TRANSCRIPTION

Company:	**Aurizon**
Conference:	**Investor Call**
Date:	**03 May 2019 @ 1:30pm**
Duration:	**59 Minutes 32 Seconds**

[START OF TRANSCRIPT]

Operator: Thank you for standing by and welcome to the Aurizon Investor call. All participants are in a listen-only mode. There'll be a presentation, followed by a question and answer session. If you wish to ask a question, you will need to press the star key, followed by the number one, on your telephone keypad.

I would now like to hand the conference over to Mr. Andrew Harding, Managing Director and CEO. Please go ahead.

Andrew Harding: Good afternoon, and thank you for joining the call. Michael Riches, Group Executive Network, and Pam Bains, CFO and Group Executive Strategy, are here with me in Brisbane, and we will go through the presentation we lodged with the ASX this morning, which is also available on our website. We will take your questions at the end of the presentation.

Turning now to slide three of the presentation. Today, I'm pleased to announce that we've reached agreements with our coal customers in Queensland on a proposed alternate UT5 access undertaking.

This follows months of constructive negotiation. Our views on the draft and subsequent Final Decision on UT5, issued by the Queensland Competition Authority, are well known. While the final decision issued in December last year represented a marked improvement on the draft decision, we still believed a better deal was possible.

One that offered a stronger commercial framework and a greater certainty for industry. We lodged a conforming access undertaking aligned to the Final Decision in February this year. This was the prudent course of action to take, given the timelines associated with the regulatory framework.

However, behind the scenes, we kept talking to our customers and working with them on an alternative that could better underpin the long term operation and performance of the Central Queensland Coal Network.

This had culminated in the signing of agreements with customers, representing over 90% of railed tonnes in the Central Queensland Coal Network. On the basis of these agreements, and with support from the customers, Aurizon Network has today submitted a draft amending access undertaking to the QCA to amend the current UT5 access undertaking.

We believe that this alternative agreement better meets customers' needs by offering improvements they desire including development of mechanisms to improve supply chain stability and improve maintenance and asset renewal programs.

For Aurizon Network, it offers an improved rate of return, more commensurate with the level of risk we take owning and operating the CQCN. Under the proposal, the weighted average cost of capital, or WACC, will be 5.9% increasing to 6.3% on the completion specified milestones, as compared to the WACC of 5.7% currently in UT5.

Michael will take you through the detail shortly. Significantly, we also propose extending the term of this access undertaking to ten years. Currently, access undertakings only cover a four year period.

This provides greater certainty for all stakeholders, and allows for better planning and long term investment decisions. The next step is for Aurizon and our customers is to engage with the QCA for it to fully consider, and if appropriate, approve the alternate undertaking in accordance with its standard procedures including consultations with stakeholders.

While there is still a way to go, I would like to take this opportunity to thank our customers for their engagement and commitment to a better outcome. It is the first such deal struck in Queensland; a customer-led proposal that we believe improves the regulatory system and shapes a better and more certain future for the resources sector in Queensland.

And with that, I will now hand over to Michael.

Michael Riches: Thank you Andrew. Before working through the detail of this agreement, I'd like to acknowledge the considerable efforts and constructive engagements of the coal industry in delivering a substantive regulatory reform. Our customers have been involved in this process from the outset, and I would like to thank them for their significant contributions, which we believe will deliver substantial benefits for all stakeholders in the Central Queensland coal supply chain and Queensland's coal export market generally.

This is a ten year agreement that will provide certainty for all stakeholders. In relation to the agreement itself, there are six key concepts that I'll touch on. Firstly, an improved return for Aurizon that appropriately recognizes the risks of owning and operating the Central Queensland Coal Network.

This improved return is the main driver behind an estimated $40 million increase in the maximum allowable revenue in FY21 when compared to the Final Decision. The agreement also provides a ten year term for the undertaking that will expire in June 2027 with a reset of the WACC and inflation at 1 July 2023, but with the only WACC parameters to be reset being the risk free rate and debt risk premium.

Thirdly, there will be the instigation of independent capacity modelling that will focus on the realistic deliverable capacity of the network in a process where any deficit in deliverable capacity compared to contracted capacity can be rectified.

Engagement between Aurizon and industry on maintenance cost and capital expenditure with a mechanism to allow industry to approve the maintenance and capital strategies and budgets will be introduced. Maintenance cost will operate on a pass through basis. Operating cost allowances will be set at the Final Decision level for FY20 and FY21 and thereafter will be the FY21 final decision allowance with escalation only if CPI exceeds 2.37%.

Cost efficiencies in maintenance are passed through to customers with cost efficiencies in other operating costs retained by Aurizon. Finally, a rebate mechanism will apply that holds Aurizon accountable for meeting agreed performance targets to be set by an independent expert that will undertake the initial capacity modelling.

