INCENTIVISING INVESTMENT IN ENERGY INFRASTRUCTURE

NETWORK SHAREHOLDERS GROUP – PRESENTATION TO AER'S WEBINAR ON EQUITY

11 August 2021

NETWORK SHAREHOLDERS GROUP (NSG)

INFRASTRUCTURE INVESTORS WITH NEARLY $300 BILLION IN EQUITY INFRASTRUCTURE[1]

MACQUARIE	ifm investors	sparkinfrastructure	AMPCAPITAL	AustralianSuper	MORRISON&CO	OMERS	Caisse de dépôt et placement du Québec
AUM: $204bn	**AUM:** $155bn	**AUM:** $18bn	**AUM:** $190bn	**AUM:** >$200bn	**AUM:** $20bn	**AUM:** $112bn	**AUM:** $390bn
Equity Infra: $100.5bn	**Equity Infra:** $68.9bn	**Equity Infra:** $3.6bn	**Equity Infra:** $20.4bn	**Equity Infra:** >$20bn	**Equity Infra:** $16bn	**Equity Infra:** $23.6bn	**Equity Infra:** $33.9bn
Markets: Australia, UK/Europe, North America, Asia	**Markets:** Australia, UK/Europe, North America	**Markets:** Australia **ASX Listed**	**Markets:** Australia/NZ, UK/Europe, North America/ Latin America, Asia	**Markets:** Australia, UK/Europe, North America, Asia	**Markets:** Australia/NZ, UK/Europe, North America, Asia	**Markets:** Australia, UK/Europe, North America/ Latin America, Asia	**Markets:** Australia, UK/Europe, North America/ Latin America, Asia

Australian energy investments

Ausgrid

TransGrid

SPARK RENEWABLES

Endeavour Energy

flow systems

evergen

SA Power Networks

Powercor AUSTRALIA

CITIPOWER

ElectraNet

Macarthur Wind Farm

tilt renewables

[1] All data supplied by NSG members, values are in AUD.

Overarching observations

- The views of market practitioners inform capital flows and are therefore critical to the regulatory task
- The approach to cost of equity must be able to address interdependencies between parameters and changes in risk profile
- 2018 RORI does not adequately compensate investors for risk – over time, this will impact investment and is not in the long term interests of consumers
- Investors take a long-term approach to returns and risk – the AER’s discretion should be exercised sparingly and only in response to structural changes

KEY ISSUES RAISED BY EQUITY OMNIBUS PAPER

Issues below discussed in this presentation; others issues raised by AER may be addressed in NSG submission

2018 RORI Position	Current AER view (and whether AER's view is preliminary/preferred/open)
Use comparator set of 9 Australian firms to estimate equity beta	Use comparator set of 9 Australian firms to estimate equity beta (preliminary position)
Give the greater weight to equity beta estimates from the longest estimation period	Give the greater weight to equity beta estimates from the longest estimation period (preferred position)
Diminished confidence in the use of dividend growth models	Consider if the dividend growth model might be used to inform the relationship between the MRP and RFR (open position)
No reliance placed on the Wright approach	Consider the potential for a relationship between the MRP and RFR, and whether an appropriate implementation method is available (open position)

MARKET RISK PREMIUM AND RISK FREE RATE

How does market practice impact the AER's exercise of discretion?

- Changes in methodology must be introduced in an unbiased manner and result in an improved estimate
  - AER's approach to data and relationship between MRP and RFR has changed over time
  - Timing of when changes are introduced is relevant in determining whether there is bias

- Market practitioners may adopt a long-term MRP, but only in conjunction with a normalized Risk Free Rate and/or Additional Risk Factor
  - Consistent with long term (through the cycle) investment horizons

- A one-for-one relationship (Wright approach) and no relationship (constant MRP & spot RFR) are not the only options
  - Other approaches are available that would dampen (but not remove) the volatility in return on equity

- MRP must be a forward-looking estimate that brings in future expectations
  - An approach solely based on historical measures risks does not sufficiently take account of future expectations
  - Investors make capital allocation decisions based on future returns expectations, which are reflected in the DGM

EQUITY BETA

How will the AER’s approach ensure changes in systematic risk flow through to the rate of return?

- AER’s approach to equity beta may not provide a contemporary estimate of systematic risks
  - Greater weight to longer estimation periods understates changes in systematic risk over time
  - Usage of delisted firms does not pick up subsequent changes in risk profile
  - Market practitioners adopt a shorter estimation period – typically five years or less

- Small comparator firm set risks introducing firm-specific risk profiles
  - Market practitioners have regard to international firms – benefit of additional firms likely to outweigh lower comparability

- Term of return on equity
  - Shorter term not supported by theory or practice
  - Investors take a long term (through the cycle) view of returns

Questions for consideration

- Does the AER acknowledge that the current return on equity is an outlier compared to other regulators?
- Does the AER consider the regulated return has an impact on investment decisions? If so, how?
- How is the AER informing itself on market practice for estimating the cost of equity?
- Is the AER's approach to estimating equity beta achieving the AER's principle that change in systematic risk will be reflected in equity beta estimate?
- How is the AER testing whether its approach to exercising discretion in estimating parameters is ensuring the best unbiased estimate of the efficient cost of equity?