

SCT Logistics

Executive summary

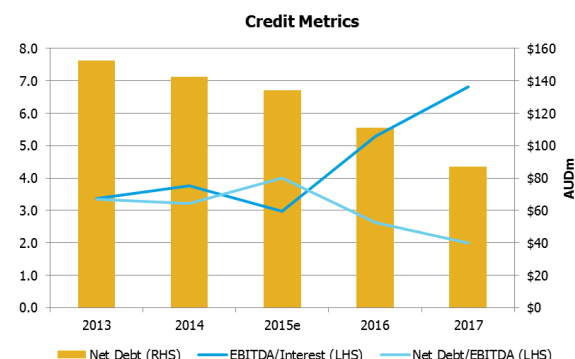
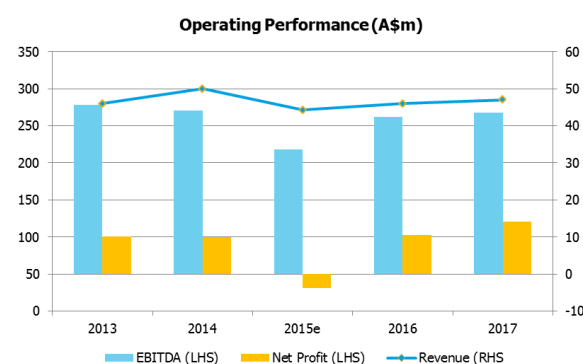
- SCT Logistics ('SCT') is Australia's largest private rail freight operator with a 40-year operating history. SCT provides a full suite of vertically integrated, national logistics services, at the core of which is Australia's most modern rail freight operation and national terminal footprint. The business was established in 1974 as a rail line-haul service by Peter Smith, and ownership of the business has remained with the Smith family
- SCT runs 11 weekly services over three rail routes, the majority of earnings generated from the Australian east-west coast corridor (40% market share) and the emerging north-south corridor. Industry dynamics are favourable on long haul routes, with rail approximately four times more fuel efficient than road on the east-west corridor. SCT operates Australia's longest general freight train at 1.8km which is able to move 6,000 tonnes of freight
- Barriers to entry are high with large upfront capital expenditure requirements (\$90m+ over the last 5 years), and stringent route accreditation being required before track owners allow route access
- SCT also operates intermodal terminals in Victoria, WA, NSW and SA under long term leases with a related property trust, delivering a competitive advantage by being able to offer collocation services to freight customers nationwide
- SCT transports fast moving consumer goods (FMCG), beer, wine and materials with limited exposure to goods used in mining and no direct exposure to commodities. Its customer base includes major recognised brands and retailers such as Nestle, Fosters, Super Retail Group and Woolworths. The average tenure of its major customers is ~15 years. Management advise that only 2-3 major customers have been lost over the past 25 years, all of whom were subsequently won back

FYE 30 Jun (\$m)	2013	2014	2015e	2016*	2017*
Total Revenue	279.8	300.1	271.5	280.1	285.1
EBITDA	45.7	44.2	34.4	42.4	43.5
Operating Profit	9.7	9.9	(1.0)	9.8	13.1
Debt	152.8	143.0	138.5	121.0	103.5
Net Debt	152.5	142.5	138.0	119.1	95.4
EBITDA/Interest	3.4x	3.8x	3.0x	4.8x	5.9x
Net Debt/EBITDA	3.3x	3.2x	4.0x	2.8x	2.2x
Debt / Total Tangible Assets	59.2%	58.1%	58.9%	55.5%	50.3%

Source: SCT, FIIG

'2015e' denotes management estimates adjusted by FIIG for Note Issue

* Management Forecasts



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- SCT's business model is unique as it contracts directly with the end customer and provides an 'end-to-end' logistics service with a single counterparty. The end to end service offering provides distribution integration and alignment of supply chain cycles, ensuring that SCT has direct relationships with its customers. SCT competes against freight forwarders on key contracts who then contract the road, rail and warehousing components separately, potentially leading to difficulties in assigning responsibility should issues arise
- SCT's historical revenue and earnings have been relatively stable, with the exception of FY15 which has been impacted by the implementation of a new \$16m SAP (IT) upgrade and some drop off in volumes linked to economic activity. SAP is a globally recognised enterprise IT system and will deliver efficiencies through improved operational management and customer integration. Credit metrics were impacted resulting in historically low EBITDA interest cover of 3.0x and a high net debt/EBITDA ratio of 4.0x
- Management forecast EBITDA to improve in FY16 to \$42m consistent with historical levels, with 80% of this EBITDA uplift expected to be achieved by programmes already in place. Credit metrics are expected to improve in FY16 driven by the improvement in EBITDA along with the amortisation of the secured debt and forecasts show FY16 EBITDA interest cover increasing to 4.8x and net debt / EBITDA reducing to 2.8x
- These metric improvements reflect a normalisation of volumes, efficiency gains from the new SAP system and the re-signing of a key customer contract. A recent material contract win puts SCT on track to meet or outperform FY16 revenue forecasts. We note that the recent actual monthly freight volumes for May 2015 are back to above prior corresponding monthly levels demonstrating the reversal of volume declines experienced at the start of FY15
- SCT owns fixed assets with a total written-down value (WDV) of \$164m as at March 2015, including locomotives, wagons and trucks valued at \$137m. We expect realisation levels on the transport assets would be at or above WDV levels given the relatively young age of the locomotive fleet and long useful lives (up to 40 years), as well as redeployment opportunities in other industries. Remaining secured equipment finance of \$53.5m post bond issue is expected to be largely repaid within the next 2-3 years, leading to de-leveraging and a suite of largely unencumbered assets supporting the bonds prior to their maturity
- The bond issue will provide funding flexibility by matching longer tenor funding to long-term assets, while allowing capacity to fund business growth (i.e. on the north-south corridor). New senior debt incurrence is capped at 2.0x EBITDA, with a limitation on total debt incurrence of 4.0x EBITDA, declining to 3.0x by 2019
- SCT is exposed to the risk of further deteriorating economic conditions in the Australian market. However, this is mitigated by the nature of the transported product (FMCG, no commodity exposure), and overall total domestic freight projected to almost double by 2030 according to government forecasts
- SCT is seeking to raise a minimum of \$75m with oversubscriptions to \$85m in unsecured bonds to replace existing secured equipment finance debt. The bonds are offered in two series:
 - Series A \$30m (minimum) to \$35m: offers a floating rate of 90 day BBSW+440bps p.a. (paid quarterly) for four years, callable at the company's option after two years at \$103 or after three years at \$101.50
 - Series B \$45m (minimum) to \$55m: offers a fixed rate of 7.65% p.a. (paid semi-annually) for six years, callable at the company's option after four years at \$103 or after five years at \$101.50

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Background

SCT Logistics ('SCT') was established in 1974 and is Australia's largest private rail freight operator. SCT provides a full suite of vertically integrated, national logistics services, at the core of which is Australia's most modern rail freight operation. SCT employs over 1,000 people nationally either directly or indirectly through a pool of subcontractors or labour hire staff.

SCT was established as a rail line-haul service between Melbourne and Perth in 1974 by Peter Smith. Mr Smith, now the Chairman of SCT, resides on the Gold Coast and the Queensland top 150 rich list places his net worth at \$167m (ranked 75th). The management of the business has remained with the Smith family, with Geoff Smith (son) the Managing Director of the business and Glenn Smith (son) as CEO, both of whom have been in the business for 20+ years.

In the mid-1990s, National Rail decided to discontinue the use of louvered vans and boxcars on its trains. At the same time, Australia's rail network was being opened up to enable private operators the use of publicly owned railway track.

SCT had a customer base who wished to retain their use, so a number of surplus boxcar wagons (louvered vans) were acquired, and hook and pull agreements were agreed with V/Line Freight (Melbourne to Adelaide) and Australian National (Adelaide to Perth) to haul the trains.

SCT was the first private operator to commence independent rail line-haul services in Australia in 1995.

In February 2007, SCT purchased nine G class locomotives and leased three NR class locomotives from Pacific National. The nine locomotives were made available to comply with an Australian Competition and Consumer Commission pledge given by Toll Holdings as part of it acquiring control of Pacific National. These were replaced between 2008 and 2012 when SCT purchased 21 new purpose built locomotives.

SCT operates Australia's longest general freight train at 1.8km and able to move 6,000 tonnes of freight. In 1999, SCT opened its own purpose built rail terminal in Perth followed the next year by one in Melbourne. As part of its corporatisation, recently SCT achieved security separation of its property trust (Blanalko) which now holds terminals in Victoria, WA, NSW and SA with a value of c\$350m (geared to 56%).

Long term arm's length leases at market rates are in place between the property trust and SCT with no other support between the property trust and SCT, and no recourse of SCT's debt holders to the assets of the property trust (and vice versa). Having said this, given the common ownership of SCT and Blanalko and their complementary purpose, we note there is a strong alignment of interest between these two businesses which supports the credit profile of SCT and makes SCT's business model difficult to replicate.

The company and ownership structure is set out in Appendix 1.

Operations

SCT operates an integrated intermodal business:

- Integrated rail freight forwarding and is the largest on the east-west corridor allowing direct access to customers and freight directed to the SCT rail operation
- The second largest rail freight operator on the East-West corridor, with approximately 40% market share and access to modern terminals in key capital cities under long term lease with a related party

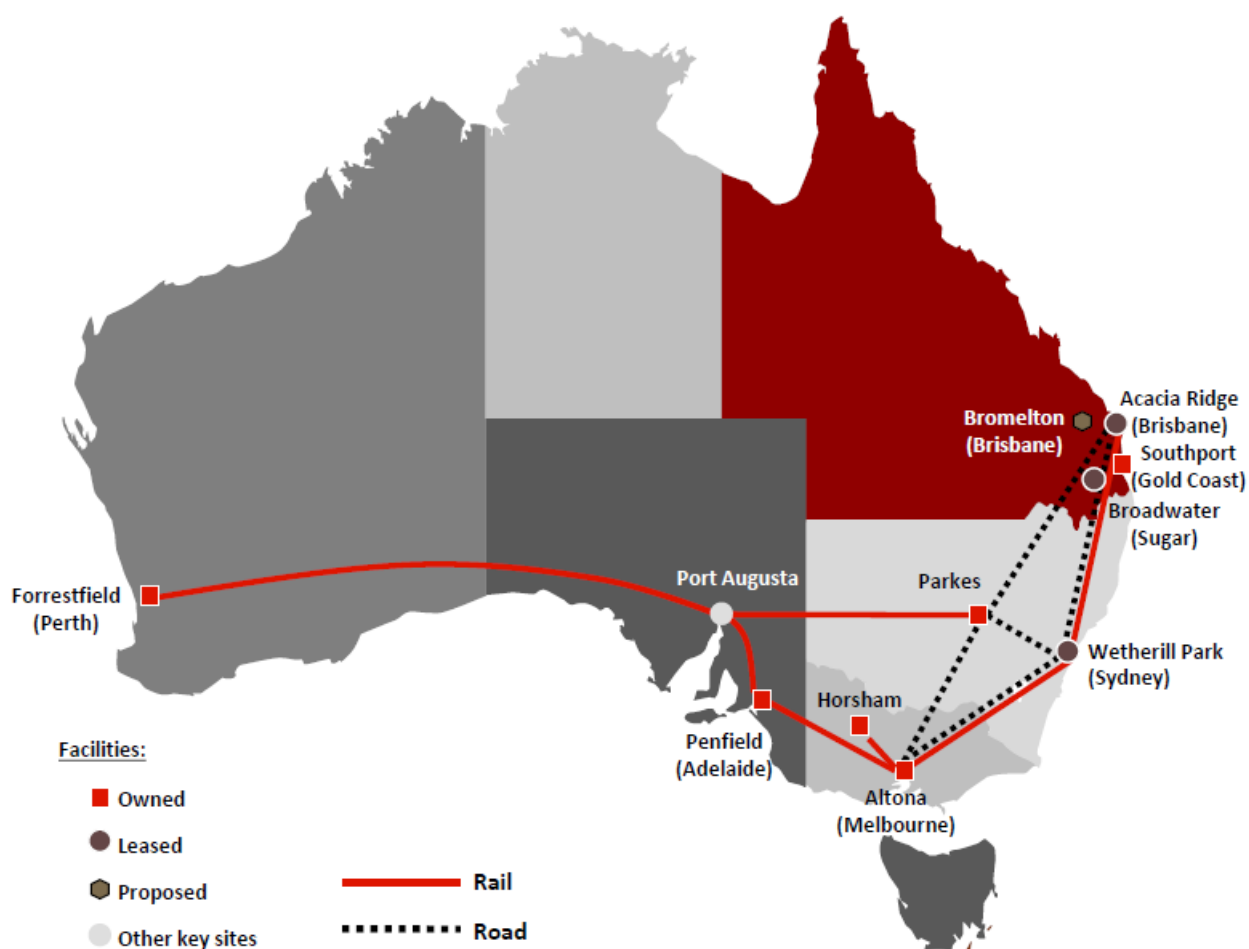
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- Road line-haul and short haul which complements the core rail operation and allows SCT to provide a full service offering to its customers
- Warehousing with SCT operating warehouses in Perth, Brisbane and Sydney allowing SCT to offer value adding services to its customers

Barriers to entry are high with route accreditation being required before track owners offer train paths. The accreditation process is formidable, with requirements including rolling stock safety audits and qualification of operating personnel. SCT has all necessary accreditations in place to undertake its operation and these are listed in Appendix 4.

SCT has sites located across Australia in key locations with respect to both the East-West corridor and the emerging North-South corridor. The limited available land (particularly adjacent to the rail line) in each key location makes these sites difficult to replicate. The location of terminals close to major ports also provides SCT with a key strategic advantage with regards to future expansion, particularly on the North-South corridor. SCT advise that it has capacity to take on incremental revenue without significant capital expenditure.

Figure 1: SCT Group's national footprint



Source: SCT presentation

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SCT runs 11 weekly services over three rail routes:

- Melbourne-Adelaide-Perth return service, four times a week
- Parkes-Perth return service, twice a week. Shuttle trucks move freight from Sydney to Parkes, the starting point for the Sydney-Perth trains
- Melbourne-Brisbane return service, five times a week

Its key assets include:

- 15 EDI locomotives (2008) and six CSR locomotives (2012) with a written-down value of \$77m as at 31 March 2015. These are new, state of the art, purpose built for SCT. Locomotives have an ATO effective life of 20-25 years but in practice many locomotives run in the vicinity of 40 years as their maintenance regimes are strict to maintain a mainline standard. For example, Pacific National continues to run locomotives constructed in the 1980s (81 Class and Class A)
- 433 box car wagons (44 refrigerated) and 182 intermodal wagons with the majority manufactured post 2005. Wagons have an ATO effective life of 30 years but in practice many wagons run in the vicinity of 40 years as again their maintenance regimes are strict. The wagons have a WDV of \$45m as at 31 March 2015
- 200 trucks and trailers with a WDV of \$14m as at 31 March 2015

Competitive dynamics

SCT is an integrated freight forwarder and rail operator, assuming responsibility for a customer's supply chain logistics from dispatch distribution centre point to arrival distribution centre. As such, SCT does not have a natural competitor in the Australian market, where the more common model is separate freight forwarding businesses (Toll, Linfox) and rail freight operators (Asciano and Aurizon). SCT's business model is therefore unique in that it contracts directly with the end customer and provides an 'end-to-end' logistics service with a single counterparty. The co-ordination of intermodal logistics is complex and therefore being able to organise a variety of movements with the one counterparty (SCT) is viewed by many customers as an advantage.

