2023-27 Revenue Proposal initial forecast

Customer Panel Presentation

5 December 2019

Purpose of today's session

- Inform and gather input from the Customer Panel on Powerlink's initial, high-level 2023-27 Revenue Proposal forecasts for capex, opex, Maximum Allowed Revenue (MAR) and Regulated Asset Base (RAB).
- This will enable further engagement both within Powerlink and externally about potential challenges and opportunities.
- **The initial forecast is a top-down view, based on a wide range of parameters and assumptions. It is a starting point for both the organisation and for customers.**
- This initial forecast presentation should be read in conjunction with the explanatory "Key Inputs and Assumptions" sheet.

Indicative high level forecast overview

Key component	Current allowance 2018-2022	Dec 19 initial forecast 2023-2027	Difference $	Difference %
Capex	$916.6	$942.1 – $1,274.7	$25.5 – $358.1	3.4% – 39.8%
Opex	$1,074.9	$1,087.7 – $1,109.7	$12.8 – $34.8	1.2% – 3.2%
Regulated Asset Base	$7,684.9 (2017/18)	$6,469.5 – $6,792.6 (2026/27)	($1,215.5) – ($892.4)	(11.6%) – (15.8%)
Rate of Return	~6%	4.3% – 5.0%	N/A	(1.7%) – (1.0%)
MAR	$4,034.6	$3,533.6 – $3,844.9	($501.0) – ($189.7)	(4.7%) – (12.4%)

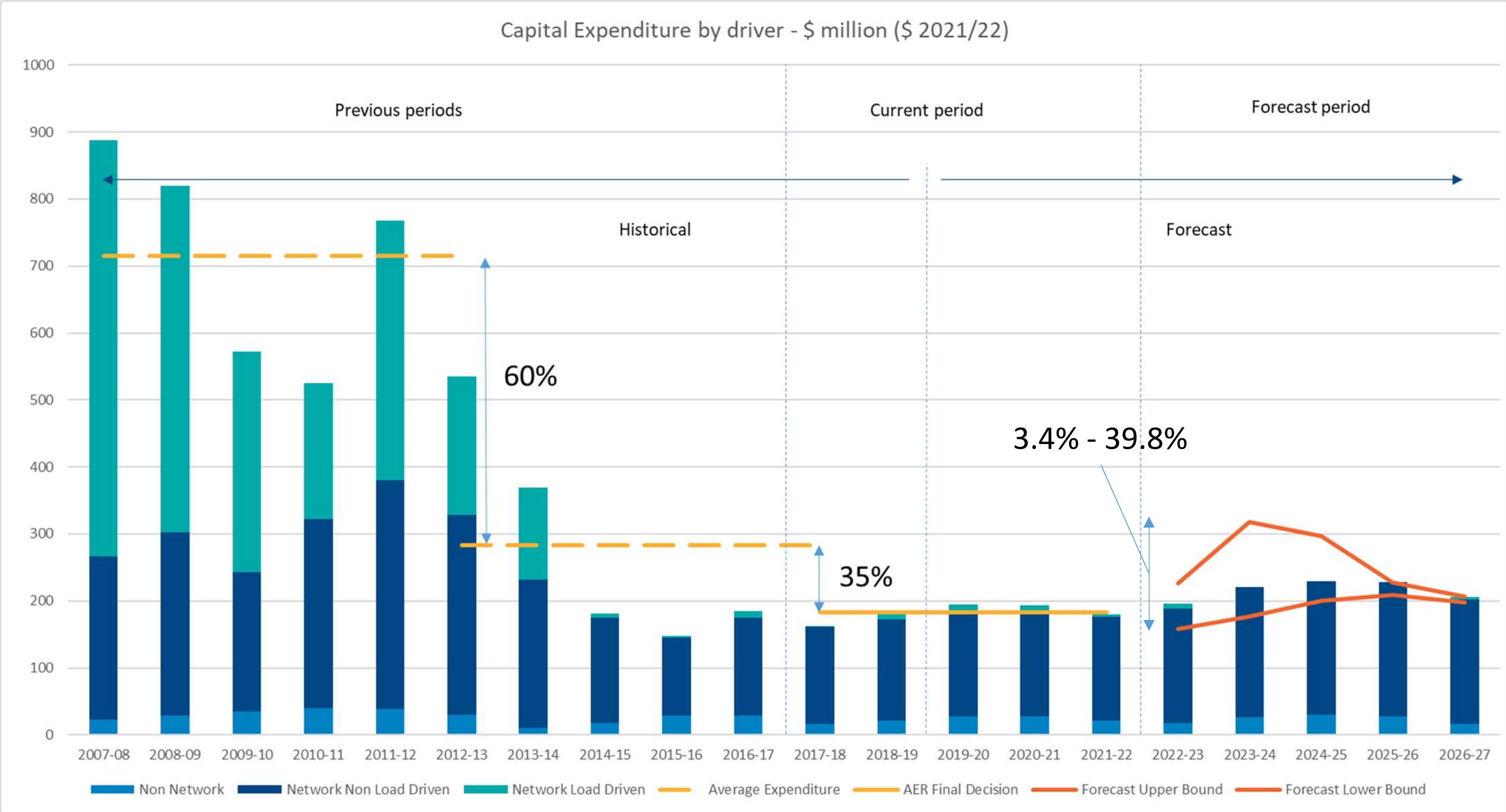
All figures are in $m (2021/22 real) and are for the full five-year regulatory period.

