Aurizon

Benchmarking of Corporate Overhead Costs for Aurizon Network Operations

22 January 2013

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22 January 2013

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Aurizon Network Corporate Cost Analysis – Operations

I am pleased to submit to you our final report setting out the findings of our benchmarking review of corporate overhead costs for Aurizon Network Operations. Our analysis suggests that using the allocation basis applied in this analysis resulted in Aurizon Network's share of corporate overhead costs falling within a reasonable range of comparable benchmarks.

We would be happy to discuss with you any aspect of this report or our work and would like to thank you for the opportunity to work with you on this project.

Purpose of our report and restrictions on its use

This report was prepared on your instructions solely for the purpose of Aurizon Network and should not be relied upon for any other purpose. Because others may seek to use it for different purposes, this report should not be quoted, referred to or shown to any other parties unless so required by court order or a regulatory authority, without our prior consent in writing. However, we acknowledge that Aurizon Network will provide this report to the Queensland Competition Authority as part of its revised network access undertaking submission.

Our report may not have considered issues relevant to any third parties. Any use such third parties may choose to make of our report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use.

This report should not be provided to any other third parties without our prior approval.

We disclaim all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from or relating to or in any way connected with the contents of this report, the provision of this report to the other party or reliance upon this report by the other party.

Liability is limited by a scheme approved under professional standards legislation.

Scope of our work

The scope and nature of our work, including the basis and limitations, are detailed in our contract dated 20 April 2012 and subsequent contract variation dated 5 December 2012.

If you would like to clarify any aspect of this review or discuss other related matters then please do not hesitate to contact us.

Yours Sincerely

Daniele Bird
Partner

Contents

Purpose and scope

- Ernst & Young (EY) was engaged to assist Aurizon Network Pty Ltd ("Aurizon Network") to undertake an analysis of corporate overhead costs allocated to the Operations function. The primary objective of the project was to determine the appropriate cost allocation methodology for corporate overheads. This was achieved by determining:
  - How these costs compare to comparable organisations (i.e. the quantum of costs), and
  - How the cost allocation method compares to the method used by other Australian regulated entities.
- This analysis will be used to inform a revised access strategy undertaking ("UT4"), for submission to the Queensland Competition Authority ("QCA"), the economic regulator in 2013.
- The scope of the analysis includes the corporate costs recorded in the FY13 4+8 financial forecast which is an update of the annual plan for the 2012/13 financial year. The categories of corporate costs are:

Finance:	Tax; Treasury; Investor Relations; Enterprise Planning, Reporting and Services; Capital Excellence and Network Finance and Governance
Enterprise Services:	Company Secretary; Internal Audit; General Counsel; Enterprise Risk Management; Branding; National Policy; and Information Technology
Human Resources:	Talent and Organisational Development; Resourcing and Services; Remuneration and Support; Employee Relations; Functional HR Support; and HR External Relations & Communications
Business Sustainability:	Safety, Health and Environment; Enterprise Real Estate; Enterprise Procurement; Innovation; and Operational Excellence
Strategy:	Enterprise Strategy and Branding
Board, Managing Director/CEO:	Board; and Managing Director /CEO

- This report was not prepared for any purpose other than that stated above and cannot be relied upon for any other purpose.
- We acknowledge the release of this report to Queensland Competition Authority.

Approach: introduction

Ernst & Young has a detailed benchmarking methodology, designed for comparing the cost and non-cost performance of corporate service functions. This methodology has been refined and updated regularly and so represents a leading practice approach to corporate and shared services performance benchmarking.

The Ernst & Young Benchmarking Methodology comprises five stages:

Ernst & Young Benchmarking Methodology

1 Project initiation

- Scoping of benchmark study
- Development of Statement of Work that details costs, timeframes, roles and responsibilities
- Agree proposed data sources

2 Scope definition

- Agreement of overhead costs data definitions
- Agree scope of survey respondents
- Design of data collection instruments (e.g. questionnaires, surveys)

3 Data collection

- Analysis of client data sources and extraction of required data sets
- Review of EY proprietary and EY subscribed data sources and extraction of required data sets
- Collection of data from invited third party participants

4 Data analysis

- Data mapping review, ensuring like costs were used in comparison
- Analysis including range, average, correlation
- Examination of performance outliers

5 Reporting

- Graphical interpretation with averages and rankings
- Supporting commentary (including, depending on scope, explanations of any performance outliers)
- Description of data sources

See pages 6 and 7 for notes related to each step of the method as it was applied for this particular engagement.

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Approach: explanatory notes

The following notes explain how the Ernst & Young Benchmarking Methodology was applied in the context of this engagement:

1) Project initiation

- The scope and approach for the study was confirmed through engagement with key managers
- Key points confirmed:
  - Ernst & Young would include a range of comparators at total and functional levels as appropriate
  - Aurizon Network cost data is based on the FY13 4+8 budget forecast figures (and not on actuals)[1]
- Three sources of benchmark data are utilised:

  (1) existing Ernst & Young benchmark data sets based on APQC[2] data

  (2) other data sets available to Ernst & Young (e.g. our data subscription with APQC)

  (3) data collected from third-party organisations

2) Scope Definition

- The scope of this work was limited to corporate overheads for Aurizon Network Operations only.
- It was necessary to classify Aurizon's detailed corporate cost buckets into "cost groups" to allow for a like-for-like comparison with benchmark data sets. See page 8 for detail.
- Ernst & Young data sources and the other external data sources were used to identify candidate benchmarks for each cost group. "Cost per $1,000 dollars of revenue" or "Cost as a percentage of revenue" were selected as the preferred benchmark types as they allowed for easy and meaningful comparison across geography, function and industry.

1 The adoption of the latest Board approved forecast dataset on which to base the corporate cost allocations is deemed by Network management to be the most prudent approach as the Aurizon Group including Aurizon Network have undergone significant structural changes since listing as a Public Company in November 2010. Aurizon Network management are of the view that the aforementioned dataset is the most accurate basis on which to forecast the actual Corporate Cost spend during the forthcoming UT4 period."

2 Founded in 1977, APQC is a member-based nonprofit serving 500 organisations worldwide in all industry sectors. APQC spearheaded the Open Standards Benchmarking Collaborative (OSBC) research to develop commonly used processes, measures and benchmarks that are available to organisations worldwide to improve performance. (www.apqc.org)

Approach: explanatory notes (cont.)

3) Data collection

- Corporate overhead cost centre data was provided by Aurizon Network. The cost analysis relied on the provision of data from Aurizon Network regarding the Network business' cost structure, cost data and current allocation basis, and no verification of data accuracy was performed by Ernst & Young.
- External benchmarking data was obtained from the following data sources:
  - Our internal benchmarking database, based on the APQC database
  - APQC Open Standards Benchmarking Collaborative Database
  - Global Audit Information Network Benchmarking Survey
  - Individual response data provided by key relevant organisations approached for the purposes of this engagement

4) Data analysis

- For each data set, definitions were compared to ensure comparisons between data provided and external data were valid. Where necessary, definitions of data provided and/or cost grouping was adjusted and figures recalculated to ensure a valid like-for-like comparison
- Data sets were filtered to identify relevant comparator organisations (i.e. those in the Transport and Distribution industries, and with comparable revenue figures)
- Specific individual comparator organisations were identified, and available data was sourced
- Results graphs were created and key statistical information calculated (i.e. averages, median, percentiles)
- Where material variations were noted between data and benchmarks, further consultation was performed to identify the likely underlying drivers of the costs involved

5) Reporting

- Results were analysed and recommendations developed
- A draft report was prepared and presented to the client representative for client review for factual accuracy and Aurizon Network contextual commentary
- The revised draft was accepted by the client and a final report issued

Approach: cost groups

The analysis was conducted for the total corporate overhead costs and at a functional level. Aurizon costs have been benchmarked at functional level where comparable benchmarks were available. In other instances, costs have been aggregated or disaggregated to achieve a valid comparison with other organisations. These "cost groups" can be seen in the diagram below.

Aurizon Functions

Cost Groups	Finance	Enterprise Services	Human Resources	Business Sustainability	Strategy	Board & CEO
Benchmarked	Tax; Treasury; Investor Relations; Enterprise Planning, Reporting & Services; Capital Excellence; Network Finance & Governance	Company Secretary; General Counsel / Internal Audit; Enterprise Risk Management / Information technology / Branding*	Talent & Organisational Development; Resourcing & Services; Remuneration & Support; Employee Relations; HR External Relations & Communications; Functional HR Support	Safety, Health & Environment / Enterprise Real Estate / Enterprise Procurement	Enterprise Strategy	Board; Managing Director/CEO
Not Benchmarked		National Policy		Innovation; Operational Excellence; Enterprise Effectiveness		

At a functional level we have not been able to source comparable benchmarks for National policy, Innovation, Enterprise Effectiveness and Operational Excellence. This is deemed acceptable given such costs are included in the total overhead costs of Rail Company 1 and Company 2. Further they represent data for only approximately 6% of the total costs being reviewed.

