

Professor Roy Green
Queensland Competition Authority
Level 27
145 Ann Street
Brisbane Queensland 4001

21 MAR 2018

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16 March 2018

Dear Professor Green,

Investors Mutual Limited (IML) is an Australian based fund manager with over AUD 8 billion that it manages on behalf of a wide range of investors including many retail investors. IML takes a long-term approach to investing and we look to invest in companies which generate a high level of recurring income, have competent management, and that can grow their earnings and dividends over time.

As shareholders in Aurizon on behalf of clients, we are of the strong opinion that the Aurizon Network UT5 Draft Decision, while grounded in theory, is ultimately inconsistent with the commercial realities of operating a complex coal network. Confidence in regulatory outcomes is a pre-requisite for long term investors such as ourselves – and the UT5 Draft Decision not only damages investor confidence, but in the long term it will also damage the economic interests of the State of Queensland by discouraging investors to invest in infrastructure assets there.

The UT5 Draft Decision ...compared to commercial reality

The proposed WACC of 5.4% is far lower than that required by any real world reasonable investor. It makes no sense to us at all that Aurizon Network should earn a lower return than recent water utility decisions. In addition, the ARTC's Hunter Valley Network – which is a close comparison to Aurizon – has only recently been allowed a 6.3% return by the ACCC.

The main cause of this material discrepancy appears to be the extremely low risk-free rate and beta assumptions used - which we urge you to reconsider. It seems to have been forgotten that coal mining is an inherently risky business activity. Coal is a commodity and as such its price can fluctuate substantially – and the Aurizon Network is fully exposed to the downside volume risk when commodities are weak and coal mining volumes fall. The QCA seems to have forgotten that it was only a few years ago when the coal industry was on its knees and many mines were being closed - as can be seen clearly from the attached media references.

The credit assumptions used in the Draft Decision are also inconsistent with reality. If finalised, the Draft Decision leaves Aurizon Network in the absurd position of not being able to meet the credit rating assumption used in determining its cost of debt, and therefore its WACC ! Clearly the model inputs need to be urgently reviewed to take into account this reality.

The maintenance practices assumed by the UT5 Draft are also inconsistent with what Aurizon and the miners know is commercial best practice. Clearly, a coal train carries a highly valuable load, and deserves priority over maintenance work, where it is safe to do so.

UT5 Outcomes

If finalised, the UT5 Draft Decision will remove all incentive for Aurizon Network to invest, or to take operating risks. The CQCN will be condemned to four years of no growth and network volumes will suffer.

If the draft decision is adopted, the decision will severely damage investor confidence in reasonable regulatory outcomes, particularly in Queensland. Unless the draft decision is revised to be more in line with commercial realities, it will ultimately have the effect of reducing the capital available for companies involved in infrastructure in future and it will act as a great deterrent for investment in Australian infrastructure. This could potentially be disastrous not just for Queensland but potentially for all of Australia.

The UT5 decision, through its impact on volumes, will impact the legitimate business interests of Aurizon Network, the miners, and royalties earned by the State of Queensland.

In light of its importance and the extremely negative repercussions from the draft decision, we urge you to consider all the above decisions when formulating your final decision.

Yours sincerely,



Anton Tagliaferro
Investment Director



Nigel Hale
Equities Analyst

THE AUSTRALIAN

More coalmine closures on cards

19/06/1997 Production at BHP's Saraji open-cut coking coal mine in Bowen Basin, Qld. Mining.

MATT CHAMBERS THEAUSTRALIAN 12:00AM September 15, 2012

THE problems for Queensland's coking coal miners may not be just short term.

BHP Billiton, Queensland's largest coking coal producer, has substantially wound down its outlook for the steelmaking ingredient, and not just because of the growing cost imposts in the state.

While coking coal is far from the least favoured of BHP's wide portfolio -- that title still sits with the likes of nickel and aluminium -- it is the one commodity about which chief executive Marius Kloppers and his team are said to have most dramatically changed their medium and long-term outlook, as they clean the company's slate of big-spending commitments amid slowing Chinese growth.

