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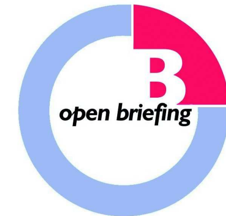

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Title: Open Briefing®. SP AusNet. MD & CFO on Update

Record of interview:

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SP AusNet recently upgraded its earnings guidance for the year ending March 2009, increasing EBIT by 10 percent and NPAT by 15 percent versus the forecasts of A$454.7 million and A$147.5 million respectively in last year's Explanatory Memorandum (EM). However, you've maintained distribution guidance, of around 2.5 percent growth from the 11.55 Australian cents per security forecast for the current year ending March 2008. Why haven't you raised the distribution guidance in line with the profit revision?

MD Nino Ficca
We're very pleased to have been able to provide positive earnings guidance, especially during these times of considerable market volatility. The upwards guidance revision was largely to reflect the impact of the recent Final Decisions regarding pricing on our electricity transmission network and gas distribution network which were released earlier this year. We finalised our work for these regulatory resets while working on the proposed Alinta transaction last year and we're particularly proud of our business for achieving these regulatory outcomes during a time of significant business disruption.

We achieved higher than expected revenues as a result of both the transmission and gas Final Decisions and as a result, we've reflected this in our forecasts. In addition, the regulators also provided a further increase in our capital expenditure allowance of around 10 percent. This additional work will need to be funded by a mixture of internal cash flows and debt.

Our aim continues to be to provide stable and predictable distributions to securityholders and in light of the step-up in forecast capital expenditure, we've maintained distribution guidance of 2.5 percent growth.

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What would be the drivers of any upside to distribution growth going forward?

MD Nino Ficca
We continue to pursue our long-term strategy of investing in, and improving the performance and efficiencies of, our networks. Meeting continued strong customer demand translates into significant investment in our regulated networks, increasing our regulated asset base and driving future revenues.

We recognise the need to balance the funding of our very strong organic growth profile with our aim of providing securityholders with a stable and sustainable distribution profile. Our Directors will therefore consider the distribution amount and components of each distribution at both the half year and full year results announcements.

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You've attributed part of the upgrade in 2009 guidance to increased revenues provided in the recent regulatory resets. Where did the Final Decisions differ from your assumptions in the EM and how will earnings and cash flow growth be impacted over the new five-year regulatory periods?

MD Nino Ficca
The Final Decisions for both the electricity transmission and gas distribution networks represented a significant improvement over the Draft Decisions. The Draft Decisions formed the basis of the Explanatory Memorandum which we provided at the end of last year.

We're pleased that both the AER and Victorian ESC recognised the recent movement in the debt markets, increasing the debt premium by 0.86 percentage points and 0.77 percentage points respectively from the Draft Decision to the Final Decision. The movement in the debt premiums represented a significant portion of the increase in revenues from Draft to Final. Other areas of difference included an uplift in operating expenditure allowances on the transmission network and a step-up in capital allowances on the gas distribution network.

In addition, on the transmission network, the significant step change in revenue from 2007/08 and 2008/09 is due to the AER assuming an increase in revenues of 12.55 percent in the 2008/09 year followed by a smooth revenue increase of CPI plus around 1 percent each year.

The earnings and cash flow impact of the assumptions utilised in the Final Decision were reflected in our earnings guidance with an increase in EBIT of around 10 percent in 2008/09 compared with the EM.

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For the gas distribution network particularly, capital expenditure allowed by the regulator in the five-year period to 2012 is significantly higher than recent actual spending levels. What are the major targets of this increased capex and to what extent will it be included in the regulated asset base (RAB) for future resets?

MD Nino Ficca
We're committed to the continued delivery of reliable and efficient gas supply to customers and we're pleased the ESC has recognised this commitment by increasing allowable capital expenditure by almost 20 percent, from the Draft Decision to the Final Decision.

Some key areas on which we'll focus our capital expenditure include meeting the requirements of continued strong customer growth – over 50 percent of our forecast capital expenditure is demand related; moving to the Australian Standard on meter accuracy testing and bringing our meter fleet into compliance with more stringent testing requirements; and increasing the low pressure mains renewal program from 75 to 90 kilometres per annum. This will achieve a system that is entirely high pressure within 17 years and deliver positive reliability, safety and environmental outcomes.

The ESC has approved a capital expenditure forecast of A$320 million, therefore we expect all of the planned capital expenditure will qualify to be rolled into our RAB at the next reset.

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The guidance upgrade also partly reflected changes in interest costs due to your recent refinancing of A$1.55 billion and the finalisation of new interest rate hedges in line with the commencement of the new regulatory resets. How do your net funding costs compare with past levels and to what extent will funding costs vary from those assumed by the regulators in the recent resets?

CFO Geoff Nicholson
We benefit from an investment grade credit rating in the A range, allowing us to source debt at competitive rates. The credit margins achieved on the A$1.55 billion, being BBSW plus approximately 40 basis points for the A$775 million expiring in 2011 and approximately 50 basis points for the A$775 million expiring in 2013, are in line with the cost of debt on existing facilities. We're happy with the rates we achieved on these facilities given credit markets have continued to deteriorate since they were finalised.

In respect of the BBSW component of our debt, we hedge this component in line with the regulatory resets – utilising a sampling period which is consistent with that undertaken by the regulator. Currently approximately 95 percent of our debt is hedged, therefore our cash flows are largely protected from increases in interest rates. This prudent approach to interest rate risk management is an important element of managing our business, especially in times of volatile credit markets which we're experiencing this year.

