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SP AusNet
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SP AusNet today announced underlying net profit after tax for its continuing operations of A$122.5 million for the first half ended September 2008, up 2.4 percent from the previous corresponding period. EBITDA was A$405.2 million, up 11.3 percent. You've indicated you're on target to meet your EBITDA growth guidance of around 8 percent in the current full year ending March 2009, implying growth of about 3 percent in the second half. What's behind your expectation growth will slow in the second half? To what extent is the business being impacted by the slowing of the broader economy?

MD Nino Ficca
We're very pleased to have delivered such a solid result in the first half and to reaffirm that we're on target to meet our full-year guidance of revenue and EBITDA growth of around 8 percent for the full year.

In terms of the second half of the year, the seasonality of our revenues, particularly in the gas distribution network where there is higher demand for heating during the winter months, results in a larger proportion of revenues being earned in the first half of our financial year. This year in particular, we saw cooler winter weather conditions which contributed around A$12.5 million of additional revenues in the distribution networks. Operating costs are more evenly spread over the year, resulting in lower profits in the second half.

In terms of the broader market, we recognise that deteriorating economic conditions, in both Australia and the global economy, may result in changes to our operating environment over the longer term. At present, we haven't noticed a significant impact on our business; the transmission network is insulated from volume risk and the growth in connections to our distribution networks remains constant. Therefore we're not expecting growth to slow in the second half.

Looking to the future, we've increased our focus on our underlying fundamentals and credit metrics to ensure we continue to be able to access capital markets to fund growth at competitive rates.

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SP AusNet announced an interim distribution of 5.927 Australian cents, up 2.6 percent from 5.776 cents in the previous year. You continue to expect distribution growth of 2.5 percent for the current year, implying a full-year distribution of 11.85 cents. What are the potential risks to the distribution in a slower growth environment?

MD Nino Ficca
We remain committed to achieving a full year 2008/2009 distribution of around 11.85 cents in line with our guidance. We've built a sustainable business that we're confident is well positioned to deliver stable distributions to securityholders. Although we're mindful of the long-term challenges in the global financial markets, operating in a regulated environment provides a level of certainty in our cash flows and revenues.

Our directors will review future distributions in due course giving consideration to our underlying fundamentals and the broader economy.

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SP AusNet has recently introduced a dividend reinvestment plan (DRP). What is the rationale for raising funds through a DRP given your view that gearing is prudent and what is the expected take-up of the DRP by securityholders?

MD Nino Ficca
We're pleased to now be able to provide securityholders with a convenient method of reinvesting all or part of their distributions in additional SP AusNet stapled securities. The funds raised by the DRP will be used for capital management purposes and to fund capital expenditure for growth. Since our listing on the ASX and the SGX, demand for energy infrastructure has exceeded our expectations, and we forecast capital expenditure of around A$2.7 billion over the next five years through to 2012/20013. The DRP will provide another source of capital for the business to fund this growth.

We've been pleased with the level of interest shown in the DRP, especially given the difficulties in the current financial environment, but we'd prefer not to speculate on the take-up at this stage as it's open for participation until 2 December.

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Can you comment on the A$43.3 million impairment charge relating to the write-down of meters that will be replaced under the Victorian State Government's Advanced Metering Infrastructure (AMI) roll-out program?

CFO Geoff Nicholson

There has been considerable uncertainty regarding the timing of the AMI roll-out and also uncertainty regarding cost recovery models. In September 2008, the Victorian Government issued a revised timetable for the roll-out of smart electricity meters requiring the roll-out to be completed by the end of 2013. The Department of Primary Industries has prepared a revised Order in Council to implement changes to the timing of the roll-out and the form of the cost recovery model for the advanced metering infrastructure roll-out.

With greater clarity on the roll-out timetable and the cost recovery model, we formed the view that there was an indication that the carrying amount of meters was greater than their recoverable amount and that, as they generate their own independent cash inflows under the specific regulatory framework for meters, they could be tested for impairment. This testing resulted in an impairment write-down of A$43.3 million before tax.

At the same time, the remaining useful life of the existing meters to be replaced under the AMI roll-out was reassessed. Given the updated announcement by the government, we formed the view that the useful lives of these meters can't extend beyond the government's timetable and have therefore reduced the useful lives of these meters. Taking the impairment write-down in this period means that the additional depreciation in the years leading up to the completion of the government's timetable won't be as high as it would otherwise have been. Importantly, the meter impairment write-down won't impact the value of our regulated asset base (RAB) as the current Electricity Distribution Price Review assumes all meters are fully depreciated by the end of the roll-out program.

