

# **Aurizon Holdings Limited**

ABN 14 146 335 622

## **Interim Financial Report for the six months ended 31 December 2016**

# Aurizon Holdings Limited ABN 14 146 335 622

## Interim Financial Report - 31 December 2016

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Aurizon Holdings Limited is a company limited by shares, incorporated and domiciled in Australia.

Its registered office and principal place of business is:

Aurizon Holdings Limited  
Level 17  
175 Eagle Street  
BRISBANE QLD 4000

## **Directors' report**

The directors present their report on the consolidated entity consisting of Aurizon Holdings Limited and its controlled entities ("the company" or "the Group") for the six months ended 31 December 2016.

### **Directors**

The following persons were directors of the Company during the six months and up to the date of this report:

T M Poole (Chairman)  
R R Caplan  
J D Cooper  
K L Field  
M Fraser  
A Harding (appointed 1 December 2016)  
S L Lewis  
K E Vidgen (appointed 25 July 2016)

The following person held office as director of Aurizon Holdings Limited during the six months:

L E Hockridge (resigned 1 December 2016)

### **Principal activities**

During the six months the principal activities of the Group consisted of:

- integrated heavy haul freight railway operator
- rail transporter of coal from mine to port for export markets
- rail transporter of bulk, iron ore, general and containerised freight
- large-scale rail services activities

#### *Coal*

Transport of coal from mines in Queensland and New South Wales to end customers and ports.

#### *Freight*

Transport of bulk mineral commodities (including iron ore), agricultural products, mining and industrial inputs, and general freight throughout Queensland and Western Australia, and containerised freight throughout Australia.

#### *Network*

Provision of access to, and operation of, the Queensland coal network. Provision of overhaul and maintenance of Network assets.

### **Review of operations**

A review of the Group's operations for the interim financial period and the results of those operations are set out in the Operating and Financial Review as set out on pages 4 to 19 of this interim financial report.

**Dividends**

Dividends paid to members during the six months were as follows:

	<b>31 December 2016</b>	31 December 2015
	<b>\$m</b>	\$m
Final dividend for the year ended 30 June 2016 of 13.3 cents 70% franked (2015: 13.9 cents, 30% franked) per share, paid 26 September 2016	<b>273</b>	295

The directors have declared a 70% franked interim dividend of 13.6 cents per ordinary share for the six months ended 31 December 2016. The Conduit Foreign Income component of the dividend is nil. The Record Date for determining dividend entitlements for the dividend declared is 28 February 2017. The payment date is 27 March 2017.

**Auditor's independence declaration**

A copy of the auditor's independence declaration as required under section 307C of the *Corporations Act 2001* is set out on page 20.

**Rounding of amounts**

The amounts contained in this report and in the financial statements have been rounded to the nearest million dollars unless otherwise stated (where rounding is applicable) under the option available to the company under ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191. The company is an entity to which the instrument applies.

This Directors' report is made in accordance with a resolution of directors.



T M Poole  
 Chairman  
 13 February 2017

## OPERATING AND FINANCIAL REVIEW

### Consolidated Results

The Group's financial performance is explained using measures that are not defined under IFRS and are therefore termed non-IFRS measures. The non-IFRS financial information contained within this Directors' Report and Notes to the Financial Statements has not been audited in accordance with Australian Auditing Standards. The non-IFRS measures used to monitor Group performance are EBIT (Statutory and Underlying), EBITDA (Statutory and Underlying), EBITDA margin (Statutory and Underlying), NPAT Underlying, Operating Ratio – underlying, Return on Invested Capital (ROIC), Net debt and Net gearing ratios. Each of these measures is discussed in more detail on page 49.

#### 1. Half on Half Comparison

##### Financial Summary

(\$m)		1HFY2017	1HFY2016	Variance %
<b>Total revenue</b>		<b>1,781</b>	<b>1,758</b>	<b>1%</b>
<b>Operating costs</b>		<b>(1,006)</b>	<b>(1,075)</b>	<b>6%</b>
Employee benefits expense		(444)	(481)	8%
Energy and fuel		(134)	(134)	0%
Track access		(126)	(162)	22%
Consumables		(276)	(260)	(6%)
Other expenses		(26)	(38)	32%
<b>EBITDA</b>	<b>- underlying</b>	<b>775</b>	<b>683</b>	<b>13%</b>
	- statutory	454	257	-
Depreciation and amortisation expense		(287)	(280)	(3%)
<b>EBIT</b>	<b>- underlying</b>	<b>488</b>	<b>403</b>	<b>21%</b>
	- statutory	167	(23)	-
Net finance costs		(92)	(70)	(31%)
<b>Income tax expense</b>	<b>- underlying</b>	<b>(117)</b>	<b>(96)</b>	<b>(22%)</b>
	- statutory	(21)	(15)	(40%)
<b>NPAT</b>	<b>- underlying</b>	<b>279</b>	<b>237</b>	<b>18%</b>
	- statutory	54	(108)	-
<b>Earnings per share<sup>1</sup></b>	<b>- underlying</b>	<b>13.6</b>	<b>11.2</b>	<b>21%</b>
	- statutory	2.6	(5.1)	-
Return on invested capital (ROIC) <sup>2</sup>		9.6%	8.8%	0.8ppt
<b>Operating ratio</b>		<b>72.6%</b>	<b>77.1%</b>	<b>4.5ppt</b>
Cash flow from operating activities		625	522	20%
Interim / Final dividend per share (cps)		13.6	11.3	20%
Gearing (net debt / net debt + equity)		37.1%	35.4%	(1.7ppt)
Net tangible assets per share (\$)		2.7	2.8	(4%)
People (FTE)		5,746	6,455	11%

##### Other Operating Metrics

	1HFY2017	1HFY2016	Variance %
Revenue / NTK (\$/'000 NTK)	49.2	48.2	2%
Labour costs / Revenue <sup>3</sup>	24.8%	25.5%	0.7ppt
NTK / FTE (MNTK)	12.6	11.3	12%
Operations net opex / NTK (\$/'000 NTK)	32.0	35.2	9%
NTK (bn)	36.2	36.5	(1%)
Tonnes (m)	135.4	138.9	(3%)

<sup>1</sup> Calculated on weighted average number of shares on issue – 2,052m 1HFY2017 and 2,109m 1HFY2016

<sup>2</sup> ROIC is defined as underlying rolling twelve month EBIT divided by the average invested capital. The average invested capital is calculated by taking the rolling twelve month average of net property, plant and equipment including assets under construction plus investments accounted for using the equity method plus current assets less cash, less current liabilities plus net intangibles

<sup>3</sup> 1HFY2017 excludes \$3m redundancy costs (1HFY2016 excludes \$16m redundancy costs and \$16m cost of employee share gift)

### Underlying EBIT by Segment

(\$m)	1HFY2017	1HFY2016	Variance %
Below Rail - Network	295	245	20%
Above Rail	219	185	18%
Commercial & Marketing	1,377	1,468	(6%)
Operations	(1,158)	(1,283)	10%
Corporate Overhead (Unallocated)	(26)	(27)	4%
Group	488	403	21%

### Group Performance Overview

Underlying EBIT increased \$85m (21%). Group revenue was up 1% to \$1.8bn, with increased Below Rail revenue offset by decreased Above Rail revenue due to a 3% reduction in volumes.

Operating costs decreased \$69m (6%) driven primarily by \$64m of transformation benefits delivered in the period (\$52m in Operations and \$12m from support functions).

Depreciation increased \$7m (3%) reflecting an increase in Below Rail asset renewals and the impact of the completion of the Wiggins Island Rail Project (WIRP) during FY2016.

Underlying EBIT also benefited from the non-recurrence of the cost of the prior period's Queensland Nickel (QNI) doubtful debt provision (\$18m) and the employee share gift (\$16m). In addition, \$16m of redundancy costs were incurred in the prior period, which were included in underlying EBIT. Non-transformation related redundancy costs of \$3m have been included in underlying EBIT in the current period.

1HFY2017 OR was 72.6% (down 4.5ppts) and Return on Invested Capital (ROIC) was 9.6% (up 0.8ppts).

Statutory EBIT was \$167m reflecting the asset impairment of \$257m and redundancy costs of \$64m which have been treated as a significant item due to materiality, consistent with the treatment in FY2013 and FY2014.

### Reconciliation to Statutory Earnings

Underlying earnings is a non-statutory measure and is the primary reporting measure used by management and the Group's chief operating decision making bodies for the purpose of managing and assessing the financial performance of the business. Underlying earnings is derived by adjusting statutory earnings for significant items as noted in the following table:

(\$m)	1HFY2017	1HFY2016
<b>Underlying EBIT</b>	<b>488</b>	<b>403</b>
<b>Significant Items</b>	<b>(321)</b>	<b>(426)</b>
Asset impairments	(257)	(426)
Intermodal	(162)	-
Freight Management Transformation project	(64)	-
Impairment of assets in exit of contracts	(10)	-
Transformation assets	(21)	-
Investment in Associate	-	(153)
Strategic infrastructure projects and assets under construction	-	(125)
Rollingstock	-	(148)
Redundancy costs	(64)	-
<b>Statutory EBIT</b>	<b>167</b>	<b>(23)</b>
Net finance costs	(92)	(70)
<b>Statutory PBT</b>	<b>75</b>	<b>(93)</b>
Taxation expense	(21)	(15)
<b>Statutory NPAT</b>	<b>54</b>	<b>(108)</b>

Aurizon reviewed the carrying value of its assets as at 31 December 2016 and has recognised impairments and significant items of \$321m (pre-tax) as noted below. A further \$9m was impaired during the period and was included in underlying earnings.

Significant asset impairments of \$257m:

- › Intermodal \$162m due to trading performance during the first half being lower than expectations. Following the impairment, the residual carrying value of the assets of the Intermodal business is \$177m
- › Freight Management Transformation (FMT) project \$64m - FMT was an investment that commenced in 2014 to standardise 18 separate legacy systems for logistics planning, scheduling, ordering and billing to a single platform. Following a review, it has been decided to terminate this project and as a result an impairment charge of \$64m has been recorded in the 1HFY2017 accounts. An amount of \$27m of the total project investment of \$91m remains capitalised on the balance sheet in relation to software and licences, which are currently in use

- › Freight Review Contract Exit Costs \$10m - following the decision by Glencore to not renew its existing contract with Aurizon to haul mine inputs and outputs between Mt Isa and Townsville, Aurizon decided to cease to operate its daily multi-customer freight service from the contract expiry date of 31 January 2017. As a result, \$10m of assets including rollingstock, plant and equipment and associated facilities have been impaired
- › Other assets \$21m – this includes property, plant and equipment of \$15m along with a further \$6m relating to various projects no longer proceeding and assets identified as surplus to requirements

Redundancy costs \$64m - 494 employees were made redundant across the business. This includes \$6m for redundancies associated with the exit of the Mount Isa freight service (as detailed above)

## 2. Other Financial Information

### Balance Sheet Summary

(\$m)	31 December 2016	30 June 2016
Total current assets	756	844
Property, plant & equipment (PP&E)	9,454	9,719
Other non-current assets	257	305
<b>Total Assets</b>	<b>10,467</b>	<b>10,868</b>
Total current liabilities	(596)	(732)
Total borrowings	(3,388)	(3,490)
Other non-current liabilities	(940)	(932)
<b>Total Liabilities</b>	<b>(4,924)</b>	<b>(5,154)</b>
<b>Net Assets</b>	<b>5,543</b>	<b>5,714</b>
<b>Gearing (net debt / net debt plus equity)</b>	<b>37.1%</b>	<b>37.4%</b>

### Balance Sheet Movements – 31 December 2016 vs. 30 June 2016

Total current assets decreased by \$88m largely due to:

- › Reduction in assets held for sale of \$95m as a result of the completion of the sale of investment in Moorebank
- › Reduction in trade and other receivables of \$41m due to improved debtor collections and decreased Network receivables due to the finalisation of UT4
- › Increase in cash and cash equivalents of \$45m due to strong free cash flow generation

Total non-current assets decreased by \$313m largely due to:

- › Net decrease in PP&E of \$265m largely due to impairments (as previously mentioned)
- › Net decrease in other non-current assets of \$48m largely due to the \$64m impairment of FMT project costs

Total current liabilities decreased \$136m mainly due to a decrease in tax payable of \$80m on payment of FY2016 liabilities and the impact of recognising the \$15m Bandanna bank guarantee as revenue.

