



**Financial Services Guide
and
Independent Expert's Report
to the
Independent Board Sub-committee
in relation to
the Proposal by APA Group**

Grant Samuel & Associates Pty Limited
(ABN 28 050 036 372)

3 March 2014



Financial Services Guide

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The Corporations Act, 2001 requires Grant Samuel to provide this Financial Services Guide ("FSG") in connection with its provision of an independent expert's report in relation to a proposal from APA Group to acquire all of the issued capital in Envestra Limited ("Envestra") that it does not already own pursuant to a scheme of arrangement ("the Proposal"). This report is to be provided to the independent board sub-committee ("IBC") of Envestra ("IBC Report"). Grant Samuel understands that the IBC intends to lodge the IBC Report with the Australian Securities Exchange for public release.

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"Grant Samuel and its related entities do not have at the date of this IBC Report, and have not had within the previous two years, any business or professional relationship with Envestra or APA Group or any financial or other interest that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Proposal. Grant Samuel advises that it prepared an independent expert's report dated 3 August 2012 for HDUF in relation to a takeover offer by Pipeline Partners Australia Pty Limited. HDUF was eventually taken over by APA Group.

Grant Samuel had no part in the formulation of the Proposal. Its only role has been the preparation of this IBC Report. If the Proposal is recommended to shareholders Grant Samuel will prepare the Shareholder Report.

Grant Samuel will receive a fixed fee of \$475,000 for the preparation of this IBC Report. This fee is not contingent on the conclusions reached or the outcome of the IBC's deliberations in relation to the Proposal. Grant Samuel's out of pocket expenses in relation to the preparation of the report will be reimbursed. Grant Samuel will receive no other benefit for the preparation of this IBC Report.

Grant Samuel considers itself to be independent in terms of Regulatory Guide 112 issued by the ASIC on 30 March 2011."

Grant Samuel has internal complaints-handling mechanisms and is a member of the Financial Ombudsman Service, No. 11929. If you have any concerns regarding the IBC Report, please contact the Compliance Officer in writing at Level 19, Governor Macquarie Tower, 1 Farrer Place, Sydney NSW 2000. If you are not satisfied with how we respond, you may contact the Financial Ombudsman Service at GPO Box 3 Melbourne VIC 3001 or 1300 780 808. This service is provided free of charge.

Grant Samuel holds professional indemnity insurance which satisfies the compensation requirements of the Corporations Act, 2001.

Grant Samuel is only responsible for the IBC Report and this FSG. Grant Samuel is not responsible for any material publicly released by Envestra or the IBC in conjunction with this IBC Report. Grant Samuel will not respond in any way that might involve any provision of financial product advice to any retail investor.



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1 Introduction

On 16 July 2013, Envestra Limited (“Envestra”) announced that it had received an unsolicited, indicative, conditional and non-binding proposal from APA Group (Envestra’s largest shareholder with a 33.05% interest) to acquire all the issued capital of Envestra that it did not already own pursuant to a scheme of arrangement. Under this proposal Envestra shareholders would receive 0.1678 APA Group securities for every Envestra share and be entitled to receive any final Envestra dividend for FY13¹.

APA Group is a stapled entity that comprises Australian Pipeline Trust (“APT”) and APT Investment Trust (“APTIT”). Australian Pipeline Limited, a subsidiary of APT, is responsible entity for each of the trusts. APA Group stapled securities are listed and trade on the Australian Securities Exchange (“ASX”). APA Group is Australia’s largest natural gas infrastructure business and has a market capitalisation of around \$5.2 billion.

Envestra formed an independent board sub-committee (“IBC”) to consider the proposal from APA Group and, on 5 August 2013, announced that the IBC had concluded that the proposal significantly undervalued Envestra shares in the context of a control transaction and therefore the IBC had decided not to proceed with the proposal.

On 17 December 2013, Envestra announced that it had received a revised proposal from APA Group (“the Proposal”). Under the Proposal, Envestra shareholders will receive consideration valued at \$1.17² per share and be able to choose between two consideration options:

- 0.1919² APA Group securities for every Envestra share; or
- a combination of APA Group securities and cash, where the cash component will be offered through a “mix and match facility”, subject to an overall cap of \$241 million and a maximum cash payment of \$1.17 per Envestra share.

Envestra shareholders will be entitled to receive the dividend of \$0.032 per share relating to the six months ended 31 December 2013 which is expected to be paid by Envestra in April 2014. If the Proposal is implemented by 30 June 2014, Envestra shareholders will be entitled to APA Group’s final distribution for the year ended 30 June 2014³.

On that date, the IBC resolved to proceed with the steps necessary to put the Proposal before Envestra shareholders for approval including:

- APA Group and Envestra undertaking mutual confirmatory due diligence;
- Envestra seeking appropriate assurance from its financiers (in a form acceptable to APA Group) that any change of control will not be deemed “unacceptable” for the purposes of Envestra’s debt financing arrangements; and
- the appointment of an independent expert to opine on whether the Proposal is fair and reasonable and in the best interests of Envestra shareholders other than APA Group (“the IBC Report”).

Envestra also announced that a formal recommendation in relation to the Proposal would be made by the Envestra board (excluding the APA Group representatives) after completion of these steps and execution of a scheme implementation agreement.

Since that announcement, the parties have continued to progress the Proposal and have:

- facilitated the conduct of a due diligence process;

¹ FYXX = financial year end 30 June 20XX

² Based on the APA Group 30 day volume weighted average price at the close of business on 11 December 2013 of \$6.0974.

³ If the Proposal is not implemented until after 30 June 2014 the consideration per Envestra share is subject to adjustment to reflect the final dividend for FY14 for Envestra (where the record date is after 30 June 2014) relative to the final distribution for FY14 for APA Group (where the record date is before implementation date).

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- received the appropriate assurances from financiers;
- reached substantive agreement on the terms of a scheme implementation agreement (“SIA”) up to the point of having a largely complete draft SIA (which remains subject to IBC approval); and
- developed a draft Notice of Meeting and Explanatory Memorandum (“Scheme Booklet”).

Subject to receiving this IBC Report, the IBC will consider its formal recommendation in relation to the Proposal. Should Envestra enter into the SIA, the Scheme Booklet will be finalised and issued to Envestra shareholders following review by the Australian Securities & Investments Commission (“ASIC”) and subject to approval by the Federal Court of Australia.



2 Scope of the Report

2.1 Purpose of the Report

It is intended that, if recommended by the IBC, the Proposal will be implemented by a scheme of arrangement under Section 411 of the Corporations Act, 2001 (“Corporations Act”) between Envestra and its shareholders. Under Section 411 the scheme must be approved by a majority in number (i.e. more than 50%) of each class of shareholders present and voting (either in person or by proxy) at the meeting, representing at least 75% of the votes cast on the resolution. If approved by Envestra shareholders, the scheme will then be subject to approval by the Federal Court of Australia.

Part 3 of Schedule 8 to the Corporations Regulations prescribes the information to be sent to shareholders in relation to schemes of arrangement pursuant to Section 411. Part 3 of Schedule 8 requires an independent expert’s report in relation to a scheme of arrangement to be prepared when a party to a scheme of arrangement has a prescribed shareholding in the company subject to the scheme, or where any of its directors are also directors of the company subject to the scheme. In those circumstances, the independent expert’s report must state whether the scheme of arrangement is in the best interests of shareholders subject to the scheme and must state reasons for that opinion.

In this case, APA Group has a relevant interest in 33.05% and Michael McCormack is a director of both APA Group and Envestra. Accordingly, in December 2013 the IBC engaged Grant Samuel & Associates Pty Limited (“Grant Samuel”) to commence preparation of an independent expert’s report for the purposes of Section 411 of the Corporations Act.

In negotiating the terms of the Proposal with APA Group, the IBC determined that prior to entering the SIA it wanted to receive an independent expert’s report assessing the merits of the Proposal. The report was:

- for the information of the IBC, although those directors will form their own view of the Proposal based on a range of external advice, due diligence and other information as appropriate;
- to be based on the information available at that time and it was recognised that this would not include:
 - a final executed SIA; and
 - a final Scheme Booklet (including information on the financial impacts of the Proposal on APA Group, an investigating accountant’s report, taxation advice and Scheme of Arrangement); and
- to be in the same form as the final report that will be required under Section 411 and to utilise the same basis of assessment (i.e. whether or not the Proposal is fair and reasonable and in the best interests of Envestra shareholders other than APA Group) subject to the information constraints outlined above.

Accordingly, the IBC requested that Grant Samuel prepare the IBC Report. The IBC recognised that a separate independent expert report incorporating additional information (“the Shareholder Report”) would ultimately need to be despatched to shareholders as part of the Scheme Booklet.

This IBC Report has been prepared for the IBC and is not being sent to the shareholders of Envestra (although it may be required to be sent to shareholders with the Scheme Booklet). Nevertheless, as Envestra intends to release the IBC Report publicly it may be construed as advice to shareholders. To this extent, this IBC Report is general financial product advice only and has been prepared without taking into account the objectives, financial situation or needs of individual Envestra shareholders. Accordingly, before acting in relation to their investment, shareholders should consider the appropriateness of the advice having regard to their own objectives, financial situation or needs. Shareholders should read the Scheme Booklet in relation to the Proposal when that is issued by Envestra.



Voting for or against the Proposal (when or if ultimately put before shareholders) is a matter for individual shareholders based on their views as to value, their expectations about future market conditions and their particular circumstances including risk profile, liquidity preference, investment strategy, portfolio structure and tax position. Shareholders who are in doubt as to the action they should take in relation to the Proposal should consult their own professional adviser.

Similarly, it is a matter for individual shareholders as to whether to buy, hold or sell shares in Envestra or APA Group. These are investment decisions upon which Grant Samuel does not offer an opinion and independent of a decision to vote for or against the Proposal. Shareholders should consult their own professional adviser in this regard.

2.2 Basis of Evaluation

There is no legal definition of the expression “in the best interests”. However, ASIC has issued Regulatory Guide 111 which establishes guidelines in respect of independent expert’s reports. ASIC Regulatory Guide 111 differentiates between the analysis required for control transactions and other transactions. In the context of control transactions (whether by takeover bid, by scheme of arrangement, by the issue of securities or by selective capital reduction or buyback), the expert is required to distinguish between “fair” and “reasonable”. A proposal that was “fair and reasonable” or “not fair but reasonable” would be in the best interests of shareholders. For most other transactions the expert is to weigh up the advantages and disadvantages of the proposal for shareholders. If the advantages outweigh the disadvantages, a proposal would be in the best interests of shareholders.

The Proposal is economically the same as a takeover offer. Accordingly, Grant Samuel has evaluated the Proposal as a control transaction and formed a judgement as to whether the Proposal is “fair and reasonable”.

Fairness involves a comparison of the offer price with the value that may be attributed to the securities that are the subject of the offer based on the value of the underlying businesses and assets. For this comparison, value is determined assuming 100% ownership of the target and a knowledgeable and willing, but not anxious, buyer and a knowledgeable and willing, but not anxious, seller acting at arm’s length. Reasonableness involves an analysis of other factors that shareholders might consider prior to accepting an offer such as:

- the offeror’s existing shareholding;
- other significant shareholdings;
- the probability of an alternative offer; and
- the liquidity of the market for the target company’s shares.

An offer could be considered “reasonable” if there were valid reasons to accept the offer notwithstanding that it was not “fair”.

Fairness is a more demanding criteria. A “fair” offer will always be “reasonable” but a “reasonable” offer will not necessarily be “fair”. A fair offer is one that reflects the full market value of a company’s businesses and assets. An offer that is in excess of the pre-bid market prices but less than full value will not be fair but may be reasonable if shareholders are otherwise unlikely in the foreseeable future to realise an amount for their shares in excess of the offer price. This is commonly the case where the bidder already controls the target company. In that situation the minority shareholders have little prospect of receiving full value from a third party offeror unless the controlling shareholder is prepared to sell its controlling shareholding.

Grant Samuel has determined whether the Proposal is fair by comparing the estimated underlying value range of Envestra with the offer price. The Proposal will be fair if it falls within the estimated underlying value range. In considering whether the Proposal is reasonable, the factors that have been considered include:



- the existing shareholding structure of Envestra;
- the likelihood of an alternative offer and alternative transactions that could realise full underlying value;
- the likely market price and liquidity of Envestra shares in the absence of the Proposal; and
- other advantages and disadvantages for Envestra shareholders of approving the Proposal.

2.3 Sources of the Information

The following information was utilised and relied upon, without independent verification, in preparing this report:

Publicly Available Information

- annual reports of Envestra and APA Group for the five years ended 30 June 2013;
- results for Envestra and APA Group for the six months ended 31 December 2013;
- Access Arrangement decisions for Envestra's regulated networks;
- press releases, public announcements, media and analyst presentation material and other public filings by Envestra and APA Group including information available on their respective websites;
- brokers' reports and recent press articles on Envestra, APA Group and the Australian gas transmission and distribution industry;
- long term credit ratings for Envestra and APA Group by Standard and Poor's and Moody's Investor Services;
- sharemarket data and related information on Australian listed companies engaged in the gas transmission and distribution industry and on acquisitions of companies and businesses in this industry; and
- information relating to the Australian and international energy sectors including supply/demand forecasts and regulatory decisions and pronouncements (as appropriate).

Non Public Information provided by Envestra

- the draft SIA dated 3 March 2014 (provided to Grant Samuel on that date);
- the draft Scheme of Arrangement dated 3 March 2014 (provided to Grant Samuel on that date);
- the draft Scheme Booklet dated 21 February 2014 (provided to Grant Samuel on 26 February 2014);
- draft minutes of Envestra's due diligence committee for meetings on 14 January 2014, 20 January 2014, 7 February 2014 and 14 February 2014;
- draft minutes of management presentation meeting between Envestra and APA Group on 28 January 2014;
- draft report of Envestra's due diligence committee to the IBC provided to Grant Samuel on 10 February 2014;
- management accounts for Envestra for the period ending 30 June 2010 to the period ending 31 December 2013;
- budget for Envestra for the year ending 30 June 2014 prepared by Envestra management and adopted by the board;
- forecast for Envestra for the year ending 30 June 2014 (based on actual results to 31 December 2013) prepared by Envestra management and provided to the board;



- Envestra’s 2013 Capital Expenditure and Operating Expenditure Strategic Plan for the period FY14 to FY34 (“2013 Strategic Plan”) prepared by APA Asset Management and reviewed by Envestra management;
- Envestra’s current regulatory models and Long Term Financial Model prepared by Envestra management;
- Operating & Management Agreements dated 2 July 2007 between Envestra and APA Asset Management; and
- other confidential documents, board papers, presentations and working papers.

In preparing this report, representatives of Grant Samuel visited the offices of Envestra in Adelaide. Grant Samuel has also held discussions with, and obtained information from, senior management of Envestra and its advisers.

2.4 Limitations and Reliance on Information

Grant Samuel believes that its opinion must be considered as a whole and that selecting portions of the analysis or factors considered by it, without considering all factors and analyses together, could create a misleading view of the process employed and the conclusions reached. Any attempt to do so could lead to undue emphasis on a particular factor or analysis. The preparation of an opinion is a complex process and is not necessarily susceptible to partial analysis or summary.

Grant Samuel’s opinion is based on economic, sharemarket, business trading, financial and other conditions and expectations prevailing at the date of this report. These conditions can change significantly over relatively short periods of time. If they did change materially, subsequent to the date of this report, the opinion could be different in these changed circumstances.

This IBC Report is also based upon financial and other information provided by Envestra and its advisers. Grant Samuel has considered and relied upon this information. Envestra has represented in writing to Grant Samuel that to its knowledge the information provided by it was then, and is now, complete and not incorrect or misleading in any material respect. Grant Samuel has no reason to believe that any material facts have been withheld.

The information provided to Grant Samuel for this IBC Report is necessarily less than would be provided if Grant Samuel was preparing the Shareholder Report for inclusion in the Scheme Booklet. Specifically, Grant Samuel has not been provided with:

- a final executed SIA; and
- a final Scheme Booklet (including information on the financial impacts of the Proposal on APA Group, investigating accountant’s report, taxation advice and Scheme of Arrangement).

However, it should be noted that Grant Samuel has received:

- a full draft of the SIA that is proposed to be entered into;
- a draft Scheme Booklet (albeit incomplete); and
- a draft Scheme of Arrangement.

It is Grant Samuel’s view that the subsequent receipt of the complete information set is unlikely to have any material impact on its assessment of the full underlying value of Envestra.

There is a risk that there could be an impact on the assessment of the value of the consideration but, on the other hand, APA Group is a stable and transparent business that is closely analysed by a number of analysts and has a reasonably liquid market for its securities. Analysis of the pro forma financial impacts of the Proposal on APA Group is relatively straightforward and has already been undertaken by a number of analysts.

The information provided to Grant Samuel has been evaluated through analysis, inquiry and review to the extent that it considers necessary or appropriate for the purposes of forming an

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opinion as to whether the Proposal is fair and reasonable and in the best interests of Envestra shareholders other than APA Group. However, Grant Samuel does not warrant that its inquiries have identified or verified all of the matters that an audit, extensive examination or “due diligence” investigation might disclose. While Grant Samuel has made what it considers to be appropriate inquiries for the purposes of forming its opinion, “due diligence” of the type undertaken by companies and their advisers in relation to, for example, prospectuses or profit forecasts, is beyond the scope of an independent expert.

Accordingly, this report and the opinions expressed in it should be considered more in the nature of an overall review of the anticipated commercial and financial implications rather than a comprehensive audit or investigation of detailed matters.

An important part of the information used in forming an opinion of the kind expressed in this report is comprised of the opinions and judgement of management. This type of information was also evaluated through analysis, inquiry and review to the extent practical. However, such information is often not capable of external verification or validation.

Preparation of this report does not imply that Grant Samuel has audited in any way the management accounts or other records of Envestra or APA Group. It is understood that the accounting information that was provided was prepared in accordance with generally accepted accounting principles and in a manner consistent with the method of accounting in previous years (except where noted).

The information provided to Grant Samuel included:

- the budget for Envestra for the year ending 30 June 2014 (“FY14 Budget”) prepared by Envestra management and adopted by the directors of Envestra;
- the forecast for Envestra for the year ending 30 June 2014 (based on actual results to 31 December 2013) (“FY14 Forecast”) prepared by Envestra management and provided to the board; and
- cash flow models for Envestra’s business operations for the period from 30 June 2014 including inputs from the 2013 Strategic Plan (“Cash Flow Models”). These models were prepared by Envestra.

Envestra is responsible for the information contained in the FY14 Budget, FY14 Forecast, the 2013 Strategic Plan and the Cash Flow Models (“the forward looking information”). Grant Samuel has considered and, to the extent deemed appropriate, relied on this information for the purposes of its analysis. In relation to the use of the Cash Flow Models Grant Samuel has made adjustments to reflect its judgement on certain matters and to ensure consistent application of assumptions. The major assumptions underlying the forward looking information were reviewed by Grant Samuel in the context of current economic, financial and other conditions. It should be noted that the forward looking information and the underlying assumptions have not been reviewed (nor is there a statutory or regulatory requirement for such a review) by an investigating accountant for reasonableness or accuracy of compilation and application of assumptions.