Capital expenditure

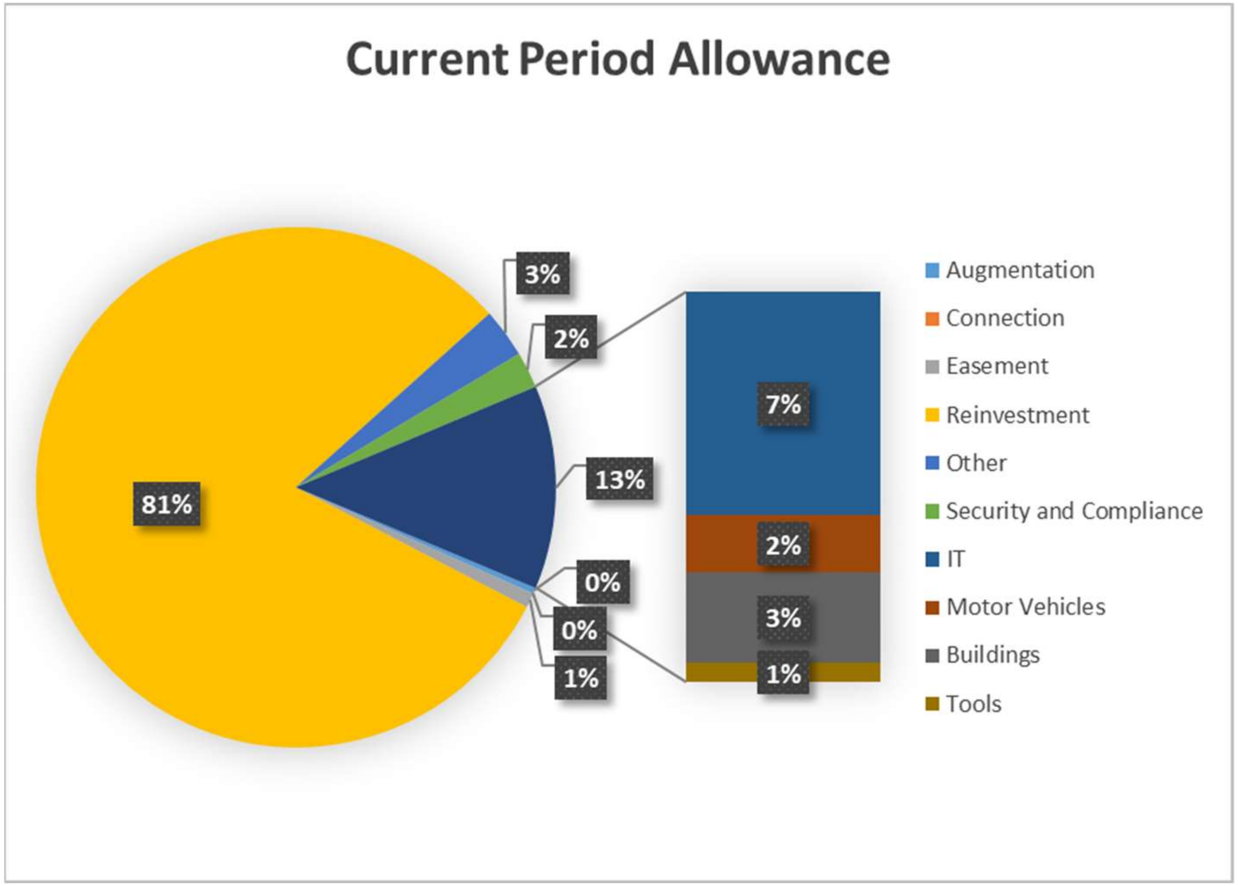
Summary of key observations – capex

Topic	Key observations
Current regulatory period	• Current period actuals expected to land near to the AER allowance, a reduction of ~35% from the previous period.
Forecast regulatory period	• Next period ‘central case’ forecast is ~18% above current period AER allowance. This is driven primarily by potentially significant transmission line reinvestment needs and is based on a high-level view adapted from Powerlink’s June 2019 Transmission Annual Planning Report (TAPR). • A band of approx. +20%, -15% has been applied to the ‘central case’ to apply a reasonable forecasting range. The range of this band will reduce in forecast updates leading up to the Revenue Proposal. • Reinvestment expenditure remains the main capex category. • Investment timing within the current forecast reflects the earliest expected investment timing.
Contribution to MAR	• Capex contributes <5% to Maximum Allowed Revenue (MAR) within the regulatory period.

Initial forecast – capital expenditure



What comprises our capex?

