholders

Key deliverables

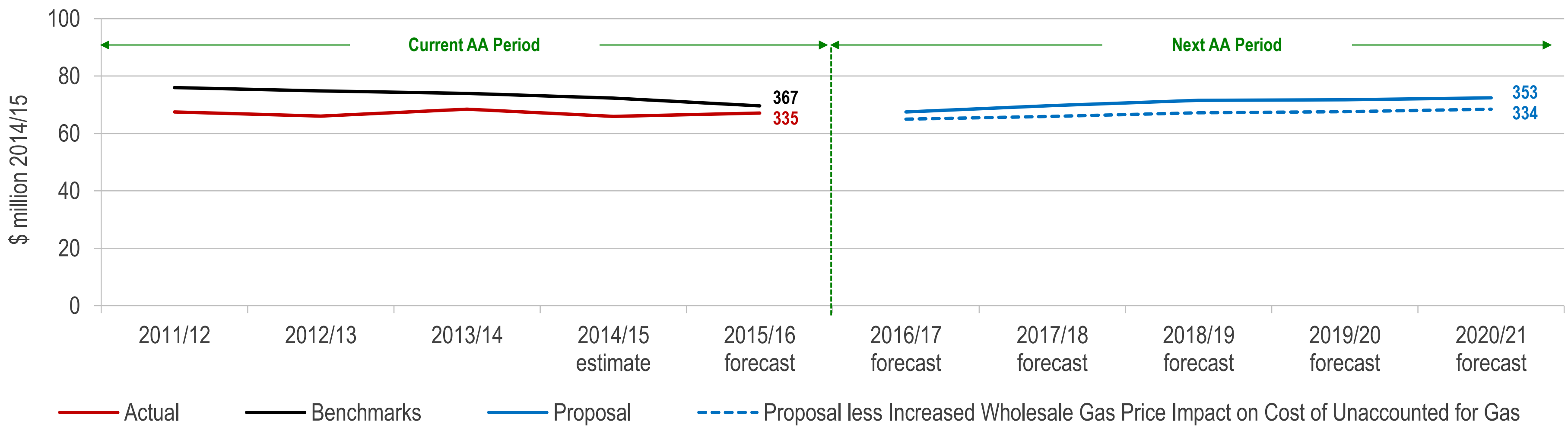
Strategy Phase	Research Phase	Implementation Phase	Ongoing Engagement
Engagement Strategy	Stakeholder Research and Insights Report	Insights and Implementation Report and AA Proposal	Ongoing Stakeholder Engagement

Who we Engaged With

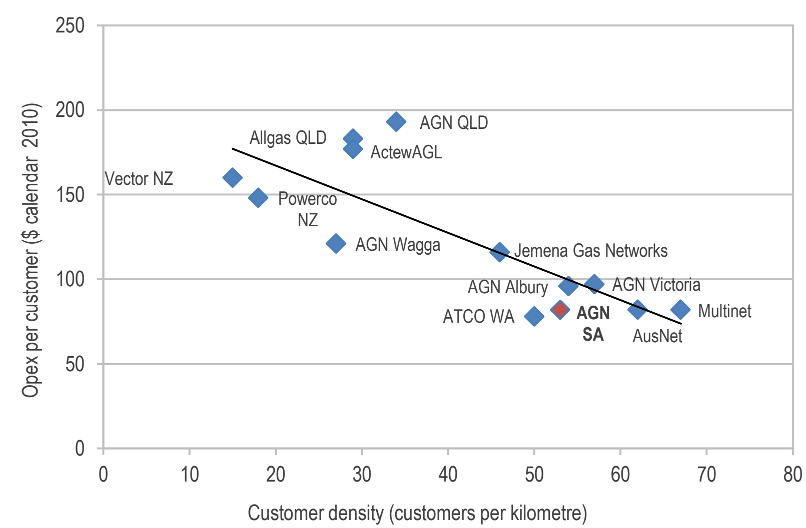
- AGL
- Australian Energy Market Commission
- Australian Energy Market Operator
- Australian Energy Regulator
- Business SA
- Commercial consumers
- Conservation Council of SA
- Consumers SA
- COTA SA
- Energy and Water Ombudsman of SA
- Energy Networks Association
- Energy Retailers Association of Australia
- EnergyAustralia
- Essential Services Commission of SA
- Local Government Association of SA
- Multicultural Society of SA
- Non-gas users
- Office of the Technical Regulator of SA
- Origin Energy
- Primary Producers SA
- Property Council SA
- Residential consumers
- SA Council of Social Service
- SA Department of State
- Simply Energy
- Uniting Care Wesley Country SA
- Uniting Communities
- Various large industrial users