Subject to these adjustments and limitations, Grant Samuel considers that, based on the inquiries it has undertaken and only for the purposes of its analysis for this IBC Report (which do not constitute, and are not as extensive as, an audit or accountant’s examination), there are reasonable grounds to believe that the forward looking information has been prepared on a reasonable basis. In forming this view, Grant Samuel has taken the following factors into account that:

- Envestra has sophisticated management and financial reporting processes. The prospective financial information has been prepared through a detailed budgeting process involving preparation of “ground up” forecasts by the management and is subject to ongoing analysis and revision to reflect the impact of actual performance or assessments of likely future performance;
- the FY14 Budget was adopted by the Directors of Envestra;

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- the FY14 Forecast is based on actual operating results for Envestra for the six months ended 31 December 2013 and management projections;
- the 2013 Strategic Plan was endorsed by the Directors of Envestra; and
- the majority of Envestra's assets are regulated and therefore revenue and costs are relatively stable and predictable.

While Envestra has made guidance statements about profit after tax for FY14, the directors of Envestra have decided that they will not include the FY14 Forecast in the Scheme Booklet and therefore this information has not been disclosed in this IBC Report.

In order to provide an indication of the expected financial performance of Envestra, Grant Samuel has considered brokers' forecasts for Envestra (see Appendix 1). Grant Samuel has used the median of the brokers' forecasts to review the parameters implied by its valuation of Envestra. These forecasts are sufficiently close to Envestra's forward looking information to be useful for analytical purposes.

Grant Samuel has no reason to believe that the forward looking information reflects any material bias, either positive or negative. However, the achievability of the forward looking information is not warranted or guaranteed by Grant Samuel. Future profits and cash flows are inherently uncertain. They are predictions by management of future events that cannot be assured and are necessarily based on assumptions, many of which are beyond the control of the company or its management. Actual results may be significantly more or less favourable.

As part of its analysis, Grant Samuel has reviewed the sensitivity of net present values to changes in key variables. The sensitivity analysis isolates a limited number of assumptions and shows the impact of variations to those assumptions. No opinion is expressed as to the probability or otherwise of those variations occurring. Actual variations may be greater or less than those modelled. In addition to not representing best and worst outcomes, the sensitivity analysis does not, and does not purport to, show the impact of all possible variations to the business model. The actual performance of the business may be negatively or positively impacted by a range of factors including, but not limited to:

- changes to the assumptions other than those considered in the sensitivity analysis;
- greater or lesser variations to the assumptions considered in the sensitivity analysis than those modelled; and
- combinations of different variations to a number of different assumptions that may produce outcomes different to the combinations modelled.

In forming its opinion, Grant Samuel has also assumed that:

- matters such as title, compliance with laws and regulations and contracts in place are in good standing and will remain so and that there are no material legal proceedings, other than as publicly disclosed;
- the assessments by Envestra and its advisers with regard to legal, regulatory, tax and accounting matters relating to the transaction are accurate and complete;
- the information set out in the draft Scheme Booklet is complete, accurate and fairly presented in all material respects;
- the publicly available information relied on by Grant Samuel in its analysis was accurate and not misleading;
- the Proposal will be implemented in accordance with the terms set out in the draft SIA and draft Scheme Booklet; and
- the legal mechanisms to implement the Proposal are correct and will be effective.

To the extent that there are legal issues relating to assets, properties, or business interests or issues relating to compliance with applicable laws, regulations, and policies, Grant Samuel assumes no responsibility and offers no legal opinion or interpretation on any issue.



3 Australian Gas Sector

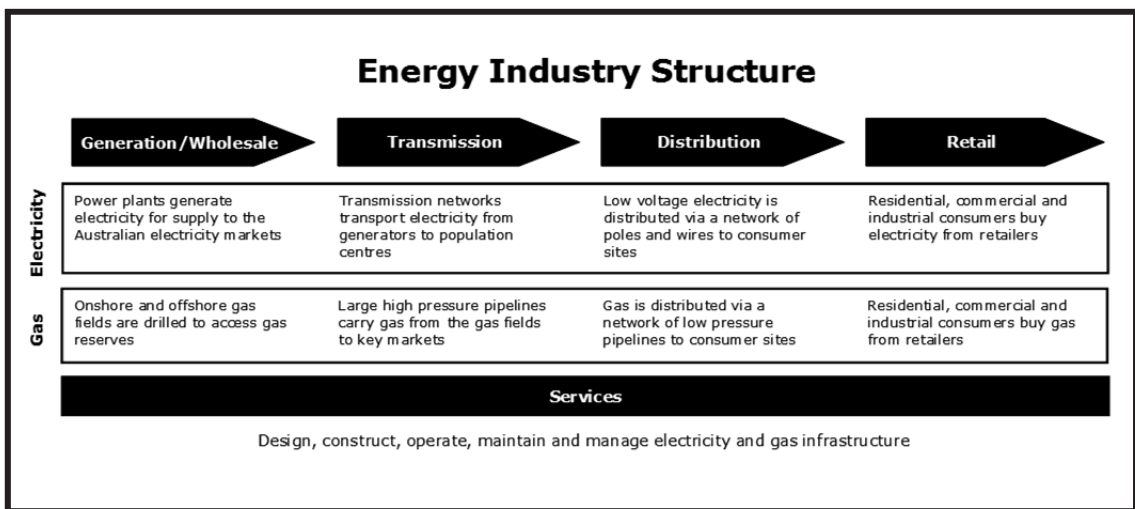
Overview of Energy Industry

World energy consumption has increased by an average of 2.4% per annum since 2000⁴ and is expected to grow on average by 1.5% per annum to 2035. Recent years have seen high and volatile world energy prices signifying shifting supply and demand conditions, changing geopolitical circumstances, increased interest in the threat of climate change and unsettled economic conditions. This has increased demand for natural gas worldwide and encouraged the growth of renewable energy sources.

The Asia Pacific region accounts for around 40% of world energy consumption with average growth since 2000 of 5.6% per annum. Chinese demand is the major driver in the Asia Pacific region accounting for 55% of the region’s energy consumption (and over 22% of world consumption). Although the major fuel sources in the Asia Pacific region continue to be coal and oil, natural gas has experienced the fastest rates of growth (albeit off a relatively low base) reflecting the substantial investment in projects for the sale of liquefied natural gas (“LNG”) to Asia. LNG currently accounts for 32% of global gas trade with the Asia Pacific region importing around 70% of that volume.

Net energy consumption in Australia has grown at an average of 2% per annum since 2000 and is expected to grow by 0.5% per annum to 2050. This moderate growth reflects the long term decline in the energy intensity of the Australian economy as a result of increased efficiency (through technological improvement and fuel switching) and the rapid growth in less energy intensive sectors. This decline has been accelerated by implementation of new policies (including renewable energy targets and carbon pricing) and Australia’s experience is expected to mirror international trends with growth in the consumption of natural gas and energy from renewable sources. However, as a net energy exporter, production of energy (excluding uranium) in Australia is forecast to grow by 1.4% per annum in the period to 2050 in response to continuing Asian demand.

The segments of, and services to, the energy industry can be depicted as follows:



Source: Grant Samuel

Historically, Australia’s energy industry comprised state based enterprises. However, as a consequence of economic and legislative changes, the industry is now more integrated across jurisdictions. As the management of energy markets is critical to the economy, parts of the energy industry remain subject to regulation.

⁴ Information in this report on the energy industry is from a range of sources. The major sources are “World Energy Outlook 2013”, International Energy Agency, November 2013, “BP Statistical Review of World Energy June 2013”, BP plc., “BP Energy Outlook 2035”, BP plc., January 2014, “International Energy Outlook 2013”, U.S. Energy Information Administration, July 2013, “State of the Energy Market 2013”, AER, December 2013, “Energy in Australia 2013”, Bureau of Resources and Energy Economics (“BREE”), May 2013, “Australian Energy Projections to 2049-50”, BREE, December 2012, “2013 Gas Statement of Opportunities”, AEMO, November 2013, “Gas Market Report”, BREE, October 2013, “2013 Australian Energy Update” BREE, July 2013 and “Australian Gas Resource Assessment 2012”, Geoscience Australia/BREE, May 2012.



In 2004, the regulatory functions for the Australian energy industry were redesigned and two new national regulatory bodies were established: the Australian Energy Market Commission (“AEMC”), responsible for rule making and market development, and the Australian Energy Regulator (“AER”), responsible for monitoring and regulating electricity and gas transmission and distribution networks and retail markets. On 1 July 2009, the Australian Energy Market Operator (“AEMO”) was established to operate the National Electricity Market and the retail and wholesale gas markets of eastern and southern Australia (replacing a number of state entities). Western Australia has opted not to transfer regulatory responsibility for its energy markets to the AER (but has adopted a modified version of the national gas law) and in the Northern Territory the AER has not been empowered to perform functions relating to the electricity market. Recently further reforms have been made to improve the efficiency of energy markets including changes to the energy rules and implementation of national regulation in the retail segment.

Envestra primarily owns assets in the gas distribution segment of the Australian energy industry while APA Group primarily operates in the gas transmission segments. Therefore, the remainder of this section focuses on the gas sector.

Gas Sector

(i) Demand

Natural gas is produced in Australia both for domestic markets and for export (as LNG). It accounts for approximately 25% of total Australian energy consumption, behind coal (31%) and oil (39%) with renewable sources accounting for 5% of consumption. Natural gas has a range of industrial, commercial and domestic applications in Australia. It is increasingly used for electricity generation and is expected to fuel 36% of generation by 2050 (up from 15% in 2010).

The consumption of natural gas in Australia is expected to grow by 1.3% per annum (a faster rate than overall energy consumption) to 34% of total consumption by 2050 driven primarily by the electricity generation sector in the eastern states and the LNG export sector. Key factors for this increase in demand include the increasing availability of gas, the increasing relative cost of coal, government initiatives to reduce greenhouse gas emissions and continued strong energy demand in Asia. The development of the LNG export sector in recent years has increased Australia’s integration with global energy markets and resulted in real increases in domestic energy costs.

The growth in gas demand differs from the west coast to the east coast. Western Australia consumes more natural gas than any other state, with demand driven by gas fired power generation, the export of LNG and the mining sector. On the east coast, total annual demand is expected to increase threefold by 2033 (at an average of 5.8% per annum) driven by gas demand for LNG export projects. In comparison, domestic gas demand is projected to grow at an average of 0.9% per annum with New South Wales expected to remain the largest domestic consumer followed by Queensland and Victoria. Queensland is forecast to experience the most rapid growth in gas consumption (other than the Northern Territory which remains relatively small) underpinned by gas fired generation and the commissioning of the LNG export projects at Gladstone.

(ii) Reserves and Production

Australia has extensive reserves of natural gas. There are two main types of natural gas produced in Australia: conventional natural gas (typically found in underground reservoirs trapped in rock sometimes in association with oil) and coal seam methane gas (“CSG”) (contained within coal seams). There are also other unconventional forms of gas including shale gas⁵, tight gas⁶ and gas from renewable sources (such as biogas and biomass).

The first commercial conventional gas project in Australia was established in central southern Queensland in 1961, the first commercial CSG project in Australia was established in late 1996 and the first commercial production of shale gas in Australia occurred in late 2012 in the Cooper Basin.

⁵ Gas which has not migrated to a reservoir rock but is still confined within low permeability, organic rich source rocks. In Australia the Cooper, Maryborough, Perth and Canning Basins are considered prospective.

⁶ Gas which occurs within low permeability reservoir rocks. Tight gas is not currently produced in Australia but the largest resources have been assessed to be in the Perth, Cooper and Gippsland Basins.

Australia's natural gas market operates as three separate regions: Western Australia, the Northern Territory and Eastern Australia (other states and territories). Total proved and probable conventional gas reserves are estimated at around 97,000PJ⁷ and proved and probable CSG reserves at 44,000PJ with total demonstrated gas resources estimated to be in excess of 270,000PJ. Estimated 2P reserves, production and demonstrated resources by region are summarised below:

Australia - Natural Gas Reserves, Gas Production and Demonstrated Resources (PJ)			
Type/Region	2P Reserves (August 2013)	Production (Year to 30 June 2013)	Demonstrated Resources⁸
Conventional Gas			
Western Australia	89,280	1,433	136,900
Northern Territory ⁹	1,192	39	22,000
Eastern Australia	6,898	481	14,100
Total Conventional	97,370	1,953	173,000
Coal Seam Gas			
Western Australia	-	-	-
Northern Territory	-	-	-
Eastern Australia			
- Queensland Basins	41,146	248	na ¹⁰
- New South Wales Basins	2,805	5	na
Total CSG	43,951	253	101,434¹¹
Shale Gas			
Western Australia	-	-	-
Northern Territory	-	-	-
Eastern Australia	na	na	2,200
Total Shale Gas	na	na	2,200
Total Natural Gas	141,321	2,206	274,434¹²
Total Eastern Australia	50,849	734	115,534

Source: EnergyQuest and Grant Samuel analysis

In aggregate, Western Australia and the Northern Territory account for around 64% of Australia's 2P natural gas reserves. At current rates of production, 2P reserves represent approximately 61 years of supply (including for export as LNG). There are also significant contingent resources in the Carnarvon, Bonaparte and Browse Basins. The bulk of the fields are located in major offshore reservoirs. There are no CSG resources identified in these regions.

2P reserves of conventional gas in Eastern Australia amount to only approximately 14 years of supply at current production levels although considerable potential remains to develop new reserves (e.g. Gippsland Basin, Otway Basin). The relatively small conventional gas resources and the fact that it is not economically viable to deliver Western Australian gas to the east coast, has resulted in the development of CSG and shale gas as alternate forms of gas fuel in the eastern states.

CSG reserves significantly exceed conventional gas reserves in Eastern Australia. The Bowen and Surat Basins in Queensland account for approximately 94% of 2P reserves. Additional CSG resources have been identified across the eastern states including the Galilee, Maryborough and Ipswich Basins in Queensland and the Gunnedah and Gloucester Basins in New South Wales.

Australia is considered to have major potential to develop other unconventional gas resources such as shale gas and tight gas. Investigations are preliminary but it has been estimated that Australia has over 460,000PJ of technically recoverable resources of shale gas¹³, with the Cooper Basin identified as a major focus for shale gas development.

⁷ PJ = petajoule

⁸ Estimated at January 2011 by Geoscience Australia/BREE using a modified version of the McKelvey resource classification system. Represents economic and sub-economic resources (i.e. excludes inferred resources) and equates to discovered gas under the more generally used oil and gas resource classification system.

⁹ Reflecting only the Australian net entitlement to Bayu-Udan.

¹⁰ na = not available

¹¹ A further 250,000PJ of inground resource of CSG is also estimated.

¹² A further 11,000PJ of conventional gas, 122,020PJ of CSG and 22,052PJ of tight gas are estimated in the inferred category.

¹³ Source: "Technically Recoverable Shale Oil and Shale Gas Resources: An Assessment of 137 Shale Formations in 41 Countries Outside the United States", U.S. Energy Information Administration and Advance Resources International Inc (June 2013).



All major gas producers/wholesalers supplying the Australian market are privately owned (although some are state owned enterprises of overseas governments). In the year ended 30 June 2013 total natural gas production was estimated to be 2,206PJ of which around 50% was consumed domestically with the balance exported to markets in Asia. CSG production has grown significantly in recent years from 13PJ in 2000 to 253PJ in 2013 and is expected to be around 2,500PJ in 2035. CSG currently accounts for 34% of natural gas production in Eastern Australia but is expected to increase to around 90% of production by 2030 due to the LNG export projects in Queensland.

Australia currently has three LNG operations: the North West Shelf Joint Venture located off the north west coast of Western Australia (which commenced export in 1989), the Darwin LNG Project in the Northern Territory (which commenced export in 2006) and the Pluto LNG Project located in the Carnarvon Basin off Western Australia (which commenced export in May 2012). Australia exported 1,103PJ⁹ of LNG in the year ended 30 June 2013, primarily to Japan, China, South Korea and Taiwan. Demand for natural gas in Asia is expected to grow by an average of 2.4% per annum to 2040 (3.3% per annum excluding Japan and South Korea) with new markets expected to commence LNG importation.

The projected growth in Asian demand has prompted investment in the Australian LNG industry (and overseas) including the expansion of existing projects and new development in Western Australia and the Northern Territory as well as LNG projects on the east coast based on CSG reserves. In this regard, there are three LNG projects with a current total production capacity of 25.3Mtpa¹⁴ under construction at Gladstone in Queensland (Queensland Curtis LNG, Gladstone LNG and Australia Pacific LNG) with first LNG production due in the period 2014-2015. A fourth project at Gladstone with initial capacity of 8Mtpa (Arrow LNG Plant) received environmental approval in December 2013 but no final investment decision has been made as yet.

Historically, gas has been sold in Australia under confidential long term contracts between producers and downstream buyers. However, in recent years there has been a shift towards shorter term contracts, the inclusion of review provisions and the emergence of spot markets¹⁵. Wholesale gas prices reflect a number of factors including cost of production, contract volume, available reserves, length of contract, price escalations and flexibility and typically include some adjustment for inflation or periodic price reset. Although gas pricing information is limited, Australian gas prices have historically been low relative to international prices due to Australia's abundant coal and natural gas reserves and geographic isolation.

It is widely accepted that Australian gas prices will increase in real terms as the Australian market becomes more integrated with international gas markets. This has already occurred in Western Australia (primarily reflecting the impact of demand for LNG and a relatively small domestic gas market) and is emerging in Eastern Australia. However, the timing and extent of gas price increases in Eastern Australia will depend on the interaction of a range of factors including:

- the growth in demand for energy in Australia;
- the continued growth in demand for LNG in Asia;
- government initiatives addressing climate change including renewable energy targets¹⁶ and carbon pricing¹⁷;

¹⁴ Mtpa = million tonnes per annum

¹⁵ Victoria operates a spot market in which approximately 10-20% of Victorian wholesale gas volume is traded. Short term trading markets commenced in Sydney and Adelaide in September 2010 and in Brisbane in December 2011. These markets provide a spot mechanism to manage contractual imbalances and not prices that would be agreed under longer term arrangements. In addition, AEMO is developing a gas trading exchange located at Queensland's Wallumbilla gas pipeline hub which is due for launch by March 2014. The aim of the exchange is to promote transparent and efficient trading so that all market participants can manage the financial risks associated with variable gas prices.

¹⁶ The Australian Government introduced a renewable energy scheme in 2001 (which was expanded in 2007) which aims to achieve 20% of total electricity generation to be supplied from renewable energy sources by 2020. The renewable energy target has driven investment in renewable power generation (principally wind) which in turn has increased demand for gas peaking power stations to support the intermittent nature of wind energy. The Coalition Government elected in September 2013 has committed to a review of this scheme in 2014.

¹⁷ On 1 July 2012, the Australian Government introduced a carbon pricing mechanism into the economy. The mechanism involved a three year fixed price period (including a price ceiling and floor) before transitioning to an emissions trading scheme on 1 July 2015. The mechanism applies directly to the largest carbon polluters and the carbon price started at \$23 per tonne. In August 2012 the mechanism was revised to link the carbon price to the price of carbon allowances in the European Union emissions trading market and, prior to the September 2013 election, the government committed to bring forward the shift to an emissions trading scheme to 1 July 2014. The Coalition Government elected in September 2013 has introduced legislation to repeal carbon pricing mechanism, reaffirmed Australia's commitment to a 5% reduction in greenhouse emissions by 2020 and committed to launch a Direct Action plan (whereby it will pay for emissions abatement activity in Australia and fund urban tree planting and rooftop solar installations).