Total borrowings decreased by \$102m due to the revaluation of medium-term notes by \$76m and the repayment of syndicated facilities of \$25m.

Other non-current liabilities increased by \$8m due to a \$39m increase in derivative financial instruments (fair value movement on Euro Medium Term Note) partly offset by a decrease in deferred tax liabilities of \$14m and by a decrease of income in advance provisions of \$7m.

Gearing (net debt/net debt plus equity) was 37.1% as at 31 December 2016.

## Cash Flow Summary

(\$m)	1HFY2017	1HFY2016
<b>Statutory EBITDA</b>	<b>454</b>	<b>257</b>
Working capital and other movements	33	(47)
Non-cash adjustments – impairments <sup>4</sup>	266	426
<b>Cash from operations</b>	<b>753</b>	<b>636</b>
Interest received	2	1
Income taxes paid	(130)	(115)
<b>Net cash inflow from operating activities</b>	<b>625</b>	<b>522</b>
<b>Cash flows from investing activities</b>		
Proceeds from sale of property, plant and equipment (PP&E) and associate	105	28
Payments for PP&E & intangibles	(285)	(418)
Interest paid on qualifying assets	(2)	(8)
Net distributions from investment in associates	0	2
<b>Net cash (outflow) from investing activities</b>	<b>(182)</b>	<b>(396)</b>
<b>Cash flows from financing activities</b>		
Net (repayments) / proceeds from borrowings	(31)	388
Payment for share buy-back and share based payments	(7)	(168)
Interest paid	(87)	(63)
Dividends paid to Company shareholders	(273)	(295)
<b>Net cash (outflow) from financing activities</b>	<b>(398)</b>	<b>(138)</b>
<b>Net increase / (decrease) in cash</b>	<b>45</b>	<b>(12)</b>
<b>Free Cash Flow (FCF)<sup>5</sup></b>	<b>356</b>	<b>63</b>

## Cash Flow Movements

Net cash inflow from operating activities increased by \$103m (20%) to \$625m largely due to:

- › \$92m increase in underlying EBITDA (excludes impact of \$160m movement in non-cash impairments)
- › \$33m reduction in working capital relating to inventories and trade receivables; partly offset by
- › \$15m increase in income taxes paid

Net cash outflow from investing activities decreased by \$214m (54%) to \$182m, largely due to:

- › \$133m decrease in capital expenditure due to completion of growth projects in the prior period
- › \$77m increase in the proceeds on sale of assets due to the sale of investment in Moorebank

Net cash outflow from financing activities increased by \$260m (188%) to \$398m due to:

- › \$419m decrease in proceeds from borrowings
- › \$161m decrease in share buy-back and share based payments
- › \$24m increase in interest paid due to refinancing of debt
- › \$22m decrease in dividend payments

<sup>4</sup> Total impairments of \$266m include \$257m significant items excluded from underlying EBIT and \$9m of other impairments included in underlying EBIT

<sup>5</sup> FCF - Defined as net cash flow from operating activities less net cash outflow from investing activities less interest paid



## Dividend

Taking into account first half probability, the trading outlook and cash requirements of the business, the Board has declared an interim dividend for FY2017 of 13.6cps (70% franked) based on a payout ratio of 100% in respect of underlying NPAT (i.e. after adjusting for significant items).

Based on current expectations, the FY2017 final dividend will be franked between 60% and 70%.

The relevant interim dividend dates are:

- › 27 February 2017 – ex-dividend date
- › 28 February 2017 – record date
- › 27 March 2017 – payment date

## Funding

The Group continues to be committed to diversifying its debt investor base and increasing average debt tenor. The debt portfolio is managed with particular regard to target credit ratings and interest rate risk inherent in the business including the Aurizon Network regulatory undertakings.

In respect of 1HFY2017:

- › Weighted average debt maturity tenor was 5.3 years (1HFY2016 - 4.5 years)<sup>6</sup>
- › Interest cost on drawn debt was 5.1% (1HFY2016 - 4.7%)
- › Approximately 76% of debt is fixed or hedged to broadly align with the Below Rail regulatory period
- › Group gearing was 37.1% (1HFY2016 – 35.4%)
- › Aurizon's credit rating remains unchanged at BBB+/Baa1

## Tax

Underlying income tax expense for 1HFY2017 was \$117m. The underlying effective<sup>7</sup> tax rate for 1HFY2017 was 30%. The underlying cash<sup>8</sup> tax rate for 1HFY2017 was 13% which is less than 30% primarily due to accelerated fixed asset related adjustments.

The underlying effective tax rate for FY2017 is expected to be in the range of 28-30% and the underlying cash tax rate is expected to be less than 20% for the short to medium-term.

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<sup>6</sup> Weighted average debt maturity profile does not include working capital facility

<sup>7</sup> Underlying effective tax rate = income tax expense excluding the impact of significant items / underlying consolidated profit before tax

<sup>8</sup> Underlying cash tax rate = cash tax payable excluding the impact of significant items / underlying consolidated profit before tax

## SEGMENT REVIEW

### Above Rail

'Above Rail' combines the Commercial & Marketing and Operations functions and represents the haulage operations for Aurizon's Coal, Freight and Iron Ore customers. Following the restructure, the Strategy & Business Development function is now managed within the Commercial & Marketing function however the associated costs remain within the Other segment, with attributable costs allocated to Commercial & Marketing consistent with prior years.

(\$m)	1HFY2017	1HFY2016	Variance %
<b>Total revenue</b>	1,495	1,612	(7%)
Coal	891	950	(6%)
Above Rail	586	577	2%
Track Access <sup>9</sup>	305	373	(18%)
Freight	364	397	(8%)
Iron Ore	139	163	(15%)
Other	101	102	(1%)
<b>Operating Costs</b>	(1,134)	(1,274)	11%
Employee benefits expense	(364)	(399)	9%
Energy and fuel	(61)	(71)	14%
Track access	(445)	(519)	14%
Consumables	(246)	(262)	6%
Other expenses	(18)	(23)	22%
<b>Underlying EBITDA</b>	361	338	7%
Depreciation and amortisation expense	(142)	(153)	7%
<b>Underlying EBIT</b>	219	185	18%

### Above Rail Revenue Metrics

	1HFY2017	1HFY2016	Variance %
<b>Coal</b>			
Total tonnes hauled (m)	103.5	104.4	(1%)
Queensland	79.9	82.0	(3%)
NSW	23.6	22.4	5%
% Volumes under new form contracts	97%	80%	16.8ppt
Contract utilisation	93%	93%	0.3ppt
Total NTK (bn)	24.8	25.0	(1%)
Queensland	20.3	20.9	(3%)
NSW	4.5	4.1	10%
Average haul length (Km)	240	240	-
Total revenue / NTK (\$/'000 NTK)	35.9	38.0	(6%)
Above rail revenue / NTK (\$/'000 NTK)	23.6	23.1	2%
<b>Freight</b>			
Total tonnes hauled (m)	20.5	22.0	(7%)
Total TEUs ('000s)	212.2	192.9	10%
Total NTK (bn)	6.7	6.5	3%
Total revenue / NTK (\$/'000 NTK)	54.3	61.1	(11%)
<b>Iron Ore</b>			
Total tonnes hauled (m)	11.4	12.5	(9%)
Contract utilisation	101%	104%	(3.0ppt)
Total NTK (bn)	4.7	5.0	(6%)
Total revenue / NTK (\$/'000 NTK)	29.6	32.6	(9%)
Average haul length (Km)	413	399	4%
<b>Total Above Rail tonnes hauled (m)</b>	<b>135.4</b>	<b>138.9</b>	<b>(3%)</b>

<sup>9</sup> An amount equal to Track Access revenue is included in Operation's costs, reflecting the pass-through nature of tariffs

## Above Rail Performance Overview

Underlying EBIT increased \$34m (18%) to \$219m, with lower revenue offset by a reduction in operating costs and depreciation.

Revenue declined 7% (\$117m) due to lower pass-through access revenue and a 3% decline in volumes.

- › Coal track access revenue declined \$68m (18%) due to a major customer converting to an End User Access Arrangement (where access charges are paid direct to Aurizon Network) following the commencement of their New Form contract. In addition, a \$30m credit was received from QR due to the overpayment of access charges on the West Moreton system following the finalisation of the access undertaking. As access charges are passed through to customers, there is a commensurate reduction in operating costs as noted below
- › Coal Above Rail revenue was \$9m (2%) higher reflecting improved revenue quality offsetting a marginal volume decline
- › Freight revenue was down \$33m (8%) due to a 7% reduction in volumes
- › Iron Ore revenues declined \$24m (15%) reflecting 9% lower volumes and the impact on average freight rates due to rate relief granted to a key customer Karara Mining Limited (KML)

Coal volumes were down 0.9mt (1%) to 103.5mt. Queensland volumes were down 2.1mt (3%) to 79.9mt reflecting the expiry of two contracts (BMA GAPE and Gladstone Power Station) and Cockatoo Coal operations being placed into care and maintenance. NSW volumes were 1.2mt (5%) higher at 23.6mt reflecting the ramp-up of the Whitehaven contract and increased spot railing. Coal volumes hauled under new form contracts increased 17ppts to 97%, reflecting the new long-term performance contract for BMA/BMC which commenced 1 July 2016 in the Goonyella corridor. Coal Above rail revenue per NTK was 2% higher due to a change in customer mix improving revenue quality.

Freight volumes declined 1.5mt (7%) to 20.5mt with Bulk Freight volumes down 7% due to the closure of QNI in March 2016 partly offset by a 10% increase in Intermodal Twenty-Foot Equivalent Units (TEUs) following the commencement of the K&S Freighters contract in August 2016. Freight revenue per NTK declined 11% due to the growth in intermodal volumes which are typically longer and lower yielding hauls.

Iron Ore volumes declined 1.1mt (9%) to 11.4mt, due to lower production from KML and Mt Gibson. Iron ore revenue per NTK declined 9% due to the impact of customer rate relief.

Operating costs reduced \$140m (11%) driven primarily by \$61m of transformation benefits (\$52m in Operations and \$9m allocated from support functions), and a \$74m net reduction in access costs as noted above. Depreciation reduced \$11m due to the lower fleet value following the impairment in FY2016.

Underlying EBIT also includes the benefit of the non-recurrence of the cost of the prior period's QNI doubtful debt provision (\$18m), the employee share gift (\$12m) and redundancy provision (\$8m).

The operational transformation program continues to drive efficiencies, with improvements in most key operating metrics including a 6% improvement in net operating costs per NTK (excluding access) and a 13% improvement in labour productivity. A detailed analysis of operating metrics is provided on page 12.

## Market update

### Coal

Coal prices increased during the half with metallurgical coal prices trading above US\$300 per tonne in November, triple the July price and the highest level in over five years. It was a similar result for thermal coal with trades above US\$100 per tonne also in November, almost double the July price and the highest in over five years. The price escalation was primarily due to policy that limited domestic coal production in China. With the longevity of higher coal prices uncertain, the improved trading conditions for coal producers only resulted in short-term opportunities for additional railings. Australian export volume for the half was flat compared to the previous year. Spot prices for metallurgical and thermal coal have retreated from the higher prices seen during the half, trading at sub-US\$200 and sub-US\$90 respectively in January.

Aurizon's coal business remains resilient with investment grade counterparties comprising 63% of Above Rail 1HFY2017 volumes and a weighted average remaining contract length as at 31 December 2016 of 10.1 years. No material haulage contracts are due to expire until FY2022.