Key Deliverables

Efficient levels of opex, held flat

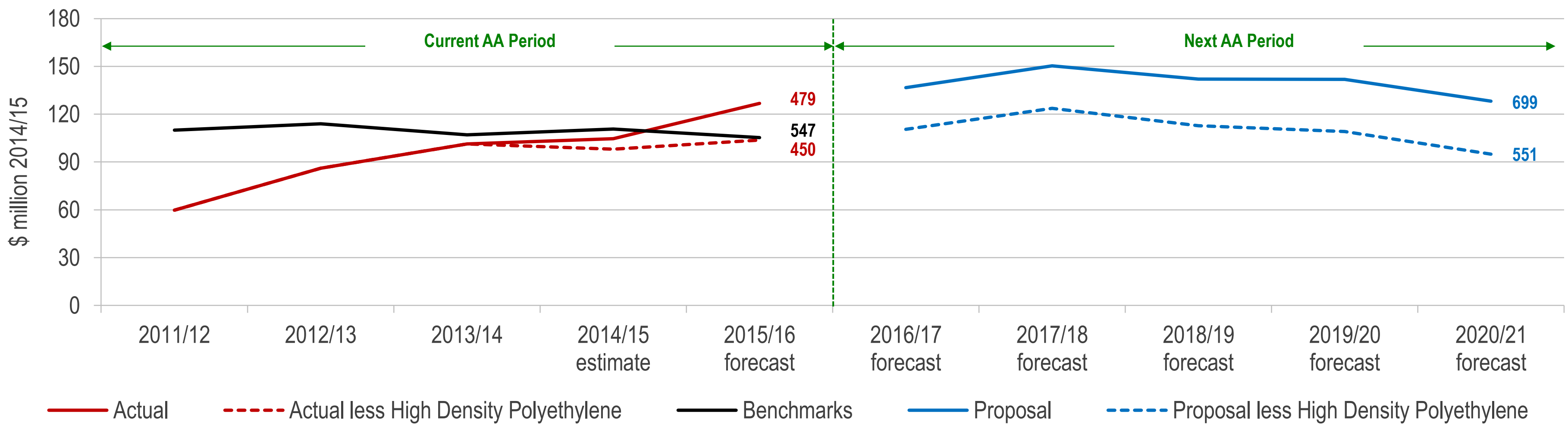


- Proposed opex over the next period is $353 million, ~5% more than that incurred over the current period
  - Increase driven by the impact of rising wholesale gas prices on the cost of purchasing gas that is lost on the Network
- Excluding the impact of rising wholesale gas costs opex is flat



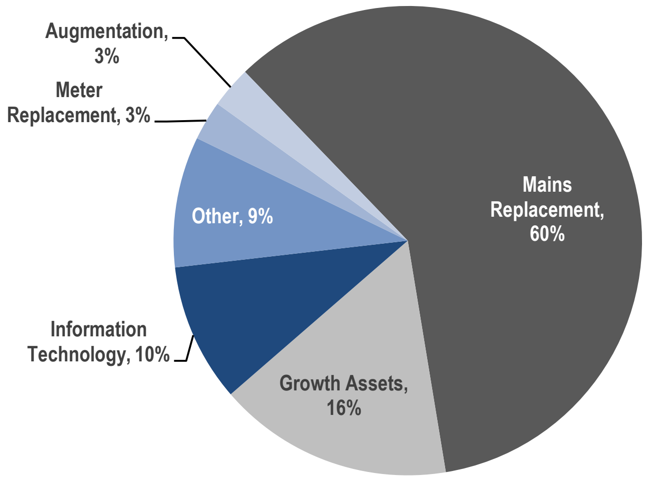
Source: Economic Insights.