If I can now draw your attention to the specifics of the agreement in terms of slide four. There is a significant long term improvement in the return for Aurizon. From 1 July 2017 until today, being the day Aurizon has submitted the draft amending access undertaking to the QCA the WACC will be at 5.7% aligned to the Final Decision.

From today until the date of completion of a capacity assessment is undertaken by an independent expert and Aurizon provides notice of the proposed options to address any identified capacity deficits, which we describe as the Report Date, WACC will be 5.9%.

From the Report Date, the WACC increases to 6.3%. We would expect to reach the report date within 12 months. The modelling work on the initial capacity assessment will commence immediately.

On 1 July 2023, the undertaking provides for a reset of certain parameters of the WACC. These are the risk free rate and the debt risk premium. The inflation rate is also reset. The WACC and inflation will be changed to the relative movement in these parameters from July 2017, based on the same methodology as used in the Final Decision. All other parameters of the WACC remain unchanged for the term of the undertaking until 2027.

If I can now draw your attention to slide five. The Final Decision will apply until the draft amending access undertaking is approved by the QCA. For the ten year term until 30 June 2027, there is long term certainty for all stakeholders, allowing for longer term investment decisions to be made.

For Aurizon, it also removes the significant cost associated with the UT6 regulatory process. We would hope the longevity of the undertaking and the constructive engagement with industry through this process will allow an opportunity in the future to have further discussion on reform of the regulatory model.

In regards to maintenance, the key difference between these arrangements and the Final Decision is that from FY21, customers can influence the strategy and approve the budgets for maintenance in each financial year through a consultation process that will start in November of the previous year.

However, if agreement is not reached with customers, the QCA will assess the strategy and budget and approve that year's budget. This should occur prior to, or shortly after the commencement of the financial year, so Aurizon has a clear understanding of budget during the financial year.

This pre-approval process significantly reduces the risk of overspend and any contention around maintenance claims, post the financial year. Maintenance cost will become pass through, provided they align with the budget and strategy, or are otherwise approved by customers or the QCA.

For FY20, the maintenance budget will be as approved under the Final Decision. If you look at the slide, you may notice that there is an additional amount of $14 million from the Final Decision that reflects a request that will be in the draft amending access undertaking for a reversal of the Final Decision's position on a return on capital for ballast cleaning plant from capital to maintenance.

This is to align our treatment of ballast cleaning plant with the regulatory treatment of return on capital for all other plant. It should be noted that otherwise maintenance drops from FY19 due to the transition of ballast costs from maintenance to capital in line with the Final Decision.

On slide six, you'll see some detail on operating expenditure. Operating expenditure will be in line with the Final Decision through to FY21. From FY22 operating expenditure will use the FY21 operating expenditure allowance under the Final Decision as a base, and there will be an uplift in the allowance with CPI greater than 2.37%.

Aurizon is therefore taking on the efficiency challenge of achieving cost savings associated with the operating expenditure allowance of CPI up to 2.37% a year. In developing our plans and budgets, Aurizon will always be seeking cost efficiencies and productivity improvements in maintenance and general operating costs to the extent that cost savings can be realized, maintenance cost savings will be for the benefit of customers through the pass through mechanism, and if general operating costs are lower than the allowance, those savings will be retained by Aurizon through to 30 June 2027.

The capital expenditure budget for FY20 will be as per the capital indicator in the Final Decision, reduced by the transfer of the return on, and return of capital on ballast cleaning plant to maintenance, as I've just described.

From FY21, customers will have influence over the capital expenditure strategy and budget, in the same way as applies to maintenance. However, unlike maintenance, if agreement cannot be reached with customers on the capital strategy and budget, Aurizon will submit its capital plan to the QCA and complete capital works in accordance with that plan. The annual capital indicator will reflect that plan with the QCA undertaking a post expenditure review for efficiency and prudency as per the current process.

Methodology for calculating depreciation remains unchanged. That is a rolling 20 year useful life is applied. However, the reset on the 20 years will now be June 2023 as opposed to the June 2021 under the Final Decision. Inflation remains unchanged with a reset to occur at 30 June 2023, using the same methodology for the determination of inflation as under the Final Decision.

Turning to slide seven, we have developed an agreement that not only appropriately compensates Aurizon for the risk it takes in owning and operating the CQCN, but also delivers on the key needs and objectives of our customers.

This is demonstrated in the significant support we have received from customers in relation to the revised undertaking. Over 90% of customers, by volume, will provide letters of support to the QCA. Negotiations with our customers have been constructive and positive.

This has taken a significant period of time to get to this point, but this reflects the level of reform that has been achieved in the agreement. Aurizon and the customer groups have engaged, together with the QCA, at a high level throughout this process. So the submission of this undertaking will not be a surprise.

The agreement provides greater certainty for all stakeholders and facilitates long term investment with the undertaking extended to June 2027. The significant changes benefiting customers that underpin the regulatory reform are the following.