In terms of tendering for customer contracts, SCT competes against freight forwarders Linfox and Toll on key contracts. Linfox/Toll then contract the road, rail and warehousing components separately. The end to end service offering provides efficiencies and a better customer service while ensuring that SCT has direct relationships with its customers. Asciano and Aurizon's business model relies on the freight forwarders and hence if they attempt to deal directly with the end user they start to come into competition with their freight forwarder customers.

The east-west corridor, on which SCT earns 50-60% of its revenue, is serviced by only three rail logistics providers. SCT holds approximately 40% of overall market share on this route, with Asciano holding 50% and Aurizon with 10%. The robustness of SCT's business model is evidenced by Aurizon having entered this market seven to eight years ago and only being able to secure a modest market share. We understand Aurizon has invested substantial capital expenditure into growing its east-west presence, but so far has not been able to achieve meaningful market penetration. This demonstrates that SCT has been able to compete successfully in its core market despite being of a smaller scale to its key rail competitors.

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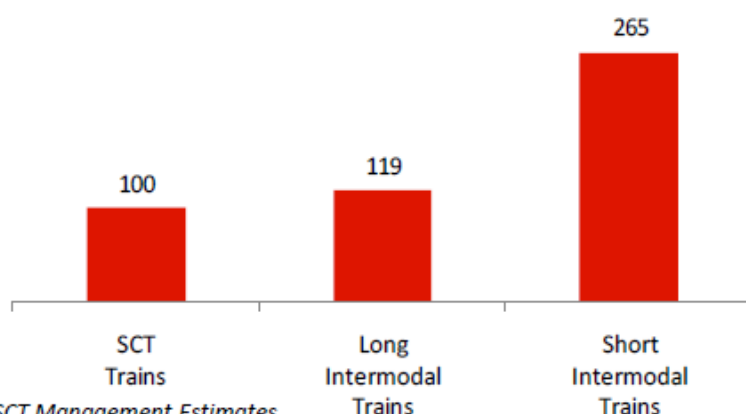
Relative to its competitors, SCT's cost advantage comes in two forms:

- Operating the most modern fleet; and
- A model which combines intermodal (containers) and boxcar wagons, a strategy that both Aurizon and Asciano moved away from several years ago. The 'mix and blend' model allows SCT to better manage its train loading with trains subject to strict length, weight and cubic meters limitations. It would require significant investment for Aurizon and Asciano to revert to this model

SCT's fleet consists of locomotives that are the most modern and technologically advanced fleet in freight transport, enabling SCT to run the largest and most environmentally efficient locomotives operating in Australia today. This increased power of the new engines allows SCT to replace the previous three locomotives with just two, while also increasing the total payload capacity of a train service by 400 tonnes. SCT also runs in-line fuelling while the train is in operation as opposed to stopping at fuelling points along the way.

In addition to its modern fleet, SCT's unique ability to mix and blend freight means that it is consistently able to operate well above the capacity that its competitors are able to achieve on their rail trips. These competitive benefits are reflected in the comparable cost advantage chart below:

Figure 2: Rail comparable cost index per payload tonne



Source: SCT Management Estimates

Notes:

1. Base Index (SCT Trains) = 100
2. Indicative for a Melbourne – Perth train (assuming top up in Adelaide)
3. Assumes no back-loading available (ie. forward freight must pay for the train returning empty)
4. Includes capital servicing (ie. leasing) on all equipment
5. SCT Trains assumes optimum performance of current trains

As noted above, Asciano and Aurizon have both moved to a fully containerised approach. Aurizon does directly haul boxcars on its north-south route but it does so on behalf of SCT. Containerisation is a system of intermodal freight transport using intermodal containers with standardised dimensions. They can be loaded and unloaded, stacked, transported efficiently over long distances, and transferred from one mode of transport to another without being opened. The handling system is completely mechanised so that all handling is done with cranes and special forklift trucks. All containers are numbered and tracked using computerised systems.

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For a business such as Asciano, which manages substantial import-export (IMEX) volumes through its Patrick ports business as well as its Pacific National rail business, the rationale for moving towards a containerised approach was about the efficient movement of freight across each of the transport modes (sea, road, rail). SCT, on the other hand, has a relatively greater focus on interstate as opposed to IMEX volumes. For SCT, the rationale for the 'mix and blend' model using boxcars is to provide flexibility to its customer base as well as efficiency. The rationale behind a boxcar is that a wagon can be completely filled with multiple customers' goods, and can also be unloaded mid-route and reloaded with other goods. Containers can run less than full on many occasions and each only caters for a single customer which creates a less efficient train trip.

Containers are also disadvantaged on the Melbourne-Adelaide leg of the east-west route because they cannot be double-stacked due to height restrictions (driven by over-rail bridges), giving SCT and its boxcar strategy an additional advantage on this leg of the East-West route.

SCT is expected to benefit from the push towards seeing rail take more of the east coast freight task. It is currently estimated that only 30% of land-based freight between Victoria and Queensland uses rail, compared to 80% of land-based freight on east-west routes. Rail volume growth on the eastern seaboard is possible and likely through the potential for market share capture from road.

Further to the above, the planned Inland Rail track between Brisbane and Melbourne is 220km shorter than the best available road route between Melbourne, and once completed, the journey could be completed in less than 24 hours. Development of the Inland Rail track would be supportive of the further use of rail on the north-south corridor and therefore to SCT. The ARTC is currently stepping up its campaign to fast-track building of the project.

Industry dynamics are favourable on long haul routes with rail:

- Approximately four times more fuel efficient than road on the east-west corridor
- Freight takes three days to be transported from Melbourne to Perth by rail and 10 to 16 days by sea
- An efficient transport mode in terms of greenhouse gas emissions
- Significantly safer than road. This advantage is likely to increase further as tougher laws targeting driver fatigue, chain of responsibility, driving hours and vehicle speed take effect on the road freight industry
- Increasing government focus on rail transportation. This includes significant investment by the government-owned Australia Rail Track Corporation (ARTC) which is improving rail competitiveness, with a focus on improving transit time, reliability, availability, capacity and price. ARTC have a proposed scope of work planned totalling c\$5b from 2016 to 2020.

SCT is also seeking to expand its footprint in relation to import-export volumes. Recently DP World Australia and SCT's bulk rail related entity, Specialised Bulk Rail (SBR) announced they will link together provide a rail service to the Port of Melbourne from Victoria's Wimmera region. The initiative leverages SCT's intermodal freight terminals at Wimmera and Altona, Victoria with the pair providing western Victoria exporters with direct access to the dock at West Swanson Terminal at the Port of Melbourne, in what will be the only true on-dock rail service at the port.

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FIIG Research site visit: Altona Intermodal Terminal

As part of the credit research opinion and report, FIIG Research conducted a site visit of the intermodal terminal in Altona, Victoria and observed a wagon-loading procedure for a scheduled departure to Perth. Within the terminal, at any given time there are goods from over 200 various customers needing to be distributed. The 'mix and blend' model adopted by SCT allows it to optimise the efficient use of each wagon, by filling it to its capacity and optimising the weight load across each wagon. In addition, the 'mix and blend' model is highly flexible to customer's needs. For example, where a customer does not require the use of a full wagon the model allows multiple users' goods to be handled in one wagon. This provides greater flexibility and efficiency versus the containerised model adopted by SCT's key rail freight competitors. The rail wagons have direct access into the warehousing facility which allows loading directly from the warehouse onto the rail line.

Figure 3: Altona warehousing facility, with direct loading access to wagons



Source: FIIG Securities

Four times per week, a 1.4km train departs Altona for Perth then adding 400m of additional wagons in Adelaide carrying 6,000 tonnes of goods, achieving a maximum journey speed of 110km/h. The stopover in South Australia allows it to drop off and load goods mid-journey which improves overall trip efficiency. The train carries a combination of box wagons, refrigerated wagons and containers, as well as carrying diesel fuel which provides refuelling capability while in transit.

Figure 4: Scheduled Melbourne-Adelaide-Perth service and refrigerated container



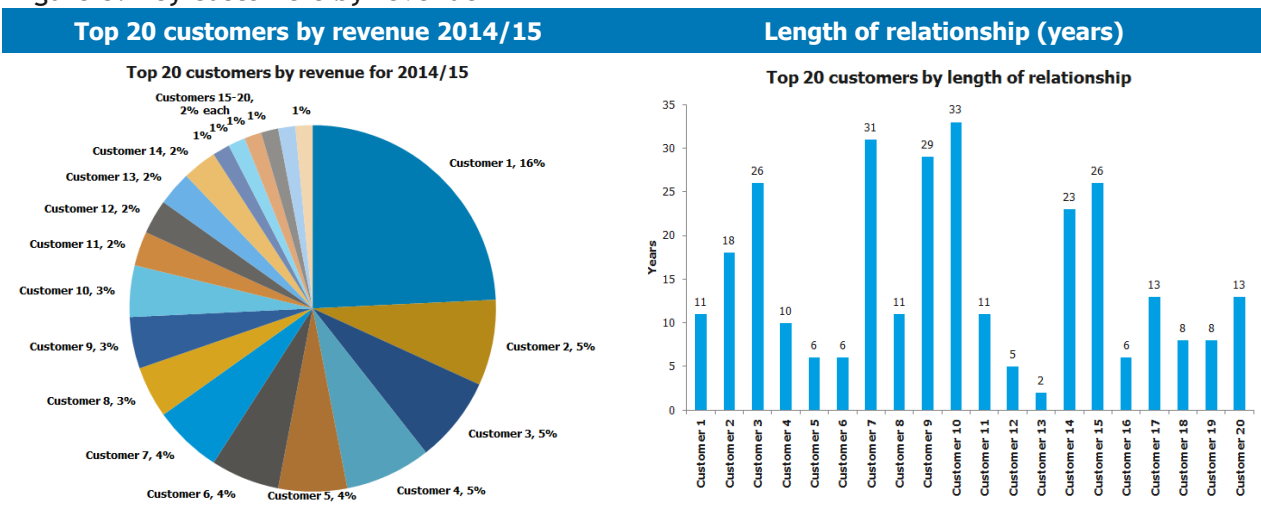
Source: FIIG Securities

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Customers and contracts

SCT has a long term contracted base of customers that have been with SCT for many years. The top 20 customers of SCT contributes 70% of total revenue in FY15 and the top 50 customers of SCT contributes 85% of total revenue in FY15.

Figure 5: Key customers by revenue



Source: SCT, FIIG Securities

The contracted nature of the business is illustrated by the contract renewal process of the top ten contracts:

- Customer 1 - expires June 2016
- Customer 2 - expires June 2016
- Customer 3 - expires August 2017
- Customer 4 - expires May 2022
- Customer 5 - expires December 2015
- Customer 6 - expires June 2016
- Customer 7 - expires April 2017
- Customer 8 - expires November 2018
- Customer 9 - expires June 2016
- Customer 10 - expires May 2015 (currently in process of renewal – 33 year relationship)

The average length of relationship amongst SCT's top 20 customers (by revenue) is 15 years. Management are confident that all customers will roll their contracts. Management advise that only two to three major customers have been lost over the past 25 years, all of whom have been won back. The products that SCT transport are fast moving consumer goods (FMCG), beer, wine and materials with limited exposure to goods used in mining and no exposure to commodities (iron ore or coal).

The recent re-signing of the Fosters' contract, where Fosters resumed business with SCT after only one contract period with a competitor, demonstrates the 'stickiness' of its customer base as well as its ability to compete with key competitors Asciano and Aurizon despite being of a smaller scale.

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SCT's combination of an east-west and north-south boxcar service is supportive of large, key customers where they rely on both routes for distribution. For example, Woolworths, a key customer, moved their Melbourne to Brisbane primary freight from road to rail two years ago.

While the length of the customer relationships is supportive of contract renewal, we note that contracts amounting to about 25% of revenue are due for renewal within the next 12 months. In the event that some or all of the upcoming contracts are not renewed, in the short term SCT would be able to respond quickly by reducing its variable costs:

SCT has a large variable cost base including:

- 75% of its below rail charges are variable as are rail access, loading and fuel costs
- A proportion of labour is also contracted so this can also be reduced

Should material volumes fall away over a longer term, SCT has the following options:

- redeployment of the trains to its related bulk rail company SBR or to another rail provider (under lease and revenue generating) or
- sell equipment on market

All of SCT's contracts have 'effective' pass through provisions for fuel which rises and falls monthly, track access fees, wages and maintenance limiting the risk of contracts becoming uncommercial.

Rail access arrangements

SCT has entered into track access agreements to secure access to the rail network. These agreements are critical to SCT's operation as they provide SCT with scheduled 'train paths' on the rail system. As an example, SCT's track access agreement includes the train path departing 7pm Thursday from Melbourne, which is scheduled to arrive in Perth by Sunday. An evening departure from Melbourne allows for goods to arrive at the Altona terminal during the day and be loaded onto wagons. This service allows freight to reach the customers' distributions centres on Monday. Many of SCT's train paths on the east-west route are considered 'premium' slots because of their scheduled departure and arrival times relative to customers' supply chain cycles.

The majority of the freight rail network is owned by the government-owned Australian Rail Track Corporation (ARTC), with the exception of the Kalgoorlie-Perth section of the network which is owned by Brookfield Rail. ARTC is vertically separated, providing 'below-rail' services (such as the rail track infrastructure) but not 'above-rail' services (such as haulage). SCT's track access agreement with ARTC expires in August 2018. Renewal is dependent on continued compliance with established protocols and SCT has successfully renewed its agreement with ARTC on multiple occasions. ARTC has a standard format access agreement which can be found at the following link:

<http://www.artc.com.au/library/Schedule%20D%20-%20Indicative%20Access%20Agreement%20clean.pdf>

The track access arrangements with ARTC are regulated by the Australian Competition and Consumer Commission (ACCC) ensuring operators on the rail network compete on a level playing field with regards to track access and associated charges. Appendix 4 provides further detail on the rail access regulatory framework and a summary of the ARTC standard track access agreement terms. The 2008 below rail access undertaking applies for a ten year term and is due to expire in 2018, at which point SCT expects it would renew its

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agreement with ARTC under a further long term agreement. We note SCT's extensive, long term experience and relationships with the track owners mitigates contract renewal risks. SCT advise that there are no outstanding regulatory or audit issues.

