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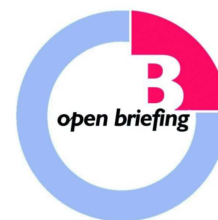

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Title: Open Briefing®. SP AusNet. MD & CFO on H1 08 Results

Record of interview:

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SP AusNet yesterday announced net profit after tax for its continuing operations of A$151.0 million for the year ended March 2008. After normalising for transaction costs, NPAT was A$168.2 million, down 1.6 percent compared with the previous year's normalised NPAT of A$170.9 million. Normalised EBITDA was A$647.9 million, up 2.0 percent. You expect to deliver EBITDA growth of around 8 percent in the current year ending March 2009. What are the expected drivers of the faster growth?

CFO Geoff Nicholson
We're very pleased to have delivered our full year results in line with guidance. The 2007/08 year saw our business deliver continued revenue growth whilst finalising two regulatory resets, representing roughly 60 percent of regulated revenues, plus successfully refinancing A$1.55 billion at competitive rates. These successes are a testament to the hard work of our employees despite the added effort required for the proposed Alinta acquisition part way through the year.

We upgraded our earnings guidance for 2008/09 in March 2008 and we continue to work towards delivering on guidance. The key drivers of the expected EBITDA growth include increased revenues and higher capital expenditure allowances provided in the transmission regulatory reset and gas access arrangement review final decision released earlier this year. The higher regulated revenues are largely driven by the higher interest rates used by the regulator in the calculation of

revenues. Accordingly our business will also face higher interest rates in the current year, and forecast NPAT is in line with the adjusted 2007/08 NPAT.

Revenue growth and controlling operational costs will continue to be a priority for the business and we're on track to deliver our earnings guidance.

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SP AusNet announced a final distribution of 5.788 Australian cents, bringing the full-year 2008 distribution to 11.564 cents, up from 11.27 cents in the previous year, and ahead of your guidance of 11.55 cents. You expect to deliver distribution growth of 2.5 percent in the current year, implying a distribution of 11.85 cents. What are the potential risks to achieving this level of distribution?

MD Nino Ficca
As always, our aim is to deliver sustainable, stable and predictable distributions to securityholders. We're very pleased to have delivered a full year distribution of 11.564 cents, which represents growth of about 2.6 percent.

With the finalisation of the electricity transmission review determination and the gas access arrangement review, nearly 100 percent of our regulated revenues are locked in until 2011. Regulated revenues account for approximately 90 percent of our total revenues and this revenue certainty allows us to plan for future network development and securityholder distributions with great confidence.

Our continued focus on organic growth and meeting customer demand for new connections to our network will deliver strong growth in our regulated asset base (RAB). Growth in our RAB ultimately leads to growth in our regulated revenues, thereby increasing the earnings from our business and delivering additional securityholder value.

In addition to organic growth, we're also focusing on the expansion and commercialisation of niche asset services offerings including metering services, technical services and the provision of telecommunication assets. Whilst the revenue contributions of these services aren't significant compared with our regulated revenues, their contributions to cash flow will continue to grow.

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The total distribution paid during the year of A$238.8 million was funded out of cash from operations, which totalled A$373.4 million after net interest payments of A$240.0 million. Can you comment on the sustainability of your operating cash coverage of distributions given capex, which last year totalled A$370.8 million, was largely paid for with borrowings?

CFO Geoff Nicholson
We have a significant capex spend which is approximately 63 percent growth related, including connecting new customers to our distribution networks and upgrading the capacity of our transmission terminal stations. In 2007/08, we funded 64 percent of our capex program from borrowings, which largely represents the growth element of our capex. This is above the 48 percent of capex

funded from borrowings in the prior year, however the one-off transaction costs relating to the proposed Alinta acquisition impacted our cash flow and the associated level of funding required during the year.

Our extensive capex program will lead to increased revenues through the increase to our RAB and our focus on niche asset services will also provide additional free cash flow for future investment or return to securityholders.