The introduction of the capacity assessment provides an independent determination of the existing, realistic capacity of the network. Where capacity deficits are identified, Aurizon is committed to fund expansions up to $300 million to address those deficits.

Aurizon will also fund up to $30 million annually for expansions to create new capacity where it would benefit more than one access holder or access seeker. Customers will

have greater involvement in assessing and pre-approving strategies and budgets for capital expenditure and maintenance.

The declaration of the CQCN will continue until 2040.

And finally, a rebate mechanism is being introduced. The customer will be entitled to a rebate where Aurizon performs below target levels for certain parameters that are within Aurizon's control, and the customer does not receive its contracted capacity due to Aurizon's under performance.

The performance parameters are established based on historical performance. Accordingly, Aurizon is backing itself to deliver performance that meets or exceeds its operational performance in prior years.

The CQCN is a high performing supply chain. This initiative will only seek to continue to improve its performance. All stakeholders have the objective of ensuring that the performance targets are met to deliver the contracted capacity. I have every confidence and fully expect us to meet those performance targets.

By doing so, industry and Aurizon will receive the benefits that the agreement delivers and in those circumstances the rebate will not apply.

In terms of next steps, I draw your attention to slide eight.

Aurizon will lodge the draft amending access undertaking with the QCA today. Customers will be lodging letters of support for the draft amending access undertaking over the coming days.

This will be treated by the QCA, consistent with any other draft amending access undertaking that has been submitted. With the process being expected to be broadly as follows. The QCA will issue the DAAU for consultation with stakeholders. This is usually for a period of four to eight weeks. Depending on the nature of the stakeholder feedback, the QCA will either issue a draft or final decision.

Given the level of customer support for the DAAU, we would be hopeful that the QCA would move directly to a final decision, in which case we would hope the DAAU could be approved within the next six months.

Aurizon will also be submitting a separate request to the QCA shortly seeking to true-up all outstanding FY18 and FY19 amounts, including transitional tariffs, to address all true-ups in FY19, and make the necessary payment to customers.

This is consistent with the accounting treatment for the network revenue at the half year results where Aurizon booked revenue based on the UT5 Final Decision and also accounted for 50% of the FY18 true-up.

And finally, a summary of what you have heard today. This represents a breakthrough, long term, ten year agreement to provide greater commercial and operational certainty for all participants in the Central Queensland's coal supply chain.

It provides a return to Aurizon that is commensurate with the risk of owning and operating the CQCN. The agreement underpins significant regulatory reform through the introduction of an independent review of capacity, which will benefit access holders and future access seekers.

It provides for a process for industry to have influence on maintenance and capital expenditure strategies and the ability to agree maintenance in capital expenditure budgets. It introduces a performance mechanism to incentivize Aurizon performance.

Again, I would like to thank our customers for their efforts, contribution, and constructive engagement in achieving reforms that are wide reaching and ground breaking in their innovation to deliver benefits to all stakeholders in the Central Queensland coal supply chain.

Andrew and I will be happy to take any questions.

Operator: Thank you, if you wish to ask a question, please press *1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press *2. If you are on a speaker phone, please pick up the handset to ask your question. Your first question comes from Simon Mitchell from UBS Investment Bank. Please go ahead.

Simon Mitchell: Good afternoon. Just a question on the $40 million of additional allowable revenue. If we deduct the GAPE amount off the RAB and apply the 50 basis points to additional WACC to that number, we get a number of well below $40 million. Can you just go through the makeup of that $40 million, and also possibly clarify the application as to GAPE Deed.

Andrew Harding: Pam, I might get you to address that.

Pam Bains: We will certainly provide more detail on the breakdown, but you will see some adjustment in tax, slight change in depreciation, and also in the way of the maintenance, and the ballast undercutting, so that's how you get to the 40.

Simon Mitchell: Okay, and just on GAPE, the treatment there, do we assume it doesn't have any implication on the GAPE Deed?

Pam Bains: No, it won't. You'll have the same GAPE recovery. Obviously, the regulatory component adjusts, but you'll still get the same GAPE.

Simon Mitchell: Okay. Second question I had was just regarding the rebate. Effectively here, you've I guess introduced some downside participation by Aurizon in the performance of the network, which I guess was not previously there under the regulatory regime, how should we think about quantifying the extent, the potential extent of that rebate? Should we think of it as being equivalent to a maximum of the $40 million, or does it actually go beyond that?

Michael Riches: Well let me perhaps provide a bit more detail on the rebate and how it operates, and to give you an indication.

... Directly. Sorry, did everyone get that? So I'll just start that again. My mic seemed to go off. But the rebate will be based on performance targets that are directly within Aurizon's control. Those performance targets will be set by the independent expert, based on the historical performance of the network.

In relation to, again, those matters that Aurizon Network can control. So none of the performance targets will be related to above rail matters, port issues, force majeure events. Once those performance targets are set, based on that historical performance, it'll be Aurizon's obligation to deliver capacity in accordance with those performance targets.