The privatisation of ARTC is currently being considered by the Federal government, which we outline further in the 'Risks' section below. While the full implications of the potential ARTC privatisation are unknown, it is SCT's expectation that existing users would secure renewed long term access agreements as part of the privatisation process. We also generally note that it is in the interests of both ARTC and Brookfield that maximum capacity on the network is achieved, therefore placing an onus on the below rail providers to ensure SCT continues to renew its track access agreements.

The pricing mechanism for track access consists of a fixed component irrespective of whether the train path is utilised or not (referred to as a 'flagfall charge') as well as a variable charge. We understand from SCT that the variable charge component makes up the majority (70%-75%) of the total access charge which we consider a positive versus a pure take-or-pay based capacity charge commonly used in the mining sector. Along with making the train path available to a rail operator, the ARTC charges also cover track maintenance, signalling and train control on the network.

In relation to the Brookfield Rail-owned track component in WA, we understand from SCT that there are no key differences between the Brookfield access agreement and that held with ARTC. SCT will be negotiating the contract renewal with Brookfield later in 2015 however SCT sees no material issues arising and terms not amending too far from the current agreement. The existing agreement with Brookfield Rail was for 7 years and SCT is expecting the Brookfield renewal will be a long term agreement.

On the north-south corridor, SCT runs the wagons and has a hook-and-pull agreement in place with Aurizon for rail haulage. This is because SCT does not have the terminal size in Queensland to handle a full train. SCT has a wagon terminal in Brisbane where the wagons are shuttled and then unloaded. The agreement with Aurizon expires in 2018. Given Aurizon and SCT compete on the east-west route, there is the risk that Aurizon does not roll over the contract in 2018 for competitive reasons. However, over time the market share of rail is expected to grow on the north-south corridor which is supportive for SCT running a train service of its own should the agreement with Aurizon not be renewed, a prospect for which they are well positioned.

Rail operators on the network must warrant they have the relevant accreditation in place and provide evidence of this accreditation to ARTC. We note that SCT has substantial experience with the accreditation process and has all necessary accreditations in place. SCT's key accreditations are also listed in Appendix 4. The accreditation process is arduous, creating a barrier to entry for prospective rail operators. For example, we understand that a train driver requires 18-24 months of training to become fully accredited.

Labour and crewing arrangements

SCT has a number of Enterprise Bargaining Agreements (EBA) in place, which are site specific and also job orientated. For example, each site has specific EBA conditions for truck drivers versus forklift drivers. All of SCT's EBAs are consistent with the award hence its industrial risk is not too dissimilar to any other organisation. Moreover, a rolling schedule of many smaller EBA renegotiations mitigates the risk of meaningfully disruptive action being taken. SCT can only note one instance when industrial action was taken at a site and this was for less than one day.

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SCT's crewing arrangements are managed through a related party, Railpro. This entity employs all the mainline rail drivers that are charged onto SCT at a cost rate plus a modest margin. Having them employed in this entity enables them to be flexible to crew train services for both SCT and related bulk rail arm Specialised Bulk Rail (SBR). These drivers operate under an EBA. Railpro took over the crewing of SCT services around September 2014.

We note that the mix and blend model adopted by SCT is relatively labour intensive as each wagon may contain product from multiple customers and needs to be stacked in such a way as to manage the load bearing profile of the wagon and the customer delivery schedule. This creates a higher degree of operational risk versus a containerised model and a higher labour cost base. This operational risk is expected to be mitigated over time with the implementation of SAP software system which will also drive improvements in operational efficiency and allow for better real-time tracking of customer freight. The SAP software system is a globally recognised enterprise software solution, and is able to provide the capability to manage financial, asset, and cost accounting, production operations and materials, personnel, plants, and archived documents within a single software application.

Property trust (Blanalko)

SCT's Property Trust has always been structurally separated and recently cross guarantees with SCT have been removed by the Property Trust's financiers. The Property Trust operates under the trading name of Blanalko and is wholly owned by the Smith family. The property trust holds interests in strategic land assets across Australia, as well as the developed intermodal terminals at each site, associated rail infrastructure and third party facilities.

SCT holds key rail-side positions at each of the intermodal terminals under long term leases with Blanalko. The sites are generally well-located to major transport routes with substantial rail infrastructure attached. All sites have the capability to expand or be reconfigured in some form to accommodate growth. While bondholders do not have direct recourse to the land assets which sit within the property trust, given the common ownership of SCT and Blanalko and their complementary purpose, there is a strong alignment of interest between these two businesses which supports the credit profile of SCT and makes SCT's business model difficult to replicate.

We understand the valuation of the property trust assets totals around \$350m, with the SCT-tenanted sites making up 30-40% of this value. The property trust has a \$205m, five-year syndicated bank facility in place which is secured against the property trust assets on a standalone basis, but holds no security over or recourse to SCT's assets. The loan-to-value ratio is approximately 56% which appears reasonable for a privately owned property trust. We understand from SCT that the rail infrastructure at the sites as well as the proximity to capital cities and the mainline would add a premium to the value of the strategic intermodal sites on a market value basis.

Significant development opportunities are available on the vacant land at major sites, offering the potential for customers to build their distribution centres next to SCT's intermodal terminal, as well as SCT expanding its own capability over time.

SCT has indicated the property trust is in adherence with all its debt covenants in relation to the syndicated bank facility, and the property trust is able to meet its full interest servicing obligations from income generated by the trust assets. The property trust operates on a standalone basis with SCT as one of its key commercial tenants at approximately 40% of total rentals, which also means that it has diversity in its customer base.

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The SCT-tenanted properties are rented to SCT with annual CPI ratcheting provisions and lease expiry dates between 2020 and 2021 (plus 2 x 5-year options). Rental rates vary according to location. We have reviewed the valuation report for one of the intermodal sites leased to SCT which notes that SCT's rental is considered to be about 20% above their determination of 'market rent'. However, we note the investment in rail track infrastructure which is not captured in the valuation report or determination of market rent, as well as the strategic benefit of the sites to SCT and its clients. On these factors together we are broadly comfortable that SCT is paying arms' length rental rates to the property trust. SCT advise that the rents are determined via a yield calculated on build cost which is not an unreasonable approach.

A number of companies are co-located with cross dock distribution facilities with SCT, or located nearby which makes moving to a competitor difficult and costly. For example, the most mature terminal in Perth has a number of customers located on or nearby the terminal land, as shown in the figure below. 60% of the Perth site is tenanted by SCT clients, such as Fosters and Supercheap Auto, with the remaining 40% by SCT.

Blanalko also holds vacant land interests in strategic sites in Northern Victoria (Wodonga) and Queensland. It has been announced that an intermodal terminal at the Wodonga site is under development, while the Queensland site has the potential to be developed into an intermodal terminal on the emerging north-south corridor. We understand Blanalko will fund the construction costs of developing these terminals should development take place, and then arm's length leases struck for operation by SCT.

Figure 6: SCT WA Intermodal Terminal



A summary of the key intermodal sites owned by Blanalko is outlined in Appendix 5.

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Board of directors and key management

The table below outlines SCT's Board of Directors, which includes key members of senior management. Many of the directors have been involved with the business for over 15 years. SCT are looking to source another independent director having had one recently retire.

Figure 7: Board of directors

Name
Peter Smith (Chairman) has been involved with the transport industry since the early 1960s. Together with Peter Gunn he previously founded Cubico which was later sold to Mayne Nickless. Mr Smith now resides in on the Gold Coast and the Queensland top 150 rich list places his net worth at \$167m (ranked 75 th).
Geoff Smith (Managing Director) joined SCT when he was 19 and has been CEO since 2003. While CEO, SCT has experienced strong growth, designed and developed new age rolling stock, commenced operations in the Goulburn Valley, acquired a new locomotive fleet, and continued to expand its rail operations and corridors.
Glenn Smith (CEO) joined SCT in 1993 and has held various key management roles before being promoted to CEO in 2012.
Grant Glinski (Non-Executive Director) long-term senior executive career in leading Asia-Pacific companies including The Mars Group.
Michael Fiteni (CFO) joined SCT in 2007 as Financial Controller and was promoted to CFO in 2013. Prior to which he was with Pitcher Partners and was Client Services/Audit manager for SCT for 8 years.
Charles Mobrici (Commercial Director) joined SCT in 1989. While at SCT, Mr Mobrici has held various senior management accounting roles including Financial Controller.
Don Axup (General Counsel) joined SCT in 2005 prior to which he was a partner with Wisewould Mahony.

Please refer to Appendix 2 for full details on the board of directors.

Equity ownership and valuation

SCT and its related parties are ultimately 100% owned by the Smith family group. As a private entity, the full extent of the Smith family's ability to contribute equity in the event of difficult trading is unknown. However, we note the Smith family's 100% ownership of the strategic property trust holding the terminal buildings. The property trust has a gross value of c\$350m and geared to around 56%, with a resultant equity value of \$150m. In addition, the Smith family owns other operating businesses including Specialised Bulk Rail and property assets.

We note there is commercial incentive to protect SCT as the major tenant of the property trust. The integrated nature of SCT, the property trust and SBR also lends itself to the common ownership structure and high prospects of equity support should any one of the businesses fall into financial distress.

The Smith family provided no indication that it intends to sell any of its businesses or publicly list the company. If SCT were to list, it is likely incoming shareholders would require management and the Smith family to remain substantially involved for a period of time, from both an ownership and management perspective.

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SCT's value can be compared to its listed competitors as follows:

Figure 8: Comparable listed competitor valuations

\$m	Asciano	Aurizon	Qube
Sales	3,934.6	3,838.0	1,368.7
EBITDA*	1076.5	1416	232.9
EV/EBITDA	9.3x	10.0x	14.3x

Sources: company accounts, LTM to Dec 2014

*Underlying before significant items

While SCT is a smaller business than its listed competitors it still operates in the same highly regulated space with high barriers to entry and hence should command a base enterprise value (EV) multiple above 6-7x.

This would place a value on SCT's equity at between \$120m-\$180m, based on FY14 and FY16 forecasts and a 6-7x EV multiple. If FY15 expected figures were to be used the valuation range would be lower at between \$70m-\$100m, however based on the reasons cited in this report the FY15 results were impacted by one-off items such as the SAP implementation and may not be indicative of future 'steady state' performance.

Figure 9: Implied SCT enterprise and equity value based on listed comparables

\$m	SCT Logistics			FY14	FY15e	FY16F
	FY14	FY15e	FY16F			
EBITDA	44.2	34.4	42.4	44.2	34.4	42.4
Multiple	6.0	6.0	6.0	7.0	7.0	7.0
EV	265.2	206.3	254.1	309.5	240.7	296.5
Debt	143.0	138.5	121.0	143.0	138.5	121.0
Equity Value	122.2	67.8	133.1	166.5	102.2	175.5

Source: SCT, FIIG

'FY15e' denotes management estimates adjusted by FIIG for Note Issue

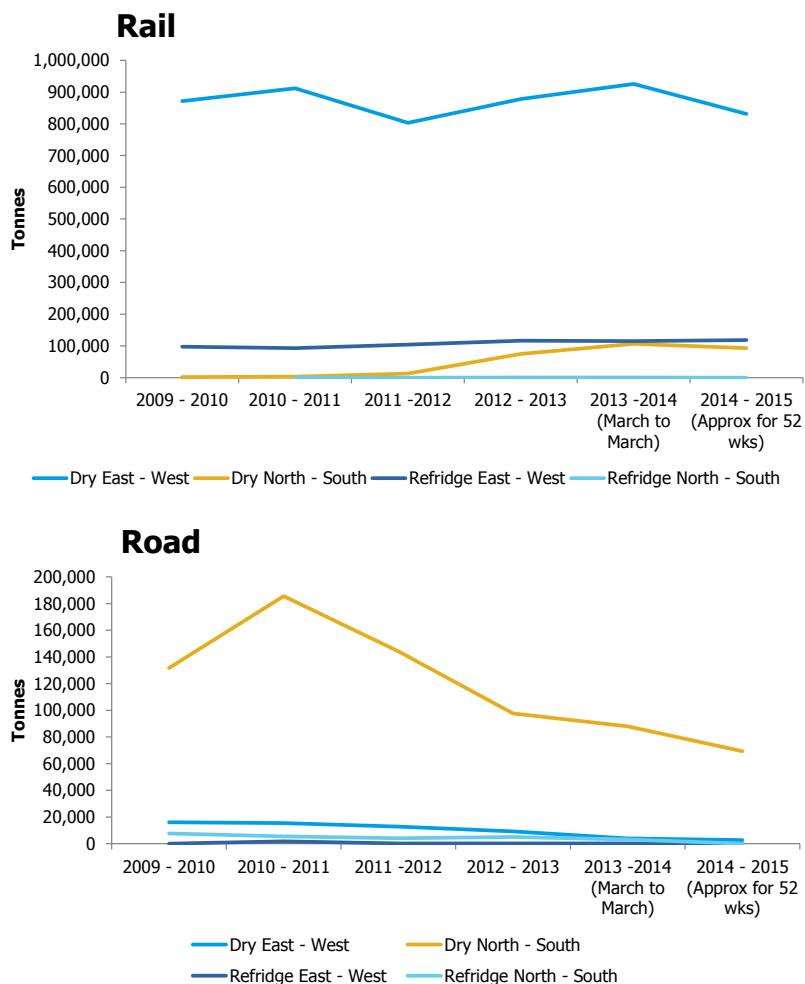
* Management Forecasts

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Freight Volumes

The figures below show SCT's historical freight volumes across rail and road. For 2014-2015, 46 weeks of actual historical volumes to 17 May 2015 have been provided then annualised to generate a comparable 52-week volume estimate for 2014-2015.

Figure 10: Historical freight volumes*



Source: Company, FIIG Securities

*2014-2015 approximation is based on 46 weeks of actual data provided to 17 May 2015

The figure above highlights SCT's volumes have operated in a tight range and the bulk travel through the east-west rail corridor. It also reflects a re-focus of the north-south corridor volumes to SCT's core business in rail as this segment moved beyond start-up and volumes increased. SCT chose to shed a number of relatively unprofitable customers that were only serviced on the north-south leg via road and focus on those that wanted to be on rail and had a connection with the freight legs of its business (eg: Woolworths). Focusing on the 'rail-plus-freight forward' delivers a more profitable approach to SCT than road freight.

The reduction in north-south volumes is not too different to the other rail volumes and has been a function of the general economic climate. In addition we note in FY15 that Aurizon have only provided SCT its contracted

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capacity on each service, whereas in prior years they would provide additional space when it was available which allowed SCT to move more freight. However, it appears that presently that Aurizon do not want SCT volumes to grow significantly. SCT's contract with Aurizon on the north-south corridor creates a potential constraint to SCT's growth on the north-south corridor in the near term, however we expected continued growth in rail's market share on the north-south corridor to be supportive of SCT running its own service on this route in time.