*Note: Branding has been benchmarked as part of the Strategy Function.

Comparison of corporate costs

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Aurizon Network Cost Allocation Methodology

Cost allocation methodology

Aurizon Network Operation's share of Aurizon's corporate overhead costs have been calculated using a cost allocation methodology based on both causal and blended allocation bases. The use of a blended allocator in the absence of a clear causal driver of costs is supported by regulatory precedent, particularly by firms with similar characteristics in regulated industries. During benchmarking activities, a causal driver for some of Aurizon Network's costs could not be determined. An alternative cost allocation method was required that would be accepted by regulators and would realistically represent Aurizon Network Operation's corporate overhead costs.

Analysis of other regulated businesses in Australia found a blended rate was commonly used to allocate overhead costs. The blended allocator used was based on three of the organisation's key cost drivers; asset value, revenue and FTEs. The rationale behind each being:

- Asset value was considered an acceptable component of the blended allocator as Aurizon Network is an asset intensive business.
- Revenue was considered an acceptable component of the blended rate as regulatory precedence shows that it is commonly used in other entities. Revenue is also commonly used as a causal allocator for corporate overhead costs.
- FTEs were considered an acceptable component of the blended rate and are commonly used as a causal allocator. Regulatory precedence also supports the use of FTEs as a component in a blended allocator.

Context

The following contextual statements should be read in conjunction with the results of the applied cost allocation methodology:

- Aurizon is Australia's largest rail freight operator. Operating within a highly regulated environment, Aurizon must adhere to legislation and regulatory requirements put in place by the QCA and other government bodies
- Aurizon Network is responsible for providing, maintaining and managing access to the Central Queensland Coal System rail network and associated rail infrastructure. The Access Undertaking provides the framework for access to the network for the purpose of operating train services
- Pursuant to the Access Undertaking, there are a number of compliance requirements including: ring fencing arrangements; negotiation of access and access agreements; pricing principles; utilisation of network capacity; interface arrangements between Aurizon Network and operators; and reporting requirements
- Safety is the core value of Aurizon, with a focus on increasing safety performance
- All of these factors are expected to impact Aurizon's costs in comparison to cross-industry median benchmarks which include non-regulated organisations

Results: Detail

With a view to deriving the most appropriate driver of activity with which to allocate overhead costs to Network Operations, the allocation methodology was developed and applied to the 4+8 FY13 budget costs for Aurizon Network. An Excel model was developed from cost centre level data and referenced identifiable Network Operation costs and 4 different driver ratios for allocation of shared costs, as summarised below.

Method description	Cost driver	Application to Cost Base	Cost Allocation	# of Cost Centres
Causal driver based allocation Cost allocation via a causal allocator at individual cost centre level. The driver/allocator is determined by consideration of key activities performed within cost centres	▶ Network Operations FTEs	▶ HR and payroll ▶ Real Estate	$2,326,613	61
	▶ Network Operations revenue	▶ HR ▶ Branding	$2,197,261	4
	▶ Network Operations direct costs	▶ Accounts Payable and Procurement	$3,103,746	8
	▶ Cost allocation via one blended allocator (calculated as the average of Network Operations Revenue, FTEs and asset base) across all cost centres.	▶ Where no one clear driver could be determined	$41,565,558	141
Identifiable Costs	▶ Overhead costs directly attributable to Network Operations.	▶ Various Network specific cost centres	$14,276,782	12
Total Allocated Costs			$63,469,961	226

Results: Summary

The benchmarking study suggests that, overall, Network operation's share of corporate overhead costs are within a reasonable range of comparable benchmarks.

On a more granular level for the material cost groups:

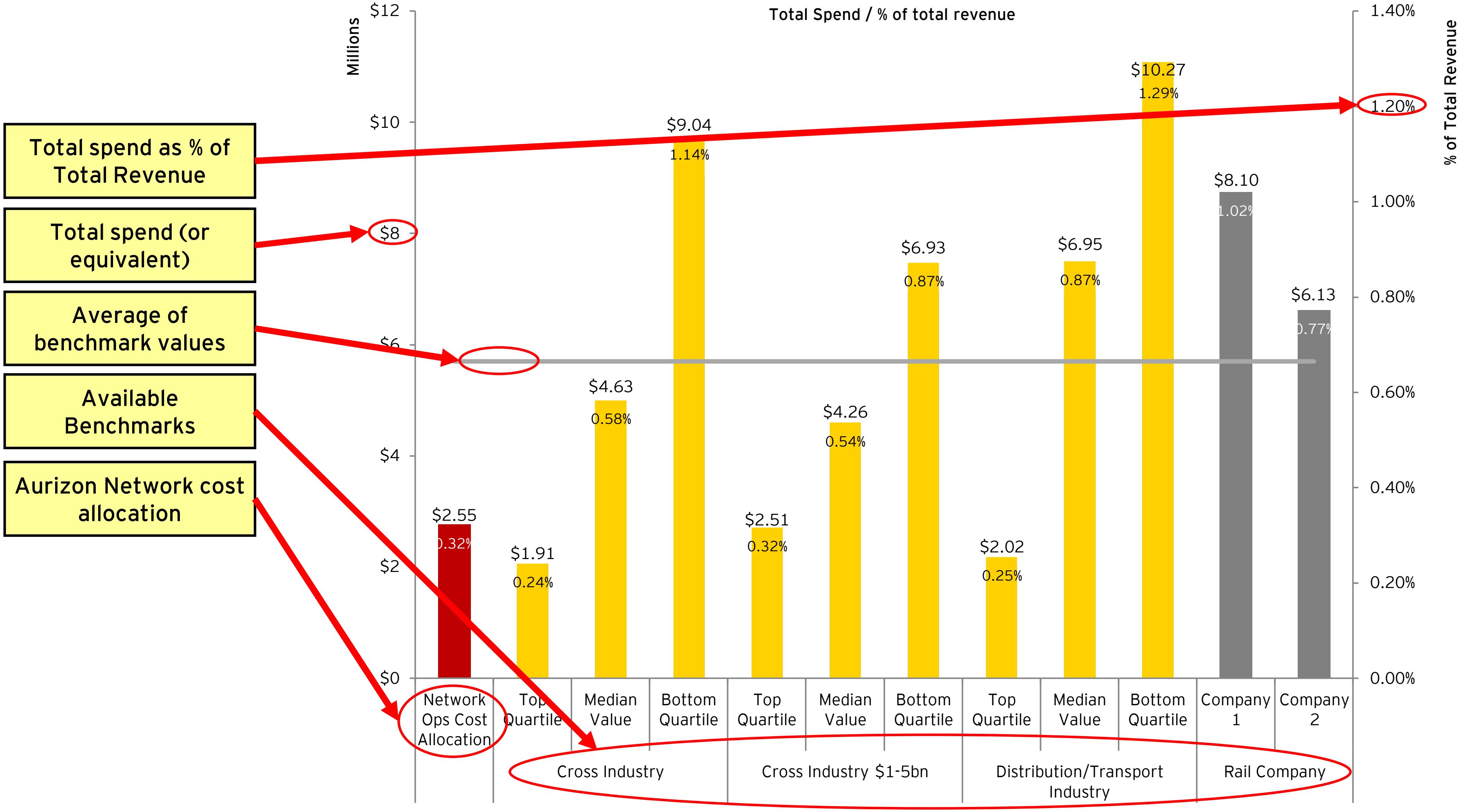
- **Finance is consistent with** the average of available benchmarks (cost as a percent of revenue 1.13%*)
- **General Counsel & Company Secretary is above** the average of available benchmarks (cost as a percent of revenue 0.93%*)
- **Information Technology is slightly above** the average of available benchmarks (cost as a percent of revenue 2.49%*)
- **Human Resources is significantly below** the average of available benchmarks (cost as a percent of revenue 0.40%*)
- **Safety, Health and Environment is above** the average of available benchmarks (cost as a percent of revenue 0.80%*)
- **Enterprise Real estate is below** the average of available benchmarks (cost as a percent of revenue 0.63%*)

Detailed results are provided on the following pages.