- the commissioning and ramp up to full capacity of the Queensland LNG projects (and any future expansion of these projects);
- the delay and increased costs associated with the development of CSG and shale gas resources as a result of community concerns as to their environmental impact;
- the length of time required to bring new gas supplies to market; and
- that available gas contract price data reflects historical (not current) capital and operating costs.

On the other hand, there are a number of factors that may limit the extent to which gas prices on the east coast may increase:

- moderation in electricity demand growth in recent years;
- natural gas may be superseded as the low carbon intensity fuel for generation;
- a substantial amount of gas would be stranded without a market if not all of the Queensland LNG projects are commissioned or developed to proposed scale; and
- an increase in east coast gas prices will stimulate supply as projects which are currently marginal become economic.

In any event, there is emerging evidence that gas prices in Eastern Australia are moving upwards, particularly as existing long term contracts run off. It remains to be seen whether domestic wholesale prices will approximate full LNG netback prices, which many commentators predict could exceed \$8.00 per GJ¹⁸ in the medium term.

(iii) Transmission and Storage

Large scale commercial gas usage in Australia commenced in the early 1970s. As most Australian gas production fields are located in areas remote from major retail load centres, high pressure steel pipeline infrastructure was developed to bring gas to the retail market. The transmission system links to gas distribution networks which deliver gas to the premises of residential, commercial and industrial customers. Large industrial users and electricity generators may connect directly to the transmission pipelines.

Gas transmission infrastructure (including processing plants, pipelines, compressors and storage facilities) has a long working life if appropriately maintained. The customer base is a small number of major gas users including power stations, energy retailers and minerals processors. Services are typically provided under long term arrangements¹⁹ (around 10 years), are tailored to customer requirements and may include:

- firm forward haulage: whereby the customer reserves capacity on the pipeline and receives priority services. In some instances, back haul services (i.e. transportation of gas in opposite direction to aggregate physical flows of gas in the pipeline) may also be available on a firm capacity basis;
- interruptible haulage: which are sold on an “as available” basis and may be interrupted or delayed at relatively short notice depending on pipeline constraints or gas supply; and
- park services: which enable customers to store gas on a pipeline in order to respond to changes in the market or customer demand.

Moving gas through a pipeline takes time and therefore customers nominate in advance the amount of gas they want gas suppliers to inject into the pipeline and the amount they want to withdraw. Deviations from the nominated amounts can create physical imbalances in the pipeline impacting operating pressure and the quantity of gas available and therefore attract additional charges. The high pressure and significant length of pipelines means that there is a large amount of gas stored in a pipeline at any time (“linepack”) providing some flexibility to a pipeline and its customers.

Pipelines are a significant capital investment and secure long term supplies of gas and viable markets are required before a commitment to build is made. Consequently, gas transmission typically relies on

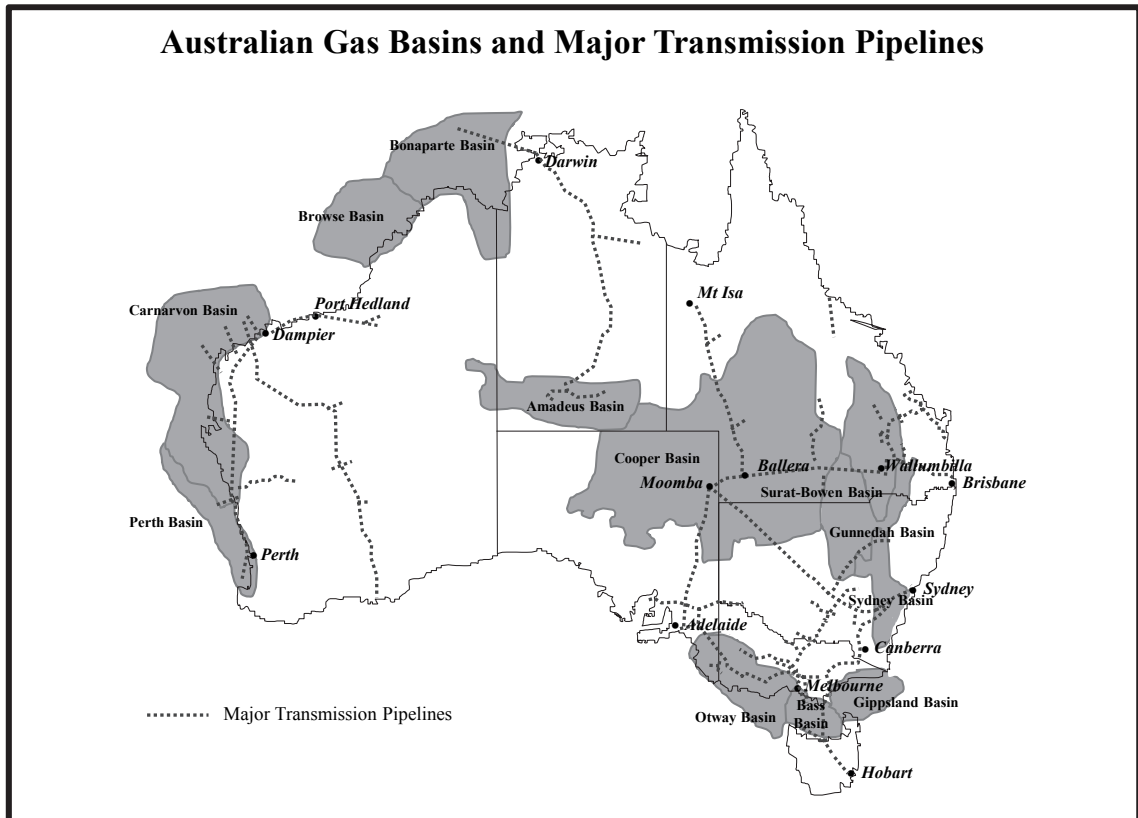
¹⁸ GJ = gigajoule

¹⁹ Due to the shorthaul characteristics of the Victorian market, AEMO manages the operations of the gas transmission system (owned by APA Group) and users are not required to enter into contracts with daily gas flow determined by bids into the wholesale gas market.



discrete large projects with long term contracts to underwrite capacity and pipelines are not developed with significant spare capacity. However, once a pipeline is built it can be expanded to meet demand growth. Whether new pipelines are developed or existing infrastructure is expanded (e.g. by looping or compression) depends on a range of factors including location and volume of gas supply and demand, existing reservation arrangements and infrastructure capacity, the technical ability to expand the pipeline, the potential for changes in pipeline tariffs and the cost of construction or expansion.

Australia's gas transmission system covers over 25,000 kilometres of pipelines:



Source: Grant Samuel

As a consequence of the location of the major gas reserves and the demand which supported commercialisation of these reserves, three independent gas transmission pipeline systems have developed:

- **Eastern Pipeline System:** an interconnected gas transmission network covering all states and territories except Western Australia and the Northern Territory. It connects the existing major gas demand hubs of south eastern Australia and the growing demand hubs of Queensland to the existing major conventional reserves basins of Eastern Australia (e.g. Cooper Basin, Otway, Bass and Gippsland Basins) as well as the CSG reserves of Queensland and New South Wales. APA Group and Jemena are the major owners and operators in the Eastern Pipeline System. Seven pipelines in the Eastern Pipeline System are covered with four subject to full regulation.

The Eastern Pipeline System has developed over the last 20 years as new pipelines have been constructed and existing infrastructure has been expanded primarily in response to the development of the CSG sector and demand for gas for electricity generation. The commissioning of the QSN Link in 2009 enabled gas delivery between Queensland and the southern states. The expansion of the South West Queensland Pipeline ("SWQP") completed in December 2011 significantly enhanced the interconnectivity and capacity of the pipeline system allowing various capacity expansion projects to be undertaken (e.g. South West Queensland Pipeline, Roma to Brisbane Pipeline, Moomba to Sydney Pipeline and Victorian Transmission System). The LNG export projects have required the construction of three major transmission pipelines to transport gas to Gladstone (due for completion by 2014/2015). Interconnection of the major pipelines has provided



energy customers with gas supply alternatives and increased competition between basins to supply gas.

- **Western Pipeline System:** encompasses gas transmission pipelines which deliver gas to the populated south west of Western Australia from the offshore Carnarvon and Perth Basins and to the resources sector in the Pilbara, Murchison and Goldfields regions of Western Australia from the Carnarvon Basin. Although the Western Pipeline System includes some of the longest gas transmission pipelines in Australia, it is less integrated than the Eastern Pipeline System. DUET Group and APA Group are the major owners and operators in the Western Pipeline System. The Dampier Bunbury Natural Gas Pipeline and the Goldfields Gas Pipeline are subject to full regulation with access arrangements due to be renewed from 1 January 2016 and 1 January 2015 respectively.
- **Northern Pipeline System:** encompasses gas transmission pipelines delivering gas from the Amadeus Basin in Central Australia and the offshore Bonaparte Basin to Darwin for electricity generation in Darwin and for export as LNG. Energy Infrastructure Investments and APA Group are the major owners and APA Group is the only operator in the Northern Pipeline System. All pipelines in the Northern Pipeline System are uncovered except the Amadeus Gas Pipeline which is subject to full regulation with access arrangements due for renewal from 1 July 2016.

Further expansion of Australia’s gas transmission system will occur to address gas supply and demand dynamics. In recent years there has been increased activity associated with dedicated gas storage facilities to complement linepack gas but this is not expected to materially impact Australia’s gas transmission system.

All major gas transmission pipelines in Australia are owned by the private sector (although some are state owned enterprises of overseas governments). The major owners of Australian gas transmission pipelines are ASX listed entities APA Group and DUET Group, Jemena²⁰, Energy Infrastructure Investments (a joint venture of APA Group, Marubeni Corporation and Osaka Gas) and QIC Global Infrastructure (“QIC”) (owned by QIC Limited, a Queensland Government company).

The regulatory framework for gas transmission pipelines in Australia is detailed in the National Gas Law and Rules under which gas pipelines are either “covered” or “uncovered”. Covered pipelines may be subject to “full regulation”, which requires owners to submit access arrangements (including reference tariffs) to the regulator for approval for a period of time (typically five years) after which they are reviewed, or “light regulation” whereby the owner must publish access prices and other terms and conditions on its website²¹. The regulatory framework also includes a mechanism for reviewing whether a pipeline requires economic regulation and for a 15 year “no coverage” period to be granted in certain circumstances.

Nationally, only 11 gas transmission pipelines (out of 64 major pipelines) are subject to economic regulation (seven subject to full regulation and four subject to light regulation). Uncovered pipelines are free to determine prices and other terms and conditions on a commercial basis, subject to the general competition provisions of the Competition and Consumer Act, 2010 and the potential for an application for coverage.

(iv) Distribution

Transmission pipelines connect to gas distribution networks at gate stations. Distribution networks are comprised of high, medium and low pressure mains which service areas of high demand and transport gas to the end users. Gas is now reticulated in all Australian capital cities and most major regional areas and towns.

As gas distribution networks in Australia generally have natural monopoly characteristics, most are “covered” under the National Gas Law and Rules. As with gas transmission pipelines, covered distribution networks may be subject to “full regulation” requiring owners to submit access arrangements

²⁰ Jemena is a division of SPI (Australia) Assets Pty Ltd (“SPIAA”) and owns a portfolio of assets in the energy infrastructure sector. SPIAA is 40% owned by Singapore Power Limited (“Singapore Power”), the largest electricity and gas utility in Singapore, and 60% owned by State Grid Corporation of China (“State Grid”), the largest utility in China.

²¹ However, if a pipeline has been deemed a “designated pipeline” it cannot be subject to light regulation. The only covered gas transmission pipeline which is currently a designated pipeline is the Dampier Bunbury Natural Gas Pipeline in Western Australia.



(including reference tariffs) to the regulator for approval for a period of time (typically five years). The owner of the distribution network must publish access prices (tariffs) and other terms and conditions on its website. The regulatory framework also includes a mechanism for reviewing whether a distribution network requires economic regulation and for a 15 year “no coverage” period to be granted in certain circumstances.

Nationally, 10 of the 12 major gas distribution networks are covered and subject to full regulation with two of the networks deemed designated pipelines (i.e. the South Australian Gas Distribution Network in South Australia and the Mid-West and South West Gas Distribution Systems in Western Australia). The two uncovered major networks (i.e. the Tasmanian Distribution System and the Darwin Distribution System) are free to determine prices and other terms and conditions on a commercial basis, subject to the general competition provisions of the Competition and Consumer Act, 2010 and the potential for an application for coverage. There are a number of smaller gas distribution networks in regional areas that are not covered.

Reference tariffs in access arrangements for distribution networks subject to full regulation are based on a building blocks approach. Under this approach, the regulator assesses the revenue needed by the owner to cover efficient costs (including a benchmark return on capital) and derives reference tariffs for the network. In doing so, account is taken of a network’s historic and forecasts operating and maintenance costs, capital expenditure, asset depreciation costs and taxation liabilities. Reference tariffs are calculated by reference to a weighted average cost of capital (return on assets) applied to the regulated asset base²². The rules also allow for income adjustments via incentive mechanisms to reward efficient operating practices over each regulatory period. Regulatory decisions are subject to merits reviews by the Australian Competition Tribunal²³.

The majority of gas distribution networks in Australia are owned by the private sector. The major owners of Australian gas distribution networks are Envestra and Jemena with DUET Group, GDI (EII) Pty Ltd (owned 20% by APA Group) and SP AusNet (31.1% owned by Singapore Power and 19.9% owned by State Grid) having smaller interests.

(v) Retailing

Retailers purchase natural gas from suppliers (producers or wholesalers) and on-sell it to residential, commercial and industrial customers. The retail price of gas represents the wholesale cost of gas, transmission and distribution tariffs, the retailer’s operating costs and a profit margin. While state and territory governments have responsibility for regulating retail energy markets, a national energy customer framework was proposed in July 2012 whereby certain non-price regulatory functions will be administered by the AEMC and AER and is being progressively implemented²⁴.

Retail tariffs have historically been subject to a regulated cap reviewed at regular intervals (usually annually). In general, small consumers (residential and small business) were charged the standard tariff (which the retailer may set equal to or lower than the tariff cap) while larger consumers (commercial and industrial) negotiate tariffs with the retailer. Today, full retail contestability for gas has been implemented in all jurisdictions²⁵ and customers may either be on a standard contract (which includes model terms and conditions that cannot be amended) or enter into a market contract (which reflects minimum terms and conditions but may offer discounts or other inducements typically for a fixed term). The state and territory governments are committed to the removal of retail price caps where effective competition can be demonstrated in the gas market. Currently, only New South Wales and Western Australia apply some form of retail price regulation for small gas customers.

²² A rule change implemented in November 2012 allows the regulator to make an assessment of the overall rate of return a benchmark entity needs to meet its efficient costs (rather than a parameter by parameter assessment) and to take into account a wider range of information thereby allowing decisions that reflect conditions in capital markets.

²³ Recent reforms to the appeals provisions are expected to benefit consumers (although currently only the South Australian parliament has passed legislation to implement these reforms). Other reforms are in train to better manage network costs in the long term interests of consumers including changes to network reliability standards.

²⁴ To date New South Wales, South Australia, Tasmania and the Australian Capital Territory have implemented the reforms and Victoria and Queensland are yet to implement them. Western Australia and the Northern Territory do not intend to implement the reforms.

²⁵ Except that in Western Australia under the Gas Market Moratorium adopted in May 2004 incumbent electricity retailer Synergy is prevented from competing for customers who consume less than 180GJ annum.

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At October 2013 there were 14 retailers active in the gas mass market in Australia, although not all were active in each jurisdiction. Most of these retailers offer the supply of both gas and electricity in at least some of the jurisdictions in which they are active. Private retailers dominate the gas market in all states except Tasmania. The major gas retailers are ASX listed companies AGL Energy Limited (“AGL Energy”) and Origin Energy Limited (“Origin Energy”), EnergyAustralia (owned by Hong Kong listed CLP Holdings Limited) and Alinta Energy (owned by a consortium of investors).



4 Profile of Envestra Limited

4.1 Background

Envestra was formed when the gas distribution assets of Boral Limited (“Boral”) (namely the South Australian, Queensland and the Northern Territory distribution networks) were combined and floated on the ASX in August 1997 with a stapled security structure (comprising one share and one loan note). At listing Boral retained a 19.97% shareholding and this interest was part of Boral’s energy assets demerged as Origin Energy Limited in 2000. Origin Energy sold its interest in Envestra (then 17.2%) to APA Group in 2007.

Envestra has grown its asset base over time both organically and through a series of acquisitions. It acquired the Palm Valley Pipeline in the Northern Territory in 1998, the Victorian gas distribution network for \$1.2 billion in 1999 and the Wagga Wagga gas distribution network for \$107 million in 2010.

Today, Envestra is the owner of the largest portfolio of gas distribution networks in Australia and is headquartered in Adelaide. Its objective is to own and operate natural gas distribution networks, pipelines and related services that generate reliable dividends and attractive returns for shareholders. Prior to the announcement of the initial approach from APA Group on 16 July 2013, Envestra had a market capitalisation of approximately \$1.9 billion.

4.2 Operations

Envestra owns gas distribution networks and associated gas transmission pipelines across Australia and serviced 1.16 million consumers (including around 1.1 million domestic users) at 30 June 2013. Its assets comprise 22,762 kilometres of mains and 1,124 kilometres of transmission pipelines with gas distribution networks in Melbourne, Adelaide and Brisbane forming the majority of its asset base. Around 90% of Envestra’s assets are subject to full regulation by the AER.

Envestra operates and reports on a regional basis as follows:

Envestra – Operations at 30 June 2013				
	South Australia/ Northern Territory ²⁶	Victoria	Queensland	New South Wales
Regulated metropolitan networks	Adelaide	Melbourne	Brisbane	
Regulated regional networks	Whyalla Port Pirie Mt Gambier Riverland Mildura	Shepparton Wangaratta Wodonga Moe Morwell Traralgon Sale Bairnsdale	Rockhampton	Albury Wagga Wagga
Unregulated regional networks	Alice Springs		Bundaberg Maryborough Hervey Bay	Wagga Wagga Region ²⁷
Transmission pipelines	Riverland Palm Valley	12 short-length pipelines	Wide Bay	Wagga Wagga region
Length of mains (kilometres)	8,122	10,106	2,692	1,842
Length of pipelines (kilometres)	531	225	284	84
Number of consumers	425,632	593,918	90,988	52,924
Gas volume in FY13 (PJ)	36.7	53.4	16.4	6.5

²⁶ Including Mildura, which is accounted for as part of South Australia/Northern Territory, although geographically in Victoria.

²⁷ The Wagga Wagga network is approximately 30% unregulated.



Envestra – Operations at 30 June 2013				
	South Australia/ Northern Territory²⁶	Victoria	Queensland	New South Wales
RAB ²⁸ (\$million)	1,154	1,163	358	100
Reset date	1 July 2016	1 Jan 2018	1 July 2016	1 Jan 2018/1 July 2015
FY13 EBITDA contribution	44%	35%	16%	5%

Source: Envestra

A description of each of Envestra’s regional operations is set out in Section 4.8 of this report.

