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AusNet Services Holdings Pty Ltd

14 May 2024

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Issuer Outline

AusNet Services Holdings Pty Ltd is a wholly owned subsidiary of AusNet Pty Ltd (AusNet, Group) and is the funding entity for the Group.

AusNet, headquartered in Melbourne, is a diversified electricity and gas infrastructure business that wholly owns, operates, and controls its assets. These include the primary regulated Victorian electricity transmission network, an electricity distribution network in eastern Victoria and a gas distribution network in western Victoria. AusNet also operates an unregulated (contracted) business that provides contracted infrastructure and asset / utility services.

AusNet is 45% owned by Brookfield alongside minority stakes from a few Australian and Canadian pension funds, post privatisation in early-2022. The owners have stated their commitment to maintain strong investment grade credit metrics.

Sector: Infrastructure
Sub-sector: Electricity & Gas
Country: Australia
Ownership: Private

Key Financials (AUDm)

LTM (31 Dec)	2023
Revenue	1,361.5
EBITDA	862.7
Net interest expense	(295.4)
Total assets	13,970.3
Cash	2.0
Total debt	10,489.9
Net debt / RAB (%)	66.4

Source: Company, FIIG Securities, S&P Capital.

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call[1]	Maturity Date
AU3CB0242527	AUD 425m	Senior Unsecured	4.40%	Semi-Annual	N/A	16 Aug 2027
AU3CB0288066	AUD 500m	Senior Unsecured	4.301%	Semi-Annual	30 Jan 2028	30 Mar 2028
AU3CB0299816	AUD 700m	Senior Unsecured	6.134%	Semi-Annual	31 Mar 2033	31 May 2033
AU3CB0309664	AUD 500m	Senior Unsecured	5.9812%	Semi-Annual	16 Mar 2034	16 May 2034
AU3FN0056594	AUD 650m	Subordinated	3M BBSW + 3.10%[2]	Quarterly	6 Oct 2025	6 Oct 2080

[1]Excludes potential terms that would allow the issuer to redeem prior to the maturity date through a make-whole call. [2]Margin step-up to 3M BBSW+3.35% from 6 October 2030 and to 3M BBSW+4.10% from 6 October 2045.

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Strengths

- Competitive position: AusNet owns and operates three regulated assets, including an electricity transmission network and sole electricity and gas distribution services in eastern and western Victoria, respectively. These assets are critical in the delivery of energy in Victoria and are monopolistic in nature. AusNet's three main regulated assets contribute more than 85-90% of the Group's EBITDA. The fact that its regulated revenue is tied to three networks, rather than the typical one for most other utility companies, means that any single adverse decision made by the regulator would have a proportionally lower impact on the Group's total revenue. The diversity of its networks also means it would be unlikely that the reasoning behind a poor regulatory decision could easily be applied to the other two networks.
- Predictability of cashflows: The Group enjoys the benefit of having a portfolio which is diversified through transmission and distribution assets, electricity, and gas sectors, as well as different regulatory revenue/tariff reset dates providing stable cashflows through the cycle. Approximately 82% of AusNet's consolidated revenues for the 12 months to 31 December 2023 (FY23) were regulated, all of which are protected from the risk of increases in inflation. The regulator has made recent final decisions regarding AusNet's regulated revenue; transmission revenue was set in the last few years to 2027, the gas revenue reset finalised in May 2023, and electricity distribution tariff to be reset in 2026.
- Minimal exposure to volume risk: AusNet's exposure to volume risk is minimal given that the electricity transmission and distribution business operates under a revenue cap mechanism, which accounts for around 70% of the Group's EBITDA. Although the gas network has some exposure to volumes, the risk has been negligible in recent times given the modest growth incorporated by the regulator as part of the rate-setting process. The medium to long-term evolution of the gas business has some existential question marks over it, however an acceleration in asset depreciation was approved by the regulator in 2023 (see further below), which is a 'non-cash' charge that lowers the amount of statutory profit (but more importantly, 'cash tax' payable in this segment).
- Strong regulatory framework: Australia's strong and supportive regulatory framework is a fundamental driver of the credit quality and stability of the regulated utilities sector. Rating agencies expect the regulatory process to continue to remain supportive and provide entities enough time to adapt to emerging disruptive technologies.
- Hedged and diversified funding sources: Although the Group has a significant level of debt, the maturity profile is well staggered with no more than AUD950m due in any single financial year, materially reducing the refinancing risk. In addition, the Group is a seasoned global issuer with outstanding debt denominated in EUR, USD, HKD, JPY, and NOK. All non-AUD sources of funding are fully currency hedged to reduce risk, while a minimum of 90% of outstanding debt is hedged against a rise in yields (currently at 95%).