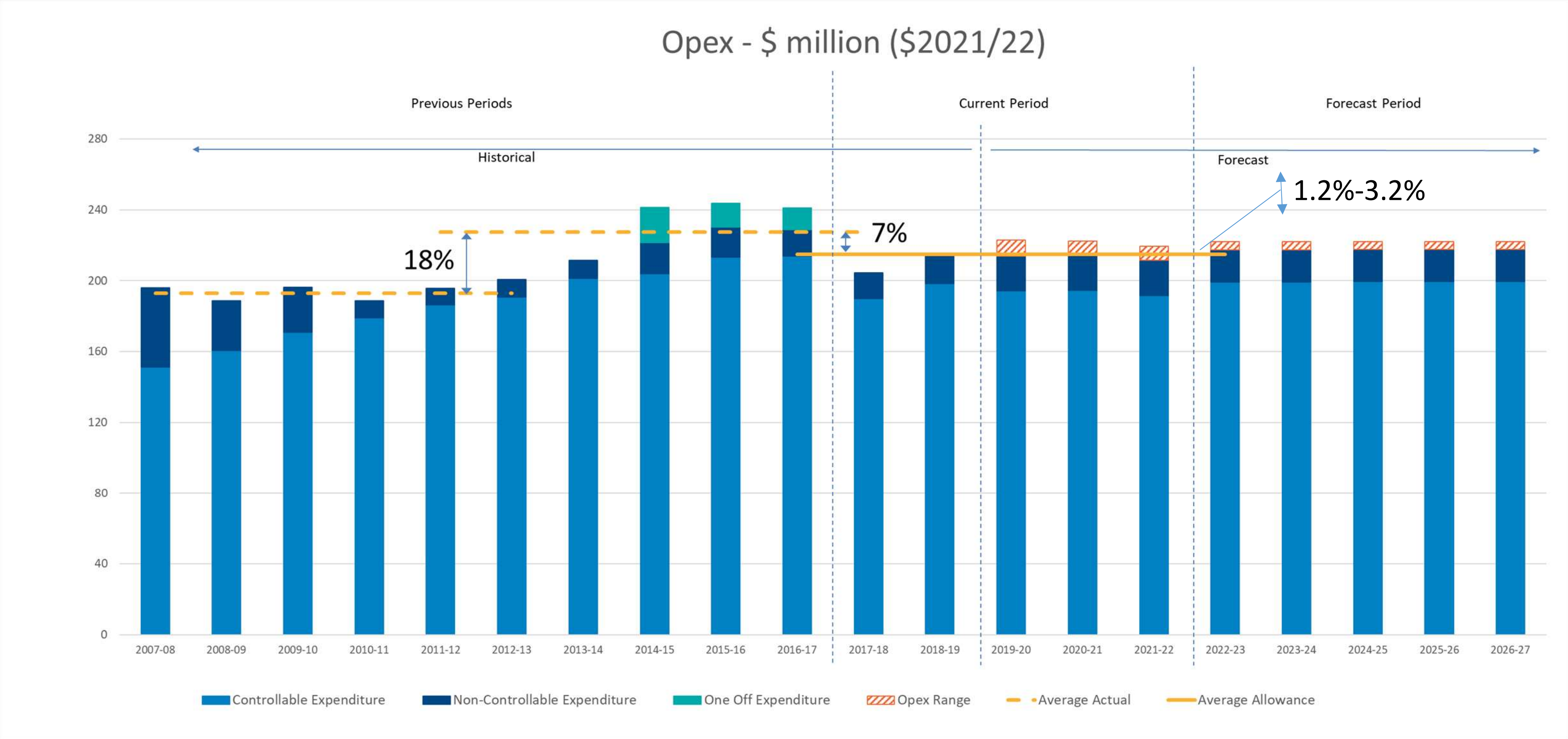


Operating expenditure

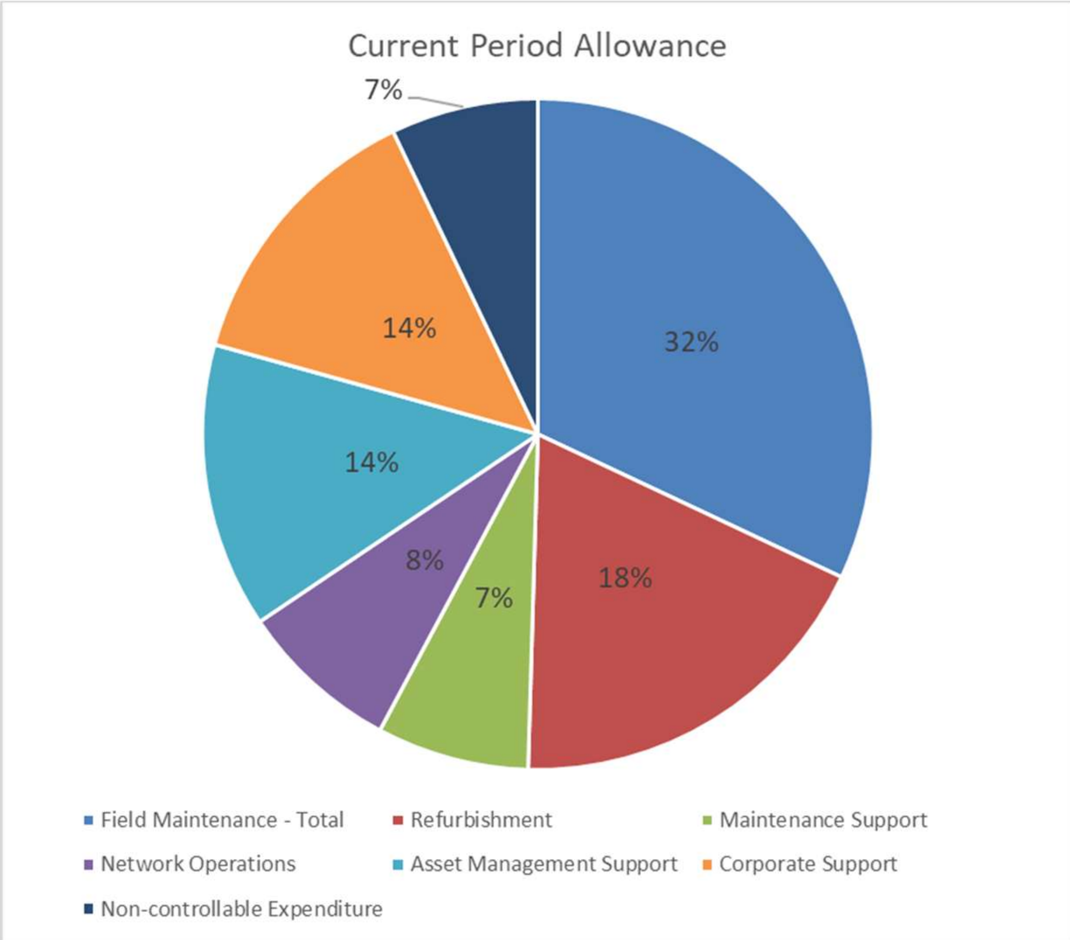
Summary of key observations – opex

Topic	Key points
Current regulatory period	• Powerlink's goal remains to operate within its current AER allowance on average for the regulatory period. This reflects a ~7% reduction from the previous period. • Powerlink has assumed an opex range for the potential base year (2019/20 in this forecast), plus years 2020/21 and 2021/22. This reflects uncertainty of some elements of the opex spend in those years (e.g. operational refurbishment works). • Non-controllable opex – AEMC levy increasing at a higher rate than CPI.
Forecast regulatory period	• Opex is forecast to be 1-3% higher than current period opex. • Controllable opex – field maintenance and operational