Well justified capex program

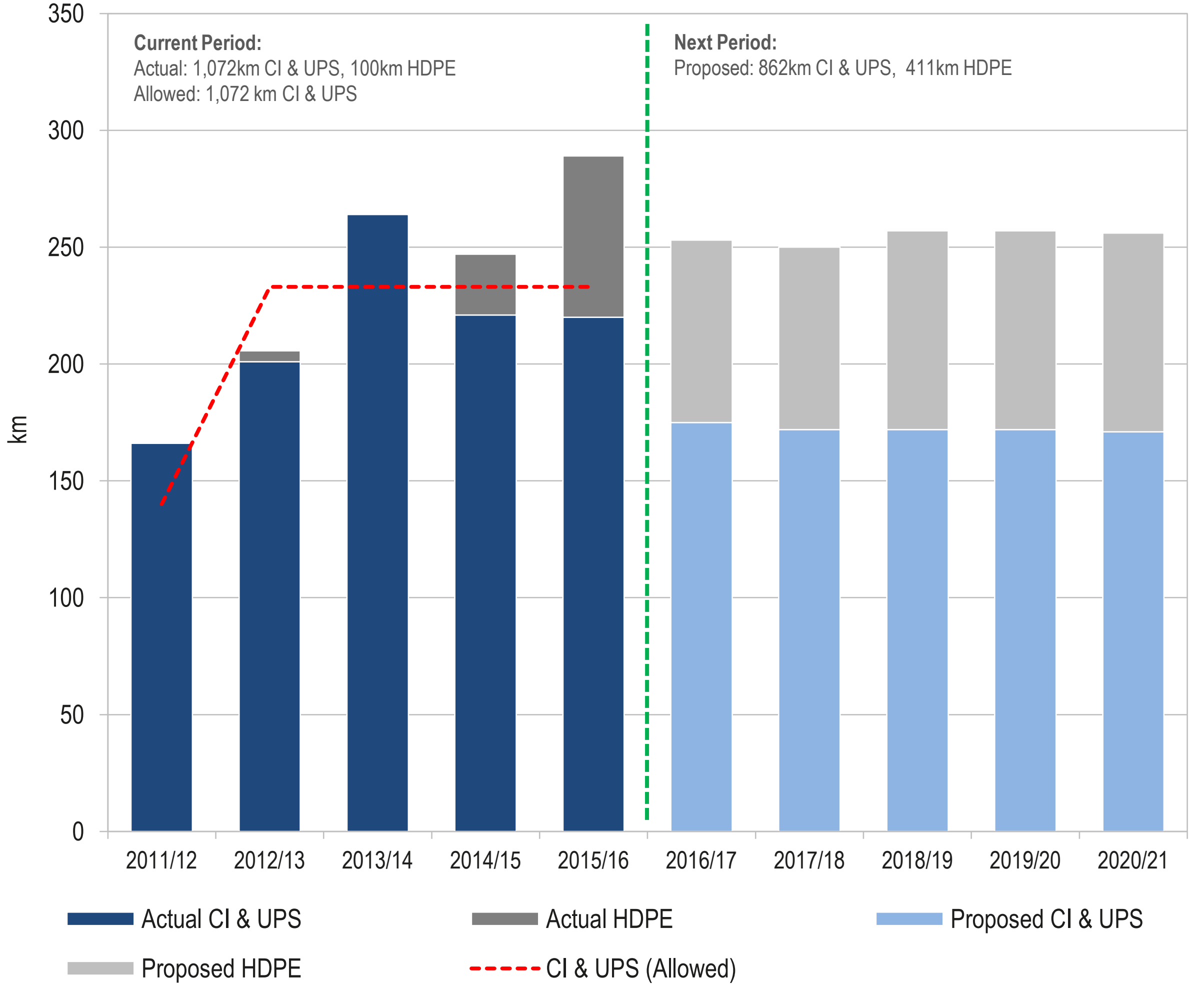


- In the current period AGN
  - Will deliver the full cast iron mains replacement program
  - Commenced HDPE (plastic) mains replacement program
- Proposed capex over the next period is $699 million
  - In line with expenditure at the end of the current period and driven by mains replacement

Forecast capex (including cost escalation and overheads)



Risk-based approach to mains replacement



- Current performance:
  - Undertake 100% of allowed cast iron and unprotected steel (CI & UPS) program
  - Complete 100 km of HDPE replacement (unfunded)
- Next period proposal:
  - Complete CI & UPS program and continue HDPE program
  - Only ~20% of total HDPE replaced, risk mitigated by camera inspections, leak surveys, other interventions

Distribution Network Composition	
CI & UPS	938 km
HDPE	2,120 km
MDPE	3,024 km
Protected Steel & Other	1,659 km