Should we do that, we should then translate to customers getting contracted capacity, all other things being equal. Then we will receive a benefit across the Queensland coal supply chain that everyone expects out of this agreement, and no rebate will be payable.

So Aurizon Network's backing its ability to perform at, or above, the operational standards that it's delivered over the last three years. So to meet those performance targets and therefore a rebate not applying.

Simon Mitchell: Thanks, I understand that, but I guess my point is that even though this agreement does give you financial benefit and a whole range of benefits, I guess it is changing slightly the nature of the access in that you are now bearing some downside participation and performance, which you didn't have before. So I guess it's important from our perspective to understand what the extent of that is. So if something does go wrong in the performance or the running of the network, and obviously there's no intention that it'll happen, but things do happen, how should we think about that downside?

Michael Riches: Well I think you're right. There's always circumstances which could apply. The way we look at it is that having regard to, and you have to look at the system overall, historical performance, we fully expect ourselves to be able to achieve that historical performance level and in fact beat it.

In circumstance where we don't, and this rebate is determined on an annual basis, so it provides an opportunity for us at various points in time, if there is some event that would impact the achievement of the objectives or the performance targets, there's an opportunity for us to recoup that and rectify that through revising the way we approach availability and delivery on those performance targets.

But in those circumstances where it did apply, what we will be doing is essentially refunding to customers the access charges, or a component of the access charges that they have paid in respect of the contracted capacity they didn't receive as a result of us not meeting those performance targets, and that non-performance being the cause of the reduction in capacity they've achieved.

So we still have to... The performance targets haven't been set, they have to be set by the independent expert. As I said, our view is that we will achieve better performance than we have in the past, and therefore there will be no rebate payable.

: But, you know, there is always a potential for that to happen, and that is one of the trade-offs associated with delivering a significantly improved return and a better outcome for Aurizon Network and the coal supply chain overall.

Simon Mitchell: Okay, thanks. Just one final question I just wanted to ask was around the treatment of under or over recovery due to disruption events. Is that changed at all, or do we still expect to see a recovery mechanism?

Pam Bains: At this point in time, there is still the two year revenue cap mechanism in place. As Michael touched on, given that we will be reviewing maintenance values with customers, there will be some true-up in relation to that as well. So that's the same. In relation to this year, we are submitting a DAAU to try and bring forward some of the payments and provide customers a repayment this year, in relation to FY18 and FY19.

Simon Mitchell: Okay, thank you.

Operator: Thank you. Your next question comes from Anthony Moulder from CLSA. Please go ahead.

Anthony Moulder: Good afternoon all. Not to labour the point on the rebate, but it just sounds like it's not a stretch target, if it's what's secured over the last three years, but can you give us some instances in which... because we can understand how above rail perhaps doesn't meet its contracted tonnage, but can you give us some examples as to how the below rail would fail to meet that level?

Michael Riches: Yeah, sure Anthony. I think, to give you perhaps, hopefully an easy example. Over the last three years, we've conducted maintenance on the network, which has taken up an amount of availability, available capacity, hours where we're in fixing rail brakes or doing repair work on the electrified network.

So there'll be an ability for the independent expert to determine over a three year basis what a baseline is for that maintenance work that has had to be conducted. Our job going forward will be to ensure that we do not use up more capacity of the network for maintenance activities than we have done in the past.

So the independent expert will initially determine capacity, we'll rectify any deficits, so contracted capacity and available capacity based on historical performance should be equivalent, and then we'll be required to meet those thresholds and those performance levels that we have in the past. And as I've said, certainly, I have every confidence that the network team will actually deliver at least or better than that.

Anthony Moulder: Better than would be better. But is there any capacity or ability to over earn from the rates that you've achieved today with coal customers?

Michael Riches: Not from a network perspective. I think, as we've said, there's a couple of trade-offs in this agreement. One is obviously the increased WACC. The other one is that we do have the ability as we pass through maintenance costs, we receive the potential benefit of any reductions in operating costs that are below the FY21 Final Decision allowance.

So where there's not additional charges to customers that apply other than the WACC, there is opportunity for us to earn greater earnings through cost efficiencies and productivity improvements.

Anthony Moulder: And looking at the CAPEX it's... appreciate it's an independent expert that's looking at the capacity assessment, but from your own perspective, is there... Has there been under investment in the network that would have to be made good over the next 12 months? Is there a potential for higher CAPEX that we would currently have forecast?

Michael Riches: On a renewal basis, no. The expectation is that our capital expenditure will be in line with the capital indicator, as per the Final Decision. There are no expectation of additional CAPEX on renewals.

The independent expert will determine capacity, as I said, we'll then look at whether the contracted capacity is equivalent. To the extent it's not, there'll be opportunities to either look at operational improvements, potentially customers relinquishing capacity; they don't feel they need it, and finally, the potential for expansions to occur to meet any capacity deficit.