### Contract update

- › A new agreement was secured with AGL Macquarie for the haulage of coal to the Bayswater and Liddell Power Stations in the Hunter Valley for a period of 8.5 years. Volumes of up to 8.7mtpa will be hauled during the term, which is due to commence on 1 July 2017
- › Wollongong Coal operation commenced on 29 August 2016 for up to 0.84mtpa for two years
- › In December, Aurizon received expansion volume notification from Whitehaven to 9.6mt, which is in addition to the 1.0mt uplift to 8.6mt commencing 1 January 2017

## Iron Ore

The iron ore price increased during the half with spot prices closing at US\$79.5 per tonne, which represents a 47% increase from 1 July 2016. The increase was primarily driven by the demand for higher grade ores, allowing steel mills to limit their coke usage, which means a lower exposure to increasingly high coking coal costs. Although current spot prices remain at ~ US\$79 per tonne in January, additional supply from the Pilbara and Brazil is expected to put downwards pressure on prices.

Aurizon continues to support the long-term viability of customers by driving efficiencies in the supply chain to optimise throughput. Aurizon hauled 11.4mt in 1HFY2017, 9% lower than the previous comparable period primarily due to production issues at KML which have recently been addressed. Mt Gibson volumes are expected to continue through to contract end in December 2018, as Iron Hill volumes replace Extension Hill volumes. As at 31 December 2016, weighted average contract life is 8.1 years after executing an extension with KML to April 2027.

## Freight

Aurizon's Freight business includes haulage of bulk commodities including base metals, minerals, grains and livestock in Queensland, New South Wales (East) and Western Australia (West) and Intermodal containerised freight and logistical solutions across Australia.

## Freight Review

A strategic Freight Review commenced in 1HFY2017 aimed at exploring the role and strategic options for Aurizon's underperforming Intermodal and Bulk Freight businesses. The Freight Review is well progressed and has been based on analysing the following:

### Bulk

- › Detailed analysis of each Bulk haul to understand key financial data including haul margins and returns
- › Data reveals mixed performance depending on service type (unit versus manifest trains), commodity types and contract age. Three decisions have emerged:
  - › Retain – hauls either already achieving target returns or reform options available to achieve targets
  - › Transform – hauls can be reformed but will require some third party decisions
  - › Exit – hauls fail to achieve acceptable returns regardless of management action
- › Now in execution phase, timing of exit decisions may be impacted by individual contracts
- › Mt Isa freighter service termination already implemented

### Intermodal

- › Detailed analysis of markets and competitive dynamics of Intermodal and IMEX
- › Review of current performance has determined the need to restructure the Intermodal business as a standalone function with full P&L accountability, reporting directly to the CEO, effective January 2017
- › Separation to increase focus on improvements in customer service, operational and financial performance
- › Further work required including consideration of all available options
- › Conclusions expected by mid-year

### Contract update - Bulk

- › Trial of export Bauxite for Alcoa commenced in Western Australia (WA)
- › Both BP (0.15mtpa) and Caltex (0.1mtpa) extended their fuel haulage agreements in WA for 3 years
- › Louis Dreyfus (NSW) extended its 0.3mtpa grain haulage contract for a further 12 months to December 2017

### Contract update - Intermodal

- › Following the establishment of a new intermodal terminal at Enfield in Sydney in June 2016, Aurizon secured a new agreement with leading freight forwarder K&S Freighters worth approximately \$20-25m in revenue per annum for five years. K&S is a foundation customer of Aurizon's Port Botany rail shuttle service which commenced in August 2016

## Operations transformation update

### Operating Metrics

	1HFY2017	1HFY2016	Variance %
<b>Operations</b>			
Net opex <sup>10</sup> / NTK (\$/'000 NTK)	32.0	35.2	9%
Net opex <sup>11</sup> / NTK (excluding access) (\$/'000 NTK)	19.7	20.9	6%
Total tonnes hauled (m)	135.4	138.9	(3%)
Net tonne kilometres - NTK (bn)	36.2	36.5	(1%)
FTE (monthly average)	4,523	5,104	11%
Labour productivity (NTK / FTE)	16.0	14.2	13%
Locomotive productivity ('000 NTK / Active locomotive day)	387.7	370.7	5%
Active locomotives (as at 31 December / 30 June)	510	514	1%
Wagon productivity ('000 NTK / Active wagon day)	14.8	14.6	1%
Active wagons (as at 31 December / 30 June)	13,438	13,082	(3%)
National Payload (tonnes)	4,611	4,538	2%
Velocity (km/hr)	29.6	29.7	0%
Fuel consumption (l/d GTK)	3.12	3.13	0%

### Transformation initiatives

Aurizon delivered \$52m in gross operational transformation benefits for 1HFY2017 with technology enabled and labour productivity initiatives driving the benefits. Despite a 3% reduction in volumes, productivity metrics continued to trend positively, delivering a 9% improvement to Net Opex /NTK.

#### Workforce

Operations reduced FTEs by 581 and improved labour productivity (NTK / FTE) by 13% from productivity initiatives enabled by the more flexible Enterprise Agreements (EAs) and the implementation of a new management structure. These include:

- › Commencement of a new regional management structure in September 2016 which has resulted in a reduction of 143 positions including leadership and frontline staff, with most operational areas reducing at least one management layer
- › More efficient work practices enabled by technology, process improvements and a geographical deployment approach delivered a further reduction of 167 frontline FTEs, including the consolidation of daily rostering activities and initiating the implementation of train crew self-sign on
- › The commencement of the consolidation of the five national operations centres into one, which will be completed during 2HFY2017
- › Introduction of 9-hour single driver operations in two key areas of WA reducing 20 frontline FTEs
- › Asset Maintenance initiatives resulted in a reduction of 150 FTEs including the commencement of the Progress Rail Services contract (see Asset Maintenance commentary below)

#### Fleet productivity

Locomotive and wagon productivity improved 5% and 1% respectively, despite lower volumes. This has been accomplished through improvements in national payloads of 2% and despite slower than expected system velocity.

National payloads improvements were driven by key initiatives including:

- › Continuing to trial and implement longer or over-length trains in the major coal corridors, with longer trains implemented in Goonyella
- › New export tonnes in Western Australia which have been accommodated within existing train services

System velocity during the period was impacted by increased delays in the major coal corridor (see Below Rail commentary), volatility in short-term customer orders and a number of significant third party network outages in the North-West, Newlands and North Coast Line regions.

<sup>10</sup> Net opex / NTK is calculated as Operations Underlying EBIT / NTK (i.e. this metric represents operational expenditure net of revenue). Net expenditure is used to measure above rail productivity, as Operations revenue includes intercompany revenue for services provided (and therefore costs incurred) for Network. In addition, Operations also incurs expenditure in generating revenue on commercial rollingstock and infrastructure maintenance contracts

<sup>11</sup> Net opex / NTK (excluding access) excludes track access costs in order to measure productivity net of access costs which are generally passed through to above rail customers (and shown in Commercial & Marketing revenue)

#### Energy and Fuel Efficiency

No significant improvement in fuel consumption was achieved during the period. Work is continuing to focus on the rollout of fuel efficiency programs including Driver Advisory System (DAS) and Trip Optimiser as well as the train management scorecard which monitors driver behaviour.

#### Assets Maintenance

Focus on labour productivity, technology investment, outsourcing of non-core work and supply chain management continued during the period.

- › Technology investment including Wayside Condition Monitoring (WCM), On Train Repair (OTR) and the development of predictive maintenance technologies continued to lower maintenance costs, including a reduction in yard shunting operations and wheel consumption, whilst improving asset availability and safety. Further rollout of WCM is forecast to take place in the Hunter Valley during early 1HFY2018
- › The commencement of the heavy maintenance and parts-supply agreement with Progress Rail Services (PRS) for non-core maintenance work which runs until October 2024. This initiative is expected to deliver significant maintenance cost savings and productivity improvements through:
  - › Direct sourcing of inventory and key components, removing third party margins
  - › Transfer of 76 Asset Maintenance FTEs to PRS
  - › Improvement in working capital with a reduction in inventory holdings
  - › Direct interface to an Original Equipment Manufacturer (OEM) to support locomotive reliability, component availability and technology enhancements
  - › Once fully imbedded it is anticipated that full year run rate cash benefit will be in the order of ~\$20m. This will be across both the operating and capital maintenance programs
- › Ongoing focus on reform in the Asset Maintenance function through standardising and centralising planning, supply chain and reliability functions to improve the efficiency of the supply chain and reduce the total cost of maintenance activities of the fleet which will result in:
  - › Increased asset availability through optimising and standardising programs of work and procedures across depots
  - › Improved depot and workshop performance through integrated demand planning
  - › Reduced level of working capital held through optimising inventory holdings
  - › Improved component warranty and supplier contract management
  - › Reduced average cost of inventory through direct supply arrangements with OEMs

## Below Rail

Below Rail refers to Aurizon's Network business which operates the 2,670km Central Queensland Coal Network (CQCN). The open access network is the largest coal rail network in Australia and one of the country's most complex, connecting multiple customers from more than 40 mines to three ports. The CQCN includes four major coal systems (Moura, Blackwater, Goonyella and Newlands) and a connecting link Goonyella to Abbot Point Expansion (GAPE).

### Below Rail Financial Summary

(\$m) Year on Year	1HFY2017	1HFY2016	Variance %
<b>Total revenue</b>	671	581	15%
Access	629	560	12%
Services and other	42	21	100%
<b>Operating costs</b>	(234)	(211)	(11%)
Employee benefits expense	(62)	(63)	2%
Energy and fuel	(73)	(63)	(16%)
Consumables	(91)	(66)	(38%)
Other expenses	(8)	(19)	58%
<b>Underlying EBITDA</b>	437	370	18%
EBITDA margin	65.1%	63.7%	1.4ppt
Depreciation and amortisation expense	(142)	(125)	(14%)
<b>Underlying EBIT</b>	295	245	20%

### Below Rail Revenue Metrics

	1HFY2017	1HFY2016	Variance %
Tonnes (m)	112.9	114.0	(1%)
NTK (bn)	28.3	28.9	(2%)
Access revenue / NTK (\$/'000 NTK)	22.2	19.4	14%
Maintenance / NTK (\$/'000 NTK)	2.1	2.1	-
Operating costs / NTK (\$/'000 NTK)	13.3	11.6	(15%)
Average haul length (Km)	251	253	(1%)

### Below Rail Performance Overview

Underlying EBIT increased \$50m (20%) to \$295m, with increased revenues partly offset by higher operating costs and depreciation. Revenue increased \$90m (15%) due to a \$69m (12%) increase in access revenue and a \$21m (100%) increase in services and other revenue. Access revenue includes a \$45m true-up for the under recovery of UT4 regulatory revenues from prior years, a \$12m true-up in relation to GAPE (non-regulated revenue) and AFD<sup>12</sup> rebates, and higher revenues attributable to electric traction.

Regulatory revenues are being recognised in alignment with the UT4 Final Decision approved by the Queensland Competition Authority (QCA) on 11 October 2016. FY2017 tariffs include a true-up of ~\$89m relating to the under-recoveries in revenue over FY2014 and FY2015 of which \$45m has been recognised in 1HFY2017.

Services and other revenue increased \$21m due to the recognition of the Bandanna Group's \$15m bank guarantee held as security following the termination for insolvency of their WIRP Deed and a \$6m insurance claim recovery.

Volumes decreased 1.1mt to 112.9mt, principally due to weaker Blackwater and Moura system railings due to the closure of two mines, with the other systems consistent with the record volumes in 1HFY2016. The decrease in NTKs (2%) primarily reflects the decrease in volumes from mines with longer average haul lengths.

Operating costs increased \$23m (11%) due to \$10m higher fuel and energy costs from an increase in electricity prices and \$13m alignment of the corporate cost allocation (\$26m full year adjustment) to the UT4 Final Decision (FY2014 and FY2015 true-up).

Depreciation increased \$17m (14%) reflecting asset and rail renewals, increased ballast undercutting and completion of the Wiggins Island Rail Project (WIRP) during FY2016.

The Regulated Asset Base (RAB) roll-forward value is estimated to be \$5.8bn<sup>13</sup> (excluding AFDs of \$0.4bn) by 30 June FY2017, including all deferred capital.