refurbishment remain the main opex categories (33% and 19% respectively). • No step changes assumed at this stage. Powerlink is considering a range of step changes which it will discuss with customers in early 2020.
Forecast trend	• The trend applied to opex is based on an average annual rate of change calculation (Output growth + Price growth – Productivity). • The initial forecast rate of change applied is a range between 0.05% – 0.79%.
Contribution to MAR	• Opex contributes approx. 25-30% to MAR within the revenue period.

Initial forecast – operating expenditure



What comprises our opex?



Non-controllable operating expenditure includes items such as insurance, the Australian Energy Market Commission (AEMC) Levy and debt raising costs.

Financials

Summary of key observations – financial elements

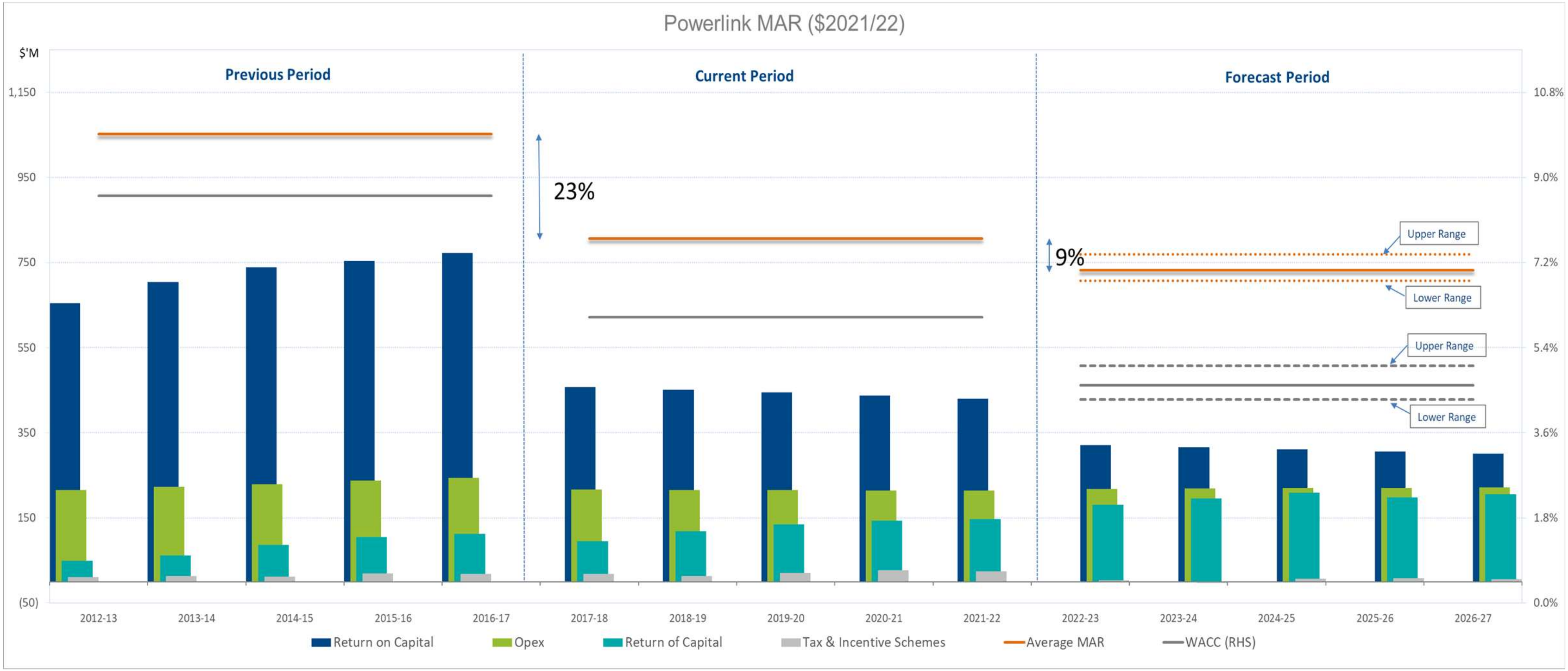
Topic	Key observations
RAB	• RAB is forecast to continue to decline in real terms within the current period and into the next period. • RAB will increase marginally in the forecast period in nominal terms, due to inflation.
WACC	• The Weighted Average Cost of Capital (WACC –referred to as the Rate of Return) is forecast to be lower over the next regulatory period. • This is primarily driven by a low risk free (Government bond) rate.
MAR	• MAR is forecast to reduce by ~9% in the next regulatory period. This is primarily driven by a reduction in the return on capital, which is lower by ~30% due to the lower WACC.
Contribution to MAR	• Return on capital, return of capital (depreciation), tax and incentive schemes contribute approx. 65-70% to MAR.