The operation and management of all of Envestra’s assets is outsourced to APA Group under contracts (“O&M Contracts”) under which APA Group is responsible for:

- managing the haulage of gas through each network;
- operating and maintaining each network;
- planning, designing and constructing network extensions;
- assisting Envestra with submissions to the AER;
- assisting Envestra in promoting the use of natural gas;
- preparing and settling with Envestra the budget for each financial year;
- providing Envestra with regular information on financial and other management issues;
- reading meters and billing retailers; and
- the development of procedures in relation to billing, System Use Gas, fair market rental or value for APA Group's assets used for the services provided, key design parameters for any network and public relations activities.

In return for providing these services, APA Group is entitled to:

- a fee of 3% of Envestra’s total network revenue (which is currently a recoverable cost under Envestra’s access arrangements);
- be reimbursed for all costs and disbursements reasonably incurred in the performance of its obligations (including redundancy costs); and
- a performance bonus of one third of any reduction in costs from the immediately preceding financial year (adjusted for inflation) as a result of decreases in the average capital cost of connecting new consumer sites to the networks and/or decreases in controllable costs per GJ of gas.

The O&M Contracts expire on 30 June 2027 and may only be terminated before then:

- by Envestra, for a breach by APA Group of their terms which has not been waived, loss of regulatory authorisations, insolvency or if, without the written consent of Envestra, there is a change in control of APA Group;
- by APA Group, for a breach by Envestra of their terms which has not been waived or if Envestra fails to pay an amount of in excess of 1% of budgeted net cash flow within 30 days of written notice by APA Group; or
- if there is prolonged force majeure.

Envestra has a corporate team of 15 staff who provide the administration, finance, treasury, regulatory and commercial functions for the company. This includes:

- negotiating third party access arrangements;
- preparing and submitting proposals, conducting negotiations with and reporting financial results to the AER in relation to access arrangement determinations;
- managing the O&M Contracts;

²⁸ RAB is regulated asset base as calculated by Envestra (i.e. not as stated in access arrangements).



- marketing activities aimed at promoting marketing natural gas to consumers; and
- managing financing requirements and shareholder reporting and other obligations.

4.3 Financial Performance

The historical financial performance of Envestra for the five years ended 30 June 2013 and the six months ended 31 December 2013 is summarised below:

Envestra - Financial Performance (\$ millions)						
	Year ended 30 June					Six months ended
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	31 December 2013 actual
<i>RAB (period end)</i>	2,260	2,380	2,454	2,594	2,775	2,879
<i>Consumers (000's)</i>	1,036.9	1,061.0	1,114.5	1,140.2	1,163.5	1,174.8
<i>Gas delivered (PJ)</i>	115.0	111.4	119.0	114.6	113.0	59.0
Total network revenue	382.2	382.2	424.2	468.6	507.5	293.1
Network operating costs	(90.5)	(99.8)	(103.2)	(108.9)	(123.0)	(62.8)
Gas purchases	(12.1)	(11.8)	(14.4)	(13.3)	(14.1)	(6.4)
Corporate costs	(9.7)	(9.7)	(10.7)	(11.6)	(10.8)	(6.2)
Operating costs	(112.3)	(121.3)	(128.3)	(133.8)	(147.9)	(75.4)
EBITDA²⁹	269.9	260.9	295.9	334.8	359.6	217.7
Depreciation and amortisation	(58.2)	(52.7)	(53.3)	(56.7)	(58.7)	(31.0)
EBIT³⁰	211.7	208.2	242.6	278.1	300.9	186.7
Net interest expense	(159.6) ³¹	(156.3)	(174.6)	(171.2)	(147.9)	(62.3)
Significant and non-recurring items ³²	0.3	(0.3)	(3.1)	(1.5)	0.8	-
Operating profit before tax	52.4	51.6	64.9	105.4	153.8	124.4
Income tax expense	(12.1)	(14.4)	(19.9)	(31.5)	(46.0)	(37.3)
Profit after tax attributable to Envestra shareholders	40.3	37.2	45.0	73.9	107.8	87.1
Statistics						
<i>Basic EPS³³</i>	3.8¢	2.8¢	3.2¢	4.9¢	6.6¢	4.8¢
<i>Dividends per share³⁴</i>	5.5¢ ³⁵	5.5¢ ³⁶	5.7¢	5.8¢	6.2¢	3.2¢
<i>Amount of dividend franked</i>	-	27%	-	-	-	-
<i>Dividends paid in year</i>	7.3¢ ³⁷	5.5¢	5.5¢	5.8¢	5.9¢	3.2¢
<i>Dividend coverage ratio³⁸</i>	1.4x	1.5x	1.7x	1.8x	2.2x	2.1x
<i>Dividend yield³⁹</i>	10.8%	11.2%	8.2%	7.4%	6.2%	
<i>Total network revenue growth</i>	10.9%	-	10.9%	10.6%	8.3%	na
<i>EBITDA growth</i>	15.7%	(3.3%)	13.3%	13.3%	7.4%	na
<i>EBIT growth</i>	20.7%	(2.3%)	16.3%	14.8%	8.2%	na
<i>EBITDA margin</i>	70.6%	68.3%	69.7%	71.4%	70.9%	74.2%
<i>EBIT margin</i>	55.8%	54.5%	57.1%	59.3%	59.3%	63.7%
<i>Interest cover⁴⁰</i>	1.3x	1.3x	1.4x	1.6x	2.0x	3.0x

Source: Envestra and Grant Samuel analysis

²⁹ EBITDA is earnings before net interest, tax, depreciation and amortisation, investment income and significant and non-recurring items. Differs to reported EBITDA due to exclusion of significant and non-recurring items.

³⁰ EBIT is earnings before net interest, tax, investment income and significant and non-recurring items. Differs to reported EBIT due to exclusion of significant and non-recurring items.

³¹ Including \$2.3 million of interest on loan notes.

³² Provided to Grant Samuel by Envestra. Not disclosed in Envestra's statutory financial statements.

³³ EPS = earnings per security including significant items.

³⁴ Represents dividends in relation to the financial year (i.e. not dividends paid during the year).

³⁵ Envestra's stapled entity structure was terminated on 29 May 2009 when the final repayment of principal on the loan notes occurred. Dividends per share in FY09 include 0.81 cents of capital per loan note and 0.05 cents of interest per loan note.

³⁶ The dividend paid on 30 April 2010 (i.e. the interim dividend for FY10) was franked to 54.6%.

³⁷ In FY09 shareholders received 4.94 cents of capital per loan note, 0.42 cents of interest per loan note plus 1.89 cents in franked dividend.

³⁸ Calculated as cash dividends paid divided by cash flow available for distribution.

³⁹ Based on dividends declared for the period and the closing Envestra share price on last day of the period.

⁴⁰ Interest cover is EBIT divided by net interest.

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Network services revenue primarily relates to haulage revenue (both regulated and unregulated) with other revenue being generated from activities such as special meter reads, disconnections, main alterations and customer contributions relating to construction activities. Approximately 90% of Envestra's revenue is generated from consumers of less than 10TJ⁴¹ of gas per annum (i.e. the retail and commercial markets). Approximately 55% of Envestra's revenue is generated in the first half of the financial year due to higher gas volumes transported during the winter period.

Revenue and earnings have grown steadily since FY10. Increased revenue in this period reflects:

- annual increases in tariffs charged;
- the acquisition of the Wagga Wagga distribution network in October 2010;
- an increase in capital expenditure (including a major mains replacement program);
- new customer connections; and
- tariff increases as a result of the most recent regulatory determinations (effective in South Australia and Queensland from 7 July 2011 and 30 June 2011 respectively and in Victoria from 29 April 2013).

Operating costs primarily relate to network operating costs (including the fee paid to APA Group), carbon tax costs, repairs and maintenance and marketing. Gas purchases refer to the gas that Envestra predominantly buys to replace gas that has leaked from the networks. Corporate costs include the administration and staff costs associated with Envestra's corporate functions. Operating costs have increased over the period as a result of:

- the expansion of the distribution networks;
- increases in marketing spend aimed at enhancing the market position of natural gas;
- the introduction of the carbon tax in FY13 (at a cost of \$9.6 million) which was fully recovered in revenue; and
- higher maintenance costs primarily as a result of leaks associated with the portion of the networks still comprised of cast iron mains.

Consequently, EBITDA and EBIT have grown on average by 7.4% and 9% respectively over the period at relatively consistent margins. Envestra's EBIT by operating region is shown below:

Envestra – EBIT by Region⁴² (\$ millions)						
	Year ended 30 June					Six months ended
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	31 December 2013 actual
South Australia/Northern Territory	82.8	77.8	92.6	119.4	135.7	87.9
Victoria	91.8	90.8	105.0	98.9	100.7	61.1
Queensland	33.7	35.2	36.9	44.7	49.0	28.6
New South Wales	3.4	4.4	8.1	15.1	15.5	9.1
Total EBIT	211.7	208.2	242.6	278.1	300.9	186.7

Source: Envestra and Grant Samuel analysis

This analysis shows that the contribution from each region has grown in the period but that South Australia/Northern Territory and Victoria remain the key contributors to Envestra's earnings. The operating performance of each region is discussed in more detail in Section 4.8 of this report.

Net interest expense increased following the FY11 acquisition of the Wagga Wagga distribution network. Lower interest rates on floating rate debt and on fixed interest rate swaps commencing January 2013 have contributed to the reduction in interest expenses in FY13.

⁴¹ TJ = terajoule

⁴² Historical EBIT has been restated to reflect current regional classifications.

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Envestra pays dividends from cash flows from operations plus the proceeds from sale of assets less payments for remediation of land and replacement capital expenditure. Dividends per share have gradually increased over the five year period as earnings and cash flow have grown (notwithstanding increases in shares on issue). Dividends have been unfranked as Envestra does not pay cash tax due to carried forward income tax losses and tax depreciation deductions in excess of accounting depreciation.

Outlook

Envestra has not publicly released detailed earnings forecasts for FY14 or beyond. However, on 12 December 2013, Envestra announced that it expects profit after tax for FY14 of around \$145 million, reflecting lower than expected borrowing costs and higher than expected gas volumes to residential and commercial markets. Envestra has also announced an increase in the annual rate of dividends paid from 5.9 cents per share paid in FY13 to 6.4 cents per share in FY14. On 20 February 2014, Envestra increased its guidance for FY14 net profit after tax to between \$145 million and \$150 million.

In order to provide an indication of the expected future financial performance of Envestra, Grant Samuel has also considered brokers' forecasts for Envestra (see Appendix 1) as follows:

Envestra – Financial Performance (\$ millions)				
	Year ending 30 June			
	2013 actual	Broker Consensus (Median)		
		2014	2015	2016
Total network revenue	507.5	555.6	575.3	606.5
EBITDA	359.6	401.0	414.1	433.2
EBIT	300.9	338.6	350.0	362.0
Net profit after tax	107.8	147.8	149.1	151.5
Earnings per share	6.6¢	8.2¢	8.3¢	8.4¢
Dividends per share ³⁴	6.2¢	6.4¢	6.7¢	7.1¢

Source: Grant Samuel analysis (see Appendix 1)

4.4 Cash Flow

Envestra's cash flow for the five years ended 30 June 2013 and the six months ended 31 December 2013 is summarised below:

Envestra – Cash Flow (\$ millions)						Six months ended 31 Dec 2013 actual
	Year ended 30 June					
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	
Cash flow from operations	122.3	117.1	137.0	171.8	233.8	135.1
Proceeds from sale of assets	1.0	1.0	7.8	0.1	0.9	-
Payment for remediation of land	-	-	(0.8)	(0.6)	(8.9)	(0.7)
Replacement capital expenditure	(18.4)	(10.7)	(14.9)	(16.2)	(20.8)	(12.4)
Available for distribution	104.9	107.4	129.1	155.1	205.0	122.0
Dividends/distributions paid	(75.8)	(73.0)	(77.5)	(87.5)	(93.7)	(57.5)
Cash flow after distributions	29.1	34.4	51.6	67.6	111.3	64.5
Growth capital expenditure	(94.1)	(87.1)	(114.3)	(159.9)	(196.6)	(123.4)
Acquisitions	-	-	(108.7)	-	-	-
Proceeds from security issues (net)	130.6	31.9	41.8	66.6	214.6	-
Proceeds from borrowings (net)	(70.2)	21.0	130.5	19.4	(129.3)	59.0
Net increase/(decrease) in cash	(4.6)	0.2	0.9	(6.3)	-	0.1
<i>Opening cash</i>	<i>10.8</i>	<i>6.2</i>	<i>6.4</i>	<i>7.3</i>	<i>1.0</i>	<i>1.0</i>
<i>Closing cash</i>	<i>6.2</i>	<i>6.4</i>	<i>7.3</i>	<i>1.0</i>	<i>1.0</i>	<i>1.1</i>

Source: Envestra and Grant Samuel analysis



Notwithstanding the increase in the quantum of dividends paid in the period (as a result of increased shares on issue as well as increases in the rate of dividend), Envestra's dividend coverage ratio³⁸ has increased from around 1.4 times in FY09 to 2.2 times in FY13. The increased cash retention has partially funded an increased capital expenditure program, a large proportion of which relates to the replacement of aging cast iron and steel gas mains with polyethylene pipes. The balance of the capital expenditure program has been funded by a mix of debt and equity. Envestra has used its dividend reinvestment plan to raise equity over the period but in FY09 (through a rights issue) and FY13 (through an institutional placement and share purchase plan) it has taken advantage of market conditions to raise additional capital.

Based on its recent regulatory decisions, Envestra anticipates capital expenditure of around \$1.3 billion in the five years from FY13. This includes around \$600 million to substantially complete the mains replacement project by FY18. The mains replacement program will benefit Envestra's earnings by increasing the RAB (and therefore revenue) and by reducing gas leakage and associated maintenance costs.

4.5 Financial Position

The financial position of Envestra as at 30 June 2013 (audited) and 31 December 2013 (reviewed) is summarised below:

Envestra - Financial Position (\$ millions)		
	As at 30 June 2013	As at 31 December 2013
Debtors, other assets and prepayments	85.2	59.2
Creditors, accruals and provisions	(70.7)	(60.3)
Net working capital	14.5	(1.1)
Property, plant and equipment (net)	2,497.0	2,593.7
Distribution licences and other intangible assets	606.0	606.0
Receivables	4.8	4.3
Deferred tax liabilities (net)	(195.2)	(228.6)
Non current provisions	(10.4)	(10.1)
Prepayment from energy retailers	(50.7)	(0.6)
Derivative financial instruments (net)	(2.7)	(13.7)
Total funds employed	2,863.3	2,949.9
Cash and deposits	1.0	1.1
Bank loans, other loans and finance leases	(2,022.5)	(2,088.5)
Net borrowings	(2,021.5)	(2,087.4)
Net assets	841.8	862.5
Statistics		
<i>Shares on issue at period end (million)</i>	1,796.8	1,796.8
<i>RAB²⁸ (\$ million)</i>	2,775	2,879
<i>Net assets per share</i>	\$0.47	\$0.48
<i>NTA⁴³ per share</i>	\$0.13	\$0.14
<i>Gearing⁴⁴</i>	63.4%	64.3%
<i>Net borrowings/RAB⁴⁵</i>	74.0%	73.4%
<i>Book gearing⁴⁶</i>	70.6%	70.8%
<i>Market gearing⁴⁷</i>	53.1%	50.5%

Source: Envestra and Grant Samuel analysis

Property, plant and equipment primarily reflects the net written down value of the mains and inlets, gas meters, gas regulators and gate stations that comprise the gas distribution networks as well as gas transmission pipelines. It also includes two former gas works sites which are subject to remediation for which a significant provision has been made. Distribution licences primarily

⁴³ NTA is net tangible assets, which is calculated as net assets less intangible assets (i.e. distribution licences and other intangible assets).

⁴⁴ Gearing is net borrowings divided by total non-cash assets. This is the definition of gearing used by Envestra.

⁴⁵ Calculated as net borrowings (before capitalised borrowing costs and fair value adjustments) divided by RAB.

⁴⁶ Book gearing is net borrowings divided by net assets plus net borrowings.

⁴⁷ Market gearing is net borrowings divided by market capitalisation (at period end) plus net borrowings.



comprise the licences in relation to the Victorian networks acquired in 1999 (\$585.6 million) and are considered to have an indefinite life and therefore not amortised.

Prepayment from energy retailers primarily represents the terms of the South Australian access arrangements which require the retailer to prepay for haulage services. Since 30 June 2013 this requirement has been changed and the prepayment released.

Envestra uses a range of derivative financial instruments to manage its exposure to fluctuations in interest rates and foreign exchange rates. At 30 June 2013 Envestra had a net derivative liability of \$2.7 million.

Envestra's borrowings comprise both capital market instruments and bank facilities with maturities over the next 28 years to match the nature of its assets. At 30 June 2013, Envestra had \$2,453.9 million in debt facilities (with an average maturity of 10 years) of which \$2,053.9 million was drawn:

Envestra – Borrowings at 30 June 2013 (\$ millions)			
Facility	Amount Committed	Amount Drawn	Maturity
Bank loans	569.5	169.5	April 2014-October 2016
Commercial paper	3.0	3.0	1 month
Capital indexed bonds	251.9	251.9	Aug 2025 Principal
Medium term notes	645.0	645.0	2015, 2024 and 2026
US private placement notes	984.5 ⁴⁸	984.5	Varying (2015 - 2041)
	2,453.9	2,053.9	
Capitalised borrowing costs	-	(28.0)	
Fair value adjustments	-	(3.4)	
Total	2,453.9	2,022.5	

Source: Envestra

The borrowings are secured over the networks owned by Envestra. Envestra and its senior debt financiers are parties to the Intercreditor Deed Poll which sets out various events of default, representations, warranties and undertakings relating to the debt and hedging arrangements. An event of default gives Envestra's senior debt financiers the right to require repayment of debt and close out hedging arrangements (subject to certain majority approval requirements) and may result in "make whole" and "swap close out" payments and other additional costs. A change of control is an event of default but only if the majority of financiers (more than 66.7%) declare the change of control "unacceptable". This declaration can only be made 60 or more days after the change in control occurs, unless financiers volunteer to make an earlier undertaking.

Envestra has a Standard and Poor's ("S&P") long term credit rating of "BBB/Stable" and a Moody's Investors Services ("Moody's") long term credit rating of "Baa2/Stable". On 17 December 2013, both S&P and Moody's announced that these credit ratings were not immediately affected by the announcement of APA Group's non-binding proposal for Envestra.

At 31 December 2013, Envestra had \$2,403.1 million in debt facilities of which \$2,115.6 million was drawn (as set out below) and a net derivative liability of \$13.7 million.

Envestra – Borrowings at 31 December 2013 (\$ millions)			
Facility	Amount Committed	Amount Drawn	Maturity
Bank loans	519.5	232.0	April 2014-October 2016
Capital indexed bonds	254.1	254.1	Aug 2025
Medium term notes	645.0	645.0	2015, 2024 and 2026
US private placement notes	984.5 ⁴⁸	984.5	Varying (2015 - 2041)
	2,403.1	2,115.6	
Capitalised borrowing costs	-	(26.6)	
Fair value adjustments	-	(0.5)	
Total	2,403.1	2,088.5	

Source: Envestra

⁴⁸ Issued in the United States of America and including \$165 million in Australian dollars and the balance in United States dollars.