<sup>12</sup> AFD (Access Facilitation Deeds) in relation to mine specific infrastructure paid for by customers

<sup>13</sup> Estimate subject to QCA Approval of RAB roll-forward and approval of the FY2016 and FY2017 Capital Claims

## Regulation update

### Access Undertaking 2013 (UT4)

- › On 11 October 2016, the QCA approved the UT4 Access Undertaking
- › The approval covers all elements of UT4 including:
  - › Aurizon Network's Maximum Allowable Revenue (MAR) over the UT4 period (1 July 2013 to 30 June 2017) totalling \$3.9bn
  - › The way in which Aurizon Network must provide and manage access to the CQCN

### Access Undertaking 2017 (UT5)

- › On 30 November 2016 Aurizon Network submitted the 2017 Draft Access Undertaking (UT5), covering the period 1 July 2017 to 30 June 2021 to the QCA for approval
- › The QCA has invited interested stakeholders to make submissions by 17 February 2017, which will then be duly considered by the QCA in making its draft decision on UT5 (no date has been set by the QCA for release of the UT5 draft decision)
- › Aurizon Network's UT5 draft proposed a MAR of \$4.9bn over the four-year regulatory period applying a 6.78% WACC to the RAB value of \$5.8bn. Primary MAR drivers are:
  - › Inflation methodology reflects the current low inflation expectations for the UT5 regulatory period (forecast at 1.22% compared to 2.5% in UT4)
  - › Change in equity beta from 0.8 in UT4 to 1.0 affecting the return on capital building block
  - › Change in gamma from 0.47 in UT4 to 0.25 affecting the tax building block
  - › UT5 RAB now includes the majority of the WIRP capital expenditure with ~\$235m of the ~\$260m in capital deferred during UT4 included in the UT5 RAB for pricing purposes
- › Aurizon Network has adopted a revised approach to calculating its efficient cost of capital to properly reflect the Pricing Principles of the QCA Act. The inherent risks faced by Aurizon Network are higher than what the QCA has determined in previous Access Undertakings due to:
  - › Increasingly volatile operating environment of the coal industry;
  - › Fragmentation of the RAB by system which increases the risk of asset stranding; and
  - › Revenue deferrals which have resulted in ~\$260m of expansion capital excluded from the RAB for pricing purposes in UT4 as part of WIRP

## Below Rail Operational Update

### Performance

- › Effective Below Rail planning and scheduling and maintenance programs resulted in a 20% reduction in system closure hours and a 1.5% increase in average payloads
- › Performance to plan achieved a strong result of 91.5%, however this represents a 1.2ppt reduction compared with the record result of 92.7% achieved in 1HFY2016 due to a 17% increase in the number of services cancelled, with mine cancellations being the largest contributor. Below Rail cancellations remained at less than 1% of total cancellations
- › Below Rail delays were impacted (17% increase) due to the wetter winter experienced in Central Queensland, with over 700mm in additional rainfall, and extreme heat in November/December, resulting in increased speed restrictions and cycle velocity decreasing 0.8% to average 23.8km/h

### Asset Management

Technology has enabled the understanding of asset condition and network performance over time and sustaining capital has been targeted to positively affect asset performance and network availability. Examples include:

- › Implementation of innovative condition monitoring solutions including:
  - › Locomotive mounted object recognition technology which detects overhead alignment issues enabling defects to be identified and fixed before failure; and
  - › Wagon mounted accelerometers, providing real time data on track alignment, enabling a more tailored, mechanised maintenance program. This facilitates prioritising maintenance work based on asset condition, rather than the previous time-based approach
- › Management focus and improved work methods on in-field rail weld quality and rail stressing has resulted in improvements in rail health metrics, including an 84% reduction in failed welds and reductions in broken rails, track misalignment and track buckles
- › Targeted data analytics of overhead high voltage faults identified problem sections which lead to infrastructure changes to strengthen affected sections, delivering an 800% improvement in overhead performance in the worst performing section
- › The first phase of the Network Asset Management System (NAMS) project, which deploys improved asset management and maintenance capabilities to the CQCN civil assets, will be completed by February 2017. NAMS will improve maintenance efficiency and increase asset reliability. Phase 1 of the deployment includes an integrated mobile solution for field engineers and maintenance practitioners. Phase 2, which is planned for late CY2017, will deploy NAMS to the electrical and telecommunication assets supporting the CQCN
- › During 1HFY2017, 42kms of rail was replaced in the Goonyella and Blackwater systems as part of the rail renewal program to replace the rail installed in the 1980s which is coming to the end of its operating life



#### Wiggins Island Rail Project (WIRP)

- › The QCA in its UT4 Final Decision applied a revenue deferral for WIRP customers who were not expected to rail during the UT4 period resulting in ~\$260m of WIRP capital expenditure being excluded for pricing purposes from the UT4 MAR, on a NPV neutral basis
- › In the UT5 submission Aurizon Network proposes that ~\$235m of the deferred WIRP capital expenditure be included in the UT5 RAB for pricing purposes
- › Aurizon Network is confident that railings in the Moura system will increase in the medium-term to enable the remaining deferred WIRP capital expenditure to be included in the RAB for pricing purposes
- › Aurizon Network maintains its position that the notices issued by the WIRP customers in relation to the commercial fee (WIRP fee) are not valid. As discussions with the customers failed to deliver a resolution, Aurizon Network issued proceedings in the Supreme Court of Queensland on 17 March 2016 to assert its rights under the Project Deed. The proceedings have been admitted to the Commercial List of the Supreme Court of Queensland, and the Court has made orders to prepare the matter for trial
- › Due to the ongoing dispute, no WIRP commercial fee revenue has been recognised during the period

### Other

Other includes miscellaneous activities such as non-rollingstock asset sales and corporate overheads that have not been allocated to the Below Rail or the Above Rail businesses. Corporate support functions include Finance, Enterprise Services, Human Resources and Strategy. The percentage of corporate support costs allocated to these functions in 1HFY2017 was 76% (1HFY2016 75%).

#### Other Summary

(\$m)	1HFY2017	1HFY2016	Variance %
<b>Total revenue</b>	2	13	(85%)
<b>Operating costs</b>	(25)	(38)	34%
Employee benefits expense	(18)	(19)	5%
Consumables	(4)	(19)	79%
Other expenses	(3)	-	-
<b>Underlying EBITDA</b>	(23)	(25)	8%
Depreciation and amortisation expense	(3)	(2)	(50%)
<b>Underlying EBIT</b>	(26)	(27)	4%

#### Performance Overview

Underlying EBIT increased \$1m (4%) to (\$26m) in 1HFY2017 due to:

- › \$11m decrease in revenue, from lower asset sales with the Forrestfield facility in Western Australia sale completed in 1HFY2016
- › \$13m net decrease in operating costs principally due to:
  - › \$9m net benefit from land rehabilitation and employee provision adjustments due to higher bond rates
  - › \$13m one-off overhead recovery from Aurizon Network to reflect the final UT4 decision in relation to the corporate cost allocation FY2014 and FY2015 true-up (refer Below Rail commentary on page 14); partly offset by
  - › \$7m net impact in relation to the property portfolio with \$10m asset impairments partly offset by \$3m from the finalisation of the sale of investment in Moorebank

Corporate support functions continue to deliver transformation initiatives, with a further \$12m in savings achieved in 1HFY2017:

- › \$7m in labour productivity following a corporate support function consolidation and redesign resulting in a reduction of 52 FTE (11%) to 419 FTE since 1HFY2016
- › \$5m reduction in discretionary spend including professional services

Note: \$9m of the support transformation benefits above have been allocated to Above Rail, consistent with the allocation of corporate overheads.

The support functions remain focussed on achieving transformation targets by continuing efforts in the following activities:

- › Ongoing consolidation and rationalisation of the property portfolio. This included the donation to the Salvation Army of 37 houses in Central Queensland and the closure of the South Townsville Yard during the period
- › Outsourcing of the property maintenance facilities help desk and contract management activities with an expected reduction of ~10 FTEs in FY2017
- › Procurement led initiatives to rationalise the supplier base and strengthen strategic partnerships with key suppliers to reduce spend and improve innovation
- › Focus on governance and disciplined spend with a significant reduction in delegations for expenditure on both capital projects and consultancy

## ADDITIONAL INFORMATION

### Senior Management Changes

On 2 September 2016, following a global recruitment search, Aurizon announced the appointment of Andrew Harding to the role of Managing Director and CEO. Andrew commenced in the role on 1 December 2016 replacing Lance Hockridge who had served in the role for nine years. Andrew has worked for more than twenty-four years at Rio Tinto, most recently as Chief Executive Iron Ore. Prior to his most recent role he held various executive management, operating and functional roles both domestically and globally across the Rio Tinto business.

On 15 December 2016, Mr Harding announced the appointment of Pam Bains to the role of the Executive Vice President and Chief Financial Officer replacing Keith Neate. Pam has been with Aurizon for the past six years most recently as the Vice President Network Finance. In her various senior management roles at Aurizon, Pam has led or played a key role in a number of major projects including transition of reporting requirements at IPO to meet external reporting requirements for a listed entity, capital restructuring in the Network business as well as support for various regulatory reforms which have improved the financial performance of the Network Business.

The recruitment process for two senior management roles, Executive Vice President Operations and Executive Vice President Human Resources and Enterprise Services remains underway.

- › Michael Carter continues to act as EVP Operations while a global recruitment process, including internal candidates, is undertaken to fill this role
- › A recruitment process is also underway to fill a merged role of Executive Vice President Human Resources and Enterprise Services. The merging of these roles was announced on 4 July 2016 to streamline management roles as part of the transformation program and was followed by the subsequent departure of the Executive Vice President Enterprise Services Jennifer Purdie in July and the Executive Vice President Human Resources John Stephens in December

### Risk

Aurizon operates a mature system of risk management that is focussed on delivering objectives and is aligned to international standards. Aurizon's Board is actively engaged in setting the tone and direction of risk management, with a clear articulation of risk appetite aligned to the company strategy and risk management practices that support consistent delivery of expected outcomes.

The Board has full confidence in the management of Aurizon's key risks and acknowledges that internal and external factors can influence financial results.

The most significant factors relating to future financial performance are:

- › Product Demand, Commodity Prices and General Economic Conditions

Aurizon's customers in core markets are reliant on demand from large export markets such as Japan, China, South Korea and India. Fluctuations in demand in turn impact commodity prices, product volumes and investment in growth projects. Aurizon references credible sources such as the International Energy Agency (IEA) in evaluating long-term demand for the key commodities of coal and iron ore. Whilst long-term demand is predicted to increase, in the short-term there may be variances in volumes, contract profitability and growth that impact on Aurizon's financial results.

- › Customer Credit Risk

Aurizon's earnings are concentrated in commodity markets across a relatively small number of customers. The following factors may have a material adverse impact on Aurizon's financial performance:

- › Deterioration in counterparty credit quality due to a weakening in their financial position, mine sale to a lower tier party, and/or mine profitability
- › Contract renewals
- › Supply chain disruptions
- › Macro-industry issues

- › Competition Risk

Capacity to compete at reduced margins as a result of the acquisitions of significant competitors by financial investors who have the benefit of a lower cost of capital and appear to accept lower returns and greater risk positions than Aurizon. This may potentially negatively impact Aurizon's comparative competitiveness.

- › Strategic Risk

Aurizon may adopt a strategy that does not deliver optimal performance outcomes for shareholders. Whilst Aurizon is confident in its strategic planning practices, the nature of planning for strategy in uncertainty leads to a possibility of sub-optimal strategic settings.

- › Retention of Customer Contracts

Aurizon's most significant customer contracts are secured on long-dated terms however failure to win or retain customer contracts will always be a risk to future financial performance.

› Capital Investment Plans

When deciding which opportunities for expansion and improvement to pursue, Aurizon must predict the rate of return associated with each project. Calculations are based on certain estimates and assumptions that may not be realised. Accordingly, the calculation of a potential rate of return may not be reflective of the actual returns.

› Strategic Freight Review

Decisions on the outcomes of the Freight Review may lead to further negative short-term financial outcomes through financial impacts such as asset impairments and/or losses under various potential scenarios.

› Asset Impairment

Aurizon's assets are subject to impairment testing each year. With a large portfolio of fixed assets, there is the potential that reduced haulage volumes or continued improvements to asset productivity may require some assets to be impaired.

› WIRP Non-Regulated Revenue Dispute

Aurizon has received notices from seven (of eight) WIRP customers purporting to exercise a right under the relevant agreements to reduce their financial exposure in respect to the non-regulated revenue component. Aurizon issued proceedings in the Supreme Court of Queensland to assert its contractual rights under the Project Deeds.