The reduction in volumes in FY15 is expected to recover with the completion of the SAP implementation and regaining of the Fosters contract which recommenced in April 2015. To support this expectation of recovery, we have been provided with more granular figures on the FY15 volume performance which are outlined below. While average monthly volumes between July 2014 to March 2015 were down 10% (rail: 8.0%) on pcg, we have seen a reversal in trend towards the back end of FY15, with April volumes only down 6.6% on pcg (rail: down 3.3%), and importantly the May volumes up 4.2% (rail: 8.0%) on pcg.

The improvements in May and April reflect a general improvement in freight volumes as well as the Fosters contract. Even if Fosters were to be excluded from the May monthly analysis, the monthly volume would be broadly in line with FY14 levels. This is positive as it indicates actual volumes have already recovered relative to pcg (and when including Fosters, volumes have improved), and that the actual recent data supports the expectation of a recovery in FY16 volumes.

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Figure 12: Comparison of FY14 to FY15 monthly volumes (tonnes)

Average (Jul - Mar) Volumes	FY14	FY15	Change
Dry East - West	69,170	61,673	-10.8%
Dry North - South	15,642	13,137	-16.0%
Refridge East - West	9,093	9,669	6.3%
Overall	93,904	84,480	-10.0%
Rail change			-8.0%
Road Change			-24.0%

April Volumes	FY14	FY15	Change
Dry East - West	59,295	56,667	-4.4%
Dry North - South	19,817	15,623	-21.2%
Refridge East - West	10,518	11,404	8.4%
Overall	89,630	83,694	-6.6%
Rail change			-3.0%
Road Change			-29.0%

May Volumes	FY14	FY15	Change
Dry East - West	85,368	92,199	8.0%
Dry North - South	12,202	9,653	-20.9%
Refridge East - West	9,583	9,840	2.7%
Overall	107,153	111,692	4.2%
Rail change			8.0%
Road Change			-64.0%

Source: SCT, FIIG Securities

We note that further deterioration in domestic economic conditions represents a risk for further volume reduction in FY16 and beyond. However, we note a recent material contract win mitigates the risk of volumes falling below FY15 levels. In addition, we note the transported goods are linked to basic household consumption levels. The most recent data from the Australian Bureau of Statistics (ABS) highlights that, while overall state final demand measures have either contracted or shown minimal increases in states such as Queensland and Western Australia, this has been driven by large reductions in private capital investment linked to a reduction in mining activity. In contrast, household consumption expenditure increased in every state in Australia for the March quarter.

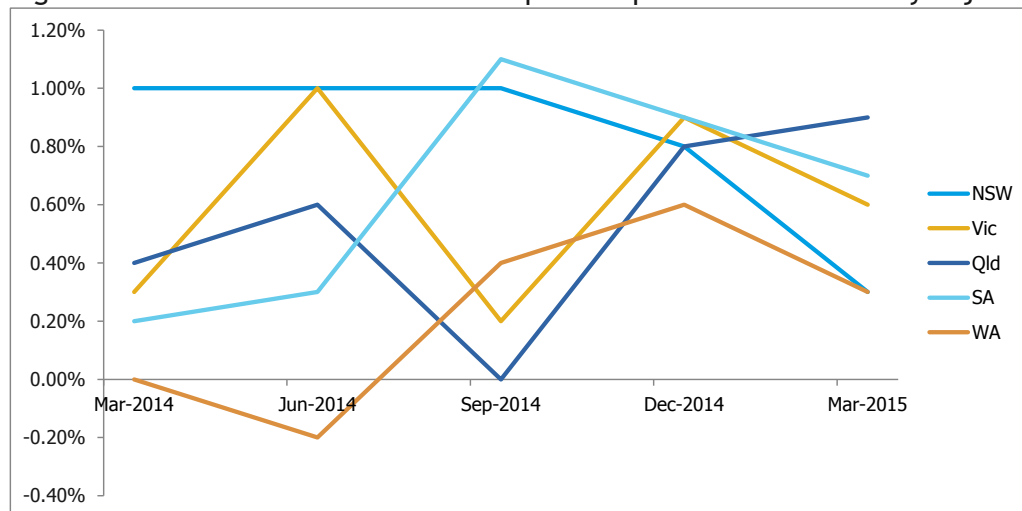
According to the ABS, household consumption expenditure in the March 2015 quarter increased by the following percentages (seasonally adjusted) across each of the key states SCT operates in:

- Victoria: +0.6%
- Western Australia: +0.3%
- New South Wales: +0.3%
- South Australia: +0.7%
- Queensland: +0.9%

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Recent historical household consumption growth is represented graphically in the figure below.

Figure 11: Historical household consumption expenditure - seasonally adjusted by state



Source: ABS

We consider that household consumption expenditure is a better indicator of SCT's volumes given the nature of the goods they transport. Overall economic measures such as State final demand factor in the downturn in capital expenditure in the mining sector, which we believe is less relevant to SCT given their limited exposure to the mining. Importantly, both mining-focused states Queensland and Western Australia have experienced improvement from having zero/negative quarters of household consumption at the start of FY15 to now showing positive household consumption growth in the December and March quarters.

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Financial analysis and commentary

The financial analysis of SCT is outlined below. We note that forecasts have been provided by SCT. Revenues post FY16 factor in no new contract wins, rather just CPI-style escalations in existing contracts and the recommencement of the Fosters contract. SCT advise that it has capacity to take on incremental revenue without significant capital expenditure.

Profit and loss

Figure 13: Profit and loss

Profit & Loss	Actual					Forecast			
FYE 30 Jun (\$m)	2011	2012	2013	2014	2015*	2016*	2017*	2018*	
Service Revenue	264.8	249.5	268.5	288.9	262.0				
Rail & Equipment Hire	5.2	6.0	6.1	4.0	4.6				
Other Revenue	5.7	8.1	5.2	7.2	4.9				
Total Revenue	275.7	263.6	279.8	300.1	271.5	280.1	285.1	290.1	
Employment Costs	109.4	101.4	102.6	106.8					
Rail charges	37.8	40.7	50.0	56.1					
Fuel & Oil	26.1	27.3	29.3	32.7					
Occupancy Expense	12.1	12.8	13.9	14.3					
Repairs & Maintenance	18.8	18.2	20.6	22.3					
Rental & Lease charges	9.5	7.3	4.7	5.6					
Other Expenses	15.2	13.1	12.9	18.1					
Total Expenses	228.9	220.8	234.1	255.9	237.1	237.7	241.6	245.5	
EBITDA	46.8	42.8	45.7	44.2	34.4	42.4	43.5	44.6	
<i>Margin (%)</i>	<i>17.0%</i>	<i>16.2%</i>	<i>16.3%</i>	<i>14.7%</i>	<i>12.7%</i>	<i>15.1%</i>	<i>15.2%</i>	<i>15.4%</i>	
Dep & Amortisation	20.8	20.9	22.4	22.5	24.1	23.8	23.0	23.0	
EBIT	26.1	22.0	23.3	21.7	10.3	18.6	20.5	21.6	
Interest	16.1	13.8	13.6	11.8	11.3	8.8	7.4	6.7	
Operating Profit	10.0	8.2	9.7	9.9	(1.0)	9.8	13.1	14.9	
Abnormal & Non-cash Items	2.0	(0.1)	0.3	0.1	(12.8)	-	-		
Net Profit	12.0	8.1	10.0	10.0	(13.8)	9.8	13.1	14.9	
Credit Stats									
Debt	169.2	167.9	152.8	143	138.5	121.0	103.5	93.8	
Net Debt	171.2	165.2	152.5	142.5	138.0	119.1	95.4	75.1	
Debt/EBITDA	3.6x	3.9x	3.3x	3.2x	4.0x	2.9x	2.4x	2.1x	
Net Debt/EBITDA	3.7x	3.9x	3.3x	3.2x	4.0x	2.8x	2.2x	1.7x	
EBITDA/Interest	2.9x	3.1x	3.4x	3.8x	3.0x	4.8x	5.9x	6.7x	

Source: FIIG Securities, Company reports. Forecasts have been provided by SCT adjusted for note issue

SCT's revenue has been relatively steady over the past five years, reflecting the business' highly contracted service revenue base and long term customer relationships. Per Figure 10, SCT now derives significantly more of its revenue from rail compared to road, particularly on the north-south corridor, with rail charge expenses reflecting this change.

The drop in FY12 revenue was largely due to the loss of the Fosters' contract which SCT has recently won back, with service recommencing in April 2015. The full year return of the Fosters' contract is then reflected in the revenue up lift in FY16. Other than the return of the Fosters' contract, revenue forecasts are conservatively

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based on contracted CPI escalations. SCT has also recently won a five year contract with a national business moving FMCG freight which is expected to generate revenue of \$3m in FY16 and \$6-8m per annum thereafter as operations expand which is not included in the forecasts.

The drop-off in FY15 performance is explained by the following factors:

- The 10% drop in service revenues has been affected by a drop in volumes from existing contracts reflective of the economy, particularly WA, as well as a reduction in fuel subsidies in line with lower fuel costs (\$5m)
- In FY15 SCT was significantly affected by this introduction of SAP throughout its business, both through direct Go Live costs, \$2m of which have been normalised, and the disruption associated time losses of introducing a new system across the business and associated increased labour costs. SAP has been a significant cost to SCT with development and licensing costs of c\$16m which were capitalised. SAP is now fully implemented, and SCT is seeing the benefits both from a customer perspective with the introduction of such things as track and trace and internally with significant efficiencies. These efficiencies will allow cost savings over the next two years only some of which are incorporated into the forecasts

Rail equipment hire relates to SCT's related bulk haul business (SBR) utilising SCT surplus stock as well as some external hire. This has reduced over FY14 and FY15 with the drop in activity in this business following the finalisation of SBR's IMX Resources Limited contract.

SCT's expenses relate to employment costs (rolling site specific EBAs), rail charges to utilise the tracks, maintenance, fuel and occupancy expenses which largely relate to related party terminal rentals on arm's length market rate long term leases. Many of SCT's contracts have 'effective' pass through provisions including fuel which rises and falls monthly, track access fees, wages and maintenance limiting the risk of contracts becoming uncommercial. The significant maintenance expense of \$20m plus per annum ensures that the capital fleet remains productive. Much of the maintenance is mandated to ensure the ability to continue to utilise the mainline. Facilities and rail maintenance is undertaken by the property owners and rail track operators.

Abnormal and non-cash items are detailed below with FY15 including \$2m in "Go Live" costs in for the implementation of the SAP system, \$10m in break fees associated with the refinance of the secured debt and \$0.8m of normalisations for non-recurring insurance premium costs. Break fees are due to the higher interest rates associated with the re-financed leases. Future cash flow benefits will accrue by re-financing these at lower rates. Many of the equipment leases were entered into between 2008-2012 under fixed rate structures when base interest rates were higher than present levels.

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Figure 14: Abnormal and non-cash items

Abnormal & Non-cash Items FYE 30 Jun (\$m)	Actual				
	2011	2012	2013	2014	2015*
FX Gain / (Loss)	2.2				
Unrealised FX Gain / (Loss)		(0.1)			
Non-operating Income / (exp)	2.2	(0.1)	-	-	-
Gain / (loss) on sale of Assets	(0.2)		0.3	0.1	
SAP Implementation Costs					(2.0)
Break Fees					(10.0)
Normalisations					(0.8)
Total Extraordinary Items	(0.2)	-	0.3	0.1	(12.8)
Total Abnormal Items	2.0	(0.1)	0.3	0.1	(12.8)

Source: FIIG Securities, Company reports. Forecasts have been provided by SCT.

The reduction in expenses between FY15 and FY16, notwithstanding the increase in revenue, is a function of the full year effect of a cost out programme currently underway at SCT off the back of SAP as detailed above and further less specified savings as SAP is further bedded down/tailored.

The recently returned Fosters' contract is well known to SCT and does not require any additional train service. Also the nature of the cargo allows it to be well dispersed throughout the train, increasing load efficiency.

SCT advise that the returned major contract and efficiencies currently being enacted are expected to produce 80%+ of the EBITDA uplift between FY15 and FY16. The balance of the EBITDA uplift is expected to be provided by improved productivity as the benefits from SAP continue to flow.

High depreciation is reflective of the amount of depreciable assets on the balance sheet with assets being depreciated over varying periods from two to 40 years. Locomotives have a useful life of 25-40 years and SCT's fleet of 21 have all been purchased since 2008 and are state of the art and are not required to be replaced for over 20 years. Hence, in SCT's case, EBITDA is a better indicator of cash flow than EBIT.

Interest is forecast at 8% for the secured equipment finance and 7% for the unsecured bonds, and reduces in line with SCT's net reduction in leasing of \$17.5m p.a. SCT is owned in a trust structure which is not a tax paying entity while it distributes all of its net income.

The dividend and related party transaction restriction in place under the bond documentation allows for all net profit to be distributed, however requires 35% of net profit to be reinvested in cash back into SCT so that the overall net cash transfer to related parties does not exceed 65% of NPAT.

Opening debt to EBITDA is set at 4x reflective of lower FY15 earnings but this quickly reduces to 2.9x in FY16 as SCT returns to historic profitability. Further, cash is expected to be retained in the business due to the restricted payment regime and scheduled amortisation of remaining leases. Total interest cover is 3x based on normalised EBITDA for FY15 which increases to 4.8x as earnings return to more normal levels in FY16.

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Balance Sheet

SCT's historical and projected balance sheet is outlined in the figure below.