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Excluding the meter write-down, SP AusNet's total operating costs and depreciation were up A$15.4 million or 4.9 percent, well below revenue growth of 8.9 percent. How do you see costs trending in a higher inflationary environment?

CFO Geoff Nicholson

Revenue growth this year has been positively affected by favourable price/volume and weather outcomes, as well as the commencement of the new transmission and gas regulatory reset period under which we were allowed a step-up in revenues. We're very pleased to have contained our operating costs, particularly in an environment of high inflation. With inflation and commodity price pressures continuing to drive up the cost of many of our consumables, we expect costs will continue to trend up in the short term. We remain committed to maintaining a low cost base and containing those operating cost pressures, and we're consistently reviewing operations to ensure we're as efficient as possible.

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The management service charge was A$15.0 million in the first half, up 32 percent. Under your recent agreement with Singapore Power Group, fees payable under the Management Services Agreement (MSA) will be reduced. What is the likely quantum of the annual fee reduction and what will be the impact of the agreement over the remainder of the year?

CFO Geoff Nicholson
The fees payable under the MSA comprise two components, being the Management Services Charge and the Management Performance Fees. The increase in the Management Services Charge in the first half related to the pass-through of actuarial losses on the defined benefits plan for SPI Management Services (SPIMS) employees and the accrual of long-term incentive plan benefits to senior management. The performance fee reduction negotiated earlier this year represents an immediate benefit for securityholders in that it lowers significantly the performance fee SP AusNet can incur, and we're pleased with this outcome.

SPIMS agreed to reduce the performance fees payable under the MSA from 1 October 2008 and for the duration of the IT Service Agreement, including waiving the base incentive fee, being 0.1 percent of market capitalisation, and reducing the performance fee cap from 0.75 to 0.5 percent of market capitalisation. The value of the reductions will fluctuate based on the actual business performance and the value of our market capitalisation. However, the base fee of 0.1 percent of market capitalisation at current values is roughly A$2 million for the full year, so the savings are meaningful in size. Using our market capitalisation at the 31 March 2008, the impact of the reduction in the performance fee cap represents potential savings of approximately A$6 million for the full year.

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You've also agreed to provide end-to-end network metering, technical and vegetation management services to networks owned and managed by Jemena, the Singapore Power owned entity that now houses the ex-Alinta network assets. What is your current capacity to provide these services to Jemena? Will you require significant additional resources?

MD Nino Ficca
These operational agreements with Jemena provide us with a fantastic opportunity to grow our niche services offering and we see this as a key platform for our future growth in a less capital intensive area. It also provides us with a footprint in New South Wales from which we can grow these niche services.

We currently have our own metering, technical services and vegetation management business units performing services for both our own networks and external parties. We therefore have extensive skills in these areas and look forward to leveraging them across the Jemena networks. As part of the operational agreements we'll employ a number of ex-Jemena employees to help deliver these services to our networks, Jemena and both existing and future external customers.

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Within the network businesses, the transmission network booked EBITDA of A$166.0 million for the half, up 16.2 percent on the back of revenue of A$260.8 million, up 11.4 percent. This reflected the impact of the regulatory reset revenue adjustment from 1 April 2008. Capex on the transmission network fell to A$53.4 million from A$56.9 million in the previous corresponding period. How do you reconcile this with the relatively robust capex allowances under the transmission reset?

CFO Geoff Nicholson
Our capital expenditure is continuously under review to ensure we deliver it with the maximum efficiency. We're currently working on a significant project to connect Victoria's first major wind farm to our transmission network. This project is progressing well and is ahead of schedule. Some of the company-initiated capital expenditure originally planned for the first half will now be undertaken in the second half, which will see a step-up in capital expenditure in the second half. Identified new wind farm and gas-fired generation connections on the transmission network will continue to grow our RAB, providing revenue growth in future periods.

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Both the electricity distribution network and gas distribution network benefited from favourable seasonal conditions and continuing strong housing development in their respective network areas, booking EBITDA of A$144.6 million, up 9.9 percent and A$94.6 million, up 5.5 percent, respectively. How might a weaker housing market impact your ability to grow electricity and gas distribution earnings nearer term?

CFO Geoff Nicholson
We're fortunate to have four of Victoria's five major urban growth corridors within our electricity and gas distribution network footprints. While a slowdown in the housing market may decrease the rate of new connections over the longer term, we haven't yet experienced a decline and continue to see strong demand for connections on both our distribution networks. Further, there has been significant recent government spending within the housing industry to avert a slowdown, and we're hopeful these measures will prove effective.