› Aurizon Credit Rating

Aurizon's credit rating metrics are forecast to continue to meet current tolerance levels. However, Aurizon's business risk profile, which has been impacted by its significant exposure to coal and iron ore and related weakening of the customer credit risk profile, could adversely impact Aurizon's credit rating. Rating agencies have not revised their long-term outlook on these commodities despite recent price improvements. The implications of a lower credit rating are increased cost of borrowing and in addition it may impact on the ability to borrow additional debt or refinance existing debt.

› Delivery of Technology Transformation Projects

Aurizon is investing in important operational and information technology programs that are expected to deliver step change improvements in efficiency leading to reduced costs. Continued focus is required on these projects to ensure benefits are delivered and flow through to support cost-out targets.

› Regulatory Risk of the Access Undertaking (UT5)

Aurizon continues to work with the QCA and industry stakeholders to secure acceptable and sustainable regulatory outcomes for the CQCN in accordance with the processes set out in the relevant legislation. Not attaining appropriate pricing and policy regulatory settings may negatively impact revenue, operational complexity, capital investment and administrative overhead. In particular Aurizon Network's Maximum Allowable Revenue (MAR) and the nominal (vanilla) weighted average cost of capital (WACC) used in deriving Aurizon Network's MAR is typically reset every four years as part of the access undertaking approval process with the QCA and the reference tariffs are reset annually based on projected system volumes and other variables. The WACC decided by the QCA may not adequately compensate Aurizon Network for its business and operational risks which could lead to a material adverse impact on the Aurizon Network business, operational performance and financial results.

› Adverse Weather Events

Aurizon's business is exposed to extreme weather events, which may potentially increase in regularity and/or severity as a result of climate change. These events, if experienced, could have a material impact in core markets on customers, supply chains and Aurizon's operational performance. Each of these factors in turn may impact Aurizon's financial performance. Weather can also have an impact on bulk haulage volumes for agricultural commodities such as grain, sugar and fertiliser.

› General Regulatory Risk

Aurizon's operations and financial performance are subject to legislative and regulatory oversight. Unfavourable changes may be experienced with respect to access regimes, safety accreditation, taxation, carbon reduction, environmental and industrial (including occupational health and safety) regulation government policy and approval processes. These changes may have a material adverse impact on project investment, Aurizon's profitability and business in general as well as Aurizon's customers.

› Climate Change Risk

The long-term implications of climate change may have impacts on Aurizon such as increased regularity or severity of weather events, reduced demand for certain commodities we transport, reduced appetite for funding either for Aurizon and/or for Aurizon's customers, increased regulation and/or reduced 'license to operate' in the community making various approvals and licenses more cumbersome to achieve. These considerations are explicitly evaluated both in strategic planning and in the general management of risk within Aurizon.

## Sustainability

On 10 October 2016, Aurizon released its third sustainability report. The report details how Aurizon takes into account social, environmental and economic considerations related to its operations. While the material priority areas have not changed over the past three years, two themes have emerged that continue to remain relevant to our stakeholders:

- › Innovation through technology: like most asset intensive businesses, access to technology is a key capability that defines how Aurizon innovates and operates. Implementing innovative technology solutions provides better customer outcomes, enhanced productivity and enables future growth
- › Climate Change: since our inaugural sustainability report we have sought to provide stakeholders with information about our position on climate change and how we are managing associated risks. These risks relate to future demand for the thermal coal we haul, regulation of our direct GHG emissions and physical impacts on our assets and people

Please refer to [www.aurizon.com.au/sustainability/overview](http://www.aurizon.com.au/sustainability/overview) for more detailed information within Aurizon's 2016 sustainability report.

For consistency with prior reporting, a brief summary of Aurizon's performance in connection with safety, environmental management and organisational capability is outlined below:

### › Safety

Aurizon's commitment to ZEROHarm has resulted in improved performance for the 2016 calendar year. At 31 December 2016, the Total Recordable Injury Frequency Rate (TRIFR) was 2.47, an 18% improvement on December 2015. This rate is the lowest six months on record and outperforms the North American Class 1 railways. This safety improvement has been driven by a sustained focus of management visibility through Safety Pauses, Safety Interactions, Efficiency Testing, High Consequence Activity monitoring, and intensifying the "STOP, Take Time & Switch On" Safety initiative.

Aurizon's use of predictive technology to detect and pre-emptively correct track and rollingstock issues that cause safety incidents e.g. the Wayside Condition Monitoring (WCM) equipment has contributed to a greater than 80% reduction in serious operational incidents such as train partings and derailments. Aurizon now has a record low running line derailment rate of 0.14 per million train kilometres, which is a 72% improvement for the 2016 calendar year.

### › Environmental Management

Aurizon delivers environmental value through superior environmental performance including participation in the development of a draft industry Standard and Code of Practice (CoP) to reduce locomotive diesel emissions and the associated impact on air quality. The draft Standard and CoP are currently being reviewed by the Rail Industry Safety and Standards Board (RISSB) and should come into effect mid-2017.

Aurizon's Environment Community of Competence continues to govern the management of key environmental issues including coal dust, noise and diesel emissions.

In December 2016, Aurizon received a score of 'Management B' for its response to the CDP Climate Change Program questionnaire. This score reflects Aurizon's continuing focus on developing our strategy on climate change to ensure both risks and opportunities are being managed effectively.

### › Organisational Capability

Aurizon believes its greatest asset is the collective capability of its people to safely and efficiently operate complex supply chains. To support our transformation opportunities, Aurizon is growing the capability of its people through programs focused on leadership, people-centred change and diversity and inclusion. For detailed information on Aurizon's organisational capability please refer to Aurizon's 2016 sustainability report <http://www.aurizon.com.au/sustainability> published in October 2016.



## Auditor's Independence Declaration

As lead auditors for the review of Aurizon Holdings Limited for the half-year ended 31 December 2016, we declare that to the best of our knowledge and belief, there have been:

- (a) no contraventions of the auditor independence requirements of the *Corporations Act 2001* in relation to the review; and
- (b) no contraventions of any applicable code of professional conduct in relation to the review.

This declaration is in respect of Aurizon Holdings Limited and the entities it controlled during the period.

A handwritten signature in blue ink that reads 'Nadia Carlin'.

Nadia Carlin  
Partner  
PricewaterhouseCoopers

A handwritten signature in blue ink that reads 'Simon Neill'.

Simon Neill  
Partner  
PricewaterhouseCoopers

Brisbane  
13 February 2017

**Aurizon Holdings Limited**  
**Consolidated income statement**  
**For the six months ended 31 December 2016**

	Notes	31 December 2016 \$m	31 December 2015 \$m
<b>Revenue from continuing operations</b>	2	1,781	1,758
Employee benefits expense		(508)	(481)
Energy and fuel		(134)	(134)
Track access		(126)	(162)
Consumables		(276)	(260)
Depreciation and amortisation		(287)	(280)
Impairment charges	3	(266)	(273)
Other expenses		(17)	(46)
<b>Operating profit</b>		<u>167</u>	<u>122</u>
Share of profit from associates		-	8
Impairment charge of investment in associates	3	-	(153)
<b>Share of loss from associates after impairment charge</b>		<u>-</u>	<u>(145)</u>
Finance income		2	1
Finance costs		(94)	(71)
<b>Net finance costs</b>		<u>(92)</u>	<u>(70)</u>
<b>Profit/(Loss) before income tax</b>		<b>75</b>	<b>(93)</b>
Income tax expense	4	(21)	(15)
<b>Profit/(Loss) for the six months</b>		<u>54</u>	<u>(108)</u>
<b>Profit/(Loss) is attributable to:</b>			
Owners of Aurizon Holdings Limited		54	(108)
		<b>Cents</b>	<b>Cents</b>
<b>Earnings per share for profit attributable to the ordinary equity holders of the company:</b>			
Basic and diluted earnings/(loss) per share	5	2.6	(5.1)

*The above consolidated income statement should be read in conjunction with the accompanying notes.*

**Aurizon Holdings Limited**  
**Consolidated statement of comprehensive income**  
**For the six months ended 31 December 2016**

	<b>31 December</b>	31 December
	<b>2016</b>	2015
	<b>\$m</b>	\$m
<b>Profit/(loss) for the six months</b>	<b>54</b>	(108)
<b>Other comprehensive income</b>		
<i>Items that may be reclassified to profit or loss</i>		
Changes in the fair value of cash flow hedges recognised in equity	51	3
Share of other comprehensive income of associates and joint ventures	-	(2)
Income tax relating to components of other comprehensive income	(15)	(1)
<b>Other comprehensive income for the six months, net of tax</b>	<b>36</b>	-
<b>Total comprehensive income/(expense) for the six months</b>	<b>90</b>	(108)
Total comprehensive income/(expense) for the six months is attributable to:		
Owners of Aurizon Holdings Limited	<b>90</b>	(108)

*The above consolidated statement of comprehensive income should be read in conjunction with the accompanying notes.*

**Aurizon Holdings Limited**  
**Consolidated balance sheet**  
**As at 31 December 2016**

		31 December 2016 \$m	30 June 2016 \$m
Notes			
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents		114	69
Trade and other receivables		473	514
Inventories		143	153
Current tax receivables		5	-
Other assets		15	7
Assets classified as held for sale		6	101
<b>Total current assets</b>		<b>756</b>	<b>844</b>
<b>Non-current assets</b>			
Inventories		41	36
Derivative financial instruments	9	74	77
Property, plant and equipment		9,454	9,719
Intangible assets		140	190
Investments accounted for using the equity method		2	2
<b>Total non-current assets</b>		<b>9,711</b>	<b>10,024</b>
<b>Total assets</b>		<b>10,467</b>	<b>10,868</b>
<b>LIABILITIES</b>			
<b>Current liabilities</b>			
Trade and other payables		283	297
Borrowings	8	-	6
Derivative financial instruments	9	13	28
Current tax liabilities		-	80
Provisions		269	274
Other liabilities		31	53
<b>Total current liabilities</b>		<b>596</b>	<b>738</b>
<b>Non-current liabilities</b>			
Borrowings	8	3,388	3,484
Derivative financial instruments	9	62	23
Deferred tax liabilities		567	589
Provisions		92	93
Other liabilities		219	227
<b>Total non-current liabilities</b>		<b>4,328</b>	<b>4,416</b>
<b>Total liabilities</b>		<b>4,924</b>	<b>5,154</b>
<b>Net assets</b>		<b>5,543</b>	<b>5,714</b>
<b>EQUITY</b>			
Contributed equity	7	1,207	1,207
Reserves		3,473	3,425
Retained earnings		863	1,082
<b>Total equity</b>		<b>5,543</b>	<b>5,714</b>

The above consolidated balance sheet should be read in conjunction with the accompanying notes.