We have agreed to fund those expansions up to $300 million for any initial capacity deficit, and any expansion funded through that process will go directly into the RAB and obviously earn the return at the regulated WACC.

Anthony Moulder: Yep which is a good outcome. And lastly, obviously doing a review of the integrated model Andrew, does this have any bearing on the necessity for that review?

Andrew Harding: Oh look, it's a great question actually. As I've said back in June when we announced the review that was going to take place, I said it would be about 12 months. We're coming to the end of that 12 month period, and in the next few months I'll come forward with our view as to the outcome of that study; the integrated model. I won't be pre-empting it at all, but decisions get made in the context of the day, so all information feeds into making that decision.

Anthony Moulder: Understood. All right, thank you.

Operator: Thank you. Your next question comes from Paul Butler from Credit Suisse. Please go ahead.

Paul Butler: Hi, good afternoon. Firstly, I just wanted to say congratulations on what looks like a very transformational step for the business.

Andrew Harding: Well thank you very much. I think the way we think about it is the result is actually a great outcome for Queensland, cementing Queensland as a premium supplier to the world for commodities. It is a great outcome for our customers. We've spent a long time sitting down with them and listening to the issues that they have, and what they would like to see out of the transformation, and we believe this agreement is very supportive of that.

And then for ourselves, it was well known that an uplift in the WACC that was commensurate with the risk that we thought we were taking in owning and operating the network was important. So thank you very much.

Paul Butler: Just a question around the independent expert, how does this person/entity get appointed? Do they have an ongoing role? I mean I don't know whether there's any agreement with the customers about there being reviews of the targets relating to the rebates, and who administers the ongoing process around measuring performance versus the targets and deciding on rebates, because it strikes me that there is some level of subjective interpretation to allocate responsibility where performance is below the target.

Michael Riches: So the independent expert is to be appointed by industry and Aurizon. So we will jointly appoint the independent expert. We're already in discussions as to how that should occur. We have a modelling firm that has already commenced work on doing the modelling so we can start that process immediately.

The independent expert, once appointed, will have an ongoing role. So they will have a role in two important respects. One is that any additional capacity that is required on the network as new mines are developed or existing mines seek to expand, the independent expert will determine the capacity level of the network at that stage and provide information as to whether expansions are required. So we have an independent determination of that.

And secondly, as mentioned, the independent expert will be the one who will undertake annually a review of Aurizon's performance against the targets and an assessment of whether contracted capacity that hasn't been received is due to that under performance. The independent expert will undertake that role.

In terms of review of the rebate mechanism, there is a process in 2023 where the QCA will have a look at the rebate mechanism and assess whether it's been effective against certain defined objectives. The QCA can recommend changes to the rebate mechanism if it believes the objectives haven't been achieved.

Aurizon will then review and has a discretion as to whether to approve any recommendations, as do customers. And in circumstances where customers and Aurizon are unable to agree to any modifications recommended by the QCA, then we will see the rebate mechanism being removed, but also in those circumstances a reduction in the WACC of 30 basis points. That will occur in 2023, and on review by the QCA in circumstances where it believes the rebate mechanism hasn't been effective.

Paul Butler: Right, and I gather the QCA is unlikely to be appointed as the independent expert? Is that...?

Michael Riches: Correct, the QCA is not a body that has the expertise to undertake modelling work and on a regular basis assess capacity and continue to develop capacity modelling in the CQCN. So it would not be the body appointed as the independent expert.

Paul Butler: Okay, thank you very much.

Operator: Thank you. Your next question comes from Ian Myles from Macquarie. Please go ahead.

Ian Myles: Congratulations guys, can we just talk on the residual 10%, I think, of the customers who haven't signed to the agreement. I think that would be what; Vale, Whitehaven, Stanmore, amongst a couple. I was just, so I'm just trying to understand why they weren't party to the agreement?

Andrew Harding: Ian, thanks for the question. I think for more insight into the, you know, from the customer side of this deal, I think it's really important to go and actually talk to them about how those sort of things came to be. But do you want to add anything?

Michael Riches: The only thing I'd add is, we had extensive discussion. I know the customer group talked through their rail working group. And as Andrew says, to the extent that others were not part of the greater than 90% who have been involved in this process, it's probably a question for the customers generally.

Ian Myles: Is it problematic that you don't have agreement, that broader agreement, to get the QCA to accept, because I think there's been times where, in the past, you had large portions of the industry agreeing, but the QCA's rejected potential changes.

Michael Riches: I think we've never had a situation where we've had greater than 90% support for agreements, and particular of this nature. I mean the QCA will have to go through its usual process. We've certainly had the discussions with the QCA and as you may recall during the maintenance consultation paper that they put out was in circumstances where there is broad industry support and agreement with Aurizon, they would look at that very favourably.