Initial Forecast - WACC

Parameter	Base	Low	High	Assumptions
Risk Free Rate (Rf)	1.10%	0.80%	1.70%	Rf based on recent 20 day averages. Low case reflects recent low rates. High range is based on the average Rf over the past 12 months.
Market Risk Premium (MRP)	6.10%	6.10%	6.10%	As per the AER's 2018 Binding Rate of Return Instrument
Equity Beta	0.6	0.6	0.6	As per the AER's 2018 Binding Rate of Return Instrument
Return on Equity	**4.76%**	**4.46%**	**5.36%**	
Return on Debt	**4.50%**	**4.20%**	**4.80%**	Cost of debt is based on estimate of the AER's trailing average approach for 2022. Low and high ranges assume +/- 30bp.
WACC	**4.60%**	**4.30%**	**5.02%**	
Gamma	0.585	0.585	0.585	As per AER's 2018 Binding Rate of Return Instrument

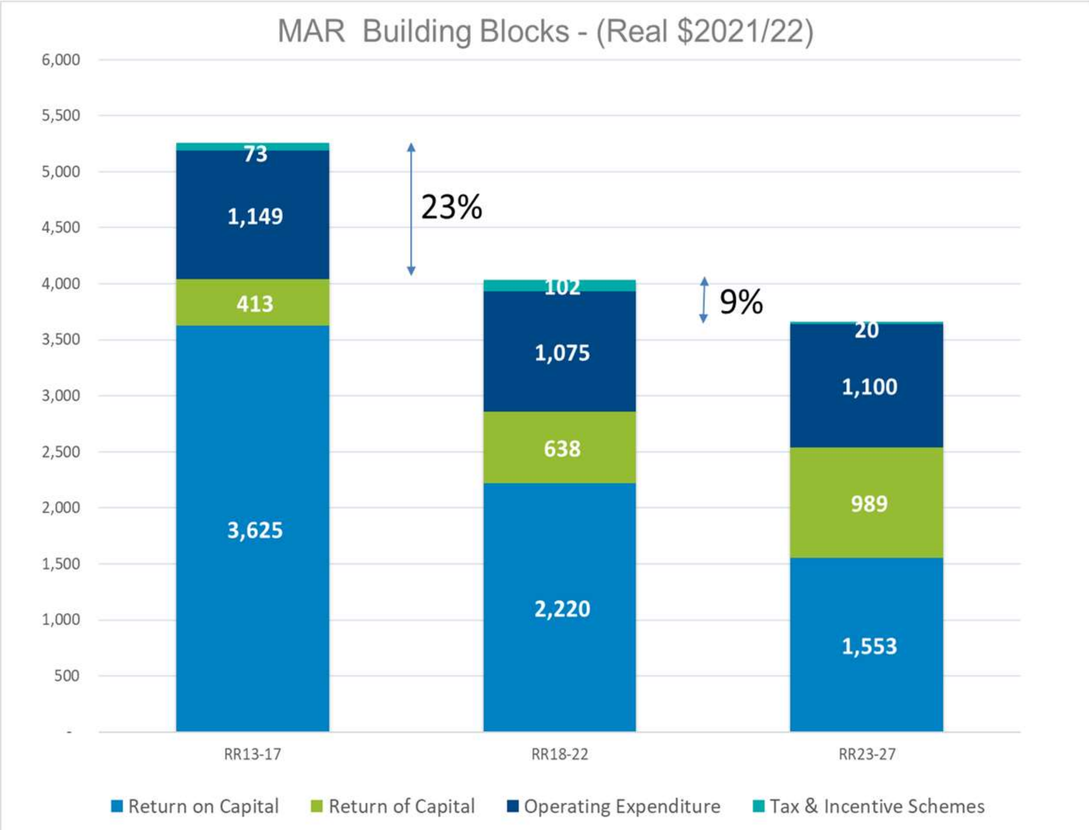
Initial forecast – MAR

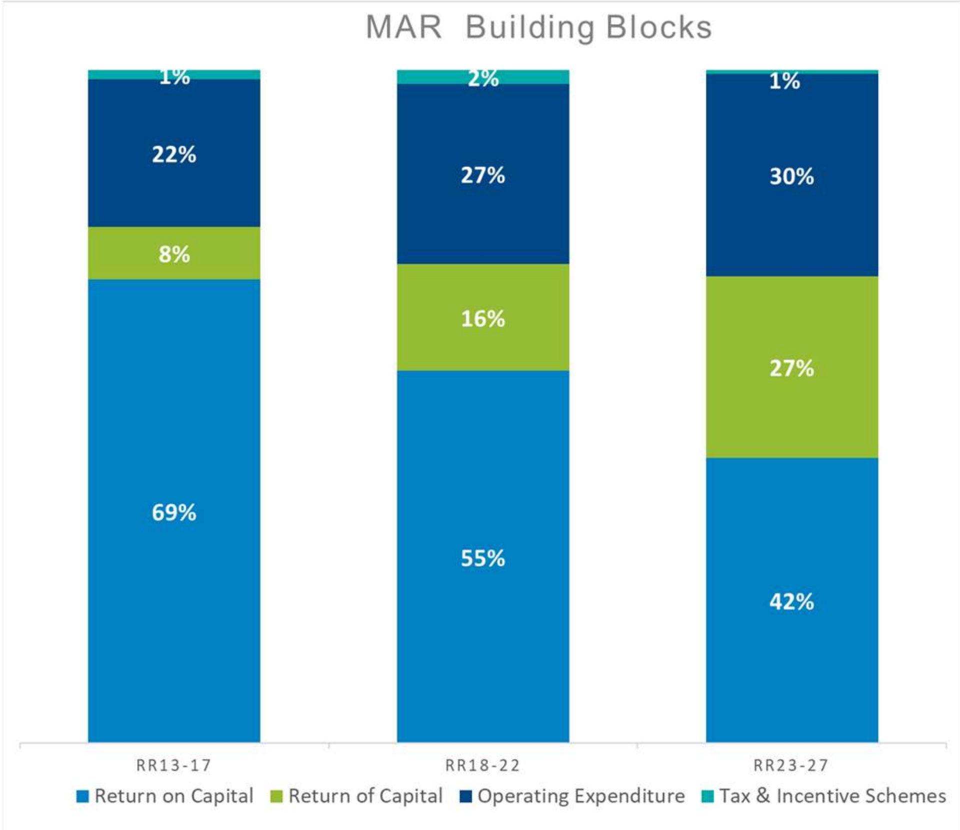
- Upper and lower average MAR forecasts based on ranges of opex, capex and WACC.