**Aurizon Holdings Limited**  
**Consolidated statement of changes in equity**  
**For the six months ended 31 December 2016**

	Notes	Attributable to owners of Aurizon Holdings Limited			Total equity \$m
		Contributed equity \$m	Reserves \$m	Retained earnings \$m	
<b>Balance at 1 July 2015</b>		1,508	3,459	1,539	6,506
Profit/(loss) for the six months		-	-	(108)	(108)
Total comprehensive income/(expense) for the six months		-	-	<b>(108)</b>	<b>(108)</b>
<b>Transactions with owners in their capacity as owners:</b>					
Buy-back of ordinary shares	7	(140)	-	-	(140)
Dividends provided for or paid	6	-	-	(295)	(295)
Share-based payments		-	(27)	-	(27)
		(140)	(27)	(295)	(462)
Balance at 31 December 2015		<b>1,368</b>	<b>3,432</b>	<b>1,136</b>	<b>5,936</b>
<b>Balance at 1 July 2016</b>		1,207	3,425	1,082	5,714
Profit/(loss) for the six months		-	-	54	54
Other comprehensive income		-	36	-	36
Total comprehensive income/(expense) for the six months		-	<b>36</b>	<b>54</b>	<b>90</b>
<b>Transactions with owners in their capacity as owners:</b>					
Dividends provided for or paid	6	-	-	(273)	(273)
Share-based payments		-	12	-	12
		-	12	(273)	(261)
Balance at 31 December 2016		<b>1,207</b>	<b>3,473</b>	<b>863</b>	<b>5,543</b>

*The above consolidated statement of changes in equity should be read in conjunction with the accompanying notes.*

**Aurizon Holdings Limited**  
**Consolidated cash flow statement**  
**For the six months ended 31 December 2016**

	<b>31 December</b>	31 December
	<b>2016</b>	2015
	<b>\$m</b>	\$m
<b>Cash flows from operating activities</b>		
Receipts from customers (inclusive of GST)	2,073	1,946
Payments to suppliers and employees (inclusive of GST)	(1,320)	(1,310)
Interest received	2	1
Income taxes paid	(130)	(115)
<b>Net cash inflow from operating activities</b>	<b>625</b>	<b>522</b>
<b>Cash flows from investing activities</b>		
Payments for property, plant and equipment	(261)	(381)
Proceeds from property, plant and equipment	7	28
Payments for intangibles	(24)	(37)
Interest paid on qualifying assets	(2)	(8)
Proceeds from sale of an associate	98	-
Payments for investment in associates	-	(1)
Distributions received from associates	-	3
<b>Net cash outflow from investing activities</b>	<b>(182)</b>	<b>(396)</b>
<b>Cash flows from financing activities</b>		
Proceeds from borrowings	100	391
Repayment of borrowings	(131)	-
Payment of transaction costs related to borrowings	-	(3)
Payments for share buy-back	-	(115)
Payments for shares acquired for share based payments	(7)	(53)
Dividends paid to Company's shareholders	(273)	(295)
Interest paid	(87)	(63)
<b>Net cash outflow from financing activities</b>	<b>(398)</b>	<b>(138)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>	<b>45</b>	<b>(12)</b>
Cash and cash equivalents at the beginning of the financial year	69	171
<b>Cash and cash equivalents at end of six months</b>	<b>114</b>	<b>159</b>

*The above consolidated cash flow statement should be read in conjunction with the accompanying notes.*

## **About this report**

### **Corporate information**

The financial statements of Aurizon Holdings Limited ("the Company") for the six months ended 31 December 2016 are for the consolidated entity consisting of the Company and its subsidiaries (together referred to as "the Group" or "Aurizon").

### **Basis of preparation**

This consolidated interim report for the six month reporting period ended 31 December 2016 has been prepared in accordance with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Act 2001*.

This consolidated interim report does not include all the notes of the type normally included in an annual financial report. Accordingly, this financial report is to be read in conjunction with the annual report of the Company for the year ended 30 June 2016 and any public announcements made by the Company during the interim reporting period in accordance with the continuous disclosure requirements of the *Corporations Act 2001*. The annual report for the year ended 30 June 2016 is accessible at [www.aurizon.com.au](http://www.aurizon.com.au).

The consolidated interim financial report is presented in Australian dollars with all values rounded to the nearest million dollars unless otherwise stated, in accordance with ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191.

## Key events and transactions for reporting period

The financial position and performance of the Group was particularly affected by the following events and transactions during the reporting period:

### (a) Access Revenue

#### Access undertaking (UT4)

The QCA approved the amended Draft Access Undertaking (DAU) on 11 October 2016 (approved UT4 Undertaking) with a Maximum Allowable Revenue (MAR) of \$1,172 million for the year ending 30 June 2017, which includes true-ups of \$89 million related to regulatory access revenue for years ended 30 June 2014 and 30 June 2015 (net of revenue cap of \$32 million relating to the year ended 30 June 2015). Revenue recognised for the six months ended 31 December 2016 is based on the approved UT4 Undertaking tariffs, applied to actual volumes railed and includes \$45 million prior year true-ups.

For the six months ended 31 December 2015, regulated access revenue was recognised as half of the MAR for the year ended 30 June 2016 in the Consolidated Draft Decision released on 16 December 2015.

### (b) Impairment (Refer to Note 3)

#### Intermodal

Impairments to the carrying value of the Intermodal cash generating unit (CGU) of \$162 million were recorded during the half year ended 31 December 2016 due to trading performance during the first half being lower than expectations.

#### Contract exit asset impairment

As a result of the decision by Glencore to not renew its existing contract with Aurizon to haul mine inputs and outputs between Mt Isa and Townsville, a decision has been made to cease to operate this daily multi-customer freight service from the contract expiry date of 31 January 2017. As a result, \$10 million of assets including rollingstock, plant and equipment and associated facilities have been impaired.

#### Freight Management Transformation project (FMT) impairment

Following a review, it has been decided to terminate the project and as a result an impairment charge of \$64 million has been recorded. An amount of \$27 million of the total project investment of \$91 million remains capitalised on the balance sheet in relation to software and licences, which are currently in use.

#### Transformation - asset impairments

As part of the ongoing transformation program, \$15 million of property, plant and equipment was impaired, along with a further \$6 million relating to various projects no longer proceeding and assets identified as surplus to requirements.

### (c) Transformation - redundancy costs

As part of the ongoing business transformation 494 employees were made redundant which predominantly relates to Operations. This resulted in redundancy expense of \$64 million being recorded for the half year ended 31 December 2016.

### (d) Moorebank

On 2 August 2016 Aurizon announced the sale of its 33.33% equity holding in the proposed Moorebank Intermodal Terminal project for \$98 million (net of transaction costs) to Qube Holdings Limited group entities. The sale completed on 22 December 2016 and a \$3 million gain on sale was recognised.

### Comparative Period

Key events and transactions affecting the performance of the Group in the comparative period are disclosed within the Annual Report for the year ended 30 June 2016.

# Results for the six months

## In this section...

Results for the six months provides segment information and a breakdown of individual line items in the consolidated income statement that the directors consider most relevant.

1	Segment information	Page 29
2	Revenue and other income	Page 32
3	Impairment of non-financial assets	Page 34
4	Income tax expense	Page 35
5	Earnings per share	Page 36

## 1 Segment information

### (a) Operating segments

Aurizon determines and presents operating segments on a function basis reflecting how the results are reported internally and how the business is managed. The Managing Director & CEO and the Executive Committee assess the performance of the Group based on the underlying EBIT.

The following summary describes the operations in each of the Group's reportable segments:

#### *Network*

Provision of access to, and operation and management of, the Central Queensland Coal Network. Provision of overhaul and maintenance of Network assets.

#### *Commercial & marketing*

The key interface between customers and Aurizon (excluding Network access customers), responsible for the commercial negotiation of sales contracts and customer relationship management.

#### *Operations*

Responsible for the national delivery of all coal, iron ore, bulk and intermodal haulage services. This includes yard operations, fleet maintenance, operations, engineering and technology, engineering program delivery and safety, health and environment.

#### *Other*

Includes costs for Managing Director & CEO, corporate finance, tax, treasury, internal audit, risk, governance and strategy.

## 1 Segment information (continued)

### (b) Segment information

31 December 2016	Network \$m	Commercial & marketing \$m	Operations \$m	Other \$m	Eliminations \$m	Total continuing operations \$m
External revenue	350	1,389	40	2	-	1,781
Internal revenue	321	5	61	-	(387)	-
<b>Total functional revenue</b>	<b>671</b>	<b>1,394</b>	<b>101</b>	<b>2</b>	<b>(387)</b>	<b>1,781</b>
<b>Functional costs</b>						
Employee benefits expense	(62)	(12)	(352)	(18)	-	(444)
Energy & fuel	(73)	-	(61)	-	-	(134)
Track access	-	-	(445)	-	319	(126)
Consumables	(91)	(5)	(241)	(4)	65	(276)
Other expenses	(8)	2	(20)	(3)	3	(26)
<b>Total functional costs excluding depreciation and amortisation (underlying)</b>	<b>(234)</b>	<b>(15)</b>	<b>(1,119)</b>	<b>(25)</b>	<b>387</b>	<b>(1,006)</b>
EBITDA (underlying)*	437	1,379	(1,018)	(23)	-	775
Depreciation and amortisation	(142)	(2)	(140)	(3)	-	(287)
<b>EBIT (underlying)*</b>	<b>295</b>	<b>1,377</b>	<b>(1,158)</b>	<b>(26)</b>	<b>-</b>	<b>488</b>
Significant adjustments (note 1 (c))						(321)
<b>EBIT*</b>						<b>167</b>
Net finance costs						(92)
<b>Profit before income tax</b>						<b>75</b>
Income tax expense						(21)
<b>Profit for the period</b>						<b>54</b>

\* Refer to page 49 for Non-IFRS information

## 1 Segment information (continued)

### (b) Segment information (continued)

31 December 2015	Network \$m	Commercial & marketing \$m	Operations \$m	Other \$m	Eliminations \$m	Total continuing operations \$m
External revenue	224	1,506	15	13	-	1,758
Internal revenue	357	4	87	-	(448)	-
<b>Total functional revenue</b>	<b>581</b>	<b>1,510</b>	<b>102</b>	<b>13</b>	<b>(448)</b>	<b>1,758</b>
<b>Functional costs</b>						
Employee benefits expense	(63)	(17)	(382)	(19)	-	(481)
Energy & fuel	(63)	-	(71)	-	-	(134)
Track access	-	-	(519)	-	357	(162)
Consumables	(66)	(5)	(257)	(19)	87	(260)
Other expenses	(19)	(17)	(6)	-	4	(38)
<b>Total functional costs excluding depreciation and amortisation (underlying)</b>	<b>(211)</b>	<b>(39)</b>	<b>(1,235)</b>	<b>(38)</b>	<b>448</b>	<b>(1,075)</b>
EBITDA (underlying)*	370	1,471	(1,133)	(25)	-	683
Depreciation and amortisation	(125)	(3)	(150)	(2)	-	(280)
<b>EBIT (underlying)*</b>	<b>245</b>	<b>1,468</b>	<b>(1,283)</b>	<b>(27)</b>	<b>-</b>	<b>403</b>
Significant adjustments						(426)
<b>EBIT*</b>						<b>(23)</b>
Net finance costs						(70)
<b>Loss before income tax</b>						<b>(93)</b>
Income tax expense						(15)
<b>Loss for the period</b>						<b>(108)</b>

\* Refer to page 49 for Non-IFRS information

### (c) Significant adjustments

The Group's underlying results differ from the statutory results. The exclusion of certain items permits a more appropriate and meaningful analysis of the Group's underlying performance on a comparative basis.

	31 December 2016 \$m	31 December 2015 \$m
Intermodal impairment	162	-
Contract exit asset impairment	10	-
Freight Management Transformation (FMT) impairment	64	-
Transformation - asset impairment	21	-
Transformation - redundancy costs	64	-
Strategic infrastructure projects and assets under construction impairment	-	125
Aquila impairment	-	153
Rollingstock impairment	-	148
<b>Total significant adjustments</b>	<b>321</b>	<b>426</b>

#### Impairment

For further disclosure on the impairment write downs for the half year ended 31 December 2016 and the comparative period refer to note 3.

#### Redundancy costs

As part of the ongoing business transformation 494 employees were made redundant which predominantly relates to Operations. This resulted in redundancy expense of \$64 million being recorded for the half year.



## 2 Revenue and other income

### (a) Revenue from continuing operations

The revenue by commodity is as follows:

*Network revenue*

Provision of access to, and operation and management of, the Central Queensland Coal Network (CQCN).

*Coal revenue*

Transport of coal from mines in Queensland and New South Wales to end customers and ports.

*Iron ore revenue*

Transport of iron ore from mines in Western Australia to ports.

*Freight revenue*

Transport of bulk mineral commodities, agricultural products, mining and industrial inputs and general freight throughout Queensland, New South Wales and Western Australia and containerised freight throughout Australia.

*Other revenue*

Items of revenue of a corporate nature, ineffective hedging gains and losses and minor operations within the Group including third party above rail provision of overhaul and maintenance services to external customers.