As with any benchmark exercise, care needs to be taken in interpreting results. This benchmark report was designed to show how Aurizon Network relates to other organisations for corporate and support service costs. Comparisons at the individual company level, where shown, need to be interpreted with care. This is because, at the company level, internal differences can have a material impact on relative cost performance. For example, organisational strategy, geographic location, regulatory regime, organisational maturity, and internal organisational structure can all materially impact relative cost performance.

Note*: Figures in brackets represent the total cost of the function/functional area as a percentage of total Aurizon Network Operations revenue.

Reading the comparison graphs

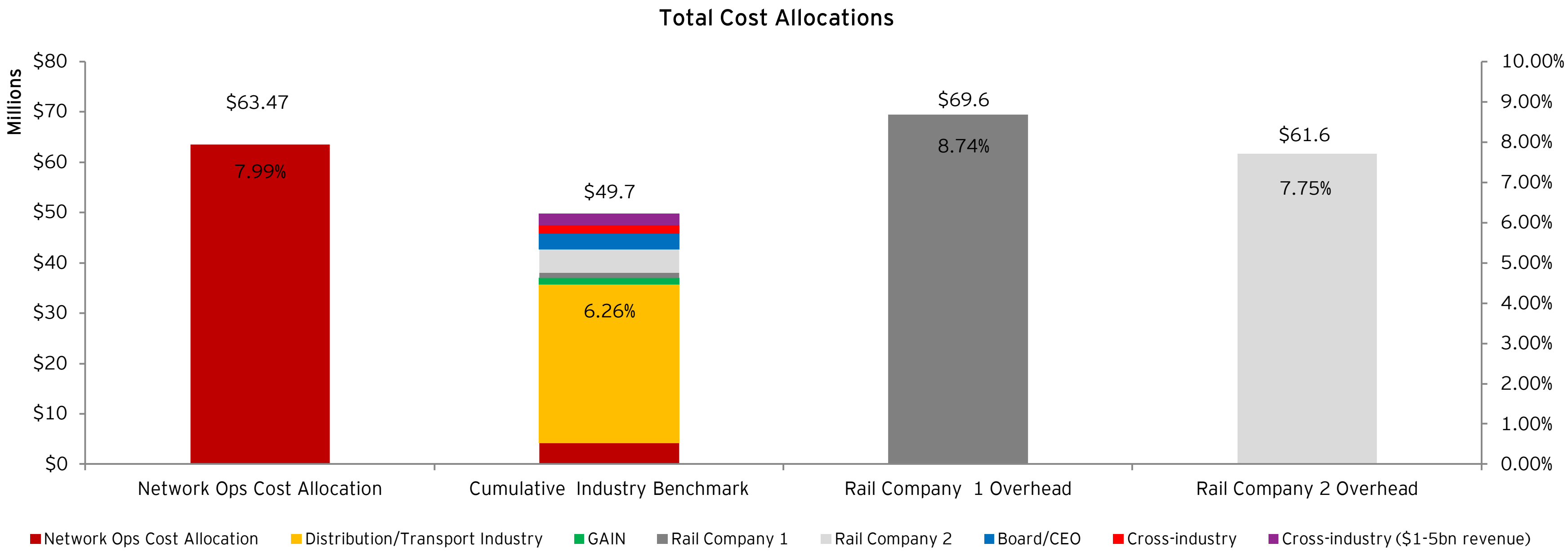


Summary of benchmark comparisons

Source	Description	Variants of benchmarks from source
APQC Cross Industry Cross Industry ($1-$5 billion revenue) Distribution and Transport industry	The APQC Process Classification Framework (PCF) is an enterprise process model that allows organisations to see their business processes from a cross-industry viewpoint. The PCF was developed by APQC and its member companies as an open standard to facilitate improvement through process management and benchmarking, regardless of industry, size, or geography. The PCF organises operating and management processes into 12 enterprise level categories, including process groups, and over 1,000 processes and associated activities. For this engagement we utilised the ▶ Total Cross Industry group ▶ Cross Industry peer group in the $1-$5bn revenue range ▶ Distribution and Transportation Peer group	Data is represented in the following ways: ▶ **Top quartile:** The top quartile indicates represents the line that separates the top performing participants from the rest of the peer group. Depending on the metric, this may be either a numerically high or low value (cost metrics will be low and efficiency metrics will typically be high for top quartile) ▶ **Median:** The median is simply the middle value for the peer group ▶ **Bottom quartile:** Similar to the top quartile, the bottom quartile represent the line that separates the bottom performing participants from the rest of the peer group
Company 1	Company 1 was a large State-owned Asia-Pacific Rail company operating network, yards and facilities, freight, passenger, rolling stock and engineering services.	
Company 2	Company 2 was a large, Government-owned Asia-Pacific Rail company specialising in the provision of rail infrastructure and maintenance.	
Internal Audit specific	Global Audit Information Network (GAIN) benchmarks were obtained from a 2011 report supplied by Aurizon for comparing internal audit costs.	The GAIN benchmarks utilised included Revenue ($500m-$1bn), Revenue ($1bn-$5bn), Assets ($1bn-$5bn) and Expenses (under $500m).
Real Estate specific	Real Estate Benchmarks were based on generally accepted industry standards regarding space per FTE and building standards from the *API Guide to Building Quality 2010* in addition to data collected by EY's Real Estate team during 2012.	
Health Safety & Environment specific	Health Safety & Environment benchmarks were sought from similar safety focussed organisations in the region, e.g. resources, industry, with comparable revenue size.	
Board & CEO specific	Board and CEO specific benchmarks were extracted from ASX data by the EY Human Capital Team in 2012 and were based on companies with a total remuneration within 50%-200% of Aurizon Network Revenue.	

Note: By design, the identities of the individual organisations are concealed.

Analysis
Total Corporate Overhead Cost Allocations



Aurizon Costs	▶ Aurizon cost allocation is the total Network allocation of corporate costs (both identifiable costs and those costs allocated via use of the driver based methodology). That is, the total accumulated Network overhead costs for all functions and functional areas
Allocation Method	▶ A causal driver based allocation has been applied at cost centre level. The driver/allocator has been determined by consideration of key activities performed within cost centres. Where no one causal allocator can be indentified a blended allocator has been applied. Refer to section 'Regulatory Precedents Assessment' for justification
Comparison to Benchmark	▶ Cumulative Industry Benchmark: Median utility industry data (orange bar) is the cumulative total of benchmarks that align with Aurizon functions and functional areas drawn from the APQC. As comparative APQC benchmarks were not available for all Aurizon Functions and Functional Areas additional benchmarks have been drawn from cross-industry (red bar) , cross-industry $1-$5bn revenue (purple bar) GAIN (green bar), Board/CEO average costs (blue bar) and Rail Company 1 and 2 (grey bars) to build a cross-industry comparable benchmark. Aurizon cost allocations have been included for the costs unable to be benchmarked (burgundy bar) ▶ Company 1 and Company 2 (grey bars) are representative of Asia-Pacific rail organisations. Total overheads costs as a percentage of revenue data was gathered as part of a specific benchmarking exercise conducted in 2012

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Analysis
Total Cost Allocations (continued)

Aurizon Cost Allocation			Benchmarks		
Aurizon Function	**Functional Areas**	**Allocated Costs**	**Cumulative Industry**	**Rail Company 1**	**Rail Company 2**
Finance	Tax; Treasury; Investor Relations; Financial Planning and Reporting; and Capital Excellence	$9,004,155	$8,490,836	$11,087,115	$6,486,860
Enterprise Services	General Counsel and Company Secretary	$7,372,462	$2,224,552	$1,896,300	$11,810,450
	Internal Audit and Enterprise Risk Management	$1,972,471	$1,253,532	$793,911	$1,153,371
	Information Technology	$19,755,261	$14,931,748	$27,778,690	$7,524,973
	Non-benchmarked: National Policy	$860,506	$860,506		
Human Resources	Talent and Organisational Development; Resourcing and Services; Remuneration and Support; Employee Relations; and HR External Relations & Communications	$3,178,839	$6,946,997	$8,099,540	$6,133,267
Business Sustainability	Safety, Health and Environment	$6,368,988	$1,747,862	$1,256,386	$6,702,794
	Enterprise Real Estate	$4,979,847	$4,599,558	$16,733,182	$4,599,558
	Enterprise Procurement	$2,844,885	$1,158,674	$842,893	$2,490,253
	Non-Benchmarked: Innovation; Operational Excellence, Enterprise Effectivness	$3,256,144	$3,256,144		
Strategy	Strategy, Enterprise Business Development; Branding; Solution Design and Support	$1,761,839	$1,092,937	$1,092,937	$8,727,821
Board & CEO	Board: Managing Director & CEO	$2,114,563	$3,157,000		$5,974,091
Total Network Corporate Overhead Cost Allocation		$63,469,961	$49,720,348	$69,580,954	$61,603,438