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You've indicated SP AusNet will have total capex of A$2.7 billion over the next five years, implying capex of over A$500 million per annum. This is significantly higher than recent annual capex levels. Can you comment on how this level of spending will be resourced and funded?

MD Nino Ficca
We recognise A$2.7 billion is a significant level of investment over the next five years. Our team has worked tirelessly to submit very detailed proposals to the regulator on both our gas distribution and electricity transmission networks. Those proposals took into consideration our ability to resource and fund the proposed capital investment.

Skilling for the future is important to our organisation and we've been active in ensuring there are sufficient resources to support our growth plans. We currently have about 114 apprentices and 10 graduates in structured programs. To ensure we have the resources to facilitate a capital program of this magnitude, we've appointed 37 new apprentices and five new graduates in 2007/08 alone. We've also initiated preferred supplier relationships to ensure reliability on the supply side.

In terms of funding, our successful refinancing of A$1.55 billion at very competitive rates, ranging from 40 to 50 basis points, highlights the strength of the company and our ability to source debt at competitive prices if required. Additionally, we'll be initiating a distribution reinvestment program (DRP) later this year which will assist in funding our increased capital investment program. Since listing in 2005, we've had a number of requests to introduce a DRP and we're happy to be able to provide this reinvestment facility to investors in the future.

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As at the end of March, SP AusNet had total debt of A$3.7 billion, up from A$3.6 billion a year earlier. Gearing was 58.5 percent, up from 57.4 percent. What level of confidence do you have that you'll be able to continue to secure debt funding for the relatively heavy capex program at an appropriate price, and what are your gearing tolerances going forward?

CFO Geoff Nicholson
We're very confident of our ability to continue to access funding. We achieved our recent bank debt refinancing at very competitive prices, and as evidenced by our experience in issuing bonds both domestically and offshore, we're not solely

reliant on bank debt or credit wrap bonds for funding. Given our strong investment grade credit rating and experience in various markets, we have a number of funding options available. In considering these options, we seek to diversify our maturity profile, our sources of debt and the terms and conditions, while at the same time looking to achieve the most cost effective funding opportunity.

Gearing, along with other important credit metrics such as interest cover, are important measures we consider when managing our capital structure and funding requirements.

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Excluding the costs relating to the Alinta deal, SP AusNet's operating expenses were A$407.2 million, up 6.2 percent from the previous year's adjusted amount. Do you expect growth in costs to continue to be higher than CPI increases? What level of cost growth is factored into the recent regulatory resets and with inflationary pressures increasing, what ability do you have contain cost growth?

CFO Geoff Nicholson
In addition to the one-off transaction costs last year, we had some additional expenses we're not expecting to incur going forward. Compared with 2006/07 we booked an extra A$5 million of non-cash asset retirements associated with our transmission terminal station rebuilds. We also experienced an increase in the management fees of around A$6 million due to the business meeting operational and financial performance targets at levels above prior years. We also had a step-up in S Factor Program expenses of around A$5 million to improve the reliability of our distribution network.

We acknowledge there'll be pressure on operating costs going forward in line with an expanded capex program, our continued commitment to increasing the reliability of our networks and potentially higher inflation adjustments. In the recent final decisions, the regulators provided for a step-up in costs, factoring in expected labour and material cost increases above CPI.

Operational cost control will remain a focus for us and we'll continue to strive toward outperforming our regulatory targets.

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Management fees paid to SPI Management Services, the manager of the SP AusNet businesses, totalled A$40.9 million, up from A$34.3 million in the previous year, with most of the increase attributable to a 41.8 percent rise in performance fees to A$18.3 million. Given the 10.6 percent fall in SP AusNet's security price to A$1.265 over the March 2008 year, how is the performance fee justified?

MD Nino Ficca
The performance fee covers operational performance, financial performance, a business incentive fee and a market outperformance fee. The market outperformance fee is just one component and in 2007/08 represented less than 15

percent of the total performance fee, or less than 7 percent of the total management fee. Whilst our security price fell during 2007/08, we in fact outperformed the wider market and the UBS Transmission and Distribution Index on which the performance fee is calculated. For the previous two years, this component of the fee was not paid as we underperformed the index. Importantly, a carry forward negative amount was applied to the 2007/08 calculation.