Risks

- Exposure to regulatory resets: Regulatory resets expose AusNet to a varying level of return depending on the interest rate environment. Since 2016, lower WACC outcomes (hence lower revenues and EBITDA) have been largely offset by lower interest rates. These risks are partially mitigated by AusNet's supportive financial and capital management policies, as well as ownership of multiple networks with staggered regulatory reset dates.
- Exposure to cost changes within a regulatory control period: The Group is exposed to cost changes within a regulatory control period and bears the risk of any shortfall in allowances for costs provided by regulatory determinations. Costs can change materially within a regulatory control period due to, among other things, changes in the costs of labour, equipment, or capital inputs (including the cost of finance).
- Growth in unregulated asset base: AusNet intends to grow the asset base of its unregulated business (which has doubled over the last five years). Despite the targeted growth, Moody's expects the contracted asset base will remain at a modest level relative to its regulated asset base (currently AUD1.2bn for contracted assets compared to AUD12.1bn for regulated assets), and that the additional investments in contracted assets will be restricted to stable infrastructure assets with a risk profile similar to its existing portfolio, which generally requires minimal capital expenditure.

FIIG The fixed income experts

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- Recent delisting following privatisation: AusNet is now privately owned, which means that the company might be not subject to the same level of public scrutiny as when it was listed on the ASX. The new owners may implement more aggressive financial policies, and there has been an initial uptick in leverage which leaves the Group more leveraged than peer networks. However, there is a public commitment by the owners to AusNet's credit metrics and ratings, and Brookfield has a long-term track record of prudent financial management of its assets. Brookfield has also demonstrated globally that, when it makes a commitment towards meeting targeted credit ratings, they stick to it.
- Weather related events: Changing weather conditions and a growing number of severe events have the potential to impact AusNet's physical assets (damage and interruptions to supply). For example, there was a serious weather event across Victoria in early 2024 which damaged some of AusNet's electricity transmission and distribution networks. The total cost of the repair and rebuild work is approximately AUD92-104m across capex and opex, plus payments under the Guaranteed Service Level regulatory framework and contributions to AusNet's Energy Resilience Community Fund. AusNet continues to strengthen the resilience of its assets and actively manage and prepare for such events, including bushfires. Additionally, AusNet is able to submit pass-through applications to seek recovery of those costs, as permitted under the regulatory framework.
- Volume risk in gas network: Around half of AusNet's gas distribution network revenues are derived from the transported volume of gas metered at the connections to the distribution networks, with the balance recovered through fixed charges. The volume of gas used is subject to seasonal fluctuations and to a range of variables, including economic conditions, population growth, government policy, weather, alternative energy sources, technology, energy saving behaviour and availability of adequate supplies of gas. Economic downturns and customer relocations out of a distribution area would also have a direct adverse effect on the AusNet's revenues. However, we note that this segment accounts for around 15% of the Group's EBITDA.