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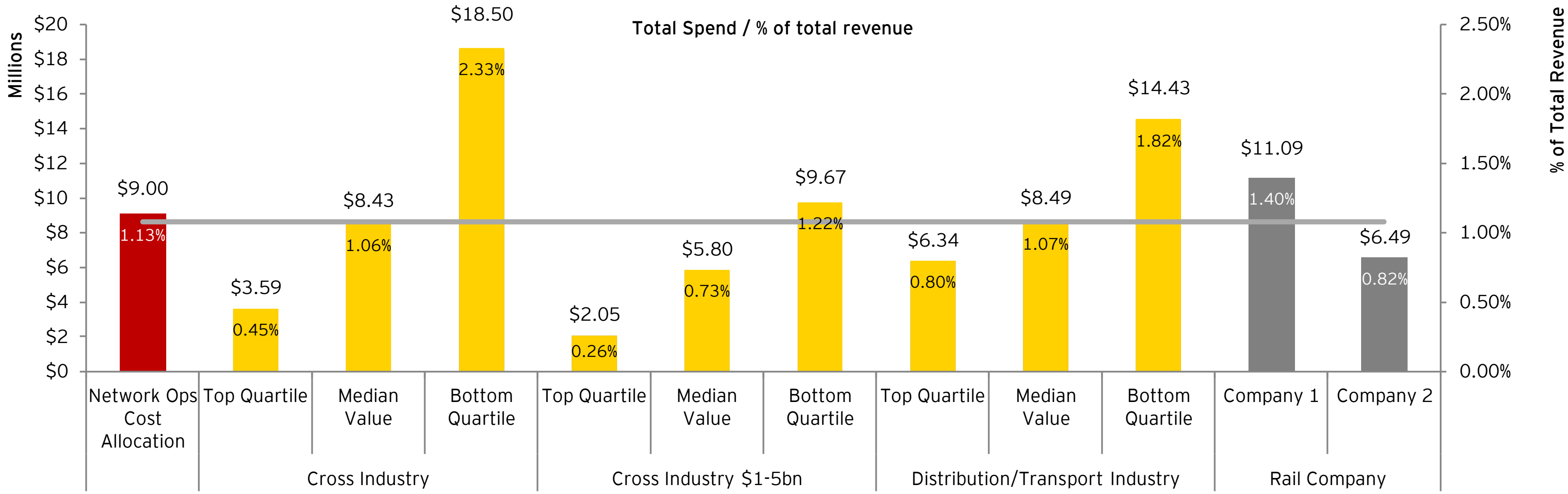
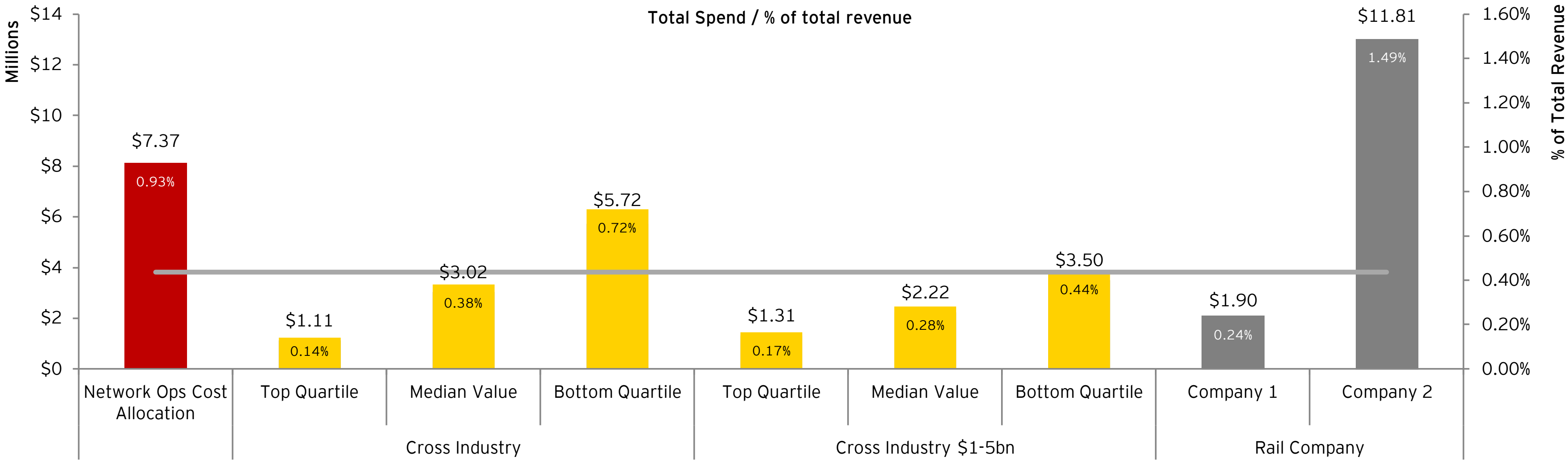
Analysis
Finance



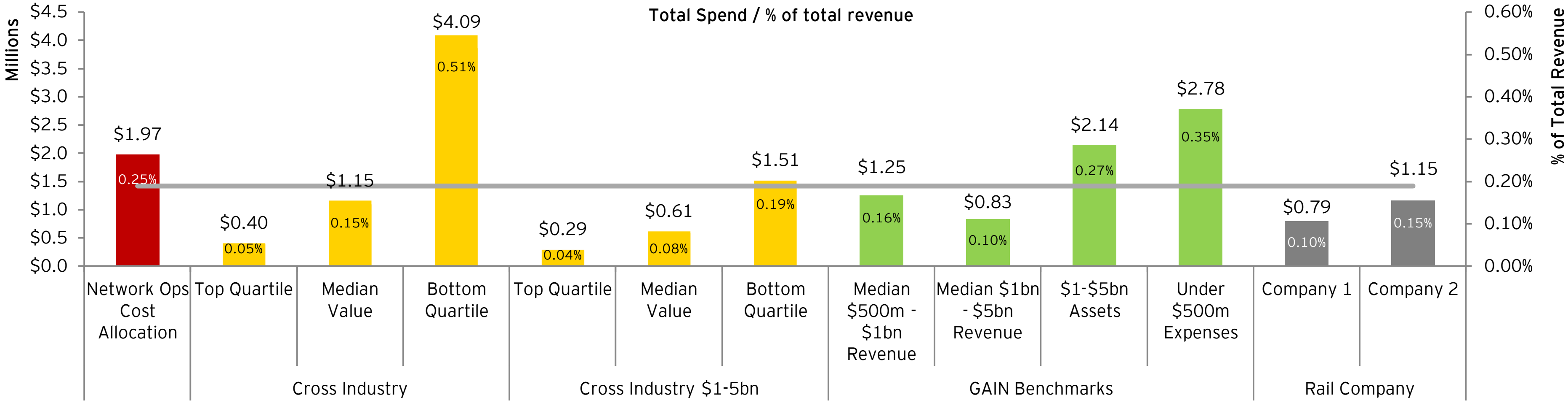
Aurizon Costs	▶Aurizon Finance activities include: Network Finance and Regulation; Enterprise Planning, Reporting & Services; Investor Relations; Tax and Treasury; and Capital Excellence
Allocation Method	▶A blended allocation method has been used to allocate all cost centres in the Finance function except for accounts payable which uses direct costs as an allocator and Payroll which uses FTEs. Research identified precedence with Energex, Aurora and Citipower using such an approach
Comparison to Benchmark	▶Cross Industry and Distribution/Transport Industry data (yellow bars) is drawn from the APQC benchmark "Total cost of the finance function per $1,000 revenue" adjusted to exclude Enterprise Risk Management and Internal Audit (Total cost to perform the processes in the process group "manage internal controls" per $1,000 revenue) which have been benchmarked separately ▶The Finance Network Operations cost allocation is consistent with cross industry, Distribution/Transport industry median benchmarks and broadly consistent with Company 1 and Company 2 benchmarks ▶Company 1 and Company 2 (grey bars) are representative of Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012. Rail company 1 includes enterprise risk management within the finance function so the costs may be slightly inflated when compared to Aurizon's costs