The largest component of the performance fee related to operational performance, and operationally the business has performed strongly with good progress made on capital programs, low health and safety incidents and positive regulatory decisions. That component of the performance fee was up 80 percent to A$8.1 million, representing roughly 44 percent of the total. The financial performance fee represented 27 percent of the performance fee in 2007/08.

It's worth stressing that the total performance fee remains capped at 0.75 percent of our market capitalisation. We believe that's conservative compared with our peers and provides certainty to our investors around the maximum fee payable in any one year.

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You're continuing to assess potential synergy opportunities in the area of corporate services with Singapore Power International (SPI), now the owner of the east coast Alinta assets. Do you have any insight into how the regulator might view such arrangements? What guarantee would there be for SP AusNet securityholders that any cost savings would be apportioned fairly?

MD Nino Ficca
Importantly for our securityholders, any potential synergy or joint operational initiatives will be subject to rigorous governance oversight, with review and approval by our audit and risk management committee comprising three of our independent directors.

In assessing potential synergies, we'll consider the impact of the current and expected regulatory environment. We have a positive relationship with the regulators and going forward we'll continue to work with them to ensure they understand any proposed changes to any existing arrangements.

With respect to our ability to retain any synergies, obviously where they relate to the regulated business we'd expect to share any cost savings with customers over time. However we operate in an incentive-based regulatory regime under which regulators encourage and reward innovation and efficiency.

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Part of your long-term strategy is to seek business extension growth through niche asset services opportunities. The non-regulated revenue from this area accounted for only 6 percent of total revenues in 2007/08, the bulk coming from the Data and Measurement Solutions (DMS) business. What is the scale of the opportunity in this area, who are your main competitors and what is your competitive positioning?

MD Nino Ficca
DMS, our metering services business, is a multi-utility service provider whose main focus is effective data management in the meter-to-cash cycle for the energy market across electricity, gas and water. DMS operates in both the regulated and non-regulated market segments and we view it as a strategic vehicle to grow revenue that will contribute long-term value for securityholders. The City West Water contract we won last year demonstrates DMS's ability to grow in a competitive metering market.

We're also seeking to expand our technical services division as part of our niche services strategy. Our technical services laboratory conducts a wide variety of specialist testing and diagnostic services and has extensive knowledge in comprehensive testing and condition monitoring of electrical assets. Recently, the technical services division was merged with DMS to allow greater scope to focus on external works. Other network businesses and some engineering firms offer similar services in this space. But through process innovation we believe we're well placed to grow these services. Another platform for niche service growth is telecommunications services. As a major infrastructure provider, we have the ability to offer communications connectivity and access capabilities across our electricity transmission and distribution networks.

Each of these areas provides exciting growth opportunities to complement our regulated revenues and contribute to further earnings and cash flow. We're also continuing to explore new areas of niche service offerings where we believe we have the skills and competitive advantage to expand externally.

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You've indicated that you've adopted an "incremental approach" to acquisitive investments as part of your long-term strategy. Are you suggesting that larger network acquisitions are now off the agenda? What sorts of opportunities will you consider?

MD Nino Ficca
We remain a disciplined investor and seek to invest where there's securityholder value. We'll continue to assess opportunities in line with our investment criteria of enhancing capabilities and capacity while maintaining our existing risk profile. We can assure our securityholders that we'll assess all relevant future opportunities and make a balanced decision based on all available information.

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What level of long-term distribution growth is achievable if SP AusNet is restricted to organic growth?

MD Nino Ficca
As we've just discussed, the business isn't limited only to organic growth as we're pursuing some exciting opportunities in the niche asset services sector which we see as having real upside. We've reaffirmed our distribution growth guidance of 2.5 percent for 2008/09 and are confident we can achieve our upgraded earnings

targets. With the security of almost 100 percent of our regulated revenues locked away until 2011, we believe we're well placed to continue to deliver sustainable and predictable distributions going forward.

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Thank you Nino and Geoff.

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

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