Safety considerations are driving HDPE replacement

Reviewing Security of Supply

- AGN is undertaking a review of actions it can take to improve the security of supply across the network
- This follows a major outage on the non-AGN owned transmission pipeline to Port Pirie in April 2015
- It is reasonably common across the network for customers to receive gas from a single supply point
- AGN has included a Cost-Pass-Through mechanism in its plan that allows AGN to proceed with, and recover the costs of, any security of supply initiative that meets the relevant criteria (as approved by the AER) over the next five year period
- Any such proposals will be discussed with relevant stakeholders, including the AER, once they have been developed
  - Following feedback, we are willing to include a cap at a level of $10 million in total, over five years

Our customers value reliability and security of supply

Continued IT modernisation to meet expectations

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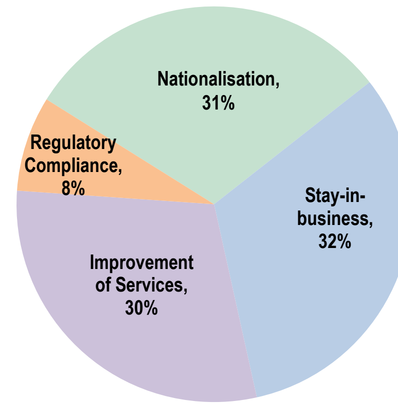
A ten + year program of work, under four key categories:

1. *Nationalisation:* state based systems no longer supported (+10 years old) upgraded to enterprise solutions
2. *Stay-in-business renewal program:* maintain the integrity, security and operability of IT investment
3. *Regulatory compliance:* meeting ongoing regulatory obligations
4. *Improvement of services:* better utilisation of existing assets

Proposed IT Expenditure (opex & capex)



ACTIVITIES

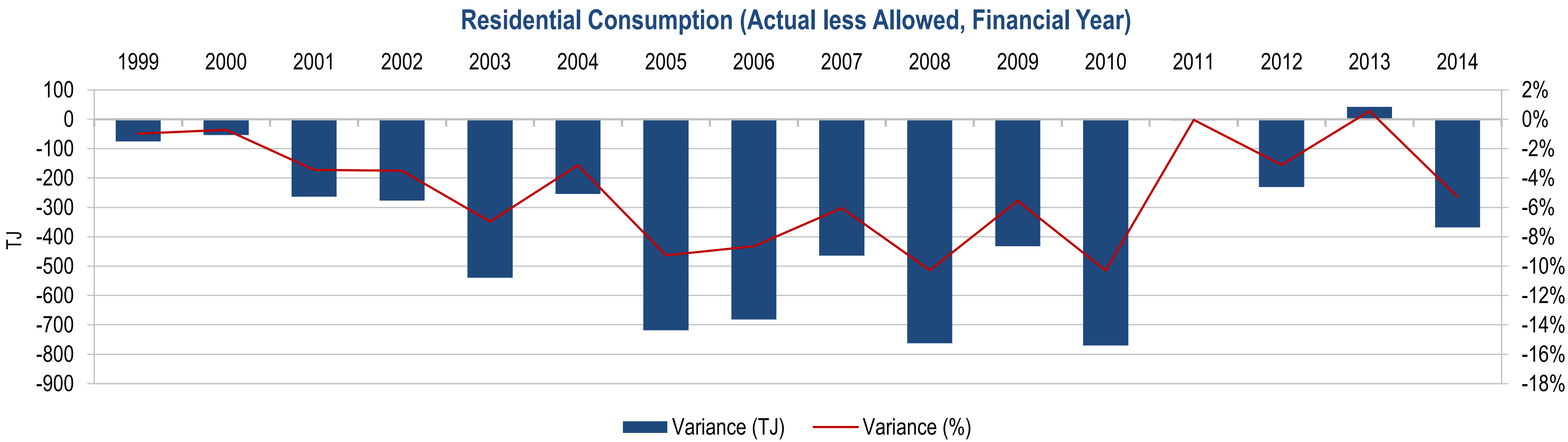
SERVICE REQUEST MANAGEMENT	WORKS MANAGEMENT				REVENUE MANAGEMENT
	DESIGN	BUILD	OPERATE & MAINTAIN	DECOMMISION	
▪ Customer connections ▪ Asset alterations ▪ Retailer requests ▪ Market transactions	▪ Planning & engineering	▪ Construct ▪ Install ▪ Commission ▪ Customer updates ▪ Customer complaints	▪ System operations ▪ Preventative & corrective maintenance ▪ Customer complaints ▪ Customer updates ▪ Third-party work	▪ Decommission	▪ Meter reading ▪ Retailer billing

