

INFORMATION UPDATE

21 November 2014

Aurizon Network's 2014 DAU – Draft Decision on MAR (Information Update)

This paper contains further information on a number of matters presented in our Draft Decision on the Maximum Allowable Revenue (MAR) aspects of Aurizon Network's 2014 Draft Access Undertaking (2014 DAU).

The matters relate to the weighted average cost of capital (WACC) parameters, the maintenance cost index (MCI) and calculation of the return of capital (depreciation). These are discussed further below.

Return on Capital

We have been requested to provide further detail on the WACC parameters used to calculate our proposed return on capital estimates for Aurizon Network. We consider it appropriate to publish this information in the interest of stakeholders that rely on this information to conduct their analysis. Accordingly, both the published and modelled parameters (rounded to the same number of decimal places as used in our model) are shown below.

<i>Parameter</i>	<i>QCA's preliminary view (published)</i>	<i>QCA's preliminary view (modelled)</i>
Credit Rating	BBB+	BBB+
Risk-free rate	3.21%	3.211%
Market risk premium	6.50%	6.50%
Asset beta	0.45	0.45
Debt beta	0.12	0.12
Debt to value	55%	55%
Equity beta	0.80	0.80
Gamma	0.47	0.47
Equity margin	5.2%	5.2%
Cost of equity	8.410%	8.411%
Debt risk premium (raw)	2.72%	2.72%
Debt transaction costs	0.108%	0.108%
Interest rate swap costs	0.113%	0.113%
Debt risk premium (total)	2.94%	2.941%
Cost of Debt	6.15%	6.152%
WACC margin	3.96%	3.95755%
WACC	7.17%	7.16855%

Maintenance Cost Index (MCI)

Proposed MCI Structure

In **Table 55—SKM's proposed MCI structure** (page 122), we presented SKM's proposed MCI structure. This table contains one typographical error under the Consumables category. The non-residential building construction index should be replaced as follows (see **bolded** text):

<i>Category</i>	<i>SKM proposed UT4 sub-index components</i>
Consumables	ABS producer price indices: <ul style="list-style-type: none"> • Fabricated metal (34.8%) • Transport equipment and parts (19.6%) • Mining and construction machinery manufacturing (45.6%)

That is, our Draft Decision is to escalate hire of heavy plant and equipment costs based on the producer price index for mining and construction machinery manufacturing. This is consistent with SKM's proposed MCI structure.

Calculation of the MCI Forecast

We have identified a typographical error in **Table 56—SKM's proposed adjusted MCI (system-wide)** and an error in SKM's model used to produce the MCI forecast. The corrected Table 56 is reproduced below (with amendments **bolded**):

Table 56 SKM's proposed adjusted MCI (system-wide)

<i>Cost driver</i>	<i>Accommodation</i>	<i>CPI</i>	<i>Consumables</i>	<i>Fuel Prices</i>	<i>Labour</i>	<i>Weighted Index</i>	<i>MCI Estimate</i>
Weights	2.6%	11.0%	33.5%	2.4%	50.6%	—	—
2011–12	100.0	100.0	100.0	100.0	100.0	100.0	—
2013–14	104.4	106.6	99.9	115.1	109.1	105.8	5.8%
2014–15	101.7	110.1	99.4	118.4	113.9	108.5	8.5%
2015–16	96.5	113.3	99.6	120.3	118.5	111.1	11.1%
2016–17	93.5	116.2	102.6	118.9	123.0	114.6	14.6%

The effect of this is a reduction of less than \$0.1 million from the overall maintenance cost published in our Draft Decision. As noted in our Draft Decision, we will update the MCI forecast in our Final Decision.

Calculation of Return of Capital (Depreciation)

We have identified a calculation error regarding the depreciation start date for part of the Wiggins Island Rail Project capital expenditure in the capital indicator. This portion of the capital indicator is expected to be commissioned in the second half of the 2014 DAU regulatory period.

The effect of this was a deferment of revenues (approximately \$22 million) beyond the 2014 DAU regulatory period. This deferment, however, would not impact on the returns, in present value terms, for the affected part of the capital indicator over its economic life.

This error has been rectified, resulting in minor revisions to return of capital (depreciation). This has flow on effects for the inflation, return on capital, tax and value of imputation credits building block estimates.

Revised Outcome

The combined effect of the MCI and depreciation matters leads to an increase in Aurizon Network's maximum allowable revenue to \$3.91 billion (as compared to \$3.88 billion presented in Table 3 of the Draft Decision). The tables below compare the published and revised estimates at the building block level.

Table 3 QCA Draft Decision proposed MAR (\$'000, nominal)

<i>Building Block</i>	<i>2013–14</i>	<i>2014–15</i>	<i>2015–16</i>	<i>2016–17</i>	<i>Total UT4</i>
Operating expenditure	175,539	184,895	197,524	202,818	760,776
Maintenance expenditure	174,388	178,127	187,774	197,491	737,780
Return of capital (depreciation)	270,693	300,456	351,946	375,766	1,298,860
Inflation	(123,867)	(132,168)	(161,106)	(160,603)	(577,744)
Return on Capital (WACC)	355,179	378,983	461,958	460,515	1,656,635
Tax	56,091	59,585	74,594	79,916	270,185
Value of imputation credits	(26,363)	(28,005)	(35,059)	(37,561)	(126,987)
Total (unsmoothed MAR)	881,660	941,872	1,077,631	1,118,343	4,019,506
UT3 CAPEX carryover account adjustments	(31,603)	(33,026)	(34,512)	(36,065)	(135,205)
(Adjusted) Total MAR	850,057	908,846	1,043,119	1,082,278	3,884,300

Source: QCA analysis. Note: Numbers may not sum due to rounding.

Revised Table 3 QCA Draft Decision proposed MAR (\$'000, nominal)

<i>Building Block</i>	<i>2013–14</i>	<i>2014–15</i>	<i>2015–16</i>	<i>2016–17</i>	<i>Total UT4</i>
Operating expenditure	175,539	184,895	197,524	202,818	760,776
Maintenance expenditure	174,512	178,237	187,766	197,184	737,699
Return of capital (depreciation)	270,693	300,456	372,754	374,643	1,318,546
Inflation	(123,867)	(132,168)	(161,106)	(160,082)	(577,224)
Return on Capital (WACC)	355,179	378,983	461,958	459,023	1,655,144
Tax	56,091	59,585	77,360	83,402	276,438
Value of imputation credits	(26,363)	(28,005)	(36,359)	(39,199)	(129,926)
Total (unsmoothed MAR)	881,785	941,981	1,099,897	1,117,790	4,041,452
UT3 CAPEX carryover account adjustments	(31,603)	(33,026)	(34,512)	(36,065)	(135,205)
(Adjusted) Total MAR	850,181	908,955	1,065,386	1,081,725	3,906,247

Source: QCA analysis. Note: Numbers may not sum due to rounding.