That continues to be the case. Obviously, they have to go through their appropriate process and governance. I think one thing, and it has been one of the factors in the time that this has taken in developing this agreement is that we're very conscious of ensuring that this is a fair and equitable agreement across all of the supply chain.

That includes current access holders and access seekers. Everyone is very aware that that will be a key focus for the QCA. So I believe that, although a small proportion of customers may not have been directly involved in this, we will engage with those customers and we feel when they look at this transaction, they will see the benefit that will be delivered and ultimately will be supportive of it.

Ian Myles: Okay. If we look at the proposal of the independent expert looking at capacity, I can't imagine you've gone into that blind without a view. How much of that $300 million do you think might be needed to be spent to lift the capacity? So I guess to correlate, what comes out of this, how much additional haulage do you think is plausible as you go and effectively de-bottleneck certain aspects of the network?

Michael Riches: Well I think, as I said that, once the capacity assessment is done, and to the extent there are any deficits identified, it can be addressed in three ways. One is to make operational improvements. So potentially, we undertake less maintenance on the network. We do maintenance in a different way and we'll talk to customers about that.

The other way it can be rectified is customers who may feel that they have oversubscribed the capacity, can actually relinquish capacity without any charge. So there could be a relinquishment in capacity.

Thirdly, it will be through expansion. So until firstly, we have an assessment as to what deficits may apply, and then how those two first elements might be implemented, we can't really make an assessment of what would be the amount of that $300 million that may be utilized for expansion.

Ian Myles: Okay, and then on that, if you think about that statement about relinquishment, how flexible are the miner's haulage, above rail haulage contracts? So that, if the capacity isn't actually there, that they could relinquish the above rail capacity as well.

Michael Riches: Look, that's I mean a matter for the miners and their above rail haulers.

Ian Myles: Which obviously AZJ is a large one.

Michael Riches: Yeah. I'll let... I only run networks, I'll let Andrew answer that one.

Andrew Harding: I think if you want, Ian, to well understand the flexibility that the miners believe they have in their haulage arrangements, you should talk to the miners about that.

Ian Myles: Okay, look, can we just, on a financial side, you've got, typically run a hedging program which matches the regulatory reset. So you've got hedges that's expiring in '21. You've now effectively extended the program, you know, reset period by two years. Can you maybe give us some colour on your approach to the hedging strategy for the '22/'23 period?

Pam Bains: Ian, as you will appreciate, we put in the submission today to the regulator. We need to work through that. Obviously this is subject to QCA review, so what we wouldn't want to do is start the hedging process, but it is something that's definitely on our mind and will be working through over the next couple of months.

Ian Myles: Okay, that's fine. That's all I have.

Operator: Thank you. Your next question comes from Michael Morrison from Deutsche Bank. Please go ahead.

Michael Morrison: Thank you. The first question I had was just, what is... what would be the incentive for the QCA to accept some restrictions in the 2023 proposed reset, for example the WACC input?

Michael Riches: I guess we don't look at the QCA as having any incentive or disincentives through the regulatory model. I mean they're there to make determinations based on the economic conditions at the time. I think this arrangement is designed to provide longer term certainty for all participants in the industry.

We would expect that with the level of support that's available, the QCA would be looking at this and saying, "Well, if that is what industry, who are the ones paying for this cost, and Aurizon, believe it is an appropriate way to manage that economic risk, then that should be applied." I don't think there's an incentive question in there for the QCA.

Michael Morrison: Okay, and then through this months of negotiation, what's been the biggest sticking point for the customers in coming to an agreement?

Michael Riches: Look, this is a whole package. You know, we've spent a long time working through this as a holistic package. There's not one particular point that we feel has been more

important for us or for our customers than others. We've worked through this constructively and collaboratively to come up with an outcome that benefits all of industry, the supply chain generally and Aurizon Network. We do see it very much as a win-win.

Michael Morrison: Okay, and just so I understand how the process works, why aren't Pacific National and BMA part of this agreement? Do you not sign agreements with them for below rail, is that only for above rail?

Michael Riches: Well no, there are... Pacific National and BMA do have access arrangements with Aurizon Network. Ultimately, those costs are passed through to customers, and so the ultimate payers of those access charges are the customers, and they're the ones who are concerned about the receipt of capacity.

We will definitely engage with Pacific National and BMA through the consultation process, as well as Aurizon Operations, to provide them with full detail of the revised undertaking and the impact this will have on them.

Again, as we say, I think those stakeholders will see the significant benefits that are achieved through this agreement and we would expect them to be supportive.

Michael Morrison: Okay, so but you haven't spoken to them yet?

Michael Riches: No, we have not spoken to any of the above rail operators.

Michael Morrison: Okay, and then last question from me, any change to your above rail guidance?

Pam Bains: No, we are still confirming guidance, as it was.

Michael Morrison: I'm sorry, I didn't catch that?