IT Systems

- CC&B: MARKET TRANS
- MAXIMO – ENTERPRISE ASSET MANAGEMENT
- CC&B: METERING & BILLING
- INDUSTRY CHANGE
- SMALLWORLD – GEOGRAPHIC INFORMATION SYSTEM (GIS)
- SCADA
- MOBILITY
- REMOTE METER READING
- BUSINESS INTELLIGENCE
- DIGITAL CAPABILITY
- SIB APPLICATION AND INFRASTRUCTURE RENEWAL PROGRAM

KEY:
- Existing System
- Nationalisation
- Improvement of Services
- Regulatory Compliance
- Stay-in-business Renewal

An appropriate demand forecast

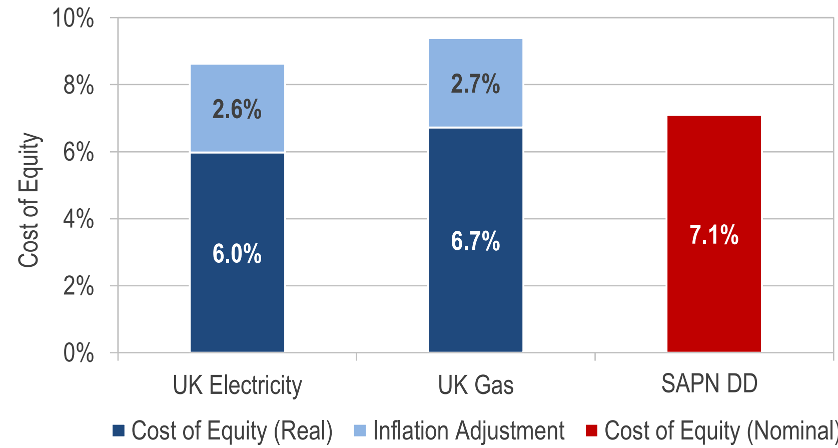


- Over the past 15 years, we have only achieved residential benchmarks once
  - Inputs used in model are generally adjusted by the regulator (past models have been accepted)
  - Forecast under recovery in revenue of around $50 million in current AA period
- Consumption per connection is declining as a result of a number of factors including warmer weather, a continued shift towards electric reverse-cycle air-conditioning and rooftop solar, as well as ongoing subdued economic conditions
- We have forecast this trend to continue into the next regulatory period

A price control, with the right demand forecast, is more appropriate than a revenue control

WACC and cash flow are important and different

- Our WACC approach differs from the AER's in two key areas
  - *Equity* – AGN propose a multi-model approach to avoid 'lottery effect' of spot market risk free rate
  - *Debt* – AGN propose a lower initial risk free rate, but no transition on the DRP
- The AER's WACC requires a financeability adjustment to maintain credit metrics