Analysis
Enterprise Services: General Counsel and Company Secretary



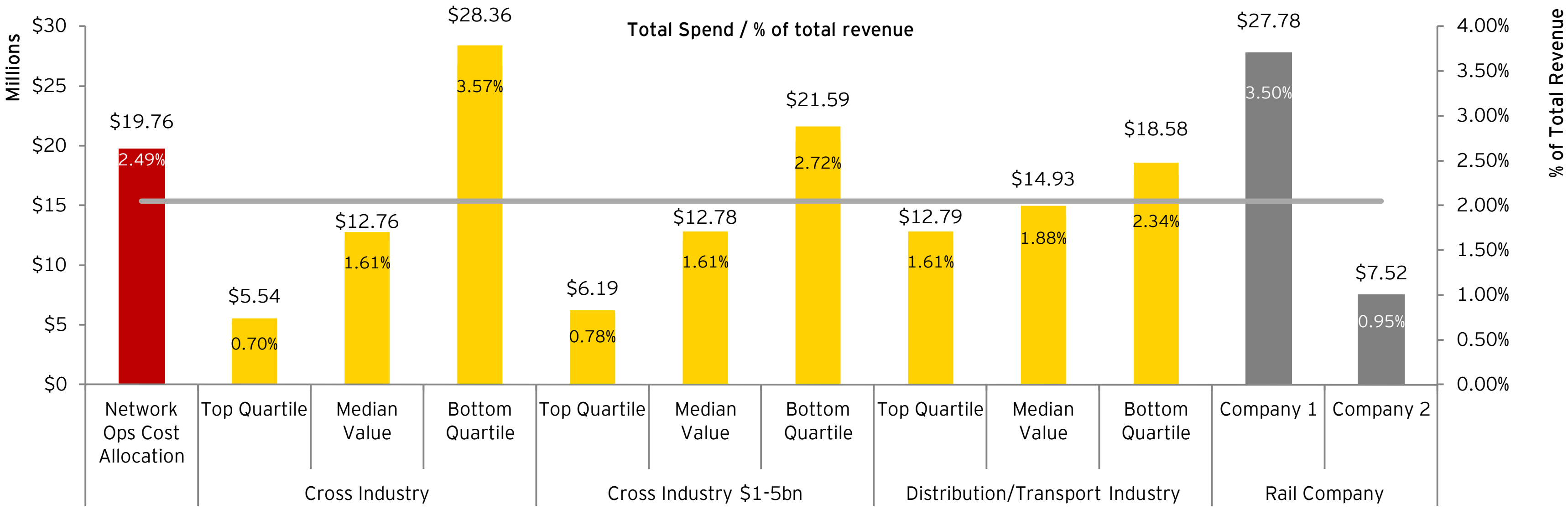
Aurizon Costs	▶Aurizon General Counsel and Company Secretary activities include: Legal advice to Management and the Board; Placement of Aurizon's insurance coverage and management of claims; Management of workers' compensation claims, as well as common law and personal injury claims and litigation; Compliance by Aurizon and its subsidiaries with the statutory obligations specified under the Corporations Act and the governance requirements set out in the ASX Listing Rules; Prime interface between the Board and Management
Allocation Method	▶The costs for Network Legal have been directly allocated in full. A blended allocation method has been used to allocate those costs incurred by the corporate legal function. Where no ideal causal allocator can be identified there is regulatory precedence for using a blended allocation approach. See comments above
Comparison to Benchmark	▶Cross-industry benchmarks (yellow bars) were drawn from a third party benchmarking service with 65 respondents in 2009 and were translated from benchmarks representing the respondents legal costs as a percentage of revenue. These costs may not include Company Secretarial costs ▶Company 1 and Company 2 (grey bars) are representative of Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012. Company 2 costs include legal claims that are maintenance in nature ▶Aurizon General Counsel and Company Secretary costs within Network Operations are above cross industry benchmarks, however this was expected given the high level of compliance requirements of operating in a regulated environment in the transport industry. This is clearly evidenced by the high costs in Rail Company 2 which like Aurizon Network operates regulated below rail infrastructure.

Analysis
Enterprise Services: Internal Audit and Enterprise Risk Management



Aurizon Costs	▶Aurizon Internal Audit and Enterprise Risk Management includes activities: Provide an enterprise wide services and approach to risk management and legal compliance; provide independent and objective assurance to Management and the Board on the adequacy of governance, risk management and internal control systems; Manage the investigations of alleged fraud and corruption
Allocation Method	▶A blended allocation method has been used for all cost centres within the Internal Audit and Enterprise Risk Management functional areas. There is regulatory precedence for using a blended allocation approach where no ideal causal allocator can be identified. See previous comments
Comparison to Benchmark	▶Cross Industry data (yellow bars) is drawn from APQC Benchmarks "Total cost to perform the processes in the process group "manage internal controls" per $1,000 revenue" ▶GAIN benchmarks (green bars) were drawn from the Global Audit Information Network Report (February 2011), a benchmarking study in which Aurizon was a participant. Metrics derived using revenue (both Aurizon and Network Operations), as well as assets and expenses, have been included ▶Company 1 and Company 2 (grey bars) are representative of Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012 ▶The Network Operations cost allocation is less than the GAIN benchmarks derived on an asset and expense basis but higher than cross industry benchmarks and Rail Company 1 and 2

Analysis
Enterprise Services: Information Technology



Aurizon Costs	▶Aurizon Information Technology activities include: Day to day management of all information, and business systems; Deliver information and business systems inline with strategy and governed by the IT Steering Committee; Responsible for the effectiveness of investment in IT
Allocation Method	▶A blended allocation method has been used to allocate all cost centres within the Information Technology functional area. Where no ideal causal allocator can be identified there is regulatory precedence for using a blended allocation approach. See comments above
Comparison to Benchmark	▶Cross Industry and Distribution/Transport Industry data (yellow bars) is drawn from the APQC benchmark "Total IT cost per $1,000 revenue" ▶Company 1 and Company 2 (grey bars) are representative of Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012 ▶The Network Operations cost allocation is higher than the distribution/transport industry median benchmarks for Information Technology costs ▶It was expected the allocation would exceed cross industry benchmarks, due to the a cost-intensive telecommunications "backbone" not typically found in other industries

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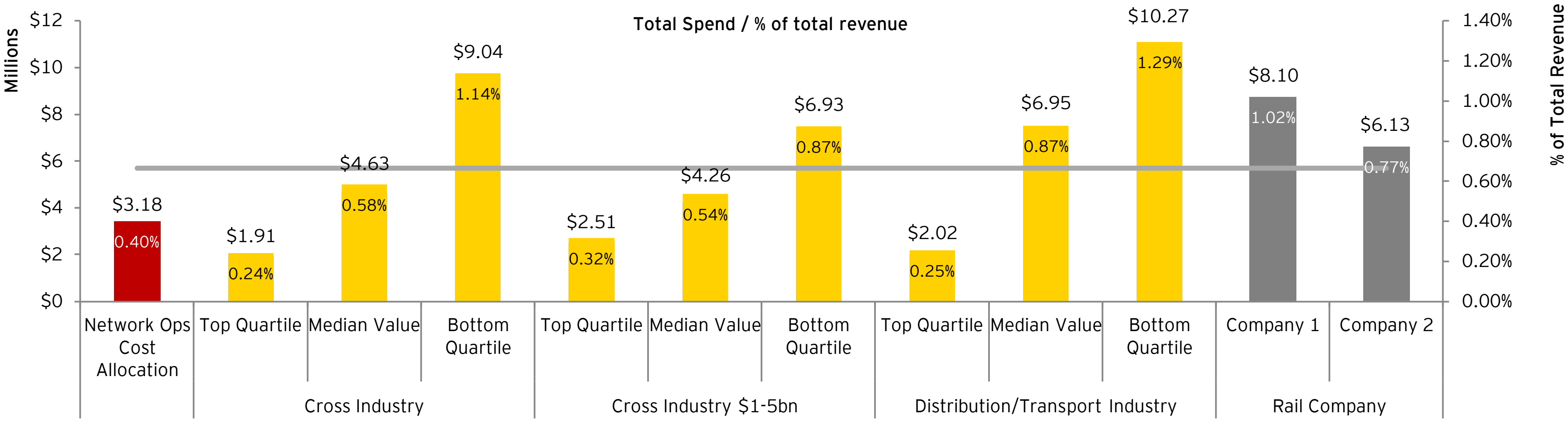
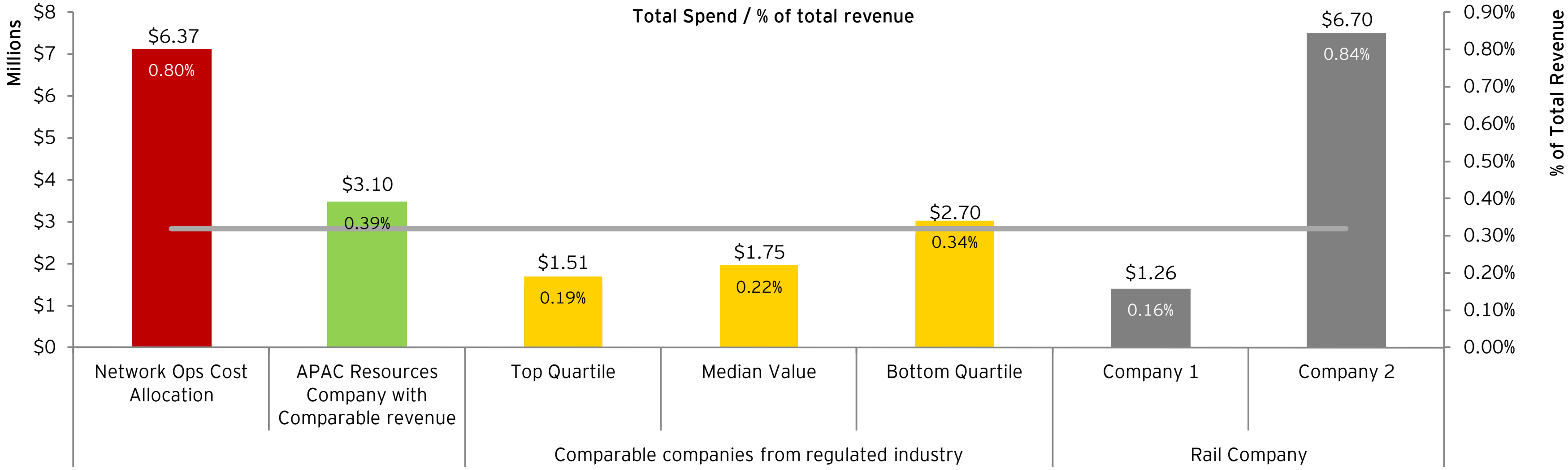
Analysis
Human Resources



