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APA Group



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APA Group (APA) announced its half year result to 31 December 2007 including underlying revenue of \$443 million up 82% versus the previous corresponding period, underlying EBITDA of \$214.7 million up 59% and underlying operating cash flow of \$109.3 million. Can you explain why these key financial measures were up strongly versus the pcq?

MD Mick McCormack

Firstly, I am very pleased at the strong contributions from our recent acquisitions, which is reflected in our financial performance. When you look at our overall performance, the things which really stand out are the ongoing growth in our existing businesses – that is, the organic growth spurred on by the resource boom and gas fired generation. I'm talking particularly of Queensland, Western Australia and also soon in the Northern Territory. Also, we're pleased with the benefits of managing operations ourselves, particularly removing the management fees and operating margins, which previously were paid to third parties, and the early successes in capturing integration efficiencies.

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For the half year to 31 December 2007, the distribution per security was 14.5 cents versus 14.0 cents in the pcp. Can you explain how underlying operating cash flow increased 48.2% to \$109.3 million?

MD Mick McCormack

It was a strong increase and, on a per unit basis, we've increased operating cash flow per security by 2.5 cents. That in itself is significant. Certainly a major factor in the increase in underlying operating cash flow was the contribution from our recent acquisitions coupled with the strong organic growth from our existing businesses. Importantly, our operating cash flow has well and truly covered our distributions for the half, translating into an operating cash flow payout ratio of around 61%.

Importantly, we have consistently paid out all our distributions from operating cash flow and will continue to do so. That is, we don't draw down debt to pay out our distributions. Our strategy ensures that we can fund distributions, stay in business capex and the future growth of our business while managing our debt profile.

I'll also point out that we are an operating business and we are no different from companies like David Jones or BHP. We all earn profits or in our case operating cash for the year, but none of us pay out 100% in dividends or distributions because some cash has to be kept in reserve to fund the business.

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What is the earnings (or cash flow) and distribution outlook? How will you continue to achieve stable and consistent growth in the business?

MD Mick McCormack

Looking at the solid growth in our existing businesses, the increased cash flows from the new businesses and the expected efficiency benefits from integrating these businesses, barring unforeseen circumstances, APA has revised its distribution guidance up to a target of 5% growth per annum over the medium term. We have increased our full year EBITDA guidance for FY08 to between \$400 million to \$410 million which is up from \$380 million to \$390 million previously. We announced this guidance at our results presentation on 26 February 2008.

Six months ago at our full year results announcement, I said that the operating efficiencies we are targeting would take about two years to flow through completely. I'm encouraged by the initial results. Some of those have come through in the first half year results, and we're comfortable that we'll be able to maintain that momentum over the next 18 months.

We will also continue to drive our businesses to maximise organic growth. In this last half year alone, we've committed to expansions of the Moomba to Sydney Pipeline, the Carpentaria Gas Pipeline and the Goldfields Gas Pipeline. We also see continued opportunities over the coming years to continue on the organic growth path.

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Can you explain the strengths and weaknesses in your balance sheet including level of gearing, interest cover, interest costs, interest rate exposure, access to undrawn debt and the ability to refinance your debt? Are you working to improve the balance sheet in any significant way?

MD Mick McCormack

I can understand the concerns in the market around the potential risk to any company in the current credit environment. However, APA has very strong predictability of its cash flow, which means we can support higher levels of debts than other industries and do so quite comfortably.

Coupled with prudent capital management with appropriate hedges, we have a very sustainable business even in these tight times. In addition, regulatory resets also provide an inbuilt protection mechanism against rising debt and equity costs. Also, APA's gearing level at 31 December was 71.6% - well within our debt covenant ratio and down from 72.4% about six months ago after the Origin Networks acquisition.

We have sufficient headroom in our existing debt facilities to accommodate our current growth capex commitments for the next 18 months to two years, and any new capex comes with additional, secure, long term cash flows typical of our business to support the investment.

APA's debt profile is secure and well managed, with no significant refinancing due until 2010. Our interest cover ratio for the calendar year was 1.82 times and this is also within our target range.

Some concern has been expressed that we are under-hedged on interest rates versus our peers, however our business model is different as we have a more diversified asset group that sets us apart from our peers. Accordingly, we're able to manage our interest rate exposure on a portfolio basis, which recognises that we have a wider group of assets both regulated and unregulated.

Having said that, APA maintains a strategy of hedging between 65% and 90% of our debt, either through fixed rate borrowings or by interest rate swaps. At present, hedging covers 70% of our borrowings and you should note that the unhedged component also has a degree of protection through the CPI linkages in our various revenue contracts.

Our hedging philosophy also recognises that, as we approach a regulatory reset like the one we now face with our Victorian access arrangement, the regulatory WACC is adjusted, taking into account movements in current rates and borrowing margins. Accordingly, there is an inbuilt protection mechanism which operates for a period after which APA can then match with direct hedges as desired. It's important to note again that APA has a wider group of assets some of which are subject to regulatory access arrangements at different times. Hence, APA is not beholden to any one particular access arrangement in respect of its debt costs.

Our investors continue to support APA through equity raisings such as the ongoing distribution reinvestment plan and the Security Purchase Plan. In total we have raised around \$100 million this half which in part has been used to reduce our borrowings.

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Can you explain how successfully you've implemented the new business model of combining infrastructure ownership with operations?

MD Mick McCormack

APA's existing and new staff have highly developed operating and financial skills across energy infrastructure. For example, Steve Ohl our Group Manager of Operations and I have over 50 years' combined experience in direct operations of infrastructure. And, together with our newest employees who have come on board with the recent acquisitions, APA is now able to drive greater value out of our assets. We own, manage and operate them so we understand how to generate maximum value out of them and we don't lose that value through external fee leakage.