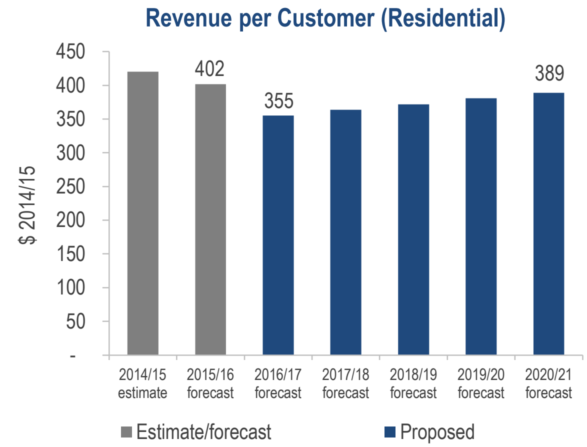


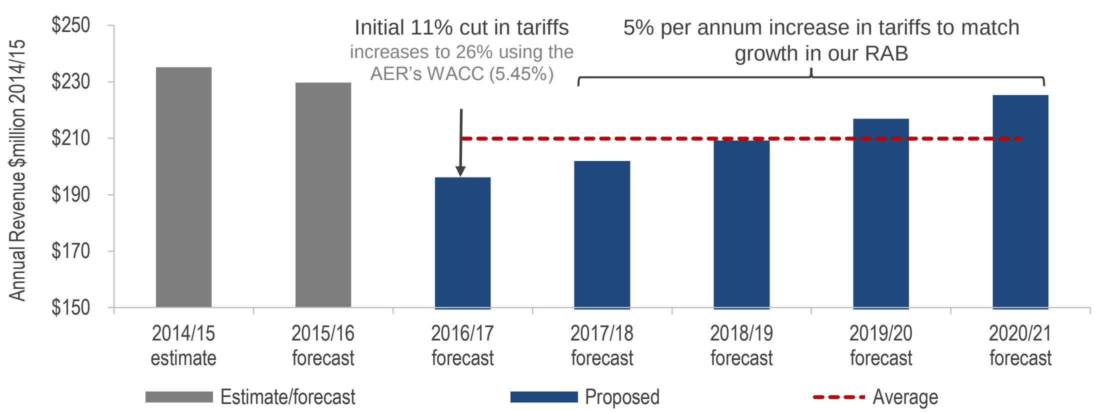
		2016/17	2017/18	2018/19	2019/20	2020/21	S&P BBB+	Moody's Baa1	P_0 Price Cut*
Proposal Case 7.23% WACC	FFO/debt	8.5%	8.5%	8.0%	8.0%	8.4%			11%
	FFO interest cover	2.6	2.6	2.5	2.5	2.5			
Adjusted Proposal 5.45% WACC	FFO/debt	6.6%	6.7%	6.4%	6.4%	6.8%	≥9.0%	≥9.0%	26%
	FFO interest cover	2.5	2.5	2.5	2.5	2.6		>2.3x	
Adjusted Proposal with 1% Financeability 5.45% WACC	FFO/debt	8.1%	8.2%	7.8%	7.9%	8.2%			17%
	FFO interest cover	2.9	2.9	2.8	2.8	2.9			

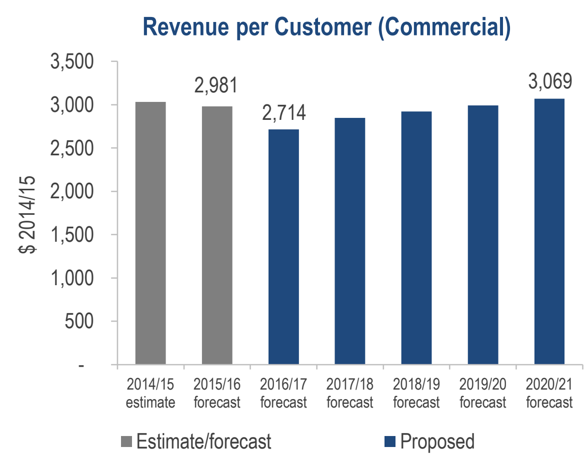
* With annual increases of 5% in each remaining year of the five-year period

An 11% price cut and lower prices overall

- Total revenue over the next AA period decreases by 9% (to $1,050 million) relative to the current benchmark, primarily driven by the fall in the rate of return
  - Revenue falls more (to $880 million, 24% less than the benchmark for the current period) if the recent AER rate of return of 5.45% is applied
  - This revenue is recovered from the distribution prices (or tariffs)
- We propose to cut our distribution price on 1 July 2016 by 11% in real (excluding inflation) terms followed by increases of 5% in line with the growth of the RAB
  - Proposed price path provides for stable credit metrics