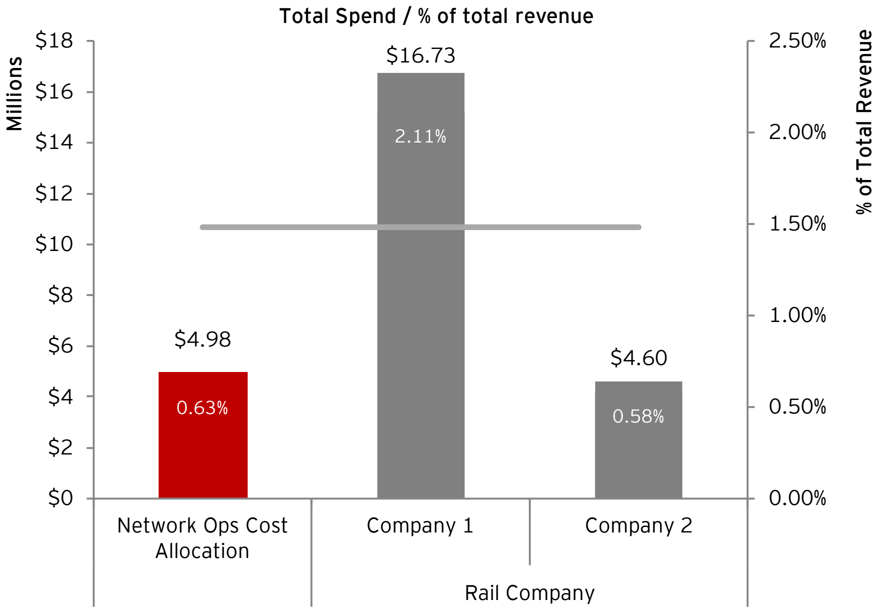
AurizonCosts	▶Aurizon Human Resources activities include: Talent & Organisational Development; Resourcing & Services; Remuneration & Support; Employee Relations; Functional HR Management. *Note: that share-based payment incentives are included in Human Resources costs*
Allocation Method	▶Network Operations revenue has been used to allocate $836k of costs, the number of FTEs was used to allocate $1.026m in the Human Resources function. A blended allocation method has been used to allocate the remaining costs ($947k) that were not directly identifiable. Directly identifiable costs amounted to $369k. The company had incurred significant one-off redundancy costs during FY13. For the purposes of this analysis these costs have been removed to provide a better picture of the recurrent HR costs. The adjustment was $91m. ▶While FTE is commonly used as a cost driver for Human Resource costs, Aurizon's HR costs include share-based payment incentives which correlate with growth. Hence, a blended allocation method, which considers revenue and asset base has been identified as the most appropriate causal driver for these specific costs ▶Where no one causal allocator can be identified, there is regulatory precedence for using a blended allocation approach. See comments above
Comparison to Benchmark	▶Cross Industry and Distribution/Transport Industry data (yellow bars) is drawn from the APQC benchmark "Total cost of the HR function per $1,000 revenue" ▶Company 1 and Company 2 (grey bars) are representative Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012 ▶The Human Resources Network Operations allocation is lower than cross industry median benchmarks and is substantially less than Distribution/Transport industry median benchmarks and representative rail company costs

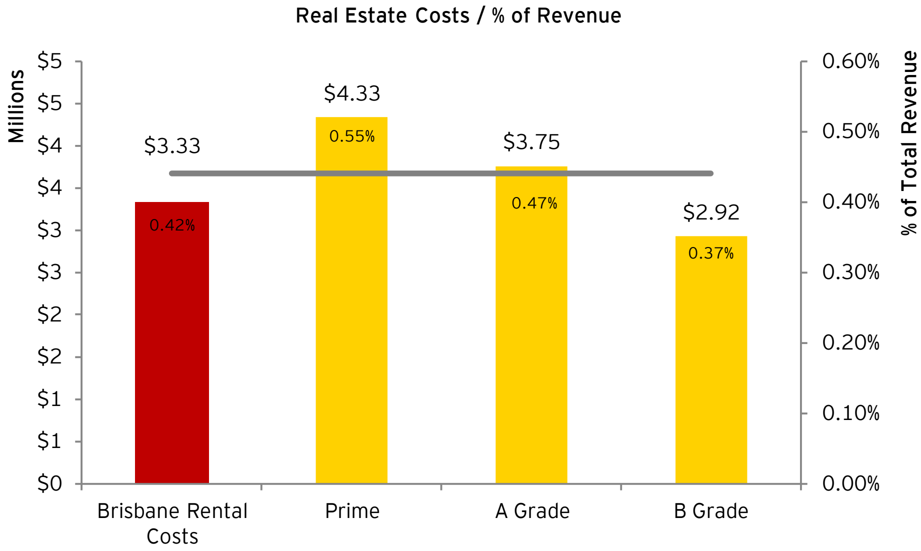
Analysis
Business Sustainability: Safety, Health & Environment



Aurizon Costs	▶ Aurizon Safety, Health and Environment activities include: Transform Safety, Health and Environmental Management systems; Manage Aurizon's accreditation (i.e. rights and authorities to operate); Management of Safety, Health and Environmental resources for the enterprise. *Note: Safety is a core value of Aurizon is expected include operational Health and Safety costs not included by other organisations*
Allocation Method	▶ Certain health and safety costs amounting to $3.97m are directlty identifiable as belonging to Network Operations. Those labour and employee related expenses which cannot be separately identified are allocated using an FTE based allocator. Other health and safety costs are allocated using a blended methodology. Where no one causal allocator can be identified there is regulatory precedence for using a blended allocation approach. See comments above.
Comparison to Benchmark	▶ The resources company data (green bar) was data available to EY collected in 2012. It provides comparison to another safety-focused industry with similar revenue ▶ Regulated industry data (yellow bars) is drawn from data collected in specific benchmarking activities conducted in 2009 (3 respondents) ▶ Company 1 and Company 2 (grey bars) are representative Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012. *Note that Company 1 data only includes labour costs and excludes operational Safety, Health and Environment roles* ▶ Aurizon Safety, Health and Environment Network Operations costs are below Company 2 costs. This representative Asia-Pacific rail company possesses characteristics that provide for a meaningful comparison to Aurizon Network costs as it includes all operational Safety, Health and Environment roles