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Can you give an update on progress with the integration and consolidation of the various businesses you have acquired? What financial benefits have you extracted and what is to come?

MD Mick McCormack

The first thing we did was to work out how the various businesses should report, whether there was any obvious duplication in processes, and how to integrate the businesses under a common culture. When delivering the full year results last August, I expected this project to take around 24 months to complete and to date we are tracking in line with that. We recognised early on that APA would be best served if it was structured along functional rather than geographical lines. Previously, APA had a state-based reporting structure with six state managers. The new structure has been put in place and provides a stronger platform to remove overlap in functions and to improve structural efficiencies between interconnecting assets, particularly in the eastern states.

There are two clear examples which relate to the interconnectedness of the Roma to Brisbane Pipeline and Allgas systems and the Victoria and NSW pipeline systems. Historically, in both cases, they have developed separately, but common ownership allows us to integrate the systems and optimise capacity. Rationalising systems, reducing duplication and implementing strategies to harness our very impressive people skills, is allowing us to pursue business growth opportunities in a real and effective manner.

And finally, aligning and simplifying finance, IT and procurement functions and platforms will also lead to cost efficiencies, but our focus will retain operational and asset integrity.

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Why has the intense corporate activity in the utilities sector subsided? What opportunities remain for APA? Will this be an important area for growth for APA in the future?

MD Mick McCormack

There has certainly been a slowdown of consolidation activities in the short-term, which has probably been driven by the state of financial markets. However, we expect more consolidation in the medium-term and APA is well positioned to examine any opportunities as and when they arise.

APA's focus for the time being remains on organic growth and integration. We have recently doubled our asset base and believe there are many opportunities to keep us busy over the next few years with or without any further M&A activity.

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What were the operating highlights for the half year? How can you improve the operating units?

MD Mick McCormack

I am particularly proud of our operational achievements. Unfortunately, our achievements have been slightly overlooked in this current market. During the half year we commissioned one new compressor, and began work on a further three compressors to increase capacity in existing pipelines to meet growing demand. The Bonaparte Pipeline in the Northern Territory is on track to deliver first gas in January 2009 with work scheduled to commence following the 2008 wet season.

Our acquisitions have performed well. Both Gasnet and Allgas have exceeded performance expectations and the removal of the Alinta O&M arrangements, allows APA direct control over our major pipelines and will reduce costs. We have increased the contracted capacity of almost all our pipelines and it's particularly pleasing to see the Moomba to Sydney Pipeline make the successful transition to a more dynamic role in satisfying eastern Australia's transport needs.

In addition, the continued expansion of resource projects in WA and Queensland, continue to drive up demand on our existing pipelines. The contributions from our complementary assets have come through this half, particularly our new 30MW Mt Isa gas fired power station, which provides additional power to the Xstrata processing plant, and will operate for at least 15 years.

The geographic location of our various assets provides further benefits such as the additional gas transported through our Carpentaria Gas Pipeline to the power station.

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A year after the Gas Transportation Deed with AGL expired on 1 January 2007, what are the growth opportunities for your major asset, the Moomba to Sydney Pipeline (MSP)?

MD Mick McCormack

So long as there is gas supply to the eastern markets, there will be growth opportunities for the MSP.

We will always welcome opportunities to compete with the Eastern Gas Pipeline and to complement delivery options for gas users. In the short-term, the MSP provides additional key services in managing load for an increasingly peaky market.

Over the longer term, we envisage additional sources of gas will be required to meet eastern Australian demand. The MSP is well positioned to deliver this gas. In any case, one of our strategies over the past five years has been to reduce the prominence of the MSP through diversifying into a number of pipelines across Australia. It is no longer our major asset – contributing about 10% of revenue, compared with over 60% back in 2000.

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How successful have your investments been in assets complementary to your traditional assets? Will this be a significant area for future growth?

MD Mick McCormack

Over the past few years we have pursued investment in complementary assets such as coal seam processing facilities, gas storage facilities and gas-fired power generation. We're happy with their performance to date and their contribution to our bottom line. As expected from these complementary assets, their geographical location has benefited our existing infrastructure with additional gas being delivered through most of our pipeline systems, for example, the Tipton West and Kogan North gas processing facilities in Queensland, are providing additional throughput for transportation in our Roma to Brisbane Pipeline.

With our extensive footprint across mainland Australia, there continues to be additional opportunities like these for APA.

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In summary, with so many changes implemented across the business in recent years, can you explain how you have positioned APA to grow shareholder value?

MD Mick McCormack

APA is comfortably positioned to target distribution growth at least 5% over the medium-term. We've been able to demonstrate this by delivering a solid financial result for the first half of the financial year - and all of that underlying performance is repeatable.

APA is robust, secure and dependable with real opportunities for organic growth in these volatile times. Relative to our peers, we are a traditional style operating business that doesn't pay management or performance fees to related parties.

The business is performing well and we will continue to provide growth in distributions that are funded from operating cash flows. The forecast increase in

demand for natural gas will provide greater opportunity to extract synergies from both our core and complementary assets.

APA has a policy of cautious capital management including a well hedged debt portfolio. This will see us well protected from any long-term movements in borrowing costs, and integration and consolidation will remain our short-term focus with a view to extracting further efficiency benefits over the next 18 months.

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Thank you Mick.

For further information on APA Group please visit www.pipelinetrust.com.au or [contact](mailto:ckotsaris@pipelinetrust.com.au) Chris Kotsaris (Investor Relations) on (02) 9693 0049 or ckotsaris@pipelinetrust.com.au.

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