Figure 15: Balance sheet

Balance Sheet	Actual					Forecast			
FYE 30 Jun (\$m)	2011	2012	2013	2014	2015*	2016*	2017*	2018*	
Cash	(2.0)	2.7	0.3	0.5	0.5	1.9	8.0	18.7	
Accounts Receivable	34.3	31	35.7	30.6	40.0	41.3	42.0	42.7	
Other	10.1	6	9.9	10.4	5.2	5.2	5.2	5.2	
Current Assets	42.4	39.7	45.9	41.5	45.6	48.3	55.2	66.6	
Loans to related parties	48.3	53.3	30.8	26.8	25.9	25.9	25.9	25.9	
Plant & Equipment	187.9	190.3	181.6	177.6	163.6	143.8	124.8	109.8	
Other					2.6	2.1	1.6	1.2	
Total Assets	278.6	283.3	258.3	245.9	237.7	220.1	207.6	203.4	
Accounts Payable	11.3	18.3	22.5	21.6	23.6	20.1	20.5	20.8	
Equipment finance debt	35.8	41.4	23	30.1	32.5	32.5	18.5	8.8	
Other Current Liabilities	16.4	17	19.8	21.1	21.1	21.1	21.1	21.1	
Current Liabilities	63.5	76.7	65.3	72.8	77.14	73.64	60.02	50.68	
Equipment finance debt	133.4	126.5	129.8	112.9	21.0	3.5			
Senior Unsecured Debt					85.0	85.0	85.0	85.0	
Other Non-current Liabilities	0.6	1	0.9	0.9	0.9	0.9	0.9	0.9	
Total Liabilities	197.5	204.2	196	186.6	184.1	163.1	145.9	136.6	
Reserves	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Beneficiary Entitlements	66.4	69.8	55.1	54.5	58.9	58.9	58.9	58.9	
Subordinated Loans	17.5	12.1	10	7.8	11.5	11.5	11.5	11.5	
Retained Earnings	(2.9)	(2.9)	(2.9)	(2.9)	(16.8)	(13.4)	(8.8)	(3.6)	
Equity	81.1	79.1	62.3	59.4	53.6	57.0	61.6	66.8	
Credit Stats									
Secured Debt	169.2	167.9	152.8	143.0	53.5	36.0	18.5	8.8	
Total Debt	169.2	167.9	152.8	143.0	138.5	121.0	103.5	93.8	
Net Debt	171.2	165.2	152.5	142.5	138.0	119.1	95.4	75.1	
Debt / Total Assets	60.7%	59.3%	59.2%	58.2%	58.2%	54.9%	49.9%	46.1%	
Debt/(Debt+Equity)	67.6%	68.0%	71.0%	70.6%	72.1%	68.0%	62.7%	58.4%	

Source: FIIG Securities, Company reports. Forecasts have been provided by SCT adjusted for Note issue

SCT's debtor book is strong reflective of the strength of its institutional customer base. Increase in debtor days has been due to an increase in trading terms to major clients.

The balance sheet is dominated by plant and equipment which is mainly rail equipment with WDV of \$133m. SCT consider that the WDV is considered a fair estimate of market value. This is made of up 15 EDI locomotives (2008) and 6 CSR locomotives (2012) with a value of \$77m as at 31 March 2015. These are new and purpose built for SCT. Locomotives have an ATO effective life of 20-25 years but in practice many locomotives run in the vicinity of 40 years as their maintenance regimes are strict to maintain a mainline standard. For example, Pacific National continues to run locomotives constructed in the 1980s (81 Class and Class A). Given the relatively young age of the fleet, and the 40 year average life of a locomotive vs the ATO

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effective life of 20-25 years, it is expected that the recovery value for the fleet would exceed the written down value.

The balance relates to:

- 433 box car wagons (44 refrigerated) and 182 intermodal wagons with the majority manufactured post 2005. Wagons have an ATO effective life of 30 years but in practice many wagons run in the vicinity of 40 years as again their maintenance regimes are strict. The wagons have a WDV of \$45m as at 31 March 2015
- 200 trucks and trailers with a WDV of \$14m as at 31 March 2015
- 9 seater Cessna Sovereign 680 jet with a WDV of \$8m as at 31 March 2015
- Other including office and EDP equipment

The balance sheet holds related party loan assets of \$25.9m to various director related entities. The recoverability of these loans is unknown and they need to be discounted from any recovery situation. No interest or repayment is forecast during the period. While this reduces the assets that the bondholder is able to rely on, this is more than offset by the value of the business and associated goodwill not reflected on the balance sheet.

As SCT has been built from scratch since 1974 the balance sheet evidences no goodwill. It is considered likely that the market value of the equity/beneficiary entitlements exceeds the book value.

Overall, while the pro-forma FY15 leverage is high, this needs to be considered in the context of FY15 performance. With normalisation of earnings expected into FY16 and beyond, the balance sheet is considered to be in a strong position and as at 30 June 2015, the bondholders will have \$53.5m of secured equipment debt ranking structurally senior in a default/liquidation scenario. Against this debt is \$164m of plant and equipment which could be sold/liquidated in an insolvency scenario, ignoring any goodwill from a likely business sale. As such, bondholders are seen as having progressively good asset backing in this transaction, which strengthens over the life of the bond as existing secured finance fully amortises.

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Cash flow statement

SCT's historical and projected cash flow statement is outlined in the figure below.

Figure 16: Cash flow

Cash Flow FYE 30 Jun (\$m)	Actual					Forecast		
	2011	2012	2013	2014	2015e	2016*	2017*	2018*
<i>Operating Cashflow</i>								
Net Income	12.0	8.1	10.0	10.0	(13.8)	9.8	13.1	14.9
Depreciation & Amortisation	20.8	20.9	22.4	22.5	24.1	23.8	23.0	23.0
Δ Working Capital	(6.7)	10.3	(0.5)	4.1	(7.4)	(4.8)	(0.4)	(0.4)
Other	(3.4)	6.9	(0.9)	0.7	15.2			
Net Operating Cashflow	22.7	46.2	31.0	37.3	18.1	28.8	35.7	37.5
<i>Investing Cashflow</i>								
Capital Expenditures	(20.0)	(26.1)	(15.2)	(19.4)	(10.7)	(3.5)	(3.5)	(7.5)
Acquisitions					(2.6)			
Disposals	5.7	2.6	1.8	1.0	0.6			
Net Investing Cashflow	(14.3)	(23.5)	(13.4)	(18.4)	(12.7)	(3.5)	(3.5)	(7.5)
<i>Financing Cashflow</i>								
Distributions						(6.3)	(8.5)	(9.7)
Related party transactions	(11.1)	(15.9)	(4.9)	(8.9)	9.0			
Net Borrowing	(6.7)	(2.1)	(15.1)	(9.8)	(14.5)	(17.5)	(17.5)	(9.7)
Net Financing Cashflow	(17.8)	(18.0)	(20.0)	(18.7)	(5.5)	(23.8)	(26.0)	(19.4)
Net Cash Flow	(9.4)	4.7	(2.4)	0.2	(0.1)	1.5	6.2	10.6

Source: FIIG Securities, Company reports. Forecasts have been provided by SCT adjusted for Note issue

SCT has been a capital expenditure (CAPEX) intensive business over the past five years, investing over \$90m in locomotives, rolling stock and trucks during FY10-12 and more recently the SAP introduction. In FY15 the CAPEX relates to the final payment for six yearly locomotive major overhaul (\$3m), SAP introduction (\$2m), container forklifts (\$2m), trucks and trailer (\$2m) and previously ordered wagons (\$2m).

Following this significant investment SCT is now post major upgrade CAPEX with future CAPEX expected to be in the \$2m to \$3.5m pa range, with the forecasts taking the upper end of this range. This largely relates to routine turnover of SCT trucks and trailers. The next six yearly locomotive overhaul is due in 2018 which is reflected in that year's higher CAPEX spend. Also note that SCT spends \$20m plus above the line in annual repairs and maintenance expenses.

SCT's remaining leases amortise at c.\$17.5m pa for FY16 and FY17 and reduce to \$9.7m in FY18 with CAPEX funded by new leases (\$3.5m pa). A key flexibility requirement for SCT under the covenant regime is the ability to purchase a new train set should material new contracts be won. With SCT's existing fleet able to take on additional incremental volume, this is considered unlikely within the next two years.

The restricted payment regime under the bond documentation limits related party capital transactions (interest, distributions, loan repayments or new loans) to a net 65% of NPAT ensuring significant cash is retained within SCT. This is significant as the NPAT is reduced by substantial depreciation which is not matched by CAPEX.

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The step down in the total debt incurrence covenant and existing rapid amortisation profile provides a de-leveraging of the financial structure over time.

Debt structure

Figure 17 illustrates SCT's current and proposed funding structure. The bonds will be used to pay down existing secured equipment financing giving SCT greater flexibility in managing its debt repayment profile and a lower interest expense given many leases were entered into under fixed rate arrangements where benchmark interest rates were higher than current levels.

Figure 17: Debt facilities (based on an \$85m bond issuance)

Financier	Maturity	Security	Pre bond	Refinancing	Post bond
Working Capital*	annual	GSA	\$16.0m		\$16.0m
Lease finance various	various	Lease finance/GSA	\$133.5m	\$(80.0)m	\$53.5m
FIIG Bond – Series A	2019	Unsecured	-	\$35.0m	\$35.0m
FIIG Bond – Series B	2021	Unsecured	-	\$50.0m	\$50.0m
Total			\$149.5m	-	\$154.5m

Lease finance amounts include break costs for the leases being re-financed

Source: FIIG Securities, Company reports.

**Working capital facility includes \$7.4m in unfunded facilities to Logicoil, a related party, outlined further below.*

Existing lease finance has been provided by multiple providers including banks and specialised equipment lease finance providers. In general, equipment financing is secured against the particular asset only as opposed to the overall company's assets. Three of SCT financiers have general security arrangements (GSA) however two of these are expected to be released over the next two years as facilities are reduced. NAB hold a GSA to cover their working capital facility along with GE who hold a GSA for an operating lease facility which is expected to be paid off in full (and subsequently released) by Dec 2016.

The primary purpose of the bond issue will be to refinance existing equipment leases, providing the company with additional financial flexibility and a substantially reduced level of secured equipment lease financing. The remaining leases amortise at c.\$17.5m pa for FY16 and FY17 which reduces to \$9.7m in FY18 and are expected to be largely repaid by the maturity date of the bonds.

As detailed below, new senior debt incurrence is capped at 2.0x EBITDA, with a limitation on total debt incurrence of 4.0x EBITDA, declining to 3.0x by 2019. In the event that \$75m rather than \$85m is raised under the bond then \$10m less of leases will be repaid.

Depending on volume growth in the north-south corridor, SCT has the flexibility to raise additional lease financing of \$25-30m to fund an additional train set. This is unlikely to occur in the next two years and if it were to occur would generate incremental revenues and EBITDA. We understand there is spare capacity within SCT's existing fleet to handle incremental growth in volumes.

SCT supports \$16m of working capital facilities with NAB, of which \$8.6m is to SCT and \$7.4m is to a related entity Logicoil. Of the SCT component, \$4.5m is available as an overdraft facility which is usually drawn up to \$1.5m per month to manage intra-month working capital requirements. The remainder relates to unfunded facilities including payroll, payments and bank guarantees. The Logicoil component is largely in the form of bank guarantees. Logicoil is a business which provides refuelling services and is wholly owned by the Smith family. Logicoil's financial statements show a low level of gearing (less than 15%) and consistent EBITDA generation of ~\$4m pa over the past three years. The facility has cross-guarantees in place, ie: SCT guarantees

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the Logicoil transaction facilities and vice versa, which is why we have shown the total of both the SCT and the Logicoil facilities in the table above.

Unsecured bond structure

The figure below highlights the key features of the bonds.

Figure 18: Key unsecured bond terms

Term	Description	
Issuer	20th Super Pace Nominees Pty Ltd ATF Byrns Smith Unit Trust trading as SCT Logistics	
Offer size	Minimum of \$75,000,000 with oversubscriptions to \$85,000,000 comprising two Series (A and B) with four and six year maturities	
Ranking	Senior unsecured	
Minimum parcel size	\$50,000 (per Tranche)	
Face value of each Note	\$1,000	
Series	A	B
Volume	Minimum of \$30,000,000 to \$35,000,000	Minimum of \$45,000,000 to \$55,000,000
Interest type	Floating rate	Fixed rate
Interest rate	440bps over 90 day BBSW (paid quarterly in arrears)	7.65% (paid semi-annually in arrears)
Maturity date	June 2019 (four years)	June 2021 (six years)
Issuer call options	June 2017 at \$103.00 (two years) June 2018 at \$101.50 (three years)	June 2019 at \$103.00 (four years) June 2020 at \$101.50 (five years)
Change of control	Investors have the option but not obligation to put the bonds back to the issuer at \$101. IPO carve out	
Covenants	Negative pledge Cross default to other debt Limitations on secured debt (max 2.0x EBITDA) Limitations on total debt incurrence (minimum Interest Coverage Ratio of 3.5x measured as EBITDA/Interest, and maximum total net debt/EBITDA of 4.0x reducing to 3.5x in FY18 and then 3x in FY19) All capital returns including dividends, interest and loan payments limited to max 65% of NPAT, net of amounts re-invested. Should SCT list then dividends would be limited to 75% of NPAT Restrictions on asset sales and application of proceeds Beneficiary accounts and related party loans to be fully subordinated All related party transactions to be on an arm's length basis Continuous disclosure	
Event of default	Non-payment Breach of other covenants/obligations Cross default to other debt Enforcement against assets Insolvency/winding-up/creditor arrangement Invalidity of bonds/guarantee No material litigation Cessation of business	

The bonds issued will comprise two series, raising up to \$85m in aggregate. Investors can elect to participate in either or both series. Each bond will subsequently trade separately on the secondary market:

- Series A \$30m (minimum) to \$35m: offers a floating rate of 90 day BBSW+440bps p.a. (paid quarterly) for four years, callable at the company's option after two years at \$103 or after three years at \$101.50
- Series B \$45m (minimum) to \$55m: offers a fixed rate of 7.65% p.a. (paid semi-annually) for six years callable at the company's option after four years at \$103 or after five years at \$101.50

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The unsecured structure for the SCT bonds has the same principal bondholder protections (incurrence based covenant package, restricted payments to equity, cross default to other debt and unilateral enforcement rights upon an un-remedied Event of Default) as other FIIG led transactions such as Silver Chef Limited, Mackay Sugar Limited, G8 Education Limited, Cash Converters International Limited and McPhersons Ltd.

The Information Memorandum contains the terms and conditions, including the full covenant package for the offering and investors are strongly encouraged to review it. The covenants below should be read in conjunction with Clause 5.1 and Clause 5.2 of the Conditions section of the Information Memorandum. The covenants offer investor protections in three primary areas:

1. Negative Pledge

- Over the life of the bonds, the Negative Pledge covenant restricts the ability of SCT to create or permit any Security Interest to exist on assets and/or revenues that will rank ahead of Note holders, other than a Permitted Security Interest. (In simplistic terms, Security Interests are generally secured bank debt and secured equipment leases and Permitted Security Interests are generally the existing or any new secured bank facility, with the Negative Pledge designed to limit the amount of prior ranking secured debt that is permitted in front of the bonds).
- The level of Permitted Security Interest that will be allowed by way of a new secured debt facility has been set at the ratio of the total of all available secured debt to EBITDA of the group for the previous 12 months being not more than 2.0x. We note for the purposes of covenant testing the debt includes equipment lease finance.

2. Limitation on Debt Incurrence

- The covenant restricts the ability of SCT to incur any new debt which causes the Interest Cover Ratio (EBITDA/total interest) of the group for the previous 12 months to reduce below 3.5x, or causes the total net debt/EBITDA to exceed 4.0x (reducing to 3.5x as at 1/7/2018 and then 3x in as at 1/7/19).

