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APA Group



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The APA Group (APA) recently reported EBITDA before significant items of \$296.8 million for FY07, an increase of 48.1% from \$200.4 million recorded in FY06. What were the major items contributing to that increase in EBITDA?

**MD Mick McCormack**

The 48.1% increase in EBITDA was principally due to four new businesses which added roughly \$84.9 million. Of our existing businesses, the Roma to Brisbane Pipeline (RBP) contributed \$4.6 million to the increase, mainly as a result of the new CS Energy contract. The Carpentaria Gas Pipeline (CGP) contributed an additional \$5.1 million following the commencement of a short term contract with Mount Isa Mines and EBITDA from the Western Australian gas businesses rose \$9.3 million, mainly through third party revenues and the resources boom in the mining sector.

Partly offsetting those positive contributions was the cessation in September 2006 of the capital return tariff on the Amadeus Gas Pipeline, amounting to about \$7.4 million, and the reduction in the gas transmission deed revenue of around \$9.7 million on the Moomba to Sydney Pipeline (MSP). The reduction in revenue on the MSP was partly offset by new contracts with other shippers for gas delivered to the Victorian market by the interconnect.

Overall, we're very happy with the increase in EBITDA and clearly the positive variations have outweighed the negatives. Excluding these known reductions, the gas transportation revenue on the core APA pipelines was up by \$22 million, or 7.9% - again reflecting the strength of the organic growth that is coming through our assets.

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Can you comment generally on the outlook? What are your priorities for FY08?

**MD Mick McCormack**

The outlook, and our main objective, is to continue to increase distributions by at least CPI. We've been saying that for at least a couple of years now.

Our immediate operational focus is to bed down our recently acquired businesses and I'm very happy with the effort of our people in consolidating those new businesses within the APA Group.

On another front, APA is still growing organically and is continuing its participation in industry consolidation, we are pursuing a number of greenfields and brownfields projects, and investing in complementary assets remains a strategic plank.

All up, there is still plenty for us to do.

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Distributions for FY07 were 28.0 cents per unit, up from 24.0 cents per unit and an increase of 16.7% over FY06. What will determine the level of distributions in the future?

**CFO Rick Francis**

We've consistently said that our objective is to grow distributions annually by at least CPI. The increase in 2007 was well in excess of CPI and reflected the cash accretion from the two major acquisitions in 2006, GasNet and Allgas. APA ensures that its operating cash flows will cover its distributions. We don't borrow to pay distributions and that is one of our rules.

Barring unforeseen circumstances, APA is committed to increasing distributions by at least CPI in FY08. We'll evaluate the level of distributions for FY08 in February next year when we report our half year results. At that stage we will have a better feel for how the business is operating and the strength of our cash flows. We recently announced that we will be paying distributions semi-annually in FY08 rather than quarterly payments as in previous years.

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What were the highlights in FY07 on a financial, operational and corporate level?

**MD Mick McCormack**

At a financial and operational level, the highlight had to be the broad range of acquisitions we completed during the year. Each of those acquisitions has brought

its own benefits, fitting into one or more of our three core strategic drivers we've pursued over the last couple of years. That is, the development of the eastern gas grid, continued asset diversification and the internalisation of asset operations.

The GasNet business satisfied all three strategic drivers. It gives us greater geographic diversity with regulated assets and makes us the dominant transmission business in Victoria. We are also uniquely positioned to ship more gas, both north and south, through the GasNet pipelines in Victoria connecting with the MSP via the interconnect at Culcairn.

In Queensland, the Allgas acquisition increased our business diversity with a regulated gas distribution business that has two important additional benefits - it is located in the fastest-growing region in Australia, south east Queensland, and it has a regulator-approved expansion program in place. All the gas on the Allgas distribution system will be transported through our RBP so, all up, we have a firm footprint in gas distribution and gas transmission in south east Queensland.

The acquisition of DirectLink complements our prior year acquisition of MurrayLink. These are electricity interconnectors and we are already operating these two assets as a single business.

Finally, the acquisition of the Origin Energy Networks business and related assets sets us up well for the future with further geographic and business diversity.

At the corporate level there were two highlights. We undertook several significant initiatives with capital management. In the first half, we raised over \$600 million in equity through various raisings, all of which were very well supported by the market. In the second half, we successfully financed over \$2.8 billion of new and existing facilities with over \$800 million in debt from US and Canadian investors, and a new \$2 billion facility syndicated locally. As a result, APA has significantly lengthened the average maturity on our debt portfolio from 4.8 years to 7.3 years, and our next refinancing obligations are not until FY09. These facilities and our strong hedge book ensure that APA is well positioned for the future.

Secondly, an undoubted highlight has been the resolution of all the issues generated by the Alinta raid on the APA Group register in August 2006.

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APA Group has successfully bid on several acquisitions over the last few years. How does APA evaluate potential acquisitions? What are the financial hurdles imposed?

#### **MD Mick McCormack**

We have been successful in acquiring a number of businesses over the past year. We put acquisition opportunities through various filters including meeting the objectives of spreading APA's asset base beyond gas transmission, spreading our core risk geographically and further cementing APA's footprint of gas supply into south east Australian markets including adding to the viability of our proposed eastern gas grid.