The near-term pressure hitting the sector was evident this week, when BHP closed its second Bowen Basin coking coal mine in the past six months and flagged 300 job losses. At the same time, Xstrata flagged 600 jobs losses in Queensland and NSW and the closure of one of its two Brisbane offices.

But the longer-term outlook for Queensland coking coal, which in 2008-09 was BHP's most profitable division after iron ore, has also changed at the company.

It is no longer being talked about as a potential growth engine, falling down the investment priority list behind the likes of petroleum, potash, copper and even iron ore.

Locally, the cost side is biting on a number of fronts. As well as inflated labour and materials prices, BHP is forecasting no relief from the Australian dollar, with weakness in other regions assumed to keep the currency at parity or above.

The carbon tax and the increase in royalties on coking coal announced by Queensland Premier Campbell Newman last week do not help.

But they are far from the leading factors (and the minerals resource rent tax was designed, with BHP's involvement, to capture only big profits, so is even less a factor at current prices). The increased local headwinds come as Queensland's coking coal, which provided almost \$30bn in revenue in 2011-12, faces growing international supply and demand pressures.

These were evident well before June 30, when coking coal began a 32 per cent slide to leave it at \$US151 a tonne yesterday.

In April, BHP knocked a little more than 100 million tonnes a year from a 2025 annual global demand forecast made six months earlier.

This is fairly substantial. BHP, the world's largest supplier of seaborne coking coal, produces about 60 million tonnes a year, and Australia, the top coking coal exporter, produces almost 150 million tonnes a year.

Beyond 2025, when BHP is expecting steel demand in China to peak, the miner expects a big drop in demand growth.

While this is similar to the demand pressure iron ore is under, a factor that apparently dampens the big miners' enthusiasm for coking coal has been growth in US coking coal exports to Asia during the high coal prices of recent years. While this will pull back under current prices, BHP expects the ability of the US to ramp up exports to put a cap on future coking coal price rises.

Interestingly, BHP does not appear concerned over additional supply coming from Mozambique, where rival Rio Tinto has taken a position through the \$4 billion takeover of Riversdale Mining, and Mongolia.



Coal mine workers will lose jobs after Isaac Plains closure: Queensland Resources Council

Updated Tue 30 Sep 2014, 9:02am

Hundreds of jobs will be lost when a foreign-owned mining company closes its coal mine in the Bowen Basin, the Queensland Resources Council (QRC) says.

The Isaac Plains Coal Joint Venture announced it would close its open cut mine east of Moranbah by January next year.

The announcement came just days after BMA revealed it was axing 700 jobs across central Queensland.

QRC chief executive officer Michael Roche said the global coal market was over-supplied and prices had dropped.

"That over-supply will work through over the next year or so, so there are many mines in Queensland that are continuing to grow and prosper, but for the more marginal mines these are very challenging times," he said.

Construction, Forestry, Mining and Energy Union (CFMEU) spokesman Steve Pierce said he believed the closure at Isaac Plains was purely based on economic reasons.

"There certainly seems to be economic factors that have led the company to have to close the mine, whereas BHP's is just about casualising their workforce," he said.

"They can't justify their actions."

He said the union would meet with the mine owners and its members later today.

Topics: work, mining-industry, coal, economic-trends, regional, mining-rural, community-development, company-news, moranbah-4744, mackay-4740, rockhampton-4700

First posted Tue 30 Sep 2014, 8:57am



Peabody Australia coal company loses nearly \$3b in 2015, notes risk from parent's bankruptcy

By business reporter Sue Lannin

Updated Fri 3 Jun 2016, 11:11am

The Australian arm of US coal giant, Peabody Energy, made a nearly \$3 billion loss last year and it could be drawn into the bankruptcy woes of its US parent, according to its latest financial accounts lodged with the corporate regulator, ASIC.

In addition, the Australian company's auditor has warned of doubts about the firm's ability to continue as a going concern.