3. Restricted Payments to Equity

- The covenant restricts the ability of SCT to distribute cash flows outside of the business. Because SCT is a unit trust, it must distribute all profits to unit holders. The covenants are structured so that all capital returns including distributions, interest and loan payments will be limited to max 65% of NPAT, net of amounts re-invested.
- Should SCT list then dividends would be limited to 75% of NPAT.

Events of Default

- Non-payment of interest and principal.
- Cross default and other standard events of default.

The unsecured nature in place for the bonds means bondholders rank alongside regular creditors in a wind-up scenario. However, in priority to related party loans and beneficiary entitlements.

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Private company disclosure

Being a private company, SCT is not subject to the same disclosure requirements as publicly listed entity. As such, the bond documentation has been set up to ensure SCT meets a level of satisfactory disclosure. The disclosure requirements are required under covenants in the bond documentation, and an unremedied failure to meet these requirements constitutes an event of default. Under a password protected section of its website, SCT will make the following information available to bondholders under the continuous disclosure covenant:

- Within 120 days after the close of each financial year, a copy of SCT's audited financial statements in respect of that financial year
- Within 90 days after the close of each half financial year, a copy of the SCT's financial statements in respect of that half financial year
- As soon as practicable after SCT becomes aware of its existence, information relating to the following events:
 - any material change to the financial forecasts or expectations, value of underlying assets or any financial rating of the Issuer or a member of the Group;
 - any material changes to the debt funding arrangements of the Issuer or the Group, including any material breaches of covenants;
 - the appointment of any external administrator to the Issuer or a member of the Group;
 - any distributions or payments on a related party loan made by the Issuer or a member of the Group and any related party transaction not on an arm's length basis at market rates; or
 - any other information likely to affect the value of the Notes or any other securities of the Issuer or a member of the Group
- All other information or reports regarding the financial condition and operations of SCT a bondholder may reasonably request

Strengths

- The rail freight industry has substantial barriers to entry, including but not limited to: large upfront capital investment, track access through securing of below rail contracts, stringent rail safety accreditation requirements, economies of scale, and customer relationships. More specifically, SCT's intermodal and boxcar wagon model would require significant investment for Aurizon and Asciano to change their course. These factors render SCT's business model difficult to replicate in the Australian market, either for a new entrant or an existing rail freight operator. The only foreseeable way the SCT model could be replicated at scale is through a merger/combination of a freight forwarding business (Toll, Linfox) with a rail freight operator (Pacific National, Aurizon), but even so it would be running a containerised model
- Further, SCT has access under long term leases to intermodal terminals and associated rail infrastructure in key sites which are owned by the related party property trust. Certain SCT customers have also built their distribution centres on these sites which provide a strategic benefit to SCT and reinforces the customer relationship. The continued development of the intermodal terminal network creates an additional barrier to entry and is supportive of protection of SCT's customer base and volumes over time. We note that the financial forecasts provided by management conservatively assume no growth in revenue apart from CPI, and even so the credit metrics of SCT materially improve over the life of the bond
- SCT has a very 'sticky' customer base, reflecting acceptance of its service offering and a validation of the vertically integrated, 'mix and blend' model which differentiates SCT from its competitors. The average

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length of relationship amongst SCT's top 20 customers (by revenue) is 15 years. Management advise that only two to three major customers have been lost over the past 25 years, all of whom have been won back. SCT's key differentiation is that it contracts directly with the end customer and provides an end-to-end supply chain service

- SCT has been able to generate a consistent level of revenue and earnings, and generate positive net operating cashflows over the past five years despite the poor domestic economic conditions in a 'post-GFC' environment which has had a significant impact on the entire transport sector, as well as the competitive pricing pressure that exists in its sector. The business experienced a fall in volumes at the start of FY15 which has impacted earnings, however has been able to turn around the declining trend in the back end of FY15 with month-on-month volumes back above corresponding FY14 levels
- The bonds receive the benefit of an asset backing which is expected to improve over time as secured equipment debt amortises. Total debt / tangible assets is expected to improve from 59% in FY15 to 46.4% by FY18, with secured debt / tangible assets falling to only 4.3% on forecasts over the same period. The transport-related tangible assets (locomotives, wagons and trucks valued at \$137m) could be sold/liquidated in an insolvency scenario, ignoring any goodwill from a likely business sale. As such, bondholders are seen as having relatively good asset backing in the context of an unsecured lend, which progressively strengthens over the life of the bond as existing secured finance amortises
- In addition, access to additional lease financing (particularly locomotives and trucks) against the transport assets is considered a readily available source of funding/liquidity subject to the secured debt incurrence covenant (limited to 2.0x EBITDA) and total debt incurrence covenant (4.0x stepping down progressively to 3.0x over the life of the bonds)
- SCT is expected to benefit from the push towards seeing rail take more of the east coast freight task. It is currently estimated that only 30% of land-based freight between Victoria and Queensland uses rail, compared to 80% of land-based freight on east-west routes. Rail volume growth on the eastern seaboard is possible and likely through the potential for market share capture from road
- Further to the above, the planned Inland Rail track between Brisbane and Melbourne is 220km shorter than the best available road route between Melbourne, and once completed, the journey could be completed in under 24 hours. Development of the Inland Rail track would be beneficial to the use of rail on the north-south corridor and therefore to SCT. The ARTC is currently stepping up its campaign to fast-track building of the project
- SCT has an operational cost advantage over its competitors through its more modern fleet and its 'mix and blend' model using boxcar wagons instead of a fully containerised model
- The business has recently made substantial investments in new locomotives which are can have useful lives of over 40 years. SCT has no major planned capital expenditure (CAPEX) requirements in relation upgrading its fleet. As such, the business is expected to generate positive free cash flows (subject to maintaining freight volumes), which will initially be used to amortise the remaining secured equipment financing but over time can be either reinvested into the business, used to repay the bonds, or returned to the owners of the business (subject to the restricted payments regime)

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Risks

- Being largely an interstate rail freight business without import-export volumes, SCT's business is exposed to the general state of Australian economic conditions, particularly its key destination points such as WA where the state economy has been impacted by the fall in commodity prices and lack of mining investment. Further deterioration in the domestic economy would lead to lower discretionary spend and hence lower volumes of consumer goods moved. This would be offset to some extent by the projected increases in population over the corridor and associated increases in basic consumption. We also note (i) the nature of goods transported by SCT – FMCG, beer, wine and materials, which are less elastic to changes in economic conditions relative to high-value luxury goods; and (ii) SCT does not have direct exposure to iron ore or coal. In addition, household consumption expenditure increased in every state in Australia for the March 2015 quarter according to recent ABS data, indicating that while overall economic conditions may be subdued there is strength coming through in household expenditure which is relevant and supportive for SCT's volumes
- While barriers to entry are high, competition in the freight forwarding and rail freight industry remains strong, driven by the pressures of end customers to be cost competitive. SCT's key rail competitors both currently generate healthy profits from their bulk coal businesses, however over time the coal businesses may decline if the coal market suffers a further downturn, and assets may be redeployed to grow their rail freight businesses. Recently, a joint venture between Qube and Aurizon announced an agreement with the Federal Government for the development of an intermodal freight terminal in Sydney (Moorebank). We note that the proposed interstate terminal at Moorebank would be developed out over a ten year period, however it does highlight the potential competitive threat that larger operators could pose in the domestic logistics market. Having said this, the robustness of SCT's business model to handle competitive pressures is evidenced by Aurizon entering the east-west freight market 7-8 years ago and only being able to secure a modest market share
- Contract lengths in the freight forwarding industry are relatively short which means the company must regularly retender for existing customer contracts. As such SCT is exposed to recontracting risk over the life of the bond, including repricing risk from heavily competed tenders. Management are confident however that all customers will roll their contracts. We recognise the long average length (15 years) of SCT's major customer relationships which supports the likelihood that contracts will be rolled over. However, to the extent the business were to experience operational issues, customers have the option to change provider after a relatively short space of time. We consider this an unlikely scenario given the strong track record of the business to date and its customer retention
- We understand from SCT there were teething issues when SAP went live in July 2014 which impacted volumes, however user volumes are back to 'normalised' levels post resolution of the teething issues. More broadly, there is the risk that the operational benefits of the SAP system take longer than expected or do not fully materialise because of a lack of staff and customer acceptance to change existing processes. We note that the company has already invested substantial time, resource and expense in implementing the SAP system, and further major SAP-related costs are unlikely
- The ARTC has been slated for privatisation by the Federal Government. Should this occur, we expect a private owner of the below rail infrastructure will seek a higher return on capital than the government, and potentially pass on more onerous conditions to the rail track users. Rail charges may increase post privatisation and this may render rail less competitive than alternative means of transport. A major risk would be the likes of Aurizon or Asciano acquiring the ARTC however we consider this is unlikely due to anti-competition concerns. While the ARTC privatisation process presents uncertainties, we consider this to be of

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limited risk to SCT for the following reasons: (i) rail's substantial cost and fuel efficiency advantage over road on the key east-west route is such that very large increases would be needed to affect competitiveness; (ii) a privatised ARTC will be incentivised to increase rail's market share and therefore it would be uncommercial for it to effect policies which render rail less competitive to road; and (iii) rail access cost pass through provisions are in SCT's contracts

- On analysis of Asciano's and Aurizon's financials, the coal rail freight businesses are more profitable than the freight business. The lack of diversity could be considered a weakness particularly as it precludes exposure to an end user market outside of Australia. Mitigating this is SCT's ability to develop deep and lasting relationships with its key locally based clients
- The mix and blend model adopted by SCT requires a labour-intensive process compared to other rail operators to ensure goods are ordered and stacked in the wagons appropriately. Staff costs could be pressured over time by a lack of supply in replacing a specialised, experienced 'blue collar' workforce or increasingly stringent training and accreditation requirements leading to fewer available train drivers. However, wage pressure should indicate a growing economy and be correlated with higher volumes of freight. We also note that the requirements for road freight are becoming increasingly more onerous, with regulations around driver fatigue, chain of responsibility, driving hours and vehicle speed taking effect on the road freight industry
- Increasingly 'customer-friendly' offerings such as more favourable debtor terms could adversely impact SCT's financial or working capital position over time. However, unlikely to be material in the context of SCT's overall business with debtors of \$35m and overdraft and cash on the balance sheet
- The prospect of double-stacking on the proposed Inland Rail route may provide a competitive advantage to the containerised rail freight models of Pacific National and Aurizon. However, SCT also double stacks containers on its trains
- Further falls in oil prices would be beneficial to the road freight alternative and allow them to preserve/increase market share versus rail. This is more likely to be a risk on the shorter north-south corridor (particularly Melbourne-Sydney) than the longer east-west route where rail is four times more fuel efficient than road
- SCT Logistics is structured as a unit trust, and as such tax is not paid at the entity level but rather on the distributions made to the equity owner of the business. To the extent SCT became a tax paying entity (eg: it was corporatised), the tax payment would create an additional leakage at the SCT level. For SCT to become corporatised would require bondholder approval and at the same time we would expect that part of that approval would lower the distribution ratio which has been set at a level to incorporate tax being paid outside of the unit trust
- As a private, unlisted company, SCT is not subject to the disclosure requirements of an ASX-listed company and information will be limited compared to a publicly listed company. However, SCT is required under covenant in the bond documentation to meet ongoing information requirements. A failure to meet its continuing disclosure requirements constitutes an event of default if not remedied within 30 days of notice. We also had good access to senior management on our site visit as well as timely information flow, which gives confidence that ongoing access to senior management and information flow will be available as and when required

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- The bonds can be called early at certain intervals at the issuer's discretion which may not be in the bondholders' best interests. Prospective bondholders should have regard to the 'yield to worst' metric which in the case of the said bonds is the lower of the yield to maturity and the yield to call. For a primary bond issue the yield to maturity generally represents the yield to worst, however this may change over time depending on the future movement in the bond price. The likelihood of an early call is a function of a number of factors, including the issuer's credit profile and the general level of interest rates over time
- Bondholders are subject to refinance risk: At maturity of the bonds, should the company face financial issues or the market for finance be closed or prohibitively expensive, this could impact SCT's ability to repay bondholders. Having said this, refinance risk is partially mitigated by the dual series structure which staggers the refinancing task, the amortisation of the existing secured finance over the life of the bonds and the ability to progressively 'roll over' the residual value component of lease financed equipment thereby managing the amortisation schedule
- The bonds rank below senior secured debt in a default/liquidation scenario which after bond issue is expected to be around \$53.5m plus debt outstanding under the working capital facilities (\$15m, inclusive of \$4.5m in overdraft facilities) but is allowed under the terms of the bonds to be up to 2x EBITDA, subject to the total financial indebtedness clause. However, while SCT has the flexibility to raise additional secured debt, we understand the business intends to pay down the remained secured equipment finance prior to the maturity of the bonds. New secured funding may be raised to acquire additional train fleet, however we expect this would be done on the basis of supporting contract volumes and an associated uplift in earnings. Three equipment lease financiers currently have general security arrangements over SCT
- The draft information memorandum sets out the full details of the structure, covenants and other terms and conditions. Investors are advised to read the full details, including risk factors, before making any investment decisions
- The higher return investors are paid for high yield bonds (as opposed to investment grade bonds) is compensation for the higher risk associated with this market such as the possibility of greater volatility, lower liquidity in a stressed market and higher risk of default

Conclusion

SCT is Australia's largest private rail freight operator with a 40-year operating history. It provides a full suite of vertically integrated, national logistics services, at the core of which is Australia's most modern rail freight operation and national terminal footprint.

SCT's business model is unique as it contracts directly with the end customer and provides an 'end-to-end' logistics service with a single counterparty. SCT competes against freight forwarders on key contracts, which they then contract the road, rail and warehousing components separately. The end to end service offering provides distribution integration and alignment of supply chain cycles, ensuring that SCT has direct relationships with its customers.

SCT operates in a market with high barriers to entry, and has invested significant amounts of capital expenditure both in terms of fleet and operationally through the SAP implementation. The business has a strong track record of holding onto its customer base in spite of the shorter term nature of its customer contracts. The recent re-signing of the Fosters' contract, where Fosters resumed business with SCT after only one contract period with a competitor, demonstrates the 'stickiness' of its customer base as well as its ability to compete with key competitors Asciano and Aurizon despite being of a smaller scale.

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There is widespread recognition of the need to increase rail freight across Australia, noting road safety, energy efficiency, reducing congestion and infrastructure development as primary considerations. This provides favourable conditions for SCT to capture further market share, particularly along the north-south corridor where road freight currently holds the majority market share. Its network of long term leases at key intermodal terminal sites create an additional barrier to entry, and a business model which would be difficult to replicate without substantial investment and time.