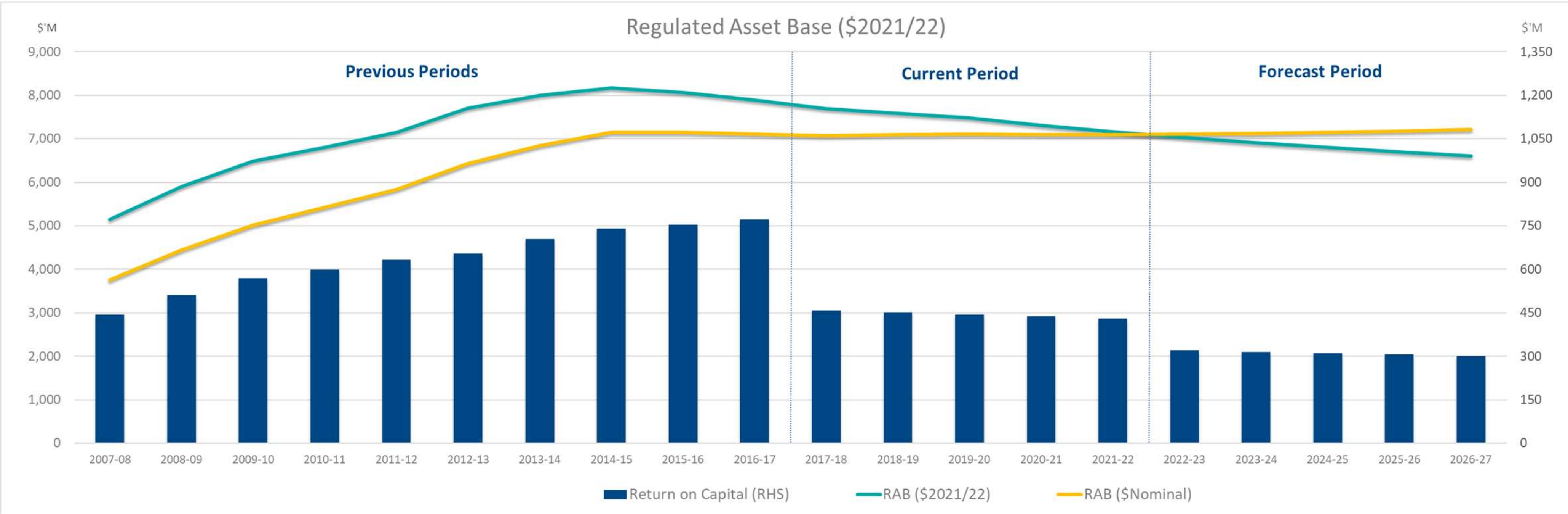
Initial forecast – MAR

Below figures show the 'central' forecast range only.





Initial forecast – RAB



Forecast impact on prices

- Powerlink's contribution to the average electricity bill is ~7% for households and small businesses[1].
- This equates to ~$110 per annum for households[2] and ~$170 for small businesses[3].
- Based on the initial forecast MAR ranges, the indicative impact to electricity prices in the first year of the next regulatory period (2022/23) would be:
    - Residential – reduction of ~$10.
    - Business – reduction of ~$15.

[1] *based on the 2018 Australian Energy Market Commission (AEMC) Electricity Price Trends Report, published December each year.*
[2] *based on the Queensland Competition Authority's (QCA) annual Tariff 11 (residential) median energy usage of 3,738kWh p.a.*
[3] *based on the QCA's annual Tariff 20 (small business) median energy usage of 6,866kWh p.a.*

Wrap up and interactive discussion

Wrap up

- We will develop our expenditure requirements over the coming months to ensure they are prudent and efficient.
- We recognise the reductions in prices within this indicative forecast are predominantly driven by the WACC and financial market movements (i.e. items not within Powerlink's control) and that we will need to demonstrate in the coming months what we are doing to deliver value for our customers.
- Powerlink intends to provide an updated forecast in March 2019 for further consideration and continue to engage per its Revenue Determination Process Engagement Plan.

Interactive discussion

Are there any improvements which Powerlink can make on how these forecasts are presented to facilitate engagement in the future?

What further information would Customer Panel members be interested in seeing in the next update of the Revenue Proposal forecast?


Powerlink