We then determine whether the acquisition opportunities are logical and a solid fit to our core skills. If all these boxes are adequately ticked, we then test the acquisition opportunities against various financial parameters including appropriate IRR and cash accretion hurdles, based on realistic, long term and achievable operating assumptions.

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What acquisitions have been the most successful? Are any not meeting your expectations?

**MD Mick McCormack**

It's fairly early days in terms of judging which acquisition has been most successful. However, there have been no nasty surprises and indeed all the acquisitions are meeting, or exceeding, our acquisition case expectations.

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Gearing now stands at 69.0% compared with your loan covenants at 75.0%. Net interest expense rose by 92.1% to \$136.6 million, up from \$71.1 million. What are the options to reduce gearing? What capital management initiatives are in place or proposed?

**CFO Rick Francis**

Firstly, we are within our existing loan covenants and hence we are under no time pressure to reduce gearing. We have sufficient headroom under those covenants and sufficient committed un-drawn facilities from our newly financed facilities. Having said that, we've stated several times that our target gearing level is 65-70% and we would look to move back into that range over time.

The biggest unknown for us with capital management is the fact that 35% of our stock is currently being distributed through an in-specie distribution. We are waiting to see the impact this has on our register as we suspect the number of security holders may increase substantially from around 30,000 to somewhere near 130,000. This in itself will create some challenges and some opportunities and we may consider some top-up facility for small holders to make their holdings more meaningful.

Otherwise, in general terms, we are always reviewing our capital management plans. All options are being assessed, including equity raisings, asset sell-downs and off-balance sheet structures which we could sell assets into. It's no secret for example that, when we looked at the Basslink bid, we considered an off-balance sheet structure with APA having part ownership. Although we were to retain operatorship, our proposed structure differed from some similar structures because the operating arrangements are more transparent and appropriately reflect the risk/reward equation for all investors including APA.

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For FY07, capital expenditure on existing businesses was \$138.5 million, up from \$29.2 million in FY06. What is the outlook?

**CFO Rick Francis**

For FY08, APA's capital expenditure is likely to be in the range of \$150-200 million although some of it is discretionary as to whether we spend it in FY08.

This further increase in capital expenditure will help maintain solid growth for APA. We've already announced to the market some of this capital expenditure, including the Bonaparte Gas Pipeline in Northern Territory, the Mount Isa power station and the new compressor station at Culcairn on the MSP.

In addition, there is capital expenditure on growth projects in the businesses that we acquired. There will be further development of our gas distribution system servicing south east Queensland and capacity expansions on the Victorian gas transmission system.

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Where are the greatest opportunities for growth in existing businesses?

**MD Mick McCormack**

The resources boom in Western Australia and Queensland continues unabated. We are examining the need for yet another capacity expansion on the Goldfields Gas Pipeline in WA, the CGP in Queensland and further expansion on the RBP may soon be required because of increasing coal seam gas production.

A new access arrangement is under consideration for the Victorian transmission system and once that is approved it will require a significant amount of growth capital expenditure for around 2008-2012. We are now into the second year after approval of the access arrangement on the Queensland gas distribution business. This involves capital expenditure of around \$120 million over the next four years.

In addition to this growth, there are the benefits we will get out of the business as we complete our integration activities. They should start flowing through to the bottom line shortly.

As you can see, there's no shortage of additional growth opportunities over and above those that we've already announced. APA has very strong and secure organic growth prospects.

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APA has diversified across all mainland states and also across business areas. What acquisition opportunities remain for APA? In what areas would you prefer to grow through acquisitions?

**MD Mick McCormack**

Industry consolidation continues and there are a number of options immediately before us. However with George Bennett, APA's Chairman since its float in 2000, announcing he will retire after the AGM in late October, and Len Bleasel taking over as Chairman, APA will review our existing strategies and ensure that we have the right strategy to take APA to the next level of growth.

In the meantime, we will seriously review any acquisition opportunities as they arise.

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What role do you see gas playing in Australia's energy mix in the future?

**MD Mick McCormack**

We see gas playing an increasing role in Australia's energy mix. Gas is more environmentally friendly than other fossil fuels like coal. State and Federal governments are encouraging the use of gas, particularly when you consider the impact of the Federal Government's proposed carbon trading regime. In this regard, I note the recent comments of the Managing Director of TRUenergy, who said that pricing between gas and coal is now similar when carbon credits are factored in.

We also look forward to the release of the Owen Inquiry report, which will hopefully recommend the construction of a major gas-fired power station in regional NSW. All in all, we believe gas demand will continue to rise and, given APA's footprint across the country, we are very well placed to benefit.

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Thank you Mick and Rick.

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For further information on APA Group please visit [www.pipelinetrust.com.au](http://www.pipelinetrust.com.au) or call Mick McCormack on (02) 9693 0011 or email [mick.mccormack@pipelinetrust.com.au](mailto:mick.mccormack@pipelinetrust.com.au)

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