In April, Peabody Energy went into Chapter 11 bankruptcy protection in the US, with debts of \$US10.1 billion, because of the plunge in coal prices amid the economic slowdown in China.

Thermal coal prices have more than halved from above \$US120 per tonne in 2011 to just above \$US50 currently, while steelmaking coal is worth less than a third of its peak, around \$US87 a tonne now down from more than \$US300.

Chapter 11 bankruptcy allows a company to restructure so it can pay its debts over time.

The 2015 accounts for the Australian subsidiary, Peabody Australia Holdco, show the company made a \$2.7 billion net loss for the year to the end of December.

That includes a write-down of \$1.8 billion and an income tax bill of \$43 million, as well as a charge of \$12.9 million for discontinued operations.

'Intercompany loan may not be sufficient'

Peabody Australia Holdco was not included in the filings for bankruptcy in the US, and it was lent \$US250 million by companies owned by its US parent on the day of the bankruptcy filing in April to provide "additional liquidity to support ongoing operations".

The financial accounts noted that the \$US250 million loan was put in place so that Peabody Investment Corporation (PIC) and a Gibraltar subsidiary of the US parent would not ask for voluntary repayment of the money or shares owed.

However, Peabody Australia's financial accounts warn of "certain additional liquidity risks" because of the US bankruptcy proceedings including possible demands for repayment or the return of leased equipment from the US parent's financiers, suppliers and other counterparties.

"The Intercompany Loan Facility may not be sufficient to accommodate some or all of the possible cash outflows" for items such as accelerated repayment of leases and "additional cash-backing for bank guarantees or other security should it be required," the 2015 financial accounts noted.

Peabody Australia Holdco owes around \$5.7 billion to companies owned by its US parent.

'Significant uncertainty' about Peabody as a 'going concern'

In the accounts, auditor Ernst & Young warned of doubts about the Australian company's ability to keep operating as a going concern.

"There is significant uncertainty whether the company and/or the consolidated entity will continue as a going concern, and therefore whether they will realise their assets and extinguish their liabilities in the normal course of business and at the amounts stated in the financial report," the auditor's report cautioned.

The company's financial accounts noted that, during 2015, Peabody Australia "continued to experience weak market conditions."

"The group is focused on cost reductions and productivity improvements across all operations."

Peabody Australia Holdco made a \$1.2 billion loss in 2014, and its latest accounts show its total debt has increased to \$10.7 billion while its total assets are worth \$4.1 billion, leaving the company owing far more than it is worth.

According to the accounts, Peabody Australia had just \$219 million cash on hand at the end of 2015.

Peabody Australia has been provided a letter of financial support from PIC, a subsidiary of the US parent, until April 30, 2017.

However, the accounts also note that Peabody Australia is unable to draw on credit facilities provided by PIC and the Gibraltar subsidiary of the parent company because of the US bankruptcy proceedings.

Peabody Australia Holdco is also considering settling a legal claim for \$20 million from Queensland Bulk Handling for the alleged breach of a coal port services agreement.

'We don't see how Peabody can finance those operations'

Around 2,300 people are employed by Peabody's mines in New South Wales and Queensland.

Climate and finance lawyer David Barnden, from not-for-profit legal firm Environmental Justice Australia, has studied the accounts of Peabody Australia Holdco.

"Our research suggests that the Australian operations are intimately connected with the US bankruptcy proceedings," Mr Barnden said.

"It may be operations as usual, but we don't see how Peabody can finance those operations."

Peabody's Australian operations are also used as collateral by Peabody Energy US for some of its credit facilities.

No dividends were paid or declared by Peabody Australia Holdco for 2015 and 2014.

Peabody Australia is seeking to expand its mines at Wilpinjong and Wambo in New South Wales.

Last month, the company said it would sell undeveloped exploration tenements in Queensland's Bowen Basin for \$65 million.

Topics: coal, company-news, australia, mackay-4740, qld, nsw, newcastle-2300, mudgee-2850, united-states