Under the Australian tax consolidation regime, Envestra and its wholly owned Australian resident entities have elected to be taxed as a single entity. At 30 June 2013, Envestra had carried forward income tax losses of \$508.7 million (\$152.6 million of tax shield), all of which were recognised in the balance sheet. In addition, Envestra had carried forward Australian capital losses of \$8.2 million (\$2.5 million of tax shield). Envestra has no accumulated franking credits and does not expect to pay income tax in the short to medium term due to the ability to utilise carried forward income tax losses.

4.6 Capital Structure and Ownership

Envestra has 1,796,808,474 ordinary shares on issue.

At 30 January 2014 there were 15,684 registered shareholders in Envestra with the top 20 registered (beneficial) shareholders accounting for approximately 65.0% of the shares on issue. Envestra has two substantial shareholders:

Envestra – Substantial Shareholders		
	Number of Shares	Percentage
APA Group	593,755,789	33.05%
Cheung Kong Infrastructure Holdings (Malaysian) Ltd	313,645,693	17.46%

Cheung Kong Infrastructure Holdings (Malaysian) Ltd (“CKI”) became a substantial shareholder with a 19.97% interest following a \$310 million capital raising in September 1999 to fund the acquisition of the Victorian networks. APA Group acquired a 17.2% interest in Envestra in July 2007 from Origin Energy as part of a wider transaction. Participation in Envestra's distribution reinvestment plan and by underwriting Envestra's 2009 rights issue has increased APA Group's interest over time. Both APA Group and CKI have two directors on the Envestra board. In this regard, under Envestra's constitution:

- while CKI holds more than 15% of Envestra's shares, it is entitled to appoint up to two directors to Envestra's board; and
- if CKI holds between 10% and 15% of Envestra's shares, it is entitled to appoint one director to Envestra's board.

Other than APA Group and CKI, the top twenty registered shareholders are principally institutional nominee or custodian companies. Approximately 34% of registered shareholders hold less than 10,000 shares but this represents less than 2% of shares on issue. Envestra shareholders are predominantly Australian based investors (over 98% of registered shareholders and 82% of securities on issue).

Envestra's dividend reinvestment plan was suspended in August 2013.

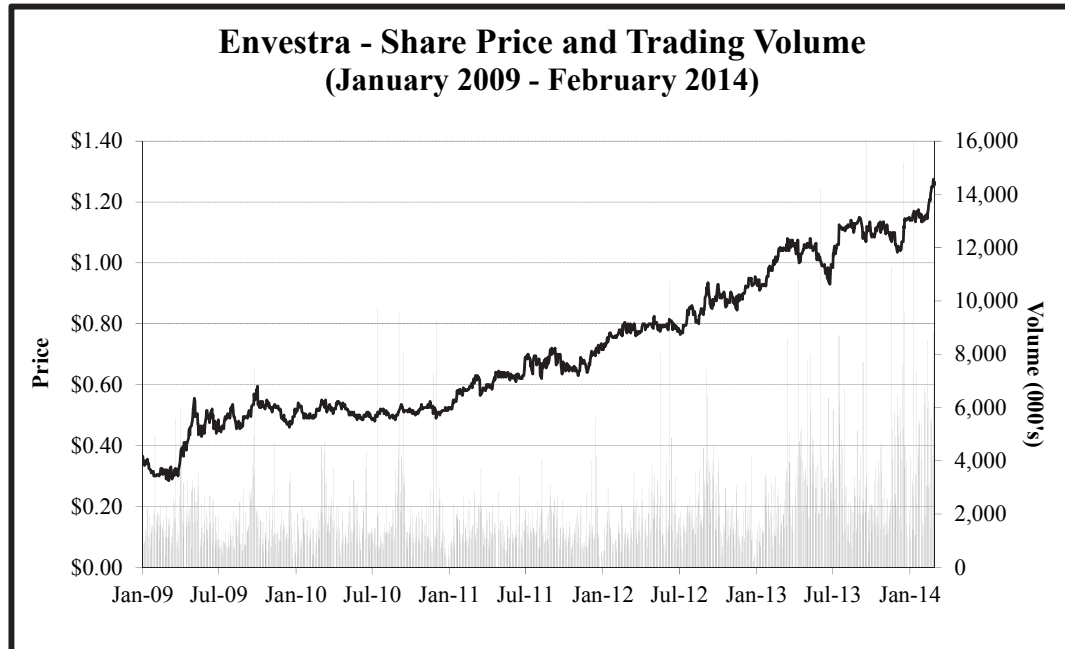
4.7 Share Price Performance

From listing in August 1997 until early 2005, Envestra securities traded broadly around \$1.00. Subsequently, the securities traded up to peak at \$1.275 in mid April 2007 around the time that APA Group acquired the O&M Contracts and a 17.2% interest in Envestra from Origin Energy. The commencement of the global financial crisis from mid 2007 and the market sentiment implications of a lower than expected regulatory decision in Victoria, negatively impacted Envestra's security price through the period to the end of November 2008 when it had declined to trade around \$0.50. In response to the challenging circumstances, Envestra reduced its distributions and undertook a rights issue in December 2008 at \$0.30 per security.

Envestra traded around \$0.30 in the first quarter of 2009 and recovered to around \$0.50 in late May 2009 following S&P's revision of the outlook for its “BBB-” long term credit rating (to “stable” from “negative”), termination of the stapled security structure, positive market responses to the AER's rate of return guidance for the electricity infrastructure sector and a FY09 profit



guidance upgrade. The following graph illustrates the movement in the Envestra share price and trading volumes since 1 January 2009:



Source: IRESS

Envestra's shares traded around \$0.50 from mid 2009 to the beginning of FY11. Following the AER's final decision on the access arrangements in Queensland and South Australia (which account for over 50% of its business) in June 2011, Envestra's share price trended upwards on the back of continued earnings improvements and increased dividends per security through to April/May 2013 when it dipped in line with the market to close at \$0.995 on 30 June 2013. During July 2013 the share price rose to close at \$1.06 on 15 July 2013, the day prior to APA Group's initial approach to Envestra. The Envestra share price jumped 6% to around \$1.12 following the approach. When APA Group's approach was rejected by Envestra on 5 August 2013 the shares closed at \$1.115.

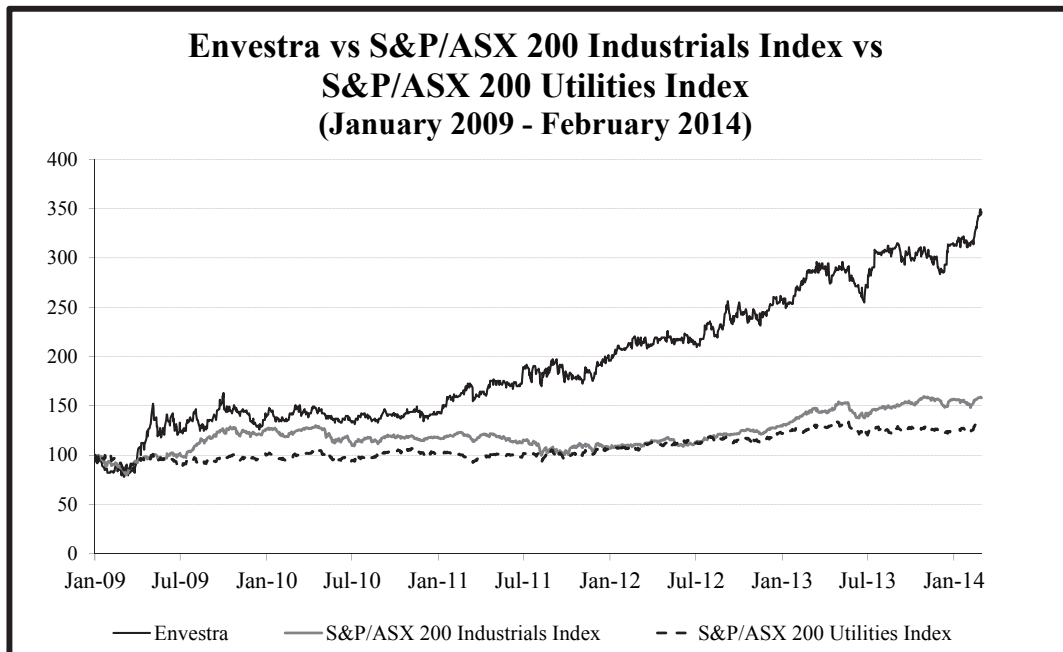
From then until APA Group's revised proposal on 17 December 2013, the Envestra share price traded around \$1.10 as the market anticipated a revised proposal from APA Group. The Envestra share price closed at \$1.07 on 16 December 2013, the day prior to the announcement of APA Group's revised proposal. Subsequently, Envestra shares traded in the range of \$1.105-1.175 (at a VWAP of \$1.15) until after 11 February 2014 when it increased in line with the APA Group security price and the 0.1919 exchange ratio under the Proposal to close at \$1.265 on 28 February 2014.

Envestra has a restricted free float of 49.5% (i.e. excluding APA Group and CKI) and is not highly liquid. Average weekly volume over the twelve months prior to the announcement of APA Group's initial proposal on 16 July 2013 represented approximately 0.8% of average securities on issue in that period or annual turnover of around 39% of total average issued capital (around 80% of free float). This is not unusual for energy infrastructure entities from which investors seek long term stable distributions.

Envestra is a member of various indices including the S&P/ASX 200 Industrial Index and the S&P/ASX 200 Utilities Index. At 28 February 2014 its weighting in these indices was 0.2% and 8.48% respectively. The following graph illustrates the performance of Envestra shares since January 2009 relative to the S&P/ASX 200 Industrials Index and the S&P/ASX 200 Utilities Index. From June 2009 to January 2012 Envestra outperformed the indices reflecting the positive implications of regulatory decisions for earnings during that period as the equity markets stabilised. From then until APA Group's initial proposal in July 2013, Envestra's performance generally mirrored the market and its peers with periods of over and under performance.



Following the initial re-rating upon announcement of APA Group's approach, Envestra continued to perform in line with the indices until re-rating again upon announcement of the revised proposal from APA Group on 17 December 2013 and then traded up in line with APA Group securities post 11 February 2014:



Source: IRESS

4.8 Operations by Region

Envestra operates and reports on a regional basis. Each of the four regions is discussed below.

South Australia/Northern Territory

Envestra's South Australia/Northern Territory region encompasses:

- the South Australian distribution network which spans the greater Adelaide region;
- regional networks in Whyalla, Port Pirie, Mt Gambier and Murray Bridge;
- the Riverland Pipeline which connects Mildura to the Moomba to Adelaide Pipeline and delivers gas to Irymple, Redcliff and Mildura;
- the Palm Valley Pipeline which connects Palm Valley with Alice Springs; and
- the distribution network in Alice Springs.

The South Australian distribution network is regulated and its current five year regulatory period is from 1 July 2011 to 30 June 2016. An accelerated mains replacement program is currently underway to replace the remaining cast iron and unprotected steel mains in the network (approximately 12% of the network). Envestra has also commenced expansion of the network into new areas in South Australia including Buckland Park (north west of Adelaide) and in Tanunda in the Barossa Valley.

Gas is delivered to Envestra's South Australian distribution network primarily via the Moomba to Adelaide Pipeline System (owned by QIC Global Infrastructure) and the SEA Gas Pipeline (50% owned by APA Group). Demand for gas in the region comes from the retail and industrial markets and from power generators. Gas is used by the retail market in this region for heating, cooking and hot water. Envestra's major customers include the integrated energy companies Origin Energy and AGL Energy, other energy retailers, power generators and industrial users.



The operating performance of South Australia/Northern Territory is summarised below:

South Australia/Northern Territory⁴⁹ - Operating Performance (\$ millions)						
	Year ended 30 June					Six months ended
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	31 December 2013 actual
<i>Period end RAB (\$million)</i>	961	999	1,024	1,072	1,154	1,192
<i>Consumers (000s)</i>	394.9	402.4	411.0	418.7	425.6	429.2
<i>Effective degree days⁵⁰</i>	1,032	921	1,126	970	857	473
<i>Gas delivered (PJ)</i>	39.6	38.7	39.6	37.2	36.7	19.2
Network revenue	158.3	152.7	167.0	196.2	216.9	130.9
Operating costs	(47.2)	(52.8)	(54.2)	(55.7)	(59.3)	(31.5)
EBITDA	111.1	99.9	112.8	140.5	157.6	99.4
Depreciation and amortisation	(28.3)	(22.1)	(20.2)	(21.1)	(21.9)	(11.5)
EBIT	82.8	77.8	92.6	119.4	135.7	87.9
<i>Network revenue growth</i>	10.3%	(3.5%)	9.4%	17.5%	10.6%	
<i>EBITDA growth</i>	16.0%	(10.1%)	12.9%	24.6%	12.2%	
<i>EBIT growth</i>	18.5%	(6.0%)	19.0%	28.9%	13.7%	
<i>EBITDA margin</i>	70.2%	65.4%	67.5%	71.6%	72.7%	75.9%
<i>EBIT margin</i>	52.3%	50.9%	55.4%	60.9%	62.6%	67.2%

Source: Envestra

Revenue and EBIT in this region have increased on average by 8.2% and 12.6% per annum respectively over the five years to FY13 while the number of consumers has grown by 1.8% per annum in the same period. In addition to increased connections and despite fluctuations in effective degree days, revenue over this period has been positively impacted by the 15.3% increase in network tariffs from 1 July 2011 and the real growth in tariffs allowed under the current access arrangement.

AEMO has estimated that mass market (retail) demand in this region will grow at a rate of 0.7% per annum to 2033. Envestra anticipates growth in the retail market to be focussed on areas north of Adelaide.

Victoria

Envestra's Victoria region encompasses

- one of the three gas distribution networks in Victoria. Envestra's network area covers northern, outer eastern and southern Melbourne, the Mornington Peninsula and regional areas such as Shepparton and Sale; and
- twelve short length gas transmission pipelines.

The Victorian distribution network (excluding Mildura) is regulated and the current five year regulatory period is from 1 January 2013 to 31 December 2017. An accelerated mains replacement program is currently underway to replace the remaining cast iron and unprotected steel mains in the network (approximately 4% of network). Envestra has also commenced expansion of the network into new areas near Merrifield, north west of Melbourne.

Gas is delivered to Envestra's Victorian distribution networks via the Victorian Transmission System (owned by APA Group). Demand for gas in Victoria comes from the retail and industrial markets and from power generators. Gas is used by the retail market in this region for heating, cooking and hot water. Envestra's major customers include the integrated energy companies Origin Energy, AGL Energy and EnergyAustralia, other energy retailers, power generators and industrial users.

⁴⁹ For the purposes of this analysis South Australia/Northern Territory includes Mildura.

⁵⁰ Effective degree days is a measure of coldness used to model daily gas demand (i.e. the weather relationship for demand for gas from the retail market).



The operating performance of Victoria is summarised below:

Victoria⁵¹ - Operating Performance (\$ millions)						
	Year ended 30 June					Six months ended
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	31 December 2013 actual
<i>Period end RAB (\$million)</i>	988	1,055	1,015	1,088	1,163	1,213
<i>Consumers (000s)</i>	536.2	550.1	565.3	580.5	593.9	600.3
<i>Effective degree days</i>	1,368	1,265	1,465	1,293	1,337	761
<i>Gas delivered (PJ)</i>	55.3	53.6	57.5	54.6	53.4	28.6
Network revenue	159.2	162.6	181.1	177.7	189.8	106.5
Operating costs	(46.6)	(50.4)	(53.9)	(55.3)	(63.8)	(31.9)
EBITDA	112.6	112.2	127.2	122.4	126.0	74.6
Depreciation and amortisation	(20.8)	(21.4)	(22.2)	(23.5)	(25.3)	(13.5)
EBIT	91.8	90.8	105.0	98.9	100.7	61.1
<i>Network revenue growth</i>	9.9%	2.1%	11.4%	(1.9)%	6.8%	
<i>EBITDA growth</i>	14.2%	(0.4)%	13.4%	(3.8)%	2.9%	
<i>EBIT growth</i>	20.2%	(1.1)%	15.6%	(5.8)%	1.8%	
<i>EBITDA margin</i>	70.7%	69.0%	70.2%	68.9%	66.4%	70.0%
<i>EBIT margin</i>	57.7%	55.8%	58.0%	55.7%	53.1%	57.4%

Source: Envestra

Despite fluctuations in the effective degree days, revenue and EBIT in this region have increased on average by 3.5% and 2.3% per annum respectively over the five years to FY13 broadly in line with the growth in the number of consumers (2.6% per annum) in the same period. As the latest regulatory decision was handed down later than expected, it had no impact on the results for FY13. However, under the decision the Victoria network tariffs increased by 2.3% from 1 July 2013 and will increase by around 5% each year thereafter during the current access arrangement.

AEMO estimates demand for gas in by the mass market (retail) in Victoria will increase by around 1.1% per annum to 2033. Envestra anticipates growth in the retail market to be focussed on areas north east of Melbourne.

Queensland

Envestra's Queensland region encompasses

- the regulated gas distribution network covering the northern parts of Brisbane and including Ipswich;
- the regulated gas distribution network in Rockhampton;
- the Wide Bay Pipeline from Gladstone to Bundaberg; and
- the unregulated gas distribution networks in Bundaberg, Maryborough and Hervey Bay.

The current five year regulatory period for the regulated assets in Queensland is from 1 July 2011 to 30 June 2016. An accelerated mains replacement program is currently underway to remove the remaining cast iron and unprotected steel mains in the network (approximately 6% of the network).

Gas is delivered to Envestra's Brisbane and Ipswich networks via the Roma to Brisbane Pipeline (owned by APA Group), the Gladstone and Rockhampton networks by the Queensland Gas Pipeline (owned by Jemena) and the Bundaberg, Maryborough and Hervey Bay networks by its own Wide Bay Pipeline. Demand for gas in Queensland comes from the retail and industrial markets and from power generators. Unlike Envestra's other regions gas is used by the retail

⁵¹ For the purposes of this analysis Victoria excludes Mildura.



market in this region primarily for cooking and hot water and not heating (therefore effective degree days is not a statistic used in reviewing operational performance). Envestra's major customers include the integrated energy companies Origin Energy and AGL Energy, other energy retailers, power generators and industrial users.

The operating performance of Queensland is summarised below:

Queensland - Operating Performance (\$ millions)						
	Year ended 30 June					Six months ended
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	31 December 2013 actual
<i>Period end RAB (\$million)</i>	278	292	319	336	358	373
<i>Consumers (000s)</i>	82.5	84.7	87.1	89.1	91.0	91.9
<i>Gas delivered (PJ)</i>	16.5	15.8	16.6	16.5	16.4	7.8
Revenue	57.6	59.4	60.3	70.7	75.2	41.5
Operating costs	(15.9)	(16.1)	(15.2)	(17.8)	(18.7)	(9.0)
EBITDA	41.7	43.3	45.1	52.9	56.5	32.5
Depreciation and amortisation	(8.0)	(8.1)	(8.2)	(8.2)	(7.5)	(3.9)
EBIT	33.7	35.2	36.9	44.7	49.0	28.6
<i>Network revenue growth</i>	16.4%	3.1%	1.5%	17.2%	6.4%	
<i>EBITDA growth</i>	23.4%	3.8%	4.2%	17.3%	6.8%	
<i>EBIT growth</i>	28.1%	4.5%	4.8%	21.1%	9.6%	
<i>EBITDA margin</i>	72.4%	72.9%	74.8%	74.8%	75.1%	78.3%
<i>EBIT margin</i>	58.5%	59.3%	61.2%	63.2%	65.2%	68.9%

Source: Envestra

Revenue and EBIT in this region have increased on average by 6.9% and 9.8% per annum respectively over the five years to FY13 while the number of consumers has grown by 2.5% per annum over the same period. In addition to increased connections, revenue over this period has been positively impacted by the 12.5% increase in network tariffs from 1 July 2011 and the real growth in tariffs allowed under the current access arrangement.