Pam Bains: Yes, we're still confirming guidance. So no change.

Michael Morrison: Great, thank you and congratulations.

Andrew Harding: Thank you.

Pam Bains: Thank you.

Operator: Thank you. Your next question comes from Owen Birrell from Goldman Sachs. Please go ahead.

Owen Birrell: Hi guys. Just a couple from me. Firstly, on the I guess, the contracted capacity that is underpinning the rebate structure. Is it fair to say that that contracted capacity is going to be broadly in line with the above rail contracted capacity?

Michael Riches: Oh look, I don't know. I have no idea what the contracted above rail capacity is and the haulage arrangements. That would be a question for the customers as to whether they align their below rail capacity with their above rail haulage.

Owen Birrell: Just to confirm the structure, so they don't procure their below rail capacity through their haulage provider? They go to you directly to…

Michael Riches: Some do, some don't. So some will contract through their above rail provider, and some will contract with us directly.

Owen Birrell: Okay, so for those that do go through their above rail provider, assuming that they're aligned, is there any provision there for spot capacity above that? Or you do not have any performance metric associated with that spot capacity?

Michael Riches: We don't have any performance metric associated with above contracted below rail capacity.

Owen Birrell: Okay, excellent. And just wondering, the measurement timeframes, is that going to be measured on a monthly basis? Can you give us a bit of a colour on how that's actually going to be measured?

Michael Riches: It will be measured annually. So as I indicated, there may be circumstances that arise in a particular month where we might have been below a performance target for a month. There'll be no consequence associated with that month. Our job in those circumstances will be to improve our performance so as to make up any losses over the course of the year. And as I said, I fully expect that we will deliver above the performance target levels of the course of each year.

Owen Birrell: Can I just confirm with you Andrew that your take or will pay is measured monthly?

Andrew Harding: For... What are we talking about, per month?

Owen Birrell: Above rail take or pay are measured monthly?

Andrew Harding: Yes, yes.

Owen Birrell: Okay and I just wanted to ask whether this revised or amended undertaking essentially constitutes your submission for the UT6 submissions that the QCA was asking for late last year.

Michael Riches: Well I don't think... QCA haven't actually made any request for submissions on UT6, but effectively this will supersede what would've otherwise been UT6 regulatory period, which would've run from 1 July 2021 through to 30 June 2025.

Owen Birrell: Okay, and final question from me, is there any clauses in this agreement that you've signed with the miners for them to exit the agreement at the reset date in 2023?

Michael Riches: No.

Owen Birrell: Okay, so they're effectively locked in through to '27.

Michael Riches: Yes.

Owen Birrell: Okay, that's great. Thank you.

Operator: Thank you. Your next question comes from Cameron McDonald from Evans & Partners. Please go ahead.

Cameron McDonald: Good afternoon guys. Just one question from me after the range of questions that have already been asked. Is there... Through the independent expert process, what is... how is the submissions going to be made to that independent expert? Are you gonna make a submission on what you think, and then the customers make their submission on what they think, or is the independent expert gonna come up with their completely own assumptions and outcomes? What happens if you disagree with that outcome?

Michael Riches: Yeah, so the idea of the independent expert is to provide them with full data and information, both from ourselves, from industry. We'll be engaging with ports and above rail operators for them to provide information as well to allow the independent

expert to develop a capacity model that reflects the operating environment over the last three years.

Now there's always the potential for the independent expert to calibrate or assess that data in a particular way that may be different from our view or from the miner's view. I guess that's the objective of having someone completely independent, is that they will look at this without any bias.

Of course, if there are parameters developed and capacity modelling done that people don't agree with, there'll be the opportunity to have discussions with the independent expert to identify where we think improvements can be made, and that would apply for each of us. But it will not be a process that involves the usual we submit this, industry submit that, and the independent expert tries to determine between the two what's a fair outcome. It is a completely independent, bottom-up, starting-from-zero approach to determining capacity.

Cameron McDonald: Okay and then in the unlikely event that the QCA rejects this, what's the process that you'd need to go through and unwind all this again?

Michael Riches: Well I think this represents an agreement which is a whole package. In circumstances where the QCA rejected this and identified particular areas where it wasn't in agreement, we would sit down with the customers and assess whether there were improvements we could make that align with the QCA's issues and address their issues. If they were and we could get agreement on those things, then we would submit a revised DAAU for approval. If there isn't, then we will both be obviously significantly disappointed in having to withdraw this DAAU and continue with the UT5 Final Decision as the underlying undertaking and then through a UT6 process.

So that's what would happen, but as I say, I think we believe given the time and effort we put into this with our customers that, although the QCA has to go through its appropriate processes and procedure, that we've addressed all of the elements that we believe the QCA might otherwise have concern with.

Cameron McDonald: Okay, thanks guys.