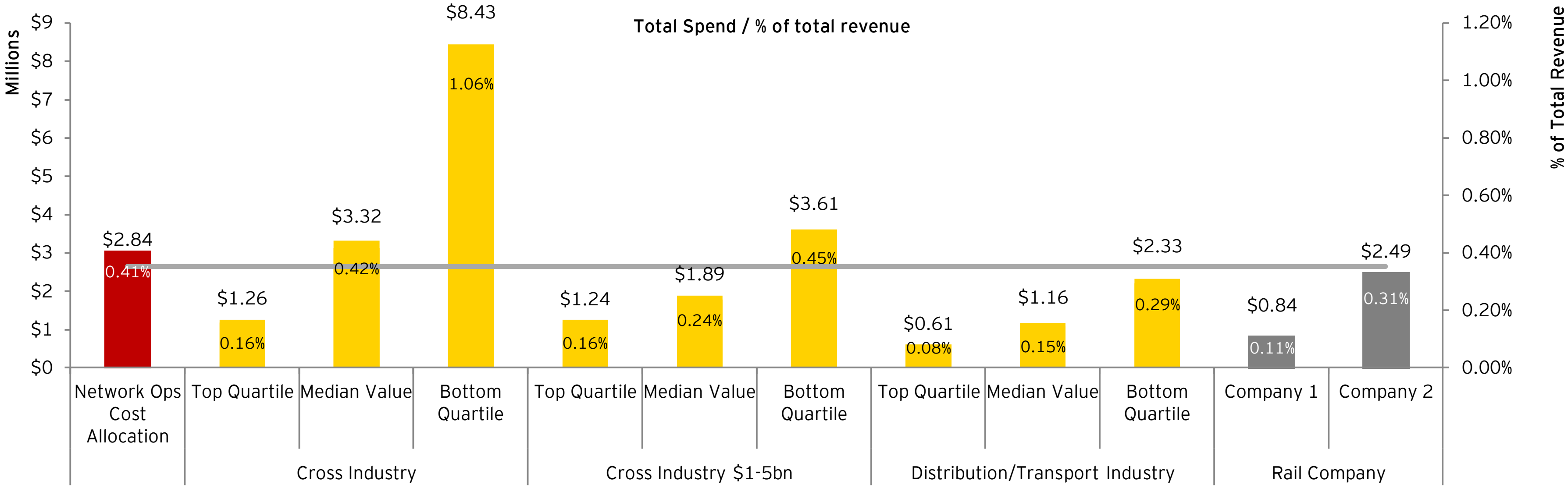
Analysis
Business Sustainability: Enterprise Real Estate





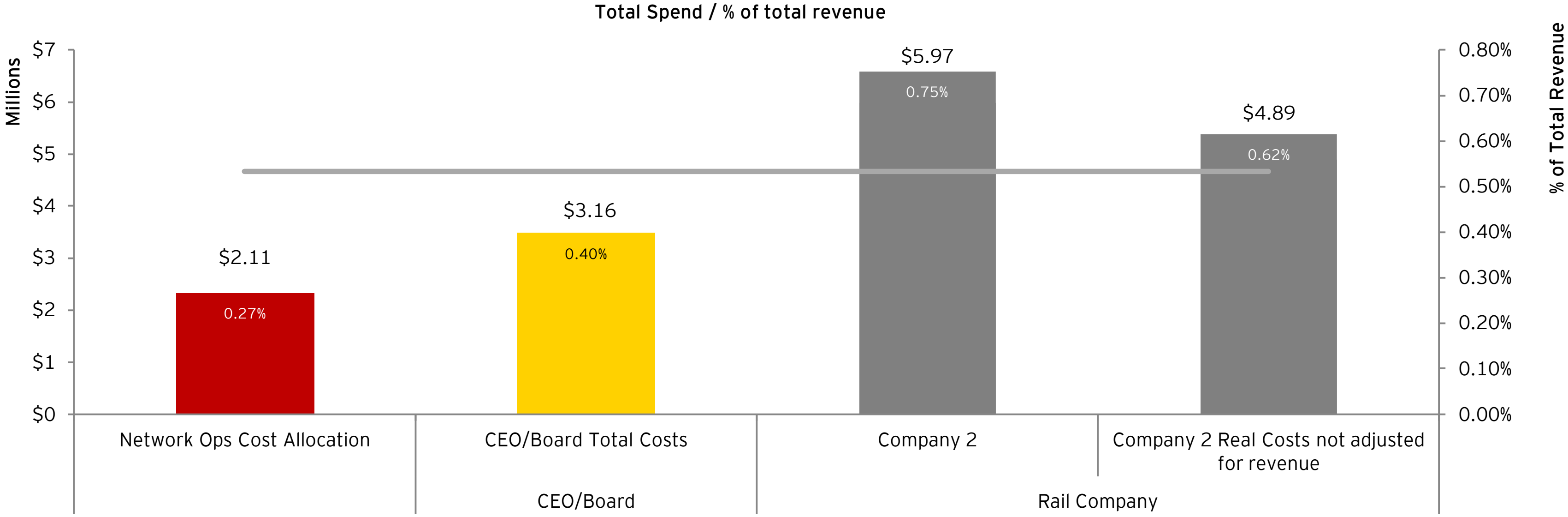
Aurizon Costs	▶Aurizon Enterprise Real Estate activities include: Management of Aurizon land and buildings; Manage real estate acquisitions and divestment; Leasing and asset management; Facilities management and Housing portfolio ▶Of the $4.98 million allocated, an estimated $2.59 million was spent on Network Brisbane Rental costs of the 192 Ann Street premises and $744k on maintenance costs. This subset was benchmarked separately. Additional costs include labour and oncosts for the facilities management activities and depreciation of real estate assets
Allocation Method	▶Brisbane rental costs and depreciation of Network Operations properties has been specifically attributed. For other real estate costs, an FTE-based allocation method has been used to allocate all cost centres in the Enterprise Real Estate functional area. FTE was identified as the most suitable cost driver for Aurizon Enterprise Real Estate as space requirements correlate with FTEs
Comparison to Benchmark	▶Company 1 and Company 2 (grey bars) are representative Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012. Rail Company 1 costs include their property team, rental and facilities management costs ▶It was agreed to benchmark a subset of Brisbane CBD rental costs. Benchmarks (yellow bars) have been calculated using "rule of thumb" industry standards of $15m^2$ per person by the number of Network Operations FTEs (including Corporate staff allocated to Network activities) before applying industry rates for Prime, A Grade and B Grade Brisbane CBD rental costs (API Guide to Building Quality 2010)

Analysis
Business Sustainability: Enterprise Procurement



Aurizon Costs	▶Aurizon Enterprise Procurement activities include: Transforming the procurement function; Enterprise-wide procurement/ sourcing; Supplier relationship management (SRM); Procure to pay (P2P); Supplier contract management
Allocation Method	▶Percentage of Network Operations direct costs has been selected as the most appropriate causal driver for all cost centres in this functional area ▶There is precedent for using direct costs as a driver, with both Energex and Jemena using % of direct costs as an allocation method
Comparison to Benchmark	▶Cross Industry and Distribution/Transport Industry data (yellow bars) is drawn from the APQC benchmark "Total cost of the procurement cycle per $1000 revenue" ▶Company 1 and Company 2 (grey bars) are representative of Asia-Pacific rail organisations. Data was gathered as part of a specific benchmarking exercise conducted in 2012 ▶Aurizon Network Operation's cost allocation compares favourably to Cross Industry median benchmarks but is above Distribution/ Transport industry procurement benchmarks

Analysis
Board and Managing Director/CEO



Aurizon Costs	▶ Aurizon Managing Director/CEO costs include: Board costs and salaries for the Managing Director, and CEO
Allocation Method	▶ A blended allocation method has been used to allocate Managing Director/CEO costs. Where no one causal allocator can be identified there is regulatory precedence for using a blended allocation approach. See comments above
Comparison to Benchmark	▶ Company 2 (grey bar) represents an Asia-Pacific rail organisation. Data was gathered as part of a specific benchmarking exercise conducted in 2012. As this data is on the basis of % of revenue, this may not be comparable due to Board and CEO costs not being directly correlated with the revenue of an organisation, hence an additional cost has been provided ($4.89m) which shows Company 2's real costs not adjusted for Aurizon Network's revenue ▶ Board and CEO specific benchmarks (yellow bars) were extracted from ASX data by the EY Human Capital Team in 2012 and were based on companies with a total remuneration within 50%-200% of AurizonNetwork Revenue. Costs include CEO fixed remuneration, short-term incentives, long term incentives, non-executive directors and chairman of the Board ▶ Aurizon's cost allocation is favourable when compared to the average benchmark figure. The lower costs in this area are the result of share-based incentives being included within the costs of the HR function for Aurizon.