  Last year, the Victorian state government announced bans on new gas connections and legislation to limit the replacement of gas appliances. AusNet intends to re-open the AER's 2023 final decision following these developments and has informed the AER (i.e. gas demand forecasts will need to be reduced, and this should result in an increase in price per unit to ensure network recovery. AusNet will also ask to increase the accelerated depreciation). Management noted that the gas transition will take a long time to play out. Government policy at this stage is intended to reduce and limit growth in new gas connections, rather than impact the existing client base, although this is expected over time. This development should have a limited effect on the Group's financial results, as existing network connections are not directly impacted by the ban (only new ones, which have been a lower proportion of total connection each year). In future as new connection come off, AusNet commented that they wouldn't need to spend capex investment to connect those customers, so there is an expected cashflow benefit to that.

Risks relevant to the Subordinated notes

- Subordinated nature of the notes: The subordinated notes and the guarantee are subordinated with limited remedies for non-payment, upon the occurrence of an Event of Insolvency of the issuer, payments on the subordinated notes will be subordinated in right of payment to the prior payment in full of all other liabilities of the Issuer, except for obligations which rank equally with the subordinated notes or in respect of the Issuer's ordinary shares.
- Interest deferral: Consistent with subordinated notes issued by corporates as a form of capital supporting their rating, the notes include an option for AusNet to defer interest, noting that deferred interest would be cumulative and compounding (i.e. not foregone and investors will earn interest on the deferred portion of interest).
- Long dated maturity: The subordinated notes will mature in October 2080 and, although the AusNet may redeem the Notes in certain circumstances prior to such date, the issuer is under no obligation to do so. Therefore, Holders should be aware that they may be required to bear the financial risks associated with an investment in long-term securities.
- Rating risk: The notes have been issued in part to support AusNet's corporate rating. This is because the terms of the notes (subordination, interest deferral, perpetual) results in the rating agencies treating 50% of the notes as equity for the purpose of their financial analysis. Further, based on S&P's current rating methodology, the notes would be treated as 100% debt from their first call date. This current rating construct means that AusNet would have a significant incentive to

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redeem the notes at the first possible option. However, should rating agencies change their methodology and provide rating support for a longer period of time, this would remove this incentive to call and would likely result in a (potentially significant) drop in the price of the notes.

Summary Financials

The financial summary below represents the consolidated operations of AusNet Services Holdings Pty Ltd (AUDm, FYE 31 December).

Income Statement	FY19*	FY20*	FY21*	FY22	FY23
Revenue	1,861.5	1,977.6	1,924.5	1,360.1	1,361.5
EBITDA	1,134.2	1,196.6	1,154.6	850.4	862.7
Interest expense	(324.2)	(343.8)	(306.6)	(301.8)	(472.2)
Depreciation & amortisation	(456.4)	(464.5)	(463.9)	(350.3)	(372.0)
Net income	253.9	290.7	302.1	1,110.3	685.4
Balance Sheet	FY19	FY20	FY21	FY22	FY23
Cash	339.4	155.3	827.9	14.5	2.0
Total assets	12,815.8	14,284.8	14,629.6	12,616.4	13,970.3
Total debt	7,946.4	9,280.7	9,187.2	9,992.9	10,489.9
Total equity	3,289.1	3,005.6	3,434.9	1,664.6	2,457.7
Cash Flow Statement	FY19	FY20	FY21	FY22	FY23
Cash flow from operating activities	813.7	720.6	844.5	123.5	357.3
Cash flow from investing activities	(882.9)	(1,204.7)	(1,204.7)	(349.3)	(507.5)
Cash flow from financing activities	(249.6)	219.1	1,032.8	(30.5)	137.7
Capital expenditure	(969.8)	(989.1)	(525.4)	(541.2)	(588.2)
Credit Metrics	FY19	FY20	FY21	FY22	FY23
Net debt / RAB	67.1%	67.4%	66.6%	69.1%	66.4%
EBITDA / Interest expense	3.5x	3.5x	3.7x	2.8x	1.8x

Source: S&P Capital, Company, FIIG Estimates.

**Financial year end 31 March. The financial results in these years were prior to the change in ownership.*

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