AEMO estimates overall demand for gas in Queensland will increase by 1.1% per annum over the period to 2033 with growth in mass market (retail) demand of around 2.4% per annum.

New South Wales

Envestra's New South Wales region encompasses

- the Albury gas distribution networks which is regulated with a current five year regulatory period 1 January 2013 to 31 December 2017; and
- the Wagga Wagga gas distribution network. Approximately 65% of this network is regulated with a current five year regulatory period of 1 July 2010 to 30 June 2015.

A mains replacement program is currently underway to replace the remaining cast iron and unprotected steel mains from these networks.

Gas is delivered to Envestra's New South Wales networks from a lateral pipeline off the Moomba Sydney Pipeline (owned by APA Group) and the New South Wales-Victoria Interconnector Pipeline (owned by APA Group). Demand for gas in New South Wales comes from the retail and industrial markets and from power generators. Gas is used by the retail market in this region for heating, cooking and hot water.

The operating performance of New South Wales is summarised below:



New South Wales - Operating Performance (\$ millions)						
	Year ended 30 June					Six months ended
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	31 December 2013 actual
<i>Period end RAB (\$million)</i>	33	34	96	98	100	101
<i>Consumers (000s)</i>	23.4	23.8	51.1	51.9	52.9	53.4
<i>Gas delivered (PJ)</i>	3.6	3.4	5.3	6.4	6.5	3.4
Revenue	7.1	7.5	15.8	24.0	25.6	14.2
Operating costs	(2.6)	(2.0)	(5.0)	(5.0)	(6.1)	(3.0)
EBITDA	4.5	5.5	10.8	19.0	19.5	11.2
Depreciation and amortisation	(1.1)	(1.1)	(2.7)	(3.9)	(4.0)	(2.1)
EBIT	3.4	4.4	8.1	15.1	15.5	9.1
<i>Network revenue growth</i>	7.6%	5.6%	110.7%	51.9%	6.7%	
<i>EBITDA growth</i>	(11.8)%	22.2%	96.4%	75.9%	2.6%	
<i>EBIT growth</i>	(17.1)%	28.2%	85.8%	86.4%	2.6%	
<i>EBITDA margin</i>	63.4%	73.3%	68.4%	79.2%	76.2%	78.9%
<i>EBIT margin</i>	47.9%	58.1%	51.3%	62.9%	60.5%	64.1%

Source: Envestra

The acquisition of the Wagga Wagga network in October 2010 doubled the number of consumers and the amount of gas delivered in this region. However, the margins contributed by this acquisition are higher than the Albury network, largely due to the RAB of the network and in part also due to the unregulated portion of the network. In addition, the current access arrangement for Albury was handed down later than expected and had no impact on the results for FY13. However, under the decision the Albury network tariffs have increased by 2.3% from 1 July 2013 and will increase by around 5% each year of the access arrangement.



5 Valuation of Envestra Limited

5.1 Summary

Envestra has been valued in the range \$1,994.4-2,373.4 million which corresponds to a value of \$1.11-1.32 per share. The valuation represents the estimated full underlying value of Envestra assuming 100% of the company was available to be acquired and includes a premium for control. The value exceeds the price at which, based on current market conditions, Grant Samuel would expect Envestra shares to trade on the ASX in the absence of a takeover offer.

The value for Envestra is the aggregate of the estimated market value of Envestra’s operating business and other assets less external borrowings and non-trading liabilities at 31 December 2013. The valuation is summarised below:

Envestra - Valuation Summary (\$ millions)			
	Report Section Reference	Value Range	
		Low	High
Business operations	5.3	4,027.0	4,378.0
Corporate cost savings	5.5	160.0	180.0
Other assets and liabilities	5.4	(64.9)	(56.9)
Enterprise value		4,122.1	4,501.1
Net borrowings	5.6	(2,127.7)	(2,127.7)
Value of equity		1,994.4	2,373.4
Fully diluted shares on issue (millions)		1,796.8	1,796.8
Value per share		\$1.11	\$1.32

The value attributed to Envestra’s business operations is an overall judgement having regard to discounted cash flow (“DCF”) analysis, the capitalisation of earnings or cash flows methodology and other measures commonly used in the energy infrastructure sector (i.e. multiples of regulated asset base). The specific factors taken into consideration in reaching this judgement are set out in Section 5.3 of this report.

It should be noted that Grant Samuel’s estimate of full underlying value:

- assumes elimination of all corporate costs;
- includes value for Envestra’s carried forward income tax losses; and
- is based on a discount rate range of 6.5-7.0%.

The value of Envestra includes a premium for control. Takeover premiums are typically in the range 20-35% depending on the individual circumstances. Synergies available to acquirers such as cost savings through merging operations are normally a significant factor in justifying their ability to pay a meaningful premium over market prices. In this case, direct synergies available to any acquirer of Envestra include all corporate costs (see Section 5.5).

The premia implied by Grant Samuel’s value range over the \$1.06 share price prevailing on 15 July 2013 (the day prior to the announcement of APA Group’s initial proposal) are in the range of 5-25%. In Grant Samuel’s opinion, these premiums, while lower than typically observed, are reasonable for Envestra. High premiums for control are not generally expected for listed businesses with gas distribution assets as:

- cash flows of gas distribution networks are stable and predictable with long run growth generally limited to economic growth and inflation and, as regulated assets, are reasonably transparent with a considerable level of publicly available information on revenues, volumes, operating costs and capital investment;



- distributions typically represent a substantial proportion of available cash flow;
- while there are likely to be some operating cost synergies, there is little opportunity for integration with other assets (particularly in revenue terms) and, therefore, there is limited scope for an acquirer to achieve synergies; and
- energy infrastructure entities are typically highly leveraged and, therefore, there is limited scope to enhance returns by increasing debt.

For these reasons, it is Grant Samuel's view that listed gas infrastructure assets trade on the ASX at close to full underlying value underpinned by distribution yield (and yield growth). This view is broadly confirmed by historical transaction evidence, except for the period 2005-2008 where there was a greater propensity to pay premiums above listed entity multiples (possibly due to the increased market interest in the investment class and the availability of leverage).

Grant Samuel's value range is wide (16-19%) reflecting the impact of financial leverage on the value of equity in Envestra. At the business operation level, the value range is only 8-9%.

The valuation range of \$1.11-1.32 per share exceeds Envestra's reported net tangible assets of \$0.13 as at 30 June 2013. This primarily relates to the difference resulting from the application of accounting standards in comparison to Grant Samuel's judgement as to the price that an acquirer may be willing to pay for Envestra.

5.2 Methodology

5.2.1 Overview

Grant Samuel's valuation of Envestra has been estimated by aggregating the estimated market value of its business operations together with the realisable value of non-trading assets and deducting external borrowings and non-trading liabilities. The value of the operating business has been estimated on the basis of fair market value as a going concern, defined as the maximum price that could be realised in an open market over a reasonable period of time assuming that potential buyers have full information.

The valuation of Envestra is appropriate for the acquisition of the company as a whole and, accordingly, incorporates a premium for control. The value is in excess of the level at which, under current market conditions, shares in Envestra could be expected to trade on the sharemarket. Shares in a listed company normally trade at a discount of 15-25% to the underlying value of the company as a whole (but this discount does not always apply).

The most reliable evidence as to the value of a business is the price at which the business or a comparable business has been bought and sold in an arm's length transaction. In the absence of direct market evidence of value, estimates of value are made using methodologies that infer value from other available evidence. There are four primary valuation methodologies that are commonly used for valuing businesses:

- capitalisation of earnings or cash flows;
- discounting of projected cash flows;
- industry rules of thumb; and
- estimation of the aggregate proceeds from an orderly realisation of assets.

Each of these valuation methodologies has application in different circumstances. The primary criterion for determining which methodology is appropriate is the actual practice adopted by purchasers of the type of business involved.

Nevertheless, valuations are generally based on either or both discounted cash flow or multiples of earnings and Grant Samuel has had regard to both methodologies in the valuation of Envestra. In addition, some weight has also been given to the implied



multiples of regulated asset base (“RAB”) which is the value of the fixed assets set by the AER as the basis for determining tariffs.

5.2.2 Discounted Cash Flow

Discounting of projected cash flows has a strong theoretical basis. It is the most commonly used method for valuation in a number of industries, including resources and energy infrastructure, and for the valuation of start-up projects where earnings during the first few years can be negative but it is also widely used in the valuation of established industrial businesses. DCF valuations involve calculating the net present value of projected cash flows. This methodology is able to explicitly capture depleting resources, development projects and fixed terms contracts (which are typical in the resources and energy infrastructure sectors), the effect of a turnaround in the business, the ramp up to maturity or significant changes expected in capital expenditure patterns. The cash flows are discounted using a discount rate which reflects the risk associated with the cash flow stream.

Considerable judgement is required in estimating future cash flows and it is generally necessary to place great reliance on medium to long term projections prepared by management. The discount rate is also not an observable number and must be inferred from other data (usually only historical). None of this data is particularly reliable so estimates of the discount rate necessarily involve a substantial element of judgement. In addition, even where cash flow forecasts are available, the terminal or continuing value is usually a high proportion of value. Accordingly, the multiple used in assessing this terminal value becomes the critical determinant in the valuation (i.e. it is a “de facto” cash flow capitalisation valuation).

The net present value is typically extremely sensitive to relatively small changes in underlying assumptions, few of which are capable of being predicted with accuracy, particularly beyond the first two or three years. The arbitrary assumptions that need to be made and the width of any value range mean the results are often not meaningful or reliable. Notwithstanding these limitations, DCF valuations are commonly used and can at least play a role in providing a check on alternative methodologies, not least because explicit and relatively detailed assumptions as to expected future performance need to be made.

A financial model of the operating business has been developed by Grant Samuel based on the long term cash flow models prepared by Envestra. The model allows the key drivers of revenue, operating costs and capital expenditure to be modelled. The model is based on a large number of assumptions and is subject to significant uncertainty and contingencies, many of which are outside the control of Envestra. A number of different scenarios have been developed and analysed to reflect the impact on value of various key assumptions relating to revenue, operating costs, capital expenditure and other factors. The financial model is discussed in more detail in Section 5.3.2 of this report.

5.2.3 Capitalisation of Earnings or Cash Flows

Capitalisation of earnings or cash flows is the most commonly used method for valuation of industrial businesses. This methodology is most appropriate for industrial businesses with a substantial operating history and a consistent earnings trend that is sufficiently stable to be indicative of ongoing earnings potential. This methodology is not particularly suitable for start-up businesses, businesses with an erratic earnings pattern or businesses that have unusual capital expenditure requirements. This methodology involves capitalising the earnings or cash flows of a business at a multiple that reflects the risks of the business and the stream of income that it generates. These multiples can be applied to a number of different earnings or cash flow measures including EBITDA, EBIT or net profit after tax. These are referred to respectively as EBITDA multiples, EBIT multiples and price earnings multiples. Price earnings multiples are commonly used in the context of the sharemarket. EBITDA and EBIT multiples are more commonly used in valuing whole businesses for



acquisition purposes where gearing is in the control of the acquirer but are also used extensively in sharemarket analysis.

Application of this valuation methodology involves:

- estimation of earnings or cash flow levels that a purchaser would utilise for valuation purposes having regard to historical and forecast operating results, non-recurring items of income and expenditure and known factors likely to impact on operating performance; and
- consideration of an appropriate capitalisation multiple having regard to the market rating of comparable businesses, the extent and nature of competition, the time period of earnings used, the quality of earnings, growth prospects and relative business risk.

The choice between parameters is usually not critical and should give a similar result. All are commonly used in the valuation of industrial businesses. EBITDA can be preferable to EBIT if depreciation or non-cash charges distort earnings or make comparisons between companies difficult. On the other hand, EBIT can better adjust for differences in relative capital expenditure intensity.

Determination of the appropriate earnings multiple is usually the most judgemental element of a valuation. Definitive or even indicative offers for a particular asset or business can provide the most reliable support for selection of an appropriate earnings multiple. In the absence of meaningful offers it is necessary to infer the appropriate multiple from other evidence.

The primary approach used by valuers is to determine the multiple that other buyers have been prepared to pay for similar businesses in the recent past. However, each transaction will be the product of a unique combination of factors, including:

- economic factors (e.g. economic growth, inflation, interest rates) affecting the markets in which the company operates;
- strategic attractions of the business - its particular strengths and weaknesses, market position of the business, strength of competition and barriers to entry;
- rationalisation or synergy benefits available to the acquirer;
- the structural and regulatory framework;
- investment and sharemarket conditions at the time; and
- the number of competing buyers for a business.

A pattern may emerge from transactions involving similar businesses with sales typically taking place at prices corresponding to earnings multiples within a particular range. This range will generally reflect the growth prospects and risks of those businesses. Mature, low growth businesses will, in the absence of other factors, attract lower multiples than those businesses with potential for significant growth in earnings.

An alternative approach in valuing businesses is to review the multiples at which shares in listed companies in the same industry sector trade on the sharemarket. This gives an indication of the price levels at which portfolio investors are prepared to invest in these businesses. Share prices reflect trades in small parcels of shares (portfolio interests) rather than whole companies and it is necessary to adjust for this factor. To convert sharemarket data to meaningful information on the valuation of companies as a whole, it is market practice to add a "premium for control" to allow for the premium which is normally paid to obtain control through a takeover offer. This premium is typically in the range 20-35%.

The premium for control paid in takeovers is observable but caution must be exercised in assessing the value of a company or business based on the market rating of comparable companies or businesses. The premium for control is an outcome of the valuation process, not a determinant of value. Premiums are paid for reasons that vary from case to case and may be substantial due to synergy or other benefits available to the acquirer. In other situations



premiums may be minimal or even zero. It is inappropriate to apply an average premium of 20-35% without having regard to the circumstances of each case. In some situations there is no premium. There are transactions where no corporate buyer is prepared to pay a price in excess of the prices paid by institutional investors through an initial public offering.

Acquisitions of listed companies in different countries can be analysed for comparative purposes, but it is necessary to give consideration to differences in overall sharemarket levels and ratings between countries, economic factors (economic growth, inflation, interest rates) and market structures and the regulatory framework. It is not appropriate to adjust multiples in a mechanistic way for differences in interest rates or sharemarket levels.

The analysis of comparable transactions and sharemarket prices for comparable companies will not always lead to an obvious conclusion as to which multiple or range of multiples will apply. There will often be a wide spread of multiples and the application of judgement becomes critical. Moreover, it is necessary to consider the particular attributes of the business being valued and decide whether it warrants a higher or lower multiple than the comparable companies. This assessment is essentially a judgement.

5.2.4 Industry Rules of Thumb

Industry rules of thumb are commonly used in some industries. These are generally used as a “cross check” of the result determined by a capitalised earnings valuation or by discounting cash flows. While they are only used as a cross check in most cases, industry rules of thumb can be the primary basis on which buyers determine prices in some industries. In the case of energy infrastructure businesses a common rule of thumb parameter is the multiple of RAB. However, it should be recognised that rules of thumb are usually relatively crude and prone to misinterpretation.

5.2.5 Net Assets/Realisation of Assets

Valuations based on an estimate of the aggregate proceeds from an orderly realisation of assets are commonly applied to businesses that are not going concerns. They effectively reflect liquidation values and typically attribute no value to any goodwill associated with ongoing trading. Such an approach is not appropriate in Envestra’s case.

5.3 Value of Business Operations

5.3.1 Overview

Grant Samuel estimates the value of Envestra’s business operations to be in the range \$4,027-4,378 million.

The value range is the aggregate of the values attributed by Grant Samuel to each of Envestra’s operating regions and includes a value for carried forward income tax losses. The individual values have not been disclosed in this report but represent overall judgements having regard to DCF analysis and multiples analysis (EBITDA and RAB) for each region. The primary focus was on the DCF analysis. The value ranges selected are judgements derived through an iterative process. The objective is to determine a value that is both consistent with the market evidence as to multiples and fits with the output of the DCF analysis in terms of the various cases and their likelihood.

5.3.2 DCF Analysis

A DCF Model has been developed by Grant Samuel based on financial models prepared by Envestra. Grant Samuel has made adjustments to the financial models to reflect its judgement on certain matters.

The DCF Model projects nominal after tax cash flows from 31 December 2013 to 30 June 2034 (a period of 20.5 years) by operating region, with a terminal values calculated to



represent the value of cash flows in perpetuity (by capitalising net after tax cash flows based on a perpetual growth assumption). Net present values are calculated on an ungeared after tax discount rate (weighted average cost of capital) in the range 6.5-7.0%⁵². Appendix 3 sets out a detailed analysis of the selection of these discount rates. A corporate tax rate of 30% has been assumed but the DCF analysis takes into account the benefit of utilising existing carried forward tax losses (over the first four and a half years).

The DCF Model allows revenue, operating costs and capital expenditure to be modelled by region. Regulated revenue is sourced from regulatory models for the Victorian, South Australian, Queensland, Wagga Wagga (New South Wales) and Albury (New South Wales) assets and adjusted to reflect Envestra’s views. Unregulated revenue has been assumed to grow at inflation (2.5%). The base DCF Model assumes the business operations continue on an “as is” basis reflecting Envestra’s estimate of future regulatory returns (referred to in this report as “Case A”). The key general and specific operational assumptions underlying Case A are set out in Appendix 2.

Case A is based on a number of assumptions many of which are outside the control of Envestra. Expected gas volume varies between regions and reflects factors such as population growth, economic growth, volume usage per customer, gas connections and weather patterns⁵³. However, the interaction of these factors is reflected in the gas volumes assumed by the AER in the tariff determination process for each network. To the extent actual gas volume is different to that assumed by the AER, Envestra’s revenue will be higher or lower than assumed in the access arrangements. However, under or over performance will only occur until the regulatory assumptions are reset at the next determination date. If under performance occurs, Envestra has the ability to manage capital expenditure and, to a lesser degree, operating costs. Over performance (i.e. higher volumes) will be a benefit to Envestra but is unlikely to continue into the next determination period.

As a consequence, modelling the factors driving gas volumes is not meaningful. In the medium and longer term, Envestra’s revenue will reflect the allowed regulatory revenue derived from the rate of return on the regulated asset base that the AER determines to be appropriate. A sustained change in gas volumes would be taken into consideration by the AER in its determination of future tariffs. Similarly, longer term regulatory operating expenses and capital expenditure will reflect the AER’s view of market factors, including gas volumes. Consequently, as over 90% of Envestra’s revenue is derived from assets subject to full regulation, the largest uncertainty for future cash flows is the outcome of the AER determinations.