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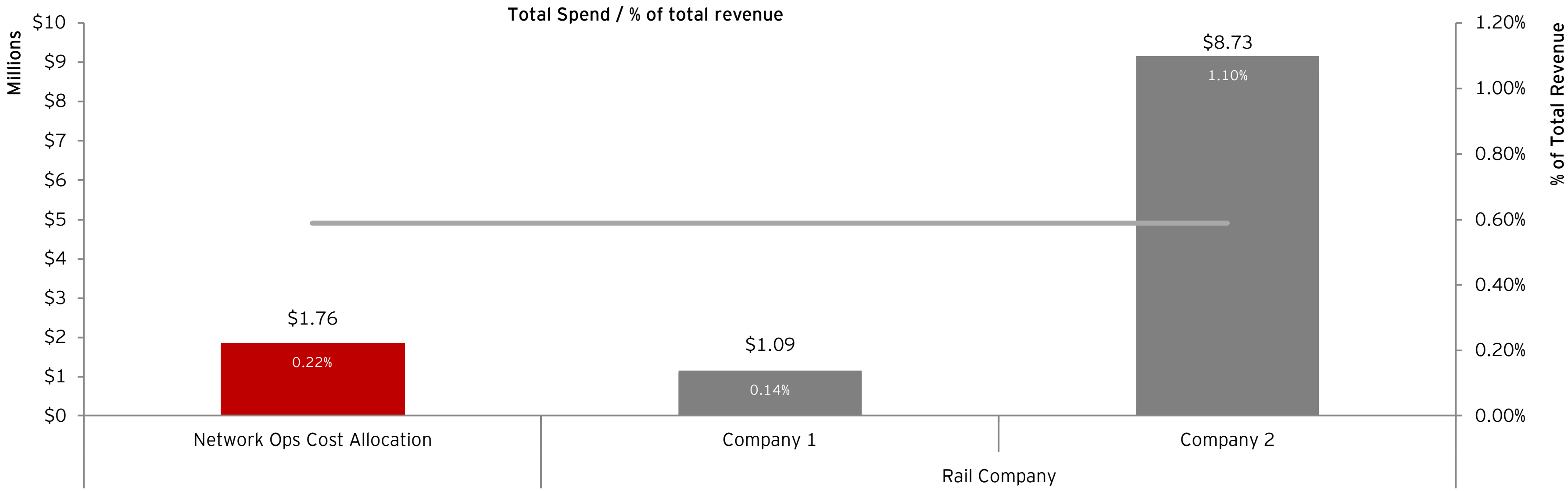
Analysis
Enterprise Strategy and Branding



Aurizon Costs	▶Aurizon Strategy and Branding activities includes: Enterprise Strategy; Manage and protect the value of the Aurizon brand on behalf of the enterprise; Develop, deliver and manage enterprise marketing communications that are consistent, effective and support the brand positioning
Allocation Method	▶A revenue based allocation method has been used for Strategy and Branding costs.
Comparison to Benchmark	▶Company 2 (grey bar) represents an Asia-Pacific rail organisation. Data was gathered as part of a specific benchmarking exercise conducted in 2012 ▶Aurizon Network Operation costs are similar to the costs of Company 1, but are not comparable to Company 2 as Strategy and Branding are not a focus of the Network business of Aurizon ▶There has been an increase of $2.3m in professional fees across corporate branding and marketing due to Aurizon rebranding. This increase in costs in 2013, is likely to continue into 2014.

Regulatory Precedents Assessment

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Regulatory Precedents Assessment

The objective of this task was to identify overhead cost definitions and cost allocation bases accepted by regulators in Australia and which Aurizon Network could potentially use to derive its corporate overhead estimate for its UT4 submission.

Australian regulatory decisions across the rail, ports and energy sectors were reviewed in order to:

- Identify cost allocation bases that have been accepted by the respective regulators
- Determine which allocation bases are most appropriate for Aurizon Network's analysis

We drew on our network of contacts amongst regulated businesses in Australia to assist in collating this information as this level of detail is not commonly found in published regulatory decisions.

The output of the research was then confirmed with Aurizon before commencing the quantitative cost analytics. The findings of this research were used to inform the selection of cost allocators to be considered in the development of the costing model.

The findings of this research indicated a wide variety of cost buckets and allocators were accepted by regulators. Common allocators included proportion of FTEs, asset bases direct costs, as well as the use of blended allocators.

A summary of these findings is contained in the following pages.

Summary of precedents

	Company	Regulator	Allocation basis
Blended	Energex	Australian Energy Regulator (AER)	Energex's corporate overhead cost allocation is based on a **blended allocation method:** ▸ For regulated services – Total direct spend (reg services) ▸ For non regulated services: 1. Assets (proportion of non regulated assets versus total assets) 2. Headcount (proportion of non regulated headcount versus total headcount) 3. Revenue (proportion of non regulated revenue versus total revenue) ▸ The average of the three basis forms the basis of the overhead cost allocation to non regulated services
Blended	CitiPower/Powercor	Australian Energy Regulator (AER)	For shared costs, **a blended allocation** method is used where a three factor formula is applied to the function categories to allocate the costs recorded in these functions between CitiPower and Powercor. The three factor formula is based on an equal weighting of: ▸ Value of the Regulated Asset Base ▸ Distribution revenue ▸ Customer numbers Shared costs are allocated between categories of Distribution Services using an appropriate causal allocator.
Various Causal	Aurora	Australian Energy Regulator (AER)	The overhead cost allocators vary depending on the shared cost. **Various Causal Allocators** include: ▸ Number of PCs (e.g., IT Management) ▸ Occupied floor space (e.g. Facilities Management) ▸ Dollar value of contracts (e.g. Procurement) ▸ FTE employees (e.g. People and Culture Business Systems) ▸ Total number of light and heavy vehicles per division (e.g. Fleet Management Systems) Aurora uses just one non-causal allocator, being the weighted average of the total cost allocations that have a causality driver (e.g., Corporate affairs).
Cost	Jemena	Australian Energy Regulator (AER)	Jemena's corporate overhead cost allocation method is based on **Direct Costs**: ▸ The proportion of direct costs for each service category to total direct costs

Summary of precedents

	Company	Regulator	Allocation basis
Cost	**Victorian Rail Track Corporation (VicTrack)**	**Essential Services Commission (ESC)**	VicTrack uses a **Direct Cost Allocation Method**. VicTrack's indirect costs, including corporate costs, are allocated in proportion to: ▸ Pro-rata basis of total direct cost by business unit. Where costs are incurred that cannot be directly attributed to a particular activity of VicTrack's rail business (e.g. the management of the rail business), the costs will be allocated on the basis of a reasonable estimate of the causation of those costs.
Cost	**Dalrymple Bay Coal Terminal (DBCT) (operated by Prime Infrastructure)**	**Queensland Competition Authority (QCA)**	DBCT uses a **Direct Cost Allocation Method.** The QCA commissioned consultants to evaluate the DBCT's overhead costs as compared to a notional stand alone operator: ▸ Using a bottom up approach dividing overhead costs into non-contested costs; type contested costs; size contested costs; and excluded costs. ▸ Using a top down approach by comparing the level of overhead costs as a percentage of total terminal costs or operating revenue compared to other terminals (i.e. benchmarking).
Revenue	**APA Group**	**Australian Energy Regulator (AER)**	APA Group corporate overheads are allocated to each asset based on the forecast revenues received for each asset.
Tonnes/Kms	**Australian Rail Track Corporation Ltd (ARTC)**	**Australian Competition and Consumer Commission (ACCC)**	ARTC Non-Segment Specific Costs for the Hunter Valley Coal Network are allocated in proportion to: ▸ Gtkm (Gross tonnes multiplied by kilometres) for Non-Segment Specific Costs associated with track maintenance ▸ Train kilometres for Non-Segment Specific Costs not associated with track maintenance.

Conclusion

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Conclusion

Aurizon Network Operation's share of Aurizon's corporate overhead costs have been calculated using a cost allocation methodology based on causal and blended allocation bases. Causal allocators were used where clear causal drivers were identified during the benchmarking activity mapping, and where no one causal driver could be identified, a blended rate based on three of the organisation's key cost drivers was used. There is strong regulatory precedent for using both causal and blended allocation bases for overhead cost allocation.

Aurizon Network operation's share of corporate overheads has been tested against comparable organisations using cost data derived from the FY13 4+8 forecast. The benchmarking study suggests that overall, using the allocation basis described above, Aurizon Network Operation's share of corporate overhead costs are within a reasonable range of comparable benchmarks:

- Human Resources and Enterprise Real Estate costs are significantly below the average of available benchmarks, while Finance and Information Technology costs are equal, or only slightly above the average of available benchmarks
- Safety, Health & Environment is significantly above the average of available benchmarks which is considered reasonable due to the nature of the Network business. General Counsel and Company Secretary costs are above cross industry benchmarks, however this was expected given the high level of compliance requirements of operating in a regulated environment in the transport industry

Thank you

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