The regulator assumes a BBB/BBB+ rated company when determining the debt premium to be included in the WACC calculation. Therefore, we benefit from some out-performance due to our rating in the A range and our ability to source debt at lower rates.

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Will the recent downgrade of your credit rating by Standard & Poor's to A- from A have a material impact on funding costs going forward?

CFO Geoff Nicholson
It's important to note that there has been no change to our business. Our inherent business fundamentals, finances and underlying credit quality remain sound. The reason for the change in rating was due to S&P lowering its corporate credit rating on Singapore Power Ltd, our 51 percent majority securityholder, to AA- from AA. We still enjoy the rating benefit of having a strong majority owner.

The adjustment in credit rating will not have a material impact on our interest costs.

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As at the end of February 2008, SP AusNet had net debt of approximately A$3.9 billion and gearing of 59 percent. Following the recent refinancing, SP AusNet does not face a major refinancing until the year ended March 2011, when A$860 million of debt will mature. Will additional borrowing be required in the interim to fund the larger on-going capex?

CFO Geoff Nicholson
The recent refinancing of A$1.55 billion means we now have very limited exposure to short-term refinancing risk. This is another very positive feature of our business given the continued volatility in credit markets.

The forecast capital expenditure programs for both our transmission and gas distribution networks will continue to be funded by a mixture of debt and cash flow from operations. We currently have approximately A$370 million of committed but undrawn debt facilities available to us, which include A$170 million of commercial paper back-up lines.

With regard to debt raising requirements into the future, we benefit from a well diversified debt maturity profile together with well diversified sources of debt. This, together with our strong investment grade credit rating, allows us ready access to debt markets both in Australia and offshore, meaning we're not reliant on any one capital market or any one source of debt.

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The gas access arrangement provides a return of 6.2 percent and includes an equity beta of 0.7, compared with 1.0 used in previous regulatory decisions. If this lower beta is adopted in future resets, how might it affect your ability to reinvest in the networks and what might be the implications for securityholder returns longer term?

MD Nino Ficca
We're disappointed that the ESC maintained an equity beta of 0.7 in the gas distribution Final Decision. This is inconsistent with the recent decision by the AER for our transmission revenue and other regulatory precedents. It's also contrary to the conclusions and analysis that we and the other distribution businesses provided to the ESC in response to the Draft Decision.

We do however note that the ESC provided a specific allowance in the Final Decision to recognise an equity beta of 0.8 in order to reduce the impact of the headline 0.7 equity beta. We continue to believe that an equity beta of 0.7 does not provide the distribution businesses with a satisfactory return on the capital required to provide efficient and reliable services, and the transitionary equity beta of 0.8 only partly recognises this concern.

With all economic regulation of our assets moving to the AER shortly, we'll continue our dialogue on equity betas with that body during the Statement of Regulatory Principles discussions later this year.

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You also partly attributed the guidance revision to an updated management review of forecast operating and capital expenditure. Can you be more specific about how these costs are expected to vary from the EM? Are you seeing any areas of cost pressure?

CFO Geoff Nicholson
In light of the Final Decisions being released on the transmission and gas distribution networks, we did an internal review of our 2008/09 forecasts to ensure we were well positioned to deliver the increased capital and operating expenditure allowances. We're not seeing any specific areas of cost pressures and we're committed to driving efficiency within the business to ensure we deliver our work programs as efficiently and effectively as possible.

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At the time of SP AusNet's proposed acquisition of the Alinta assets from Singapore Power International (SPI), you highlighted the growth prospects of the Alinta asset management business. Following your decision not to proceed with the acquisition, what is your strategy in the asset management area?

MD Nino Ficca
We continue to focus on owning and operating our existing transmission and distribution assets to provide reliable and efficient energy services to our customers. In addition to managing our regulated networks, we're continuing to pursue unregulated revenues, examples of which include our metering business Data & Measurement Solutions, and telecommunication related assets including antenna site leasing and fibre leasing. Whilst these businesses do not contribute a significant percentage of our total revenues of around A$1 billion, they do provide higher than regulated returns, benefiting our cash available for internal funding and distribution to securityholders.

We're unable to comment on the future strategy of the Alinta asset management business as these assets continue to be owned by SPI. Ensuring the improved reliability and efficiency of our own networks and continuing to explore ways of creating value for securityholders remain our focus.

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When you announced the Alinta deal wouldn't go ahead, you indicated that you would work together with SPI to ensure synergies between the two businesses are realised. Can you comment on the potential synergies and the progress you've made toward realising them?

MD Nino Ficca
The EM included a significant number of synergies largely driven by people related savings. Whilst the savings associated with reducing staff numbers are no longer available, we believe that some ability remains to realise a portion of non-labour synergies. A collaborative project team has been established between us and SPI to pursue these synergy initiatives.

Within the non-labour area, we see a number of areas of common interest such as the possibility of joint procurement of goods and services across the two groups, optimisation of insurance policies and other similar activities which can be undertaken on a joint basis. The cost/benefit analysis and timing of each of these potential opportunities is under review and we'll continue to update the market as things progress. Importantly for us, any potential synergy or joint operational initiatives will be subject to rigorous governance oversight, with review and approval to be undertaken by our Audit and Risk Management Committee which includes our three independent Directors.

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Thank you Nino and Geoff.

For more information about SP AusNet, visit www.sp-ausnet.com.au or call Adrian Hill, General Manager Corporate Development & Investor Relations, on (+61 3) 9695 6701 or +61 438 533 193

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