Accordingly, Grant Samuel has analysed the DCF Model to examine the sensitivity of the NPV outcomes to changes in the following variables:

- the regulatory rate of return assumed in the periods beyond the current access arrangements. Envestra’s current access arrangements are as follows:

Envestra – Current Access Arrangements		
Region	Regulatory Rate of Return	Reset Date
South Australia/Northern Territory	10.28%	1 July 2016
Victoria	7.39%	1 January 2018
Queensland	10.28%	1 July 2016
New South Wales (Albury)	7.39%	1 January 2018
New South Wales (Wagga Wagga)	9.72%	1 July 2015

⁵² The evidence set out in Appendix 3 indicates that discount rates in the range of 6.5-8.0% would be plausible for this DCF analysis in current market conditions. However, in order to ensure that the fairness assessment for the Proposal is robust, discount rates in the range of 6.5-7.0% have been adopted (i.e. the NPVs are higher than if a higher discount rate was adopted).

⁵³ Weather impacts (as measured by the movements in the number of degree days) are short term fluctuations in revenue. To the extent there is a sustained change in weather patterns it would be captured in future regulatory decisions.

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Although Envestra puts forward submissions to the AER, the ultimate decision regarding the rate of return it is allowed to earn on its regulated assets, allowable costs and pass-through capital expenditure, lies with the AER. Grant Samuel has chosen to review this variable by changing the regulatory rate of return for future determination periods to cover a range of possible outcomes, consistent with current market conditions and the AER’s guidelines. Case A assumes a 7.58% rate of return⁵⁴ beyond the current access arrangements based on the AER’s guidelines. For the purposes of this sensitivity analysis, rates of 7.1%⁵⁵ and 8.1%⁵⁶ have been reviewed⁵⁷;

- a scaling back in the operating expenditure outperformance currently assumed by Envestra. Case A reflects outperformance on the allowed operating expenditure of an “efficient provider”. There is a risk that this situation may not continue in the future, and has been modelled by increasing cash operating expenditure by 1% (relative to Envestra’s assumption); and
- the gamma (which determines the allowable tax value of imputation credits) to be applied in the period beyond the current regulatory arrangements. Many participants have different views as to the appropriate gamma that should be applied by the AER. In this case, Grant Samuel has decreased the gamma from 0.5 to 0.25.

Each scenario assumes Case A as the starting point. A description of each scenario is outlined in the table below.

Envestra – Summary of DCF Scenarios	
Case	Description
A	Envestra networks on an “as is” basis as described in Appendix 2
B	Case A with a regulatory rate of return of 8.1% beyond the current regulatory periods
C	Case A with a regulatory rate of return of 7.1% beyond the current regulatory periods
D	Case A with a 1% increase in the annual forecast cash operating expenditure
E	Case A with a regulatory gamma of 0.25 beyond the current regulatory period

Grant Samuel has selected discount rates in the range 6.5-7.0%. However, as discussed in Appendix 3, there is considerable uncertainty as to the discount rates that an acquirer would apply in current market conditions. Therefore, Grant Samuel has also reviewed each of the above scenarios across a range of discount rates.

The output of the DCF analysis for a range of discount rates is summarised below:

Envestra – NPV Outcomes (\$ millions)					
Case	Discount Rate				
	6.0%	6.5%	7.0%	7.5%	8.0%
A	5,038	4,381	3,877	3,480	3,157
B	5,404	4,694	4,150	3,721	3,373
C	4,674	4,069	3,605	3,239	2,942
D	5,013	4,359	3,858	3,462	3,141
E	5,142	4,469	3,954	3,547	3,217

⁵⁴ Calculated as: $(R_e \times E/V) + (R_d \times D/V)$, where R_e (the cost of equity) is calculated as $(R_f + (\text{Beta} \times (R_m - R_f))) = (4.26\% + (0.7 \times 6.50\%)) = 8.81\%$ and R_d (the cost of debt) is calculated as $(R_f + \text{debt risk premium}) = (4.26\% + 2.5\%) = 6.76\%$. The gearing (D/V) is 60% and therefore E/V is 40%. The effects of the interest tax shield and gamma (the implied value of imputation credits) are separately taken into account by the AER to derive regulatory revenue and not specifically in the stated rate of return.

⁵⁵ Calculated as: risk free rate of 4.8%, market risk premium of 6.5%, equity beta of 0.7, gearing of 60% and debt risk premium of 2.5%.

⁵⁶ Calculated as: risk free rate of 3.8%, market risk premium of 6.5%, equity beta of 0.7, gearing of 60% and debt risk premium of 2.5%.

⁵⁷ It should be noted that the regulatory rate of return is not the same as the discount rate used by Grant Samuel as they are calculated on different bases (i.e. the tax shield is calculated differently). Assuming the same parameters underlying the 7.58% regulatory rate of return (see footnote 54) and the approach adopted in Appendix 3 would result in a discount rate of 6.4%.

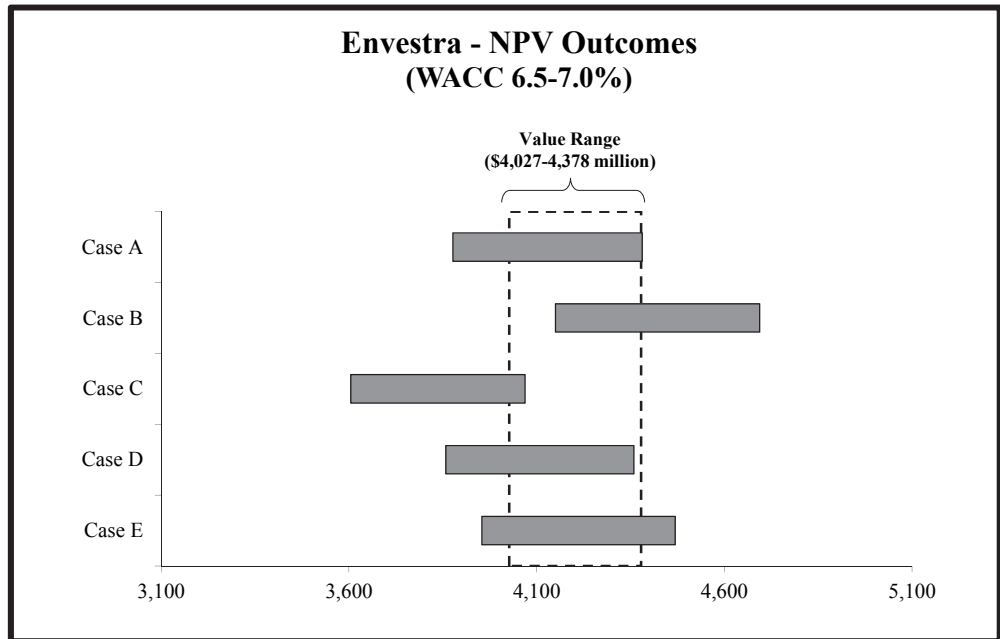


As with any long term projections, there are inherent uncertainties about future events and outcomes and, as shown above, small changes in certain assumptions can have disproportionate impacts on the calculated values. In this regard, the scenario analysis does not fully take into account the operational flexibility that management has to react to changes in markets in which Envestra operates. However, as over 90% of its revenue is regulated, Envestra's ability to react to market changes is somewhat limited. Nonetheless, Envestra has full control over the actual level of capital expenditure spent and in the past has responded to changing market conditions by curtailing this expenditure. Envestra also has some control over the timing and nature of its operating expenses and may choose to vary these under certain market conditions. However, the primary downside risk for Envestra lies with unfavourable regulatory rate of return decisions.

As discussed above, net present values from DCF analyses are subject to significant limitations and should always be treated with considerable caution. The following factors are relevant to consideration of the above NPV outcomes:

- relatively small changes in assumptions regarding the regulatory rate of return can have a large impact on cash flow and therefore NPV outcomes. While the AER's new guidelines on rates of return is useful and allows flexibility for the actual regulatory outcomes, market conditions are uncertain. Grant Samuel has reviewed a range of regulatory rates of returns that are reasonable in current market conditions but the actual outcomes may be significantly different to the range considered;
- Case A reflects the rates of return in current regulatory periods with the regulatory rate of return reverting to 7.58% for all periods thereafter (having regard to the AER's current guidelines). Case B and C present NPV outcomes under future regulatory rates of return of 7.1% and 8.1% respectively. In each case it is assumed that the rate of return adopted after the current access arrangement period remains constant indefinitely. This is unlikely to occur and there will be fluctuations over time;
- the scenarios have been reviewed across a range of discount rates but the long term regulatory rate of return is not independent of the discount rate that an acquirer would apply in assessing the value of the assets. As the regulatory rate of return and the discount rate are based on common factors, it is reasonable to expect that high rates of return would mean high discount rates are appropriate (and vice versa);
- it is unlikely that if market conditions improve, future regulatory rates of return will be as high as those determined for the South Australian/Queensland access arrangements in 2011 (10.28%);
- changes in operating expenditure have a limited impact on NPV and, although it is possible that Envestra may underperform its targeted operating expenditure by more than the 1% shown in Case D, the impact on NPV would not be expected to be significant compared with the impact of other operational variables;
- Envestra effectively controls when and how much capital expenditure will be spent. The capital expenditure planned over the next four years is significant, as it includes the accelerated mains replacement programmes in South Australia, Victoria and Queensland. This expenditure has an upfront negative impact on cash flow while the benefits of the expenditure are derived over the long term in the form of increased tariffs and decreased operating costs. Deferral of this capital outlay would have an impact on the NPV outcomes but is unlikely to be material; and
- the terminal values represents around 45-50% of NPV under all cases.

Grant Samuel's selected value range of \$4,027-4,378 million for Envestra's business operations reflects a subjective balancing of the cases and a view that the appropriate discount rate to apply is 6.5-7.0%. This is depicted diagrammatically below:



The range of NPV outcomes produced by the cases highlights the impact that regulatory decisions on rates of returns have on value. The bottom end of Grant Samuel's value range is above the bottom end of Case A and at the top end of Case C. In comparison, the top end of Grant Samuel's value range is towards the midpoint of Case B. This result is appropriate as the regulatory rate of return is likely to rise above 7.58% on average in the long term as market conditions (particularly interest rates) revert to longer term norms. Increased operating costs and a decrease in the gamma have a lesser impact on NPV and are captured in Grant Samuel's value range. It should also be noted that the value range is the aggregate of the values selected for each of the regions, all of which have different levels of regulated and unregulated revenue, future capital expenditure and potential growth.

5.3.3 Multiples Analysis

Grant Samuel's selected value ranges by region have been reviewed having regard to the multiples of EBITDA and RAB for comparable listed entities and for transactions involving selected energy infrastructure assets.

Although EBIT multiples have also been analysed in Appendix 4, they are not presented in the table below as the most common metric for energy infrastructure businesses is EBITDA multiples which remove the distortion of differences in depreciation and amortisation charges between entities.

Transaction Evidence

The following table sets out the EBITDA multiples implied by transactions involving the acquisition of selected energy infrastructure assets since 2003:

Recent Transaction Evidence – Gas Transmission and Distribution in Australia					
Date	Asset/Entity Acquired	Regulation ⁵⁸	Consideration (millions)	EBITDA Multiple (times)	
				Historical	Forecast
Gas Distribution					
Dec 11	Allgas Network	F	\$540	15.0	14.4
Jul 11	WA Gas Networks	F	\$312	12.5	10.3
Jun 11	Multinet Gas (20.1%)	F	\$149	7.9	7.9
Oct 10	Country Energy Gas Networks	F	\$109	na	11.3
Apr 07	Envestra (17.2%)	F	\$990	12.7	13.1
Oct 06	Allgas Energy Pty Ltd	F	\$521	na	18.1
Gas Transmission					
Apr 13	Moomba Adelaide Pipeline	U	\$401	10.8	10.8
Aug 12	HDUF (Epic Energy)	U	\$1,385	26.2	17.7
Jul 11	Tasmanian Gas Pipeline	U	\$200	11.0	na
Jul 11	Dampier Bunbury Pipeline (20%)	F	\$840	9.6	9.2
Jun 11	Amadeus Gas Pipeline	F	\$63	2.6	4.2
Nov 10	SEA Gas Pipeline (33.4%)	U	\$278	na	10.9
Mar 10	Berwyndale to Wallumbilla Pipeline	U	\$83	na	32.9
Aug 08	Central Ranges Pipeline	F	\$24	na	32.2
Jun 08	North Queensland Gas Pipeline	U	\$202	na	na
Apr 07	SEA Gas Pipeline (33.3%)	U	\$400	na	14.5
Nov 06	Alinta Infrastructure Holdings	F/U	\$956	14.3	14.5
Aug 06	GasNet Australia Group	F/U	\$452	13.9	13.3
Feb 05	Carpentaria Gas Pipeline (30%)	L	\$327	na	na
Aug 04	Dampier to Bunbury Natural Gas Pipeline	F	\$1,860	na	11.1
Aug 04	Southern Cross Pipelines (45%)/Parmelia Gas (100%)	F	\$206	8.3	na
Apr 04	Epic Energy	U	\$ ⁻⁵⁹	8.2	8.8
Mar 04	Duke Energy Australian and New Zealand assets	F/U	\$1,690	17.0	15.5
Energy Infrastructure					
May 13	SP AusNet (19.9%)	F	\$4,141	9.1	8.6
May 13	SPI (Australia) Assets Pty Ltd (60%)	F/U	\$8,714	12.2	na
Nov 12	ElectraNet (41.1%)	F	\$1,217	9.8	na
Dec 08	Various energy infrastructure assets of APA Group	F/U	\$165	na	10.6
May 07	Alinta Limited	F/U	\$8,041	15.4	14.5
Apr 06	AGL Infrastructure Assets	F/U	\$6,500	13.0	12.6

Source: Grant Samuel analysis (see Appendix 4).

Further details on these transactions are set out in Appendix 4.

The following factors are relevant to consideration of the transaction evidence:

- in the period 2005 to 2008 there was an increase in the multiples paid for gas infrastructure assets in Australia due to competition for the available assets as the Eastern Pipeline System developed and sector consolidation occurred. Since the commencement of the global economic downturn in 2007, multiples paid have moderated;
- the number of transactions involving gas distribution assets since 2007 is limited but indicate prospective multiples in the range of 10-14 times EBITDA for 100% interests in assets. APA Group's divestment of the Allgas Network occurred at a forecast EBITDA multiple of 14.4 times and a RAB multiple of 1.24 times. This transaction is an outlier for gas distribution assets in terms of EBITDA multiples but the RAB multiples are in line with other evidence. The reason for this discrepancy is unclear

⁵⁸ F = full regulation; L = light regulation; U = unregulated

⁵⁹ Equity consideration paid was nominal (\$4) and \$662 million of borrowings were assumed (i.e. gross consideration of \$662 million).



but it is noted the APA Group divested this asset into an unlisted entity in which it holds a 20% interest and it remains operator of the network under a long term contract. Excluding this transaction the implied multiples fall in the range of 10-11 times EBITDA;

- although the acquisition of a 20.1% interest increased DUET Group’s interest in Multinet Gas to 100%, it was an acquisition of a minority interest and is unlikely to include a full premium for control. Further, it was undertaken as part of wider transaction undertaken to simplify ownership structures of Australian gas utilities businesses (WA Gas Networks, Multinet Gas and Dampier Bunbury Pipeline) and, accordingly, multiples of individual components may be less meaningful;
- the transactions generally involve interests in single assets rather than portfolios of assets. The exception in recent times is APA Group’s acquisition of HDUF which involved an extensive unregulated, strategically located pipeline system;
- multiples paid for unregulated gas transmission assets appear marginally higher than for regulated gas distribution assets. In this regard, HDUF was a strategic acquisition with earnings to emerge following substantial capital expenditure (by forecast year three the multiples implied by the transaction decline to around 11 times) and involved a competitive bidding process and the sale of Moomba Adelaide Pipeline was required by the ACCC to allow APA Group’s takeover of HDUF;
- APA Group has been highly active both in acquiring and divesting pipeline assets as its business model and asset portfolio have evolved, particularly on the east coast. Other transactions primarily involve existing owners increasing their interests (e.g. SEA Gas Pipeline in November 2010) or the divestment of assets by owners under financial distress (e.g. the sale of a 20% interest in Dampier Bunbury Pipeline and the Tasmanian Gas Pipeline by AET&D Holdings No 2. Pty Ltd);
- transactions involving both gas transmission infrastructure and other energy assets (e.g. the acquisition of APA Group assets by unlisted investment vehicle Energy Infrastructure Investments Pty Limited (“EII”) and the acquisition of Alinta Infrastructure Holdings) will have multiples that represent a blend of businesses; and
- the recent transactions involving electricity assets (SP AusNet and ElectraNet) are acquisitions of minority interests but, in both instances, the acquirer was State Grid which is building a portfolio of energy infrastructure assets in Australia. In this regard, it also acquired a 60% interest in SPIAA in 2013.

Sharemarket Evidence

The following table sets out the implied EBITDA multiples for a range of listed comparable entities based on share prices as at 28 February 2014:

Sharemarket Ratings of Listed Entities – Energy Transmission and Distribution					
Company	Market Capitalisation (millions)	EBITDA Multiple (times)			
		Historical	Forecast Year 1	Forecast Year 2	Forecast Year 3
<i>Australia - Gas</i>					
APA Group (standalone)	A\$5,583	14.4	13.0	11.7	10.8
DUET Group	A\$2,749	10.7	10.7	10.0	9.8
<i>Australia - Electricity</i>					
SP AusNet	A\$4,487	9.8	9.9	9.5	na
Spark	A\$2,269	8.2	8.1	8.8	na
<i>New Zealand</i>					
Vector	NZ\$2,430	7.9	8.6	8.5	8.3

Source: Grant Samuel analysis (see Appendix 4).

A detailed analysis of these entities is set out in Appendix 4.



The following factors are relevant to consideration of the comparable entity multiples:

- the multiples for the listed entities are based on share prices and therefore do not include a premium for control;
- APA Group has been presented on a standalone basis (excluding any allowance in earnings for the potential acquisition of Envestra). APA Group's near term multiples are high reflecting the earnings expected to emerge from the HDUF assets acquired in 2012, multiples decline to around 11 times in Forecast Year 3 (FY16);
- although none of the entities is directly comparable to Envestra they generally exhibit characteristics and value drivers similar to Envestra's gas distribution networks. The least comparable is APA Group which, although focussed on the gas sector, is primarily an owner and operator of unregulated gas transmission pipelines and provider of energy infrastructure services to third parties (rather than an owner of regulated distribution networks). In relation to the other entities the following should be noted:
 - DUET Group owns 100% of Multinet Gas (gas distribution in Victoria), a 66% interest in United Energy (electricity distribution in Victoria) and an 80% interest in Dampier Bunbury Pipeline (gas transmission in Western Australia), all of which are regulated assets (although Dampier Bunbury Pipeline's revenue is based on commercial contracts and not regulatory decisions);
 - Spark Infrastructure Group ("Spark") owns 49% interests in each of Victoria Power Network (Citipower and Powercor electricity distribution networks in Victoria) and SA Power Networks (electricity distribution in South Australia), all of which are regulated assets;
 - SP AusNet owns Victoria's primary electricity transmission network, an electricity distribution network located in eastern Victoria and a gas distribution network located in central and western Victoria, all of which are regulated; and
 - Vector Limited ("Vector") owns and manages a portfolio of energy infrastructure networks in New Zealand including electricity distribution (approximately 55% of EBITDA), gas transmission (25%), gas distribution (9%) and electricity and gas metering installations and telecommunications (11%). Vector has a restricted free float, with Auckland Energy Consumer Trust holding a 75.1% interest;
- all of the entities are internally managed, except SP AusNet to which a subsidiary of Singapore Power provides funds and asset management services (although SP AusNet intends to terminate this agreement by 30 September 2015). Externally managed entities are often discounted by investors because of perceived conflicts of interest and cost overlays (but it depends on the circumstances); and
- electricity distribution and transmission is generally more capital intensive than gas distribution or transmission and therefore the EBITDA multiples for SP AusNet and Spark (prospective EBITDA multiples of 8-9 times) are lower than for the gas entities (over 10 times prospective EBITDA).