We've also experienced an increase in volume distributed as our existing customers utilise more electricity and gas. As climate conditions continue to become more extreme, we may well see an increase in both gas and electricity volumes to provide heating and cooling to homes and offices in Victoria.

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Can you comment on the outcome of the Gas Access Arrangement Review appeal, under which SP AusNet's items of appeal were recently dismissed? How will gas distribution earnings be impacted over the five-year term of the Access Arrangement?

MD Nino Ficca
We lodged formal appeals against two areas of the review's Further Final Decision which was released in May this year. The first area was a joint appeal with the other Victorian gas distribution businesses against two elements of the allowed benchmark return on capital; the equity beta and gamma settings. The second area of our appeal was against the application of the unaccounted-for gas (UAFG) benchmark to gas distribution systems not connected to the principal transmission system, the high pressure pipeline transporting gas from Longford to Melbourne. Whilst we're disappointed both areas of appeal were dismissed, the results will have no financial impact on our 2008/2009 full-year guidance or future revenues under the five-year term of the Access Arrangement.

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In the first half, finance expenses were A$152.2 million, up A$33.6 million from the previous period, reflecting higher levels of debt and increased interest rates. Can you comment on the relatively large increase?

CFO Geoff Nicholson
Interest costs increased due to a combination of factors. Firstly, there was an increase in the level of debt as we fund a portion of our growth capex via debt. Secondly, as we rolled into higher interest rate hedges in line with the electricity transmission and gas distribution regulatory resets, the higher interest rates increased the overall cost of borrowing.

The regulator recognised the higher cost of debt through the building block methodology when it calculated the WACC as part of the regulatory resets. Therefore, revenues for both the electricity transmission and the gas distribution businesses also increased to reflect this higher cost of debt.

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As at the end of September, SP AusNet had net debt of A$4.0 billion, up from A$3.7 billion six months earlier. Gearing was 62.0 percent, up from 58.4 percent and EBITDA interest cover fell to 2.8 times from 3.3 times. What level of comfort do you have with interest cover below 3 times and in a tighter credit environment what scope is there within your current bank facilities to fund the ongoing growth of the business?

CFO Geoff Nicholson
It should be noted that the gearing levels you quote are based on the debt on the balance sheet as at balance date. Under the accounting standards, foreign debt is valued at the spot exchange rate on balance date, and thus, any foreign currency debt will increase or decrease with fluctuations in the Australian dollar exchange rate. This method of valuing debt does not take into account any currency hedges that we have in place to protect against fluctuations in the Australian dollar. Thus, net debt at hedged rates had not actually increased by A$300 million over the six months, but rather the actual increase in the net debt position was approximately A$100 million which has been used to fund our growth capital expenditure program.

Both gearing and interest cover, at current levels, are consistent with our A-range credit rating. Moreover, the rating agencies and lenders don't look just at gearing and interest cover, but also at measures such as debt to RAB and funds from operations as a percentage of debt, all of which are also consistent with our A-range credit rating.

We currently have approximately A360 million of undrawn but committed bank debt facilities after repaying the Medium Term Notes facility of A$320 million which matured this month. We've also clearly demonstrated our successful access to various forms of debt on two occasions this calendar year. In February we established a A$1.55 billion bank debt facility at very competitive rates, and in June, we issued £250 million of ten-year bonds in the UK at very competitive rates. Regulated businesses such as ours are considered defensive by both debt and equity markets, and along with our A-range credit rating, this allows us ready access to multiple sources of financing.

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Can you comment on the longer-term outlook for SP AusNet?

MD Nino Ficca
We're committed to providing a sustainable investment for our securityholders, and a reliable network for our customers. Longer term, we're keen to deliver our capital expenditure program and build our RAB whilst appreciating the need to continue to grow our business into emerging markets and new geographic areas.

We'll continue to focus on expanding and commercialising our niche asset services, in particular our metering and technical services. The new operational agreement with the Jemena group of companies provides us a footprint in New South Wales and we expect the contribution from these arrangements to increase over time as we leverage our skills and experience in these areas.

Whilst we recognise there may be long-term challenges in the global economic environment, we believe we can continue to deliver value through disciplined management and the continued effort of all our staff to ensure the business continues to operate to its full potential.

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Thank you Nino and Geoff.

For more information about SP AusNet, visit www.sp-ausnet.com.au or call Manager, Investor Relations Lucinda Kerr on (+61 3) 9695 6633 or +61 421 387 687.

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