31 December 2016	Network \$m	Coal \$m	Iron ore \$m	Freight \$m	Other \$m	Total \$m
<b>External revenue</b>						
<b>Revenue from external customers</b>						
Services revenue						
Track access	310	305	-	-	-	615
Freight transport	-	582	139	339	-	1,060
Other services	2	-	-	15	24	41
Other revenue	38	-	-	9	18	65
<b>Total revenue from external customers</b>	<b>350</b>	<b>887</b>	<b>139</b>	<b>363</b>	<b>42</b>	<b>1,781</b>
Services revenue						
Track access	319	-	-	-	-	319
Freight transport	-	1	-	1	-	2
Other services	2	3	-	-	61	66
<b>Total internal revenue</b>	<b>321</b>	<b>4</b>	<b>-</b>	<b>1</b>	<b>61</b>	<b>387</b>
Other income	-	-	-	-	-	-
<b>Total revenue and other income</b>	<b>671</b>	<b>891</b>	<b>139</b>	<b>364</b>	<b>103</b>	<b>2,168</b>
Internal elimination						(387)
<b>Consolidated revenue and other income</b>						<b>1,781</b>

## 2 Revenue and other income (continued)

### (a) Revenue from continuing operations (continued)

31 December 2015	Network \$m	Coal \$m	Iron Ore \$m	Freight \$m	Other \$m	Total \$m
<b>External revenue</b>						
<b>Revenue from external customers</b>						
Services revenue						
Track access	203	373	-	-	-	576
Freight transport	-	577	163	334	-	1,074
Other services	2	-	-	25	19	46
Other revenue	18	-	-	33	11	62
<b>Total revenue from external customers</b>	<b>223</b>	<b>950</b>	<b>163</b>	<b>392</b>	<b>30</b>	<b>1,758</b>
Services revenue						
Track access	357	-	-	-	-	357
Freight transport	-	-	-	4	-	4
Other services	-	-	-	-	87	87
<b>Total internal revenue</b>	<b>357</b>	<b>-</b>	<b>-</b>	<b>4</b>	<b>87</b>	<b>448</b>
Other income	1	-	-	1	(2)	-
<b>Total revenue and other income</b>	<b>581</b>	<b>950</b>	<b>163</b>	<b>397</b>	<b>115</b>	<b>2,206</b>
Internal elimination						(448)
<b>Consolidated revenue and other income</b>						<b>1,758</b>

### 3 Impairment of non-financial assets

#### (a) Impairment

	<b>31 December 2016</b>	31 December 2015
	<b>\$m</b>	<b>\$m</b>
Intermodal impairment (i)	<b>162</b>	-
Impairment of assets in exit of contracts (ii)	<b>10</b>	-
Freight Management Transformation impairment (iii)	<b>64</b>	-
Transformation - asset impairment (iv)	<b>21</b>	-
Other	<b>9</b>	-
Strategic infrastructure projects and assets under construction impairment (v)	-	125
Aquila impairment (vi)	-	153
Rollingstock impairment (vii)	-	148
	<b>266</b>	<b>426</b>

#### Current Period

##### (i) Intermodal

Indicators of impairment were identified for the Intermodal cash generating unit (CGU) due to trading performance during the first half being lower than expectations. As a result an impairment test was completed for the half year. The recoverable amount used in the impairment test is based on a fair value less costs of disposal methodology and has resulted in a pre-tax impairment charge of \$162 million. The fair value has been determined by reference to external valuations for property and internal valuations for rollingstock, plant and equipment and assets under construction. In relation to rollingstock we have considered the ability to redeploy assets across the Group when determining the fair value.

The output from the freight review during the period has enabled the Group to more accurately allocate the shared assets across CGUs. This refinement to the basis on which shared property assets are allocated to the CGUs resulted in an increase of \$44 million to the Intermodal asset base.

The impairment write-down of \$162 million has been allocated to rollingstock (\$101 million), land, buildings and infrastructure (\$32 million), plant and equipment (\$15 million), assets under construction (\$13 million) and intangibles (\$1 million).

Following the impairment, the residual carrying value of the assets of the Intermodal business is \$177 million.

#### Measurement of fair values

##### Fair value hierarchy

The non-recurring fair value measurement for the Intermodal CGU has been categorised as a Level 3 fair value based on the inputs to the valuation technique used.

#### Valuation technique and significant unobservable inputs

	<u>Valuation Technique</u>	<u>Significant unobservable inputs</u>
<b>Property</b>	External valuations of material Intermodal land and buildings at key sites have been completed under an in use and alternate use basis.	Valuations are based on comparable market transactions, market yield and assume disposal costs of 5%.
<b>Rollingstock</b>	Internal valuations of rollingstock have been completed based on highest and best use of assets given there is not considered to be an active secondary market for rollingstock. Therefore, rollingstock assets have been valued based on scrap metal prices after consideration of the redeployment of assets.	<ul style="list-style-type: none"> <li>- Determination of the best use of respective rollingstock assets across the enterprise fleet</li> <li>- Scrap metal prices obtained from metal market participants</li> <li>- Costs of disposal and scrap values</li> </ul>

### 3 Impairment of non-financial assets (continued)

#### (a) Impairment (continued)

##### (ii) Asset impairment as a result of contract exits

As a result of the decision by Glencore to not renew its existing contract with Aurizon to haul mine inputs and outputs between Mt Isa and Townsville, a decision has been made to cease to operate this daily multi-customer freight service from the contract expiry date of 31 January 2017. As a result, \$10 million of assets including rollingstock, plant and equipment and associated facilities have been impaired.

##### (iii) Freight Management Transformation (FMT)

Following a review, it has been decided to terminate the project and as a result an impairment charge of \$64 million has been recorded. An amount of \$27 million of the total project investment of \$91 million remains capitalised on the balance sheet in relation to software and licences, which are currently in use.

##### (iv) Transformation - asset impairment

As part of the ongoing transformation program, \$15 million of property, plant and equipment was impaired, along with a further \$6 million relating to various projects no longer proceeding and assets identified as surplus to requirements.

#### Prior Period

##### (v) Strategic infrastructure projects impairment (\$125 million)

###### *West Pilbara Infrastructure Project (\$83 million)*

As a result of the uncertainty surrounding the timing of the development as well as current market conditions, \$83 million of project costs were fully impaired. The carrying value of the project is now nil. In addition, \$91 million in respect of our investment in Aquila relating to WPIOP has been impaired.

###### *Galilee Basin (\$30 million)*

An impairment of \$30 million was recorded in relation to the brownfield expansion of the Central Queensland Coal Network. The amount represents directly attributable development costs such as engineering designs, environmental and building approvals, which could be recovered through the regulatory process at a future date. However, a decision has been made to impair these costs due to uncertainty surrounding the project's timing and the current market outlook. The carrying value of the project is now nil.

###### *Other Projects (\$12 million)*

Other projects totalling \$12 million have also been impaired which primarily relate to Central Queensland Coal Network expansion projects that are no longer expected to proceed.

##### (vi) Impairment of the Investment in Aquila (\$153 million)

At 31 December 2015, Aurizon performed a review of the value of the individual projects within the Aquila investment and an impairment of \$153 million for Aquila was recorded. A further review was completed at 30 June 2016 which resulted in additional impairment of \$73 million. The total impairment for Aquila at 30 June 2016 was \$226 million. The impairment provides for all known exposures, including Aquila's contractual obligations in respect of power and port access arrangements, and results in Aurizon's investment being fully written down.

##### (vii) Impairment of rollingstock (\$148 million)

Due to the continued improvements in rollingstock efficiency and productivity coupled with a lower volume outlook, the Enterprise Rollingstock Master Plan, which forecasts the requirements of the locomotives and wagons for the next 10 years, has been revised. This review of fleet has resulted in 131 locomotives and 1,337 wagons being identified as surplus to the current requirements of the Group. Rollingstock identified as surplus and associated inventory has been impaired by \$148 million to net realisable value.

### 4 Income tax expense

The Group's statutory effective tax rate for the half year ended 31 December 2016 is 28%. The prior period effective tax rate was not meaningful due to the impact of impairments of investments in associates recorded during the period.

## 5 Earnings per share

### (a) Basic and diluted earnings per share

	<b>31 December 2016 Cents</b>	31 December 2015 Cents
Total basic and diluted earnings/(loss) per share attributable to the ordinary equity holders of the Company	<b>2.6</b>	(5.1)

### (b) Weighted average number of shares used as denominator

	<b>31 December 2016 Number '000</b>	31 December 2015 Number '000
Weighted average number of ordinary shares used as the denominator in calculating basic EPS	<b>2,051,745</b>	2,109,168
Rights	<b>4,426</b>	3,189
Weighted average number of ordinary and potential ordinary shares used as the denominator in calculating diluted earnings per share	<b>2,056,171</b>	2,112,357

# Capital management

## In this section...

Capital management provides information about the capital management practices of the Group and shareholder returns for the six months and the Group's fair value disclosure for financial instruments.

6	Dividends	Page 38
7	Contributed equity	Page 38
8	Borrowings	Page 39
9	Fair value disclosure for financial instruments	Page 39

## 6 Dividends

### (a) Ordinary shares

	<b>31 December 2016</b>	<b>31 December 2015</b>
	<b>\$m</b>	<b>\$m</b>
Final dividend for the year ended 30 June 2016 of 13.3 cents 70% franked (2015: 13.9 cents, 30% franked) per share, paid 26 September 2016	<b>273</b>	<b>295</b>

### (b) Dividends not recognised at the end of the reporting period

	<b>31 December 2016</b>	<b>31 December 2015</b>
	<b>\$m</b>	<b>\$m</b>
Since 31 December 2016, the directors have recommended the payment of a 70% franked interim dividend of 13.6 cents per fully paid ordinary share (31 December 2015: 11.3 cents 70% franked). The aggregate amount of the proposed dividend expected to be paid on 27 March 2017 out of retained earnings, but not recognised as a liability at 31 December 2016	<b>279</b>	<b>237</b>

## 7 Contributed equity

	<b>31 December 2016</b>	<b>30 June 2016</b>	<b>31 December 2016</b>	<b>30 June 2016</b>
	<b>Shares '000</b>	<b>Shares '000</b>	<b>\$m</b>	<b>\$m</b>
Issued capital				
Fully paid	<b>2,051,745</b>	2,051,745	<b>1,207</b>	1,207

### (a) Movements in ordinary share capital

	<b>Date</b>	<b>Details</b>	<b>Number of shares '000</b>	<b>\$m</b>
	1 July 2015	Opening balance	2,122,010	1,508
		On-market share buy-back	(28,660)	(140)
	31 December 2015	Closing balance	2,093,350	1,368
	1 July 2016	Opening balance	2,051,745	1,207
	31 December 2016	Closing balance	2,051,745	1,207

## 8 Borrowings

	31 December 2016 \$m	30 June 2016 \$m
<b>Current - Unsecured</b>		
Bank facilities	-	6
<b>Non-current - Unsecured</b>		
Medium-term notes	2,011	2,086
Syndicated facilities	1,390	1,415
Capitalised borrowing costs	(13)	(17)
Total unsecured non-current borrowings	<u>3,388</u>	<u>3,484</u>
<b>Total borrowings</b>	<u>3,388</u>	<u>3,490</u>

The non-current unsecured borrowings impose certain covenants on the Group to ensure that certain financial ratios are met and restrict the amount of security that the Group and its subsidiaries can provide over their assets in certain circumstances.

## 9 Fair value disclosure for financial instruments

### Fair values of financial instruments

The carrying amounts and fair values of all of the Group's financial instruments which are not carried at an amount which approximates their fair value at 31 December 2016 and 30 June 2016 are shown in the following table.

The fair value of borrowings is estimated by discounting the future contractual cash flows at the current market interest rates that are available to Aurizon for similar financial instruments. For the period ended 31 December 2016, the borrowing rates were determined to be ranging from 2.9% to 5.3% depending on the type of borrowing (30 June 2016 - 2.8% to 5.8%).