While FY15 indebtedness ratios appear higher than historical norms as a result of the fall in FY15 earnings, an element of the earnings drop off is considered to be transitory. In particular, the teething issues associated SAP implementation which went live in July 2014 have been resolved and customer volumes are returning to normalised levels. Some volume drop-off is possible in a deteriorating economic environment, however the majority of goods transported by SCT are basic, fast moving consumer goods where demand is relatively inelastic to the state of general economic conditions. A recent major contract win not included in forecasts is expected to deliver above forecast FY16 revenues.

SCT is seeking to raise up to \$85m in unsecured bonds (with a minimum of \$75m) to refinance existing secured debt. The bonds are offered in two series: Series A with a \$30m minimum to \$35m at a floating rate of 90 day BBSW+440bps p.a. for four years (callable at the company's option after two years at \$103 or after three years at \$101.50); and Series B with a \$45m minimum to \$55m at a fixed rate of 7.65% p.a. for six years (callable at the company's option after four years at \$103 or after five years at \$101.50). Investors can elect to participate in either or both series.

With the remaining existing equipment finance expected to largely amortise over the life of the bonds, SCT bondholders progressively benefit from a de-leveraging of the financial structure and improving unsecured recourse to a fleet of largely unencumbered tangible assets, such as a modern fleet of locomotives with further useful lives of up to 40 years. While there is no active secondary market for these assets, their long useful lives and ability to be redeployed to other industries such as bulk supports realisation levels in line with written-down value.



The fixed
income experts

Alen Golubovic

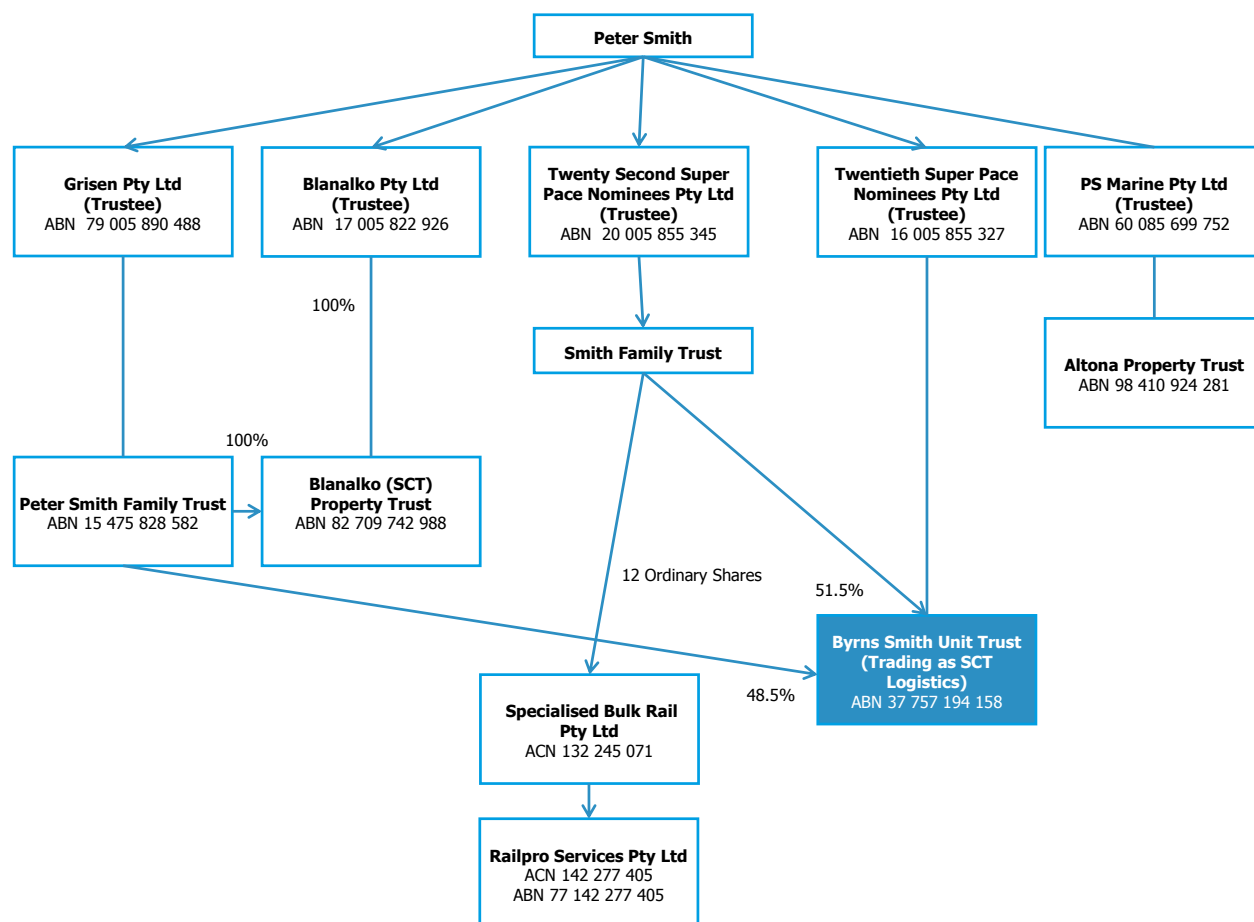
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Appendix 1: Company structure



The Smith Family is the sole beneficiary of the various trusts.

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Appendix 2: Directors

Name	
	<p>Peter Smith, Chairman</p> <p>Peter began his long association with the transport industry in the early 1960s. He established SCT in 1974 and became the first private rail operator in Australia. Peter still takes an active role with SCT's operations today as Chairman.</p>
	<p>Geoff Smith, Managing Director</p> <p>Geoff joined SCT when he was just 19 years old. Briefly leaving to gather experience in other industry sectors he returned to the company working across the business using his knowledge in various roles. Since Geoff's previous appointment of CEO, SCT has experienced exceptional growth and expansion.</p>
	<p>Grant Glinski, Non-Executive Board Member</p> <p>Grant brings his considerable finance, treasury and operational experience to the SCT board. Grant enjoyed a long-term senior executive career in leading Asia-Pacific companies including The Mars Group, where he developed a keen interest in best practice distribution and logistics planning.</p>
	<p>Charles Mobrici, Commercial Director</p> <p>Charles joined SCT in June 1989 and is responsible for the commercial aspects of the SCT Group including customer and supplier contracts. During Charles' employment at SCT he has held various senior management accounting roles including Chief Financial Officer and General Manager Administration.</p>
	<p>Don Axup, General Counsel</p> <p>Don joined SCT in 2005 as General Counsel. Prior to 2005 Don spent over thirty years as a partner in a large Melbourne law firm practicing primarily in commercial and property law.</p>
	<p>Glenn Smith, Chief Executive Officer</p> <p>Glenn joined the family business 22 years ago. Glenn has held various key operational and management roles before being promoted to Chief Executive Officer in 2012. Glenn joined the Board of Directors in 2014.</p>
	<p>Michael Fiteni, Company Secretary / Chief Financial Officer</p> <p>Michael joined SCT in 2007 as the National Financial Controller. At that time he worked very closely with the previous CFO on finance strategic projects and was responsible for the reporting for the organisation. Michael's current position is that of CFO and is responsible for the financial management and reporting of the organisation.</p>

Source: SCT presentation

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Appendix 3: Industry overview

Competitive landscape

Overall, internal competition is less significant than external competition. Major players operate in markets and geographic locations that exhibit a degree of separation, which limits internal competition. Furthermore, rail capacity and access, limits the degree of competition among operators as ongoing expansion of routes and services is not possible.

There are only 25 operators licensed to utilise the rail network and only four of these are national operators. The main operators are Aurizon Holdings (formerly QR National) with a 46% market share; Asciano (formerly Pacific National) with 35%; Qube Logistics; Genesee & Wyoming (formerly Australian Southern Rail Group and Freightlink) and SCT each hold about 3%. SCT's low total market share is due the fact that it is not engaged in bulk commodity haulage such as iron ore or coal.

The east-west corridor, on which SCT earns 50-60% of its revenue, is serviced by only three rail logistics providers. The market is broken up with SCT (40%), Asciano (50%) and Aurizon (10%). The robustness of SCT's business model is evidenced by Aurizon entering this market seven to eight years ago and only being able to secure a modest market share.

The Rail Freight Transport Industry faces the greatest level of competition in the non-bulk segment. In this segment, rail freight directly competes with road freight, against which it has historically underperformed. Rail's performance, whether measured by transit time between origin and destination, scheduled arrivals or terminal performance, has been inferior to that of road transport. As a result, rail only becomes competitive where a clear price advantage exists. This typically occurs only for bulk goods transported over long distances. Road freight has become the mode of choice for many non-bulk transport customers. This is especially true of the inter-city market on the eastern seaboard. Falling oil prices have increased the level of external competition since the middle of 2014, as less fuel efficient road freight operators made significant savings.

However, the government is spending considerable sums improving the rail network including the mooted north-south corridor and signalling in Sydney. For example, a large proportion of the 2008 stimulus package was allocated to reducing the bottlenecks around Sydney. For a rail journey from Melbourne to Brisbane via Sydney, more than 20.0% of the time is spent travelling just 15 kilometres through Sydney. Investment in rail transport is expected to continue. In December 2013, the Queensland Government announced its intention to invest in improved rail freight infrastructure, to reduce the burden on roads.

Barriers to entry

The main barriers to entry in the industry involve capital requirements, staffing, regulation and access. New entrants need funding to buy or lease expensive equipment, to purchase access to rail networks and attract appropriately skilled staff. The substantial cost of rolling stock and the difficulty in attracting suitable staff are compounded by the substantial economies of scale involved in the industry. In order to maximise profitability, operators need to also maximise services, given the substantial rail access fees.

Legislative compliance remains high. Route accreditation is required before track owners offer train paths. The accreditation process is formidable, with requirements including rolling stock safety audits and qualification of operating personnel. The introduction of the National Rail Safety Regulator in 2013 should lower these barriers over time as more uniformity is introduced.

While barriers to entry are considered high, they have decreased in the past 10 years, largely as third-party access to rail networks has improved. The establishment of bodies, such as the Australian Rail Track Corporation, has allowed new entrants to use existing infrastructure on a fee-basis.

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The industry is highly regulated, with safety, technical and operational requirements set by state governments. Regulations and standards often overlap creating a compliance burden for the industry.

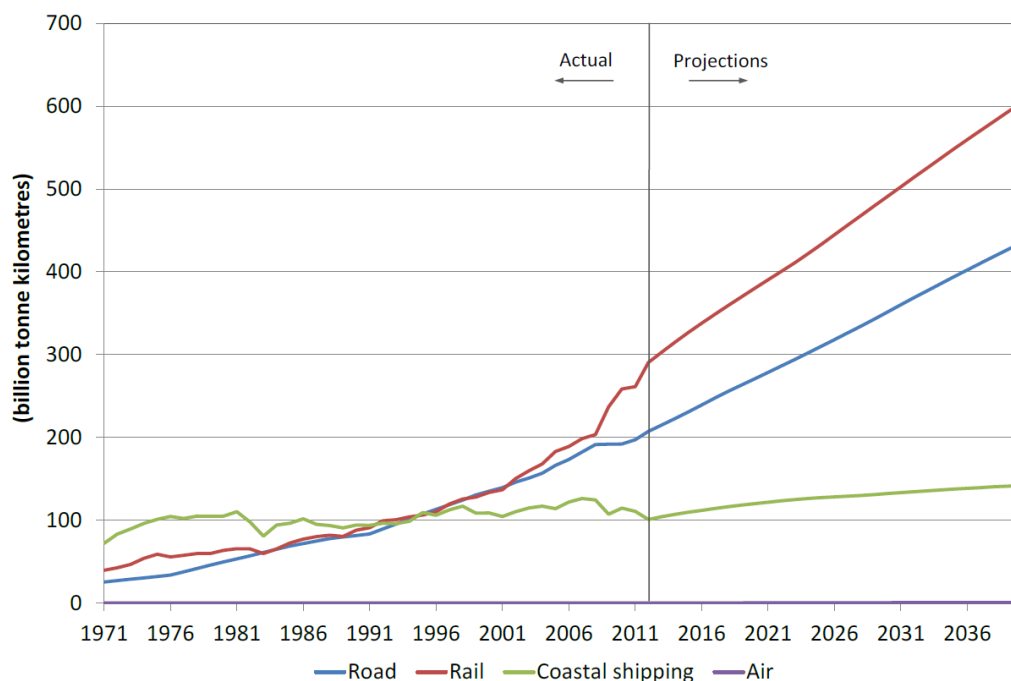
Historically, governments have owned both rail infrastructure (below rail) and rail services (above rail). Separation between below- and above-rail functions has increased over the past two decades with a greater emphasis on commercial structures. Most recently, the 2010 privatisation of QR National illustrates a continuing trend of decreasing government involvement in rail freight markets. This was the most significant privatisation since the Western Australian Government privatised freight networks in 2000.

A milestone in the deregulation process was the establishment of the Australian Rail Track Corporation (ARTC) in 1997.

Capital costs for the industry are high, due to the specific plant and equipment used by rail freight operators. Capital assets, including locomotives and wagons, have very large initial costs, but also long useful lives.

Australian freight usage is forecast to grow strongly over the next 20 years mostly to the benefit of road and rail:

Figure 20: Actual and projected domestic freight task, by mode, 1972-2040



Source: Department of Infrastructure, Transport, Regional Development and Local Government

Strategy

SCT is well placed to take advantage of a proposed new north-south rail corridor. The Australian Government has commissioned a start to the design and construction of the inland railway linking Melbourne and Brisbane. The project will complete a new rail connection between Melbourne and Brisbane, via Wagga, Parkes, Moree and Toowoomba.

The new line will be a faster, more efficient route that bypasses the Sydney rail network and will enable the use of double stacked trains along its entire length. The ARTC has been tasked with developing a ten year program to deliver the project, under the guidance of the Inland Rail Implementation Group.

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Appendix 4: Rail competition regulation

Australian Rail Track Corporation

The Australian Rail Track Corporation (ARTC) was established out of a 1997 Inter-Governmental Agreement entered into between the Commonwealth of Australia and the States of New South Wales, Victoria, Queensland, Western Australia and South Australia. ARTC is vertically separated, providing 'below-rail' services (such as the rail track infrastructure) but not 'above-rail' services (such as haulage). ARTC provides a single point of contact for parties seeking to run trains on the National Interstate Rail Network and the Hunter Valley Rail Network in New South Wales.

The Interstate Rail Network includes the mainline standard gauge track linking: Kalgoorlie in Western Australia; Adelaide, Wolsley and Crystal Brook in South Australia; Melbourne and Wodonga in Victoria; Cootamundra, Albury, Macarthur, Moss Vale, Unanderra, Newcastle (to the Queensland border) and Parkes in New South Wales. The Interstate Rail Network is used by both general freight services (such as manufactured goods) and bulk freight services (such as mining and agriculture products), as well as long distance and regional passenger services.