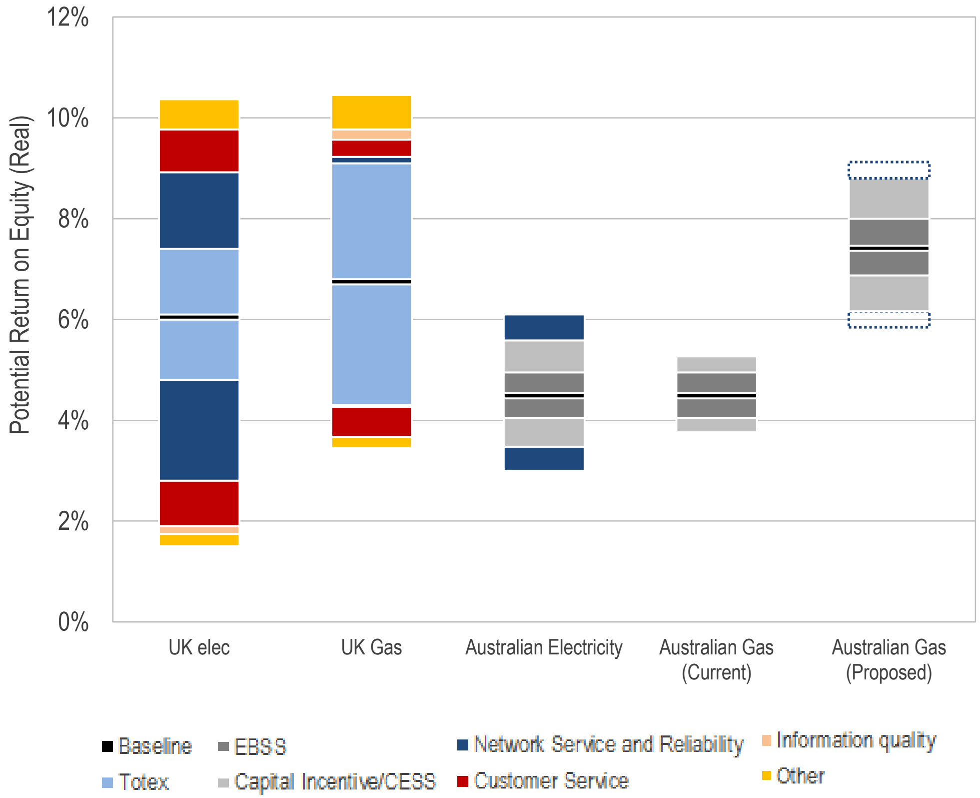






Despite our growing investment and maintaining service and reliability levels, prices will fall

Customer focussed incentives



- AGN is a strong supporter of effective, outcome-based incentive arrangements
  - Where there are strong incentives in place, companies focus on the customer, not the regulator
- AGN is proposing:
  - Strengthening the AER's opex incentive scheme
  - Introducing the AER's capex incentive scheme (with volume protection)
  - Introducing an innovation incentive scheme
  - Introducing a customer service incentive scheme

Strong incentives are better for customers

Just received: stakeholder feedback!

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"SACOSS commends AGN for its frank, open, and upfront engagement with community groups including SACOSS."

"AGL would acknowledge that the stakeholder engagement program … has been well resourced and pro-active and AGL agrees that its proposal is well-informed …"

"Origin acknowledges the proactive approach taken by AGN to engage with retailers in the lead up to this AA… We very much appreciate these efforts and would like to see a similarly consultative process undertaken for all networks going forward."

"Business SA …has found AGN's approach to stakeholder engagement to be quite genuine and well intended… we wish to acknowledge their professional approach…"

Key Feedback Themes	From	AGN Comment
Stakeholder engagement was appropriate and was well received	SACOSS, Business SA, Origin, AGL	▪ Stakeholders recognise our efforts ▪ No proposed expenditure justified by stakeholder engagement
Capex and RAB are growing but connections are slowing and volume per connection is falling – why?	SACOSS, Business SA, Nyrstar, Origin, AGL, SAWIA	▪ Capex is safety/condition driven, not growth driven ▪ RAB growth is consequence of speed of money
Opex is flat, but is that good enough?	SACOSS, Business SA, Nyrstar	▪ Flat opex against growing customers and network length is good
Incentives	**For:** SACOSS (innovation), Origin (EBSS, CESS and customer service) **Against:** SACOSS, Business SA, ATA	▪ AGN remains a strong supporter of improved incentives ▪ Further engagement required
Rate of Return is too high	All	▪ Of course!
Concerns/uncertainty over the AGN's proposed **financeability** adjustment given a low rate of return	Origin, AGL	▪ Pleased to see retailers engage ▪ Financeability is in the long-term interests of consumers and consistent with NGR
Further feedback on **the Terms and Conditions and Cost Pass Through Mechanisms**	Origin, AGL, Nyrstar	▪ We will engage further to address these concerns
Politics!!	ATA	

Conclusion

- We are committed to a constructive and open relationship with our stakeholders, including the AER
- We have delivered for South Australia over 2011-2016
  - Met all key safety requirements
  - Delivered full mains replacement program
  - Commenced HDPE replacement
- Our South Australian plan delivers for customers in 2016-2021
  - Maintain high service levels
  - Lower prices
  - Increased investment, driven primarily by safety
  - Customer focussed incentives
  - Stable credit metrics

High service levels, lower prices and increased investment

Thank you

Australian Gas Networks