AUSTRALIAN ENERGY COUNCIL

DRAFT RATE OF RETURN GUIDELINE FORUM

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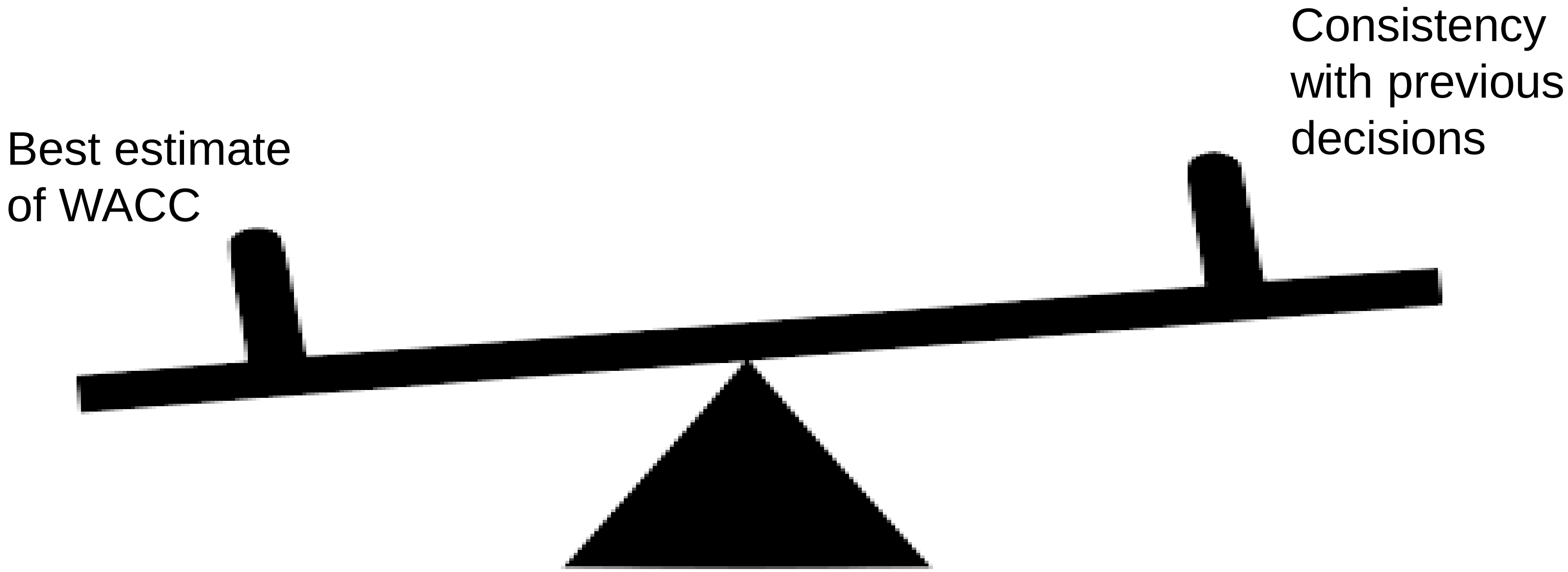
August 2018

AER’S BALANCING ACT



GEARING & CREDIT RATING

- Is a 60% gearing correlated with a BBB+ credit rating?

- Moody’s methodology has A rating = 45-60%, BBB (i.e. baa) = 60-75%
- Qualitative factors also support a higher credit rating.
- Recognise a formal change in either of these parameters at this stage may be seen to conflict with predictability/consistency
- But conservative nature of these assumptions combined could give reassurance to AER that it can fairly be less conservative in other elements of the Guideline.

EQUITY BETA

- Regulated networks very low levels of systematic risk, due to nature of business and operation of framework:
  - Zero revenue risk (electricity networks)
  - CPI uplift to revenue guaranteed
  - Opex and capex incentives entail sharing of excess costs with customers
  - Passthrough and reopeners on specific items hard to forecast ex ante
  - Limited if any currency risk
  - Cost of debt methodology a buffer against interest rate risk

EQUITY REQUIREMENTS

- Capex programmes have moderated from early years of national framework
- Networks likely to be able to finance with debt and retained earnings, i.e. no equity raising required
- Analysis suggests one network managed to quadruple its RAB over 15 years while *reducing* its overall equity
- Still require an adequate cost of equity, but given uncertainties involved in estimate this means lower impact of downside risk
- If there are exceptions, eg some transmission businesses if ISP is implemented, should not impact cost of capital for all businesses

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