	31 December 2016		30 June 2016	
	Carrying value \$m	Fair value \$m	Carrying value \$m	Fair value \$m
Borrowings	3,388	3,504	3,490	3,495

### Valuation hierarchy of financial instruments carried at fair value on a recurring basis

The Group measures and recognises the following assets and liabilities at fair value on a recurring basis:

- Forward exchange contracts
- Interest rate swaps (including cross currency interest rate swaps)

#### (a) Fair value hierarchy

The table below analyses the Group's assets and liabilities carried at fair value. The different levels are defined as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities

Level 2: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)

Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs)



## 9 Fair value disclosure for financial instruments (continued)

### (a) Fair value hierarchy (continued)

#### *Recognised fair value measurements*

31 December 2016	Level 1 \$m	Level 2 \$m	Level 3 \$m	Total \$m
Derivative financial assets	-	74	-	74
Derivative financial liabilities	-	(75)	-	(75)
Net financial instruments measured at fair value	-	(1)	-	(1)

  

30 June 2016	Level 1 \$m	Level 2 \$m	Level 3 \$m	Total \$m
Derivative financial assets	-	77	-	77
Derivative financial liabilities	-	(51)	-	(51)
Net financial instruments measured at fair value	-	26	-	26

There were no transfers between levels 1 and 2 for recurring fair value measurements during the six months to 31 December 2016.

### (b) Valuation techniques used to derive fair values

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) are determined using valuation techniques. These valuation techniques maximise the use of observable market data where available and rely as little as possible on entity specific estimates. If all significant inputs required to determine the fair value of an instrument are observable, the instrument is included in Level 2.

The fair value of forward foreign exchange contracts has been determined as the unrealised gain / loss at balance date by reference to market rates.

The fair value of interest rate swaps has been determined as the net present value of contracted cash flows. These values have been adjusted to reflect the credit risk of the Group and relevant counterparties, depending on whether the instrument is a financial asset or a financial liability. The existing exposure method, which discounts estimated future cash flows to present value using credit adjusted discount factors after counterparty netting arrangements, has been adopted.

The fair value of cross currency interest rate swaps has been determined as the net present value of contracted cash flows. The future probable exposure method is applied to the estimated future cash flows to reflect the credit risk of the Group and relevant counterparties.

# Other information

## In this section...

Other information provides information on other items which require disclosure to comply with Australian Accounting Standards and other regulatory pronouncements.

10	Summary of significant accounting policies	Page 42
11	Critical accounting estimates and judgements	Page 43

## 10 Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these consolidated interim financial statements are consistent with those of the previous financial year. These policies have been consistently applied to both periods presented, unless otherwise stated. Where necessary, comparative information has been restated to conform with changes in presentation in the current year.

### (a) New and revised accounting standards and interpretations

None of the new standards and amendments to standards that are mandatory for the first time for the financial year beginning 1 July 2016 affect any of the amounts recognised in the current period or any prior period and are not likely to affect future periods. The Group has not early adopted any amendments, standards or interpretations that have been issued but are not yet effective with the exception of AASB 9 'Financial Instruments' which was adopted from 1 July 2014.

Certain new accounting standards and interpretations have been published that are not mandatory for 30 June 2017 reporting periods and have not been early adopted by the Group.

AASB 16 *Leases* addresses the recognition, measurement, presentation and disclosures of leases. This standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, AASB 117. This standard applies to the Aurizon reporting period beginning on 1 July 2019. The Group is in the process of assessing the impact for the Group of this new standard.

AASB 15 *Revenue from Contracts with Customers* outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. It supersedes current revenue recognition guidance including AASB 118 Revenues, AASB 111 Construction Contracts and related interpretations. The core principle is that an entity recognises revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This standard also allows costs associated with obtaining a contract to be capitalised and amortised over the life of the new contract. This standard applies to the Aurizon reporting periods beginning on 1 July 2018. The Group is in the process of assessing the impact for the Group of this new standard.

## 11 Critical accounting estimates and judgements

A number of critical accounting estimates and judgements were disclosed in the 30 June 2016 financial report. Included within those judgements and estimates are the following which have particular relevance to the half year financial statements.

### (a) Impairment testing

#### *Cash generating units (CGUs)*

At the half year ended 31 December 2016 the only CGU with an indicator of impairment is Intermodal. The Intermodal CGU had indicators of impairment due to trading performance during the first half being lower than expectations. As a result, an impairment test was completed. The recoverable amount of the Intermodal CGU for 31 December 2016 has been determined based on fair value less costs of disposal (FVLCTD) calculations and has resulted in a pre-tax impairment charge of \$162 million. The fair value has been determined by reference to external valuations for property and internal valuations for rollingstock, plant and equipment and assets under construction.

The key assumptions used in the estimation of the recoverable amount of the Intermodal CGU are set out in Note 3. The values assigned to the key assumptions represent management's assessment of the market value of the CGU assets and have been based on data from both external and internal sources. The key judgements in determining the FVLCTD are the ability to redeploy rollingstock across the Group and the allocation of shared property assets.

Following the impairment loss recognised in the Intermodal CGU, the recoverable amount was equal to the carrying amount.

#### *Individual non-current assets*

Each period the Group is required to assess the recoverability of non-current assets. Each period the Enterprise Rollingstock Master Plan is reviewed. Judgement has been applied to estimate forecast volumes and productivity, as well as the required level of contingent fleet, in determining the level of rollingstock required for the foreseeable future. Any further changes to volumes and productivity could result in further reduction or reversal of previous impairment required in the future. The application of this judgement will continue to be assessed at each reporting date.

### (b) Income tax

The deferred tax asset of \$68 million, attributable to the impairment of the investment in an associate has not been recognised as it is not considered probable that it will be recovered in the foreseeable future. The recoverability of the deferred tax asset is dependent on the sale of shares in the associate.

# Unrecognised items

## In this section...

Unrecognised items provide information about items that are not recognised in the financial statements but could potentially have a significant impact on the Group's financial position and performance.

12	Contingencies	Page 45
13	Events occurring after the reporting period	Page 45

## **12 Contingencies**

Issues relating to common law claims and product warranties are dealt with as they arise. A number of common law claims are pending against the Group. Provisions are taken up for some of these exposures based on management's determination.

There have been no material changes in contingent assets or liabilities since 30 June 2016.

## **13 Events occurring after the reporting period**

On 25 January 2017, as a residual obligation under the project documents with Moorebank Intermodal Company (MIC) Aurizon provided a Parent Company Guarantee (PCG) in favour of MIC in relation to 50% of the cost to complete construction of the Terminal Works and 25% of the contract sum for design and construction of the Rail Access. The estimated maximum exposure under the guarantee is \$155 million, however Aurizon has obtained a 100% cross indemnity guarantee from Qube Holdings Ltd in respect of any call under the Aurizon PCG.

In accordance with a resolution of the directors of the company, I state that:

In the opinion of the directors of the Company:

- (a) the interim financial statements and notes set out on pages 21 to 45 are in accordance with the *Corporations Act 2001*, including:
  - (i) complying with Accounting Standards, the *Corporations Regulations 2001* and other mandatory professional reporting requirements, and
  - (ii) giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and of its performance for the half-year ended on that date, and
- (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.



T M Poole  
Chairman  
13 February 2017



## **Independent auditor's review report to the members of Aurizon Holdings Limited**

### ***Report on the Half-Year Financial Report***

We have reviewed the accompanying half-year financial report of Aurizon Holdings Limited (the company), which comprises the consolidated balance sheet as at 31 December 2016, the consolidated income statement and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement for the half-year ended on that date, selected explanatory notes and the directors' declaration for Aurizon Holdings Limited (the consolidated entity). The consolidated entity comprises the company and the entities it controlled during that half-year.

### ***Directors' responsibility for the half-year financial report***

The directors of the company are responsible for the preparation of the half-year financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the half-year financial report that is free from material misstatement whether due to fraud or error.

### ***Auditor's responsibility***

Our responsibility is to express a conclusion on the half-year financial report based on our review. We conducted our review in accordance with Australian Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the half-year financial report is not in accordance with the *Corporations Act 2001* including giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and its performance for the half-year ended on that date; and complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As the auditor of Aurizon Holdings Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of a half-year financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### ***Independence***

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.





**Conclusion**

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the half-year financial report of Aurizon Holdings Limited is not in accordance with the *Corporations Act 2001* including:

1. giving a true and fair view of the consolidated entity's financial position as at 31 December 2016 and of its performance for the half-year ended on that date;
2. complying with Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.

PricewaterhouseCoopers

Nadia Carlin  
Partner

Simon Neill  
Partner

Brisbane  
13 February 2017

## Non-IFRS Financial Information in 2016-17 Interim Financial Report

In addition to using profit as a measure of the Group and its segments' financial performance, Aurizon uses EBIT (Statutory and Underlying), EBITDA (Statutory and Underlying), EBITDA margin – Underlying, Operating Ratio – Underlying, NPAT Underlying, Return On Invested Capital (“ROIC”), Net debt and Net gearing ratio. These measurements are not defined under IFRS and are, therefore, termed “Non-IFRS” measures.

EBIT – Statutory is defined as Group profit before net finance costs and tax, while EBITDA - Statutory is Group profit before net finance costs, tax, depreciation and amortisation. EBIT underlying can differ from EBIT – Statutory due to exclusion of significant items that permits a more appropriate and meaningful analysis of the underlying performance on a comparative basis. EBITDA margin is calculated by dividing underlying EBITDA by the total revenue. These measures are considered to be useful measures of the Group's operating performance because they approximate the underlying operating cash flow by eliminating depreciation and/or amortisation.

NPAT Underlying represents the underlying EBIT less finance costs less tax expense excluding tax impact of significant adjustments.

Operating Ratio – is defined as one less underlying EBIT divided by total revenue. The Operating Ratio is the key measure of the operating cost of earning each dollar of revenue and it is used as one of the key performance measures of the Key Management Personnel.

ROIC is defined as underlying rolling twelve month EBIT divided by the average invested capital. The average invested capital is calculated by taking the rolling twelve month average of net property, plant and equipment including assets under construction plus investments accounted for using the equity method, plus net intangibles plus current assets less cash, less current liabilities. This measure is intended to ensure there is alignment between investment in infrastructure and superior returns for shareholders.

Net debt consists of borrowings (both current and non-current) less cash and cash equivalents. Net gearing ratio is defined as Net debt divided by Shareholders Equity plus Net debt. Net debt and Net gearing ratio are measures of the Group's indebtedness and provides an indicator of the balance sheet strength.

These above mentioned measures are commonly used by management, investors and financial analysts to evaluate companies' performance.

A reconciliation of the non-IFRS measures and specific items to the nearest measure prepared in accordance with IFRS is included in the table. The non-IFRS financial information contained within this Directors' report and Notes to the Financial Statements has not been audited in accordance with Australian Auditing Standards.

	Half-year ended 31 December 2016 \$m	Half-year ended 31 December 2015 \$m
<b>Profit/(loss) before income tax</b>	<b>75</b>	<b>(93)</b>
Finance costs (net)	92	70
<b>EBIT – Statutory</b>	<b>167</b>	<b>(23)</b>
Significant adjustments:		
- Intermodal impairment	162	-
- Contract exit asset impairment	10	-
- Freight Management Transformation (FMT) impairment	64	-
- Transformation – asset impairment	21	-
- Transformation – redundancy costs	64	-
- Impairment of investment in associates	-	153
- Strategic infrastructure project and AUC impairment	-	125
- Rollingstock impairment	-	148
<b>EBIT – Underlying</b>	<b>488</b>	<b>403</b>
Depreciation and amortisation	287	280
<b>EBITDA - Underlying</b>	<b>775</b>	<b>683</b>
EBIT - Underlying	488	403
Finance costs (net)	(92)	(70)
Tax - Underlying	(117)	(96)
<b>NPAT - Underlying</b>	<b>279</b>	<b>237</b>
<b>Operating Ratio</b>	<b>72.6%</b>	<b>77.1%</b>
<b>Average invested capital</b>	<b>9,934</b>	<b>10,132</b>
<b>ROIC</b>	<b>9.6%</b>	<b>8.8%</b>
	<b>Half-year ended 31 December 2016 \$m</b>	<b>Year ended 30 June 2016 \$m</b>
Borrowings – Current	-	6
Borrowings – Non-current	3,388	3,484
Total borrowings	3,388	3,490
Cash and cash equivalents	(114)	(69)
<b>Net debt</b>	<b>3,274</b>	<b>3,421</b>
Total equity	5,543	5,714
<b>Total capital</b>	<b>8,817</b>	<b>9,135</b>
<b>Net Gearing Ratio</b>	<b>37.1%</b>	<b>37.4%</b>