The Hunter Valley Rail Network is predominantly used to transport coal from mines in the Hunter Valley region to the Port of Newcastle for export and to transport coal to domestic customers, such as power stations. The network is also used by non-coal traffic, including general and bulk freight services (such as grain) and passenger services.

The Interstate Rail Network and Hunter Valley Rail Network are both regulated through access undertakings.

Rail access undertakings

Two access undertakings relating to rail infrastructure are currently in place, one for the Interstate Rail Network and one for the Hunter Valley Rail Network in New South Wales.

Interstate rail access undertakings

In 2002, the ACCC accepted an access undertaking from ARTC for the Interstate Rail Network. The 2002 access undertaking covered those parts of the network linking Kalgoorlie in Western Australia, Tarcoola in South Australia, Broken Hill in New South Wales, and Melbourne and Wodonga in Victoria. The 2002 access undertaking expired on 1 June 2007. In June 2007, ARTC submitted a replacement access undertaking to the ACCC for assessment but subsequently withdrew its proposal later in the same year. In 2008, the ACCC accepted a revised access undertaking for the Interstate Rail Network that, amongst other things, extended the coverage of the rail track. The 2008 access undertaking applies for a ten year term and is due to expire in 2018.

Figure 21: ARTC standard track access agreement terms

Term	Description
Grant of Train Paths	<ul style="list-style-type: none"> ARTC grants to the Operator during the Term the use and availability of the Train Paths and the use of the Network
Non-exclusive use of Train Path	<ul style="list-style-type: none"> The Operator's rights to the Train Paths do not give the Operator an exclusive right to any Train Path Notwithstanding the foregoing, no two Trains (whether the Operator's Trains or the Trains of another user of the Network) will be allotted scheduled arrival or departure times such that there are conflicts in arrival or departure times
Accreditation	<ul style="list-style-type: none"> Each party warrants that during the Term each such party has and will maintain Accreditation to the extent required by law, including, in the case of the Operator, all accreditation required by law in relation to Rolling Stock used by the Operator on the Network.

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Term	Description
	<ul style="list-style-type: none"> If either party's Accreditation is: <ul style="list-style-type: none"> (a) suspended for a continuous period of longer than six months; or (b) cancelled for a continuous period of longer than one month then the other party has termination rights
Flagfall charges	<ul style="list-style-type: none"> The Operator will pay all flagfall charges in respect of each Train Path, irrespective of whether or not the Operator uses all or any such Train Paths The Operator is not required to pay the flagfall Charges where ARTC is not able to provide the Train Path or an agreed substitute Train Path except where the failure to provide the Train Path is a result of an Incident, Third Party Works or an emergency
Variable charges	<ul style="list-style-type: none"> The Operator will pay to ARTC all variable Charges payable for each Train Path
Invoices and Monthly Statement	<ul style="list-style-type: none"> ARTC will issue the Operator with an invoice relating to each period from Sunday to the next Saturday (both inclusive), itemising the variable Charges payable for each Scheduled Train Path The Operator will pay to ARTC in full the amount shown in the monthly statement issued by ARTC, such payment to be received by ARTC within twenty one (21) days from the date of issue of the statement
Indexation	<ul style="list-style-type: none"> ARTC may annually vary the Indicative Access Charges for Indicative Services by CPI indexation
Rolling stock	<ul style="list-style-type: none"> The Operator agrees as at the Commencement Date and at all material times during the Term to maintain each Train operated by the Operator on the Network in a condition which is fit for use on the Network
ARTC to Repair and Maintain the Network	<ul style="list-style-type: none"> ARTC agrees at all times during the Term to maintain the Network (but only in so far as the Network is relevant to the Operator's Scheduled Train Paths) in a condition which is fit for use by the Operator to provide rail transport services.
Conduct of ARTC	<ul style="list-style-type: none"> In formulating its Indicative Access Charges, ARTC will not differentiate between operators in circumstances where: <ul style="list-style-type: none"> (i) the characteristics of the Indicative Services are alike; and (ii) the operators are operating within the same end market In determining whether the characteristics of two Indicative Services are alike ARTC may have regard to matters including but without limitation location, duration and quality of the Train Path, nature of Train consist, characteristics of the Indicative Service, longevity of access, arrival and departure times of the day and week.

Figure 22: Key SCT accreditations

- AS4801 Safety Management System
- AS4292 - Rail Safety – National
- 2006 Rail Safety Act & Regulations – VIC
- 2007 Rail Safety Act & 2008 Regulations – SA
- 2008 Rail Safety Act & Regulations - NSW
- NAP – Rail Safety – QLD
- HACCP – Hazard Analysis Critical Control Point - VIC,WA, QLD
- NHVAS - National Heavy Vehicle Accreditation Scheme
- Retail Logistics Supply Chain Code of Practice

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Appendix 5: Key strategic assets owned by SCT related property trust

Figure 23: Key intermodal terminals and strategic land owned by SCT property arm Blanalko

Location	Description
Altona, Vic	<ul style="list-style-type: none"> 75 hectares of prime development land with direct access to the national rail network, Westlink Altona is strategically positioned in Victoria's Industrial hub with easy access to all major arterial roads and is the ideal location for national distribution. With over 10km of rail track on site and infrastructure in place to service the expanding import and export needs of Victoria Almost daily services to Adelaide and Perth, with future rail services in the planning for the eastern sea board
Penfield, SA	<ul style="list-style-type: none"> SCT has recently completed construction and is operating at its new facility on over 52 hectares of land north of Adelaide in Penfield SCT's Penfield terminal will become a major rail hub intersecting Perth, Adelaide and Parkes rail services, including daily services in and out of the Adelaide port Planned expansion of intermodal and container operations Additional rail track infrastructure bringing total track on site to 12km Along with the intermodal terminal, the site is already home to the Carlton and United Breweries (CUB) distribution centre and the recently completed 22,500sqm Treasury Wine Estates' temperature controlled distribution centre
Parkes, NSW	<ul style="list-style-type: none"> Parkes, the most important strategic regional hub in Australia with its overnight proximity to four of Australia's five capital cities, is also the strategic junction point for the north-south and east-west rail corridors Shuttle trains and trucks move freight from Sydney to Parkes, the starting point for the Sydney-Perth trains
Forrestfield, WA	<ul style="list-style-type: none"> Located 15 km west of Perth CBD covering 36Ha of prime development land with direct access to the national rail network, Forrestfield Distribution Park is arguably the premier logistical estate in Australia, strategically positioned with major intermodal capabilities, state of the art warehousing and inland port facilities Forrestfield is the most mature terminal in the SCT group with a number of customers located on or nearby the terminal land, including Supercheap Auto and Fosters
Wodonga, Vic (proposed)	<ul style="list-style-type: none"> SCT has gained local council approval to build an intermodal terminal at the Logic business park development in Wodonga, Vic The council passed a motion in January 2015 to sell a parcel of land – including space for a warehouse and a 1.5km rail siding – to Blanalko It aims to provide cost-effective freight to and from Victoria's north east, helping to increase export competitiveness from regional Victoria It is reported SCT and Blanalko will invest \$39m in building the rail terminal and other infrastructure
Beaudesert, Qld (proposed)	<ul style="list-style-type: none"> Blanalko owns a site in Beaudesert, Brisbane, which could potentially be developed for a terminal and warehouse

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Appendix 6: Peer analysis

Figure 24: Comparison to listed peers

Latest Financials Company	FY15* SCT	FY16* SCT	LTM Asciano AIO	LTM Aurizon AZJ	LTM Qube QUB
ASX Code	NA	NA	BBB	BBB+	NR
S&P rating	NR	NR			
\$A m's					
Market Cap	NA	NA	6,369.0	10,960.0	2,927.0
Revenue	271.5	280.1	3,934.6	3,838.0	1,368.7
EBITDA ^	34.3	42.4	1,076.5	1,416.0	232.9
EBIT ^	10.2	19.0	738.0	914.0	135.3
Interest expense	9.2	9.6	224.0	127.0	26.0
NPAT	1.0	9.4	256.6	454.0	106.8
CFO	18.1	28.8	672.6	1,181.0	193.4
Cash	0.5	1.9	183.8	191.0	81.1
Tangible Assets	235.2	218.0	5,799.5	11,003.0	1,583.5
Debt	138.5	121.0	3,780.5	3,328.0	483.4
Equity	53.6	57.0	3,833.4	6,416.0	1,475.3
Enterprise Value (EV)			9,965.7	14,097.0	3,329.3
Debt + Equity	192.1	178.0	7,613.9	9,744.0	1,958.7
Credit Metrics					
EBITDA / Revenue margin (%)	12.6%	15.1%	27.4%	36.9%	17.0%
EBITDA / Interest Expense	3.7x	4.4x	4.8x	11.1x	9.0x
EBIT / Interest Expense	1.1x	2.0x	3.3x	7.2x	5.2x
CFO/Debt	13.1%	23.8%	17.8%	35.5%	40.0%
EV / EBITDA			9.3x	10.0x	14.3x
Mkt Cap / NPAT			24.8x	24.1x	27.4x
Debt/EBITDA	4.0x	2.9x	3.5x	2.4x	2.1x
Net Debt/EBITDA	4.0x	2.8x	3.3x	2.2x	1.7x
Debt/Tangible Assets	58.9%	55.5%	65.2%	30.2%	30.5%
Debt/Debt+Equity	72.1%	68.0%	49.7%	34.2%	24.7%

Source: FIIG Securities, Company reports. Forecasts have been provided by SCT adjusted for Note issue. LTM to 31 Dec 2014

SCT has 3 listed comparables:

- Asciano Limited (ASX: AIO) is a national rail freight and cargo port operator providing logistics services within infrastructure-based supply chains. Asciano has four key businesses namely Pacific National Coal, Pacific National Rail, Terminals & Logistics and Bulk & Automotive Port Services.
- Aurizon Holdings Limited (ASX: AZJ) is an Australian rail freight operator company. AZJ owns and operates a coal network made up of 2,670 kilometres of heavy haul rail infrastructure. AZJ also provides a range of services in rail design, engineering, construction, management and maintenance, and offers supply chain solutions to a range of customers in Australia. AZJ operates four businesses namely, Coal, Freight, Network, and Iron Ore.
- Qube Holdings Limited (ASX: QUB) is an integrated provider of import and export logistics services. QUB operates in three divisions covering Automotive, Bulk and General Stevedoring, Landside Logistics and Strategic Development Assets.

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Both AIO and AZJ own much of the rail networks that they operate on increasing their respective EBITDA margins. For example, SCT spends 18.7% of its revenue on rail access charges where this would mainly show up as a CAPEX item for AIO and AZJ. SCT is smaller and hence has a higher reliance on debt funding resulting in higher debt / EBITDA and debt / Debt + equity ratios. Although this reverts to the peer group once SCT returns to its traditional level of profitability in FY16.

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Appendix 7: Credit Statistics

SCT Logistics Credit Statistics (A\$m)	2011	2012	2013	2014	2015*	2016*	2017*	2018*
Operating Cashflow	22.6	46.1	31.1	37.3	18.1	28.8	35.6	37.5
EBITDA	46.8	42.8	45.7	44.2	34.3	42.4	43.5	44.6
EBIT	26.1	22.0	23.3	21.7	10.2	18.6	20.5	21.6
Occupancy Costs	12.1	12.8	13.9	14.3	17.2	17.2	17.2	17.2
EBITDAR	58.9	55.6	59.6	58.5	34.3	42.4	43.5	44.6
Net Acquisition & CAPEX	20.0	26.1	15.2	19.4	13.3	3.5	3.5	7.5
Interest expense	16.1	13.8	13.6	11.8	11.3	8.8	7.4	6.7
Cash	(2.0)	2.7	0.3	0.5	0.5	1.9	8.0	18.7
Finance Leases	169.2	167.9	152.8	143.0	53.5	36.0	18.5	8.8
Unsecured Debt	-	-	-	-	85.0	85.0	85.0	85.0
Total Debt	169.2	167.9	152.8	143.0	138.5	121.0	103.5	93.8
Total Net Debt	171.2	165.2	152.5	142.4	138.0	119.1	95.4	75.1
Total Liabilities	197.6	204.3	196.0	186.5	184.1	163.1	145.9	136.6
Tangibles Assets	278.6	283.2	258.3	245.9	235.2	218.0	205.9	202.3
Equity	81.1	79.0	62.3	59.4	53.6	57.0	61.6	66.8
Credit Ratios								
EBITDA Interest Cover	2.9x	3.1x	3.4x	3.8x	3.0x	4.8x	5.8x	6.7x
EBIT Interest Cover	1.6x	1.6x	1.7x	1.8x	0.9x	2.1x	2.8x	3.2x
Fixed Charge Cover	2.1x	2.1x	2.2x	2.2x	1.8x	2.3x	2.5x	2.6x
Operating Cashflow Interest Cover	1.4x	3.3x	2.3x	3.2x	1.6x	3.3x	4.8x	5.6x
Secured Debt / EBITDA	3.6x	3.9x	3.3x	3.2x	1.6x	0.8x	0.4x	0.2x
Total Debt / EBITDA	3.6x	3.9x	3.3x	3.2x	4.0x	2.9x	2.4x	2.1x
Net Debt / EBITDA	3.7x	3.9x	3.3x	3.2x	4.0x	2.8x	2.2x	1.7x
Net Debt / Operating Cashflow	7.6x	3.6x	4.9x	3.8x	7.6x	4.1x	2.7x	2.0x
Net ACQ & Capex/EBITDA	88.2%	56.6%	49.0%	52.1%	73.4%	12.2%	9.8%	20.0%
Secured Debt / Tangible Assets	60.7%	59.3%	59.2%	58.1%	22.7%	16.5%	9.0%	4.3%
Total Debt / Tangible Assets	60.7%	59.3%	59.2%	58.1%	58.9%	55.5%	50.3%	46.4%
Total Liabilities / Tangible Assets	70.9%	72.1%	75.9%	75.8%	78.3%	74.8%	70.9%	67.5%
Debt / (Debt+Equity)	67.6%	68.0%	71.0%	70.6%	72.1%	68.0%	62.7%	58.4%
Net Debt to Capitalisation Ratio	67.9%	67.7%	71.0%	70.6%	72.0%	67.6%	60.8%	52.9%
Net Debt/Equity	211.2%	209.2%	244.8%	239.7%	257.4%	208.8%	154.9%	112.4%
Asset Coverage								
Tangible Assets/Secured Debt	165.0%	169.0%	169.0%	172.0%	440.0%	606.0%	1114.0%	2304.0%
Tangible Assets/Total Debt	165.0%	169.0%	169.0%	172.0%	170.0%	180.0%	199.0%	216.0%
Tangible Assets/Total Liabilities	141.0%	139.0%	132.0%	132.0%	128.0%	134.0%	141.0%	148.0%

Source: FIIG Securities, Company reports. Forecasts have been provided by SCT adjusted for Note issue

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