Operator: Thank you. Your next question comes from Scott Ryall from Rimor Equity Research. Please go ahead.

Scott Ryall: Thank you very much. A hell of a thing you've done here today guys, well done. I have a few questions. The independent expert, how far along the path is that towards being a Hunter Valley Coal Chain Coordinator?

Michael Riches: Well I think the independent expert is only assessing capacity, and then reviewing capacity to the extent there are any expansions. It won't be operating the network in any way, shape, or form. It won't be making decisions about which trains run when. It will not be doing any of the planning or scheduling work that is done through the HVCCC style model. So although it has a role, which is also a role that the HVCCC has, it is a long way from the HVCCC.

Scott Ryall: Okay, so in terms of the ongoing role I guess that you just described to one of the earlier questions, there's nothing operational in that respect. It's just a continual assessment of capacity in the network requirements from new customers, or access seekers, and things like that.

Michael Riches: Correct, and the only other thing that we'll do is annually assess our performance. But no operational role.

Scott Ryall: Okay, sure. And then in terms of the mechanism on the WACC moving to 6.3% on completion of the first assessment review, is that basically a step up from 5.9 to 6.3 to recognize that you are then, after that capacity assessment review, you'll be on the hook for your rebates, and therefore you've got a higher WACC during that period? Is that the reason for the timing?

Michael Riches: That's correct.

Scott Ryall: Okay, and then can we... Is it fair to assume, just based on a few of the questions earlier, is it fair to assume that, you know, if you do have to pay rebates and things like that, that a level in alignment with 5.9% as a WACC would be a baseline to your earnings?

Michael Riches: No, I think the way we look at it is that, given that performance targets will be based on historical performance, we will deliver our obligations in line with, or above those historical levels, and therefore no rebate would be payable.

We have not undertaken or gone through this process expecting to pay rebates that are equivalent to 0.4% of WACC, it's not the way we've approached it. It's a whole package, and we believe 6.3% is the right return for the risk of owning and operating the network.

Scott Ryall: Okay, good, thank you. And then in terms of the efficiency and prudence you spoke to, I just want to confirm I've got this right. So maintenance is effectively a pass through based on the agreements with customers, but then your operational costs, effectively you have said, "Unless inflation is more than 2.37%, we will deliver you flat nominal costs, and any efficiency you make in excess of that, you keep." Is that... that's correct?

Michael Riches: Broadly, that's correct, yes.

Scott Ryall: Okay, great. In terms of that, I guess the maintenance agreements, or sorry, the maintenance costs, and the fact that you're meeting annually with customers to assess that and a range of other things, is it fair to assume here that actually we can look forward and see a much more collaborative approach between network and customers with respect to delivery of the overall whole coal system's needs, but also the customers would envisage that this would more accurately, or more appropriately deliver to their individual needs as well, based on things like seasonality or mine plans that they've got, expansion plans, those sorts of things. Do you envisage a hell of a lot more collaboration between yourselves and customers?

Michael Riches: Look I think the process we've gone through in developing this agreement with customers has certainly laid the foundation for greater collaboration. The intension of the arrangements around maintenance and capital expenditure are absolutely designed to facilitate that collaboration and we would fully expect that there would be enhanced collaboration, and therefore better supply chain outcomes as we go forward.

Scott Ryall: Right, good, thank you. That's all I had.

Operator: Thank you. Your next question comes from Rob Koh from Morgan Stanley. Please go ahead.

Rob Koh: Yes, good day guys. Maybe it's a little bit me too, but just maybe let me add my congratulations also to everybody else's. Most of the questions I wanted to ask have been covered. If I could maybe just ask a little bit of extra colour on that OPEX saving from FY22, or that OPEX opportunity. Could you give us a sense of how advanced you are on thinking about that? I mean should we... In the past, the company’s announced productivity targets and things like that. Does this framework now give you an opportunity to think about something kind of transformational along those lines?

Michael Riches: Oh look, I think Rob, as we work through our plans and budgets over the course of the coming years, we'll obviously look for cost efficiencies and productivity improvements across the business. So that'll be in general operating cost, it'll be in maintenance. And so we're always looking for those opportunities. I think this agreement provides both us and the customers with improved incentives mechanisms to try and deliver those cost efficiencies for greater improvements across the supply chain. So we'll look at those as time progresses.

Rob Koh: Yeah, okay. All right, well all the best with it. Thanks again.

Andrew Harding: Okay look, just in summary, thank you all for the many questions. Just to reiterate, this has been a breakthrough agreement. It's come after a lot of listening on our part to our customer's needs and working out a way to provide for their needs going forward. One of the things that I really, really like about what we've managed to achieve with the customers is that we've got out of this endless cycle of regulatory discussions and we're actually focusing on the running of the actual coal supply chain itself for the betterment of the industry and Queensland.

So thank you very much for taking the time to listen. I wish you all the best for the weekend.

[END OF TRANSCRIPT]