FIIG Factsheet

AusNet Services Holdings Pty Ltd

25 March 2022

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

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Issuer Outline

AusNet Services Holdings Pty Ltd is a wholly owned subsidiary of AusNet Services Limited (AusNet or Group) and is the common vehicle for the Group's fundraising activities.

AusNet, headquartered in Melbourne, is a diversified electricity & gas infrastructure business that wholly owns, operates and controls its assets, including the primary regulated Victorian electricity transmission network, an electricity distribution network in eastern Victoria and a gas distribution network in western Victoria. The Group also has an unregulated business (Select Solutions) which provides specialised utility related solutions, in particular metering and asset intelligence services.

AusNet's total Regulated/Contracted Asset Base was AUD11.3bn as at 30 September 2021 (AUD10.4bn regulated and AUD913m contracted), up 4.6% over the previous 12 months.

AusNet shareholders recently approved the acquisition of the company by a consortium led by Brookfield, which also includes a number of Australian and Canadian pension funds. Following completion of the acquisition (expected mid-February), AusNet shares will be delisted from the ASX. The acquisition valued AusNet's equity at AUD10.1bn.

Key Financials (AUDm)

LTM (30 Sep)	2021
Revenue	1,916.9
EBITDA	1,110.1
Net Interest Expense	290.6
Total Assets	13,872.9
Cash	330.4
Debt	9,024.4
Net Debt/EBITDA	7.8x
EBITDA/Interest Exp.	3.8x

Source: FIIG Securities, S&P Capital

Summary Bond Details

ISIN	Issue Amount	Ranking	Coupon	Coupon Frequency	First Call	Maturity Date
AU3CB0242527	AUD 425m	Senior Unsecured	4.40%	Semi-Annual	N/A	16 August 2027
AU3FN0056594	AUD 650m	Subordinated	3M BBSW+3.10%[1]	Quarterly	6 Oct 2025@100	6 October 2080
AU3CB0288066	AUD 500m	Senior Unsecured	4.301%	Semi-Annual	30 Jan 2028@100	30 March 2028

Note 1: Margin step-up to 3.35% from October 2030 and to 4.10% from October 2045

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Strengths

- Competitive position: The AusNet Group owns and operates three regulated assets, including an electricity transmission, and are the sole provider of electricity and gas distribution services in eastern and western Victoria, respectively. These assets are critical in the delivery of energy in Victoria, are capital intensive, and difficult to replicate. AusNet's three main regulated assets contribute more than 90% of the Group's EBITDA. The Group enjoys the benefit of having a portfolio which is diversified through transmission and distribution assets, electricity and gas sectors, as well as different regulatory revenue/tariff reset dates. This diversity provides a more stable suite of cashflows.
- Predictability of cashflows: The electricity transmission, electricity distribution and gas distribution assets provide regulated, largely predictable cash flows. About 95% of AusNet's consolidated revenues for the first half of FY22 were regulated, all of which were protected from the risk of increases in inflation. Of these amounts, revenues from the Group's electricity transmission business (which amounted to 29% of total consolidated revenue) were not exposed to volume risk. Transmission revenue was recently set for the period to 2027, with gas revenue reset due in 2023 and electricity distribution tariff to be reset in 2026.
- Staggered regulatory reset dates: The Group's staggered regulatory reset timing for its three businesses helps to smooth out reset risks and gives AusNet time to adjust to resets. S&P expects the regulated assets to continue contributing more than 80% of the Group's EBITDA despite the forecast incremental growth in unregulated but highly contracted income over the next few years, coming primarily from stand-alone electricity transmission lines linking renewable energy sources to the wider grid.
- Minimal exposure to volume risk: AusNet's exposure to volume risk is minimal given that the electricity transmission and distribution business (nearly 90% of EBITDA) operates under a revenue cap mechanism. Although the gas network has some exposure to volumes, the risk has also been minimal over the past few years given the flat to very modest growth incorporated by the regulator as part of the rate-setting process.
- Strong regulatory framework: Australia's strong and supportive regulatory framework is a fundamental driver of the credit quality and stability of the regulated utilities sector. Rating agencies expect the regulatory process to continue to remain supportive and provide entities enough time to adapt to emerging disruptive technologies.
- Staggered maturity and diversified funding sources: Although the group has a significant level of debt (AUD8.3bn, based on hedged rates for non-AUD debt), the maturity profile is well staggered with no more than AUD950m due in any single financial year, materially reducing the refinancing risk. In addition, the group has issued debt denominated in AUD, EUR, USD, HKD, JPY, NOK, demonstrating a strong acceptance across global fixed-income investors.

Risks

- Exposure to regulatory resets: Regulatory resets expose AusNet Services to a varying level of return (weighted-average cost of capital [WACC allowance]) depending on the interest rate environment. During the recent round of resets since 2016, lower WACC outcomes (hence lower revenues and EBITDA) compared with the prior-period reset have been largely offset by lower interest rates. AusNet's regulatory returns are also dependent on movements in inflation rates under the Group's regulatory arrangements. An unexpectedly low, and sustained, inflation rate is likely to result in lower than expected cashflows and revenue. There is also downside risk in the rate of increase in annual tariffs within regulatory periods, which are inflation linked. However, we expect this risk to be mitigated by AusNet's supportive financial and capital management policies, as well as its diversity benefits from owning multiple networks with staggered regulatory reset dates.
- Growth in unregulated asset base: AusNet intends to grow the asset base of its unregulated business (which has doubled over the last five years). Despite the targeted growth, Moody's expects the contracted assets will remain at a modest level relative to its regulated asset base, and that the additional investments in contracted assets will be restricted to stable infrastructure assets with a risk profile similar to its existing portfolio, which generally requires minimal capital expenditure.

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- Exposure to cost changes within a regulatory control period: The Group is exposed to cost changes within a regulatory control period and bears the risk of any shortfall in allowances for costs provided by regulatory determinations. Costs can change materially within a regulatory control period due to, among other things, changes in the costs of labour, equipment or capital inputs (including the cost of finance).
- Volume risk in gas network: The majority of the AusNet's gas distribution network revenues are derived from the transported volume of gas metered at the connections to the distribution networks, with the balance, which amounted to 47% in 2019/20, recovered through fixed charges. The volume of gas used is subject to seasonal fluctuations and to a range of variables, including economic conditions, population growth, government policy, weather, alternative energy sources, technology, energy saving behaviour and availability of adequate supplies of gas. Economic downturns and customer relocations out of a distribution area would also have a direct adverse effect on the AusNet Services Group's revenues.
- Interest rate risk: The group is exposed to interest rate movement, especially as revenue are derived from interest rate at the time of the tariff reset. Any rise in interest rate would only be compensated at the time of the next tariff reset. To mitigate this risk, the group hedged most of its interest rate exposure to match the various regulatory periods and has historically maintained interest rate hedging in excess of 90% of its debt.
- Recent delisting following privatisation: AusNet is expected to be delisted from the Australian Securities Exchange (ASX) following the acquisition by private company Brookfield. This means that the company will be not subject to the same level of public scrutiny and the new owners may implement more aggressive financial policies. However we believe this to be unlikely, as there is an expectation that the Brookfield infrastructure funds (via a contractual arrangement with other shareholders) will exercise control of, and manage AusNet's balance sheet consistent with its credit profile which Brookfield has publicly articulated at the time of the acquisition.

Risks relevant to the Subordinated notes

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

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