RAB Multiples

A common rule of thumb parameter used in the valuation of energy infrastructure assets is RAB multiples⁶⁰. The RAB (or regulated asset base) is determined by the relevant regulator using concepts such as depreciated optimised replacement cost to determine an appropriate investment value for the asset (for its current and forecast workload). This investment base is then combined with a determination of the appropriate return on capital (usually a weighted average cost of capital) to develop a tariff structure designed to deliver that return over the regulatory period.

Theoretically, listed infrastructure entities should trade at, and assets should be acquired at, 1.0 times RAB. However, that does not occur and, in fact, most assets generally trade at a

⁶⁰ Represents enterprise value (i.e. business value before debt) divided by RAB.



premium to RAB. The precise reasons for this are uncertain but contributing factors probably include:

- expectations of volume growth above the levels used by regulators (at least until the next regulatory reset);
- expectations of savings relative to the level of operating and capital costs assumed by regulators;
- a cost of capital less than that assumed by regulators. Reasons for this might include:
 - benefits from tax efficient structuring;
 - the benefits of diversification. Most of the listed entities own a number of different assets which dilutes the exposure to any one asset in terms of operating and regulatory risks. Regulators only calculate the cost of capital for individual assets rather than a portfolio of assets (although theoretically there should be no difference);
 - use of higher levels of gearing than regulators assume (60%). The analysis in Appendix 3 indicates a number of entities (DUET Group, Spark) have gearing levels closer to 70%; and
 - long term funding at rates lower than current or expected regulatory determinations;
- growth options that may be available to an entity and reflected in its market capitalisation; and
- profit streams from other businesses (although these should be backed out in any analysis).

The RAB multiples implied by acquisitions of regulated energy infrastructure assets in Australia since 2003 (for which sufficient information is available to do so) are set out below. This data should also be treated with caution:

Recent Transaction Evidence – RAB Multiples		
Date	Entity/Asset Acquired	RAB Multiple (times)
<i>Gas Distribution</i>		
Dec 11	Allgas Network	1.23
Jul 11	WA Gas Networks	1.20
Jun 11	Multinet Gas (20.1%)	1.13
Oct 10	Country Energy Gas Networks	1.25
Apr 07	Envestra (17.2%)	1.50
Oct 06	Allgas Energy Pty Ltd	1.64
<i>Gas Transmission</i>		
Jul 11	Dampier Bunbury Pipeline (20%)	0.95
Jun 11	Amadeus Gas Pipeline	0.68
Aug 08	Central Ranges Pipeline	0.45
Aug 06	GasNet Australia Group	2.19 ⁶¹
Aug 04	Dampier to Bunbury Natural Gas Pipeline	1.20
Aug 04	Southern Cross Pipelines (45%) and Parmelia Gas (100%)	1.47
<i>Energy Infrastructure</i>		
May 13	SP AusNet (19.9%)	1.17
Nov 12	ElectraNet (41.1%)	1.32
Dec 06	DirectLink	1.45
Apr 06	AGL Infrastructure Assets	1.41-1.52
Mar 06	Murraylink	1.47

Source: Grant Samuel analysis (see Appendix 4)

⁶¹ RAB multiple is 1.64 times if adjusted for unregulated assets which are assumed to represent approximately 25% of enterprise value.



The transactions show a diversity of RAB multiples and have moderated since 2007. In any event, the evidence certainly indicates that acquirers are prepared to pay multiples in excess of 1.0 times RAB for regulated assets generally and at least 1.2 times for gas distribution assets.

Summarised below are RAB multiples for those listed entities which have a relatively high proportion of regulated revenue and for which meaningful RAB multiples can be calculated from publicly available information:

Selected Listed Entities – RAB Multiples	
Company	RAB Multiple (times)
APA Group	nmf ⁶²
DUET Group	1.30
SP AusNet	1.31
Spark	1.43
Vector	1.47

Source: Grant Samuel analysis (see Appendix 4).

Some caution is necessary in relying on this data as it is difficult to isolate the full effects of other activities and to determine what adjustments may be necessary.

Summary of Market Evidence

Recent market evidence indicates that a difference has emerged in the market pricing for the electricity and gas infrastructure sectors (as can be observed in the sharemarket ratings). Evidence also indicates that pricing differs between gas transmission and distribution assets, possibly reflecting lower capital intensity for transmission assets and that gas distribution assets are regulated while most gas transmission pipelines are not.

In broad terms, recent transaction evidence implies multiples of 10-11 times prospective EBITDA for gas distribution networks and RAB multiples in excess of 1.2 times. However, the transaction evidence is limited (particularly since 2007) and generally reflects single network assets rather than portfolios of assets (albeit that the networks remain effectively “ring fenced”).

In contrast, the listed gas infrastructure entities own portfolios of assets. These entities are trading around 10 times prospective EBITDA (with APA Group trading at premium multiples of 11-12 times reflecting its blend of activities and the earnings to emerge from HDUF’s assets in the period to FY16). Indeed, prior to the announcement of APA Group’s initial proposal, Envestra was trading around 10 times prospective EBITDA (see Appendix 4). Including a premium for control, the multiples would be higher. However, any such premium for control is unlikely to be substantial for the reasons discussed in Section 5.1 (i.e. as gas infrastructure assets have stable cash flows, are reasonably transparent and there are limited operating cost synergies). In any event, the effective premium for control at the EBITDA level will be diluted by relatively high gearing.

The RAB multiples implied by the trading of listed energy infrastructure entities are not dissimilar to the 1.4 times that Envestra was trading prior to the announcement of the initial proposal (see Appendix 4). This compares to the transaction evidence that implies RAB multiples of around 1.2 times for single gas distribution networks.

⁶² nmf = not meaningful. Only 25% of APA Group’s revenue is derived directly from regulated revenue.



Comparison of Value of Envestra to Market Evidence

Grant Samuel’s value range of \$4,027-4,378 million for Envestra’s operations implies the following multiples of EBITDA and RAB:

Envestra – Implied Valuation Parameters			
	Variable (\$ million)	Value Range	
		Low	High
Value Range (\$ million)		4,027	4,378
Multiple of EBITDA (times)⁶³			
FY13 (actual)	359.6	11.2	12.2
FY14 (broker consensus)	401.0	10.0	10.9
FY15 (broker consensus)	414.1	9.7	10.6
FY16 (broker consensus)	433.2	9.3	10.1
Multiple of RAB (times)⁶⁴			
As at 30 June 2013 (actual)	2,775	1.5	1.6
As at 31 December 2013 (Case A, DCF Model)	2,879	1.4	1.5
As at 30 June 2015 (Case A, DCF Model)	3,221	1.3	1.4

While Envestra has provided guidance in relation to profit after tax for FY14, the FY14 Forecast has not been released and therefore this information has not been disclosed in this report. Accordingly, the implied prospective multiples set out above are based on the median of brokers’ forecasts for Envestra (see Appendix 1 for details). However, forecasts of Envestra’s RAB are not generally disclosed and this is problematic for value analysis for Envestra as substantial growth capital is to be spent over the period to FY18. Consequently, the implied RAB multiples for 31 December 2013 and 30 June 2015 set out above are based on Case A of Grant Samuel’s DCF Model. In Grant Samuel’s opinion, the broker consensus EBITDA forecasts and projected RAB in the DCF Model are sufficiently close to Envestra’s forward looking information to be useful for analytical purposes.

The overall multiples of EBITDA implied by the value range are towards the low end of relative transaction evidence although the overall implied RAB multiples are high relative to transaction evidence. In Grant Samuel’s opinion, these overall multiples are appropriate as:

- the EBITDA multiples implied by the value range reflect the aggregate earnings for Envestra. It is difficult to interpret these aggregate multiples given differing outlooks for each of Envestra’s operations in relation to:
 - the mix of regulated and unregulated revenue;
 - capital expenditure plans;
 - growth profiles and potential; and
 - regulatory periods and rates of returns.

However, Grant Samuel’s value range has been built up on an individual region basis and the values attributed to each of these regions imply multiples of projected EBITDA that Grant Samuel considers appropriate in terms of that network’s growth opportunities, future earnings profile and future capital intensity (see below);

- the South Australian/Northern Territory and Queensland networks are approximately halfway through a regulatory period whereby they are entitled to a rate of return of 10.28%. This level of return is unlikely to continue beyond 30 June 2016 and,

⁶³ Represents Grant Samuel’s value range divided by Envestra’s EBITDA.

⁶⁴ Represents Grant Samuel’s value range divided by Envestra’s RAB.



consequently, Envestra’s overall EBITDA is higher in the short term than is anticipated in the future (resulting in lower EBITDA multiples in the near term but higher in the medium term);

- around 10% of Envestra’s revenue is derived from non-regulated sources and the assets generating this income are not recognised in the RAB. Consequently, implied RAB multiples are marginally higher than if all revenue was regulated;
- Envestra is undertaking an accelerated mains replacement programme, which will result in a significant increase in RAB in South Australia, Victoria and Queensland over the short to medium term. Consequently, Envestra’s RAB will increase significantly over the medium term and RAB multiples would be lower if the value assumed the mains replacement programme had been completed; and
- none of the market evidence is directly comparable to Envestra. Transaction evidence since 2007 is limited and generally reflects single distribution networks (not a portfolio of networks). Although all the comparable listed entities own some regulated assets, none is solely a gas distribution entity and most own a mix of gas and electricity transmission and distribution assets. Consequently, although the market evidence provides useful guidance for the valuation of Envestra, the extent of the focus of Envestra’s portfolio on regulated gas distribution networks suggests that lower multiples may be warranted.

The values attributed to the individual regions have also been reviewed by reference to the implied EBITDA and RAB multiples based on values excluding the benefit of tax losses:

■ **South Australia/Northern Territory**

South Australia/Northern Territory – Implied Valuation Parameters		
	Value Range	
	Low	High
Multiple of EBITDA (times)		
FY13 (actual)	10.5	11.4
FY14 (Case A, DCF Model)	9.2	9.9
FY15 (Case A, DCF Model)	8.4	9.1
FY16 (Case A, DCF Model)	8.1	8.8
Multiple of RAB (times)		
As at 30 June 2013 (actual)	1.4	1.6
As at 31 December 2013 (Case A, DCF Model)	1.4	1.5
As at 30 June 2015 (Case A, DCF Model)	1.2	1.3

The EBITDA multiples are marginally lower than the overall multiples but are appropriate as the current access arrangement has a relatively favourable regulatory rate of return (10.28%). When the current determination period finishes in June 2016, the rate of return for this network is expected to decline. Consequently, near term earnings are high relative to longer term earnings and, therefore, the EBITDA multiples implied by the valuation are low. In comparison, the current RAB multiple implied by the valuation is high but expected to decline over the next few years as the effect of the accelerated mains replacement programme (expected to be completed by FY17) increases RAB. The South Australian/Northern Territory network has a low proportion of non-regulated revenue.



■ **Victoria**

Victoria – Implied Valuation Parameters		
	Value Range	
	Low	High
Multiple of EBITDA (times)		
FY13 (actual)	11.9	13.0
FY14 (Case A, DCF Model)	10.9	12.0
FY15 (Case A, DCF Model)	10.1	11.1
FY16 (Case A, DCF Model)	9.4	10.3
Multiple of RAB (times)		
As at 30 June 2013 (actual)	1.3	1.4
As at 31 December 2013 (Case A, DCF Model)	1.2	1.4
As at 30 June 2015 (Case A, DCF Model)	1.1	1.2

The multiples implied by the value of the Victorian network are higher than the overall multiples. In Grant Samuel's view, these multiples are appropriate as:

- the current access arrangement only commenced in 2013, meaning that the Victorian (and Albury) network have the most time remaining of any of the networks under the current arrangements. The current regulatory rate of return that applies to this network is 7.39%, marginally lower than the Case A forecast regulatory rate of return that applies to subsequent periods (7.58%). Therefore, EBITDA for the network is forecast to trend upward over the medium term;
- the RAB multiple is forecast to decline over the next few years as the impact of the accelerated mains replacement programme (expected to be completed by FY20) increases RAB; and
- nearly all of the Victorian network is regulated although it is better positioned for real long term growth relative to Envestra's other networks. Several of Melbourne's growth corridors lie in or adjacent to Envestra's regulated areas. Victoria has the population and climate to support increasing gas usage growth opportunities in areas such as Merrifield (north of Melbourne) implying higher long term value generation.

■ **Queensland**

Queensland – Implied Valuation Parameters		
	Value Range	
	Low	High
Multiple of EBITDA (times)		
FY13 (actual)	9.6	10.4
FY14 (Case A, DCF Model)	8.6	9.4
FY15 (Case A, DCF Model)	8.1	8.9
FY16 (Case A, DCF Model)	7.7	8.4
Multiple of RAB (times)		
As at 30 June 2013 (actual)	1.5	1.6
As at 31 December 2013 (Case A, DCF Model)	1.4	1.6
As at 30 June 2015 (Case A, DCF Model)	1.3	1.4

The EBITDA multiples implied for Queensland are marginally lower but the RAB multiples are higher than the overall multiples. These multiples are appropriate as:

- the current access arrangement in Queensland has a relatively favourable regulatory rate of return (10.28%). When the current determination period finishes in June 2016, the rate of return for this network is expected to decline.



Consequently, near term earnings are high relative to longer term earnings and, therefore, the implied EBITDA multiples are low;

- the RAB multiples implied for Queensland are high but expected to decline over the next few years as the effect of the mains replacement programme (expected to be completed by FY18) increases RAB; and
- Queensland’s network earns a relatively high proportion of unregulated revenue. As a consequence, Queensland may grow faster than solely regulated revenue streams and only the regulated assets are recognised in RAB.

■ **New South Wales**

New South Wales – Implied Valuation Parameters		
	Value Range	
	Low	High
Multiple of EBITDA (times)		
FY13 (actual)	10.8	11.8
FY14 (Case A, DCF Model)	9.9	10.8
FY15 (Case A, DCF Model)	11.8	13.0
FY16 (Case A, DCF Model)	12.1	13.2
Multiple of RAB (times)		
As at 30 June 2013 (actual)	2.1	2.3
As at 31 December 2013 (Case A, DCF Model)	2.1	2.3
As at 30 June 2015 (Case A, DCF Model)	1.8	2.0

The multiples implied for New South Wales are appropriate as a large proportion of the network is unregulated (the revenue for which is expected to grow faster than regulated revenue) and only regulated assets are recognised in the RAB.

5.4 Other Assets and Liabilities

Envestra’s other assets and liabilities have been valued in the range \$56.9-64.9 million (negative) and include:

- a significant provision for remediation of former gas work sites at Sale and Warragul. There is a possibility that the cost involved may not be as high as provided or may be offset by contribution from other parties. Therefore, a range of negative values (net liability) has been adopted;
- Envestra’s other net assets as at 31 December 2013 (\$2.5 million); and
- under the Proposal, Envestra shareholders will retain the 3.2 cent per share dividend payable in relation to the six months ended 31 December 2013. This dividend will not be provided for in the 31 December 2013 balance sheet (i.e. as it will only be declared after period end) and therefore an allowance of \$57.5 million has been made.

No value has been attributed to Envestra’s carried forward capital losses of \$8.2 million as there is currently no expectation that these losses will be recouped.

5.5 Corporate Cost Savings

Envestra incurs costs of approximately \$11 million per annum. These costs represent costs associated with running Envestra’s head office and include:

- the Envestra executive office (such as costs associated with the offices of the Managing Director and Chief Financial Officer, company secretarial and legal, planning and development, regulatory affairs, corporate affairs, treasury, tax etc.); and
- listed company expenses (such as directors’ fees, annual reports and shareholder communications, share registry and listing fees and dividend processing).



These costs are fully allocated to Envestra’s regional operations for financial reporting purposes and therefore are reflected in the DCF analysis in Section 5.3.2 of this report. However, any acquirer of Envestra would be able to save the costs associated with being a listed company. Furthermore, an acquirer of Envestra which has an existing presence in the energy infrastructure sector in Australia should be able to eliminate most of these costs.

Grant Samuel has assumed that all corporate costs would be saved for the purposes of the valuation (i.e. cost savings available to the acquirer) and, based on a discount rates in the range 6.5-7.0%, has attributed a value of \$160-180 million to corporate cost savings.

5.6 Net Borrowings

Envestra’s net borrowings for valuation purposes as at 31 December 2013 are \$2,127.7 million as follows:

Envestra – Net Borrowings for Valuation Purposes	
	\$ million
Bank loans	232.0
Capital indexed bonds	254.1
Medium term notes	645.0
US private placement notes	984.5
Total borrowings	2,115.6
Fair value adjustments	(0.5)
Derivative financial instruments (net)	13.7
Cash	(1.1)
Total	2,127.7

Envestra’s borrowings comprise a portfolio of capital market instruments and bank loans. The portfolio is long term with around 80% of the portfolio (by value) with maturities beyond five years and an average maturity profile of 10 years. Envestra also has a portfolio of swaps and other derivatives that are designed to hedge any currency exposure and to convert interest rate exposure to fixed rates matching the term of its access arrangements (currently 3-4 years).

The nature of Envestra’s portfolio gives rise to the question as to whether the market value of the debt differs to book value. In this regard, the fair value adjustments recognised at 31 December 2013 (\$0.5 million asset) and the net value of Envestra’s derivative financial instruments (\$13.7 million liability) have been taken into account in determining net borrowings for valuation purposes in the table above.

Grant Samuel has also reviewed the terms of the individual facilities comprising the debt portfolio. It is clear that there are some long term debt tranches that are on favourable terms relative to current market rates. For example, two \$300 million tranches of credit wrapped medium term notes (issued in 2005 with 10-12 years remaining) have all up margins, including wrap costs, of 0.52% and 0.54% over the 90 day bank bill swap rate (“BBSW”) respectively. On the other hand, there are some facilities with an effective cost above current market rates (e.g. some tranches of fixed rate US private placement notes).

The net present value of the differential between the interest rates applicable to the existing debt portfolio and current market rates is around \$60 million assuming a discount rate of 6%, tax rate of 30% and current margins of 2% over BBSW for 10 year debt (with shorter tenor at lower margins and longer tenor at higher margins). However, Grant Samuel has not made an adjustment for this theoretical value as the net outcome of Envestra’s hedging arrangements is that it has effectively fixed its overall cost of debt at around 6% for the 3-4 year period of its current access arrangements. A rate of 6% represents margins of 2.5-2.8% over current 3-4 year BBSW (in the range 3.2-3.5%). These margins are above those that Envestra (as a BBB rated corporate) could achieve in today’s debt capital markets (i.e. if it was borrowing directly for the same 3-4 year term) and are a “cost” of having the very long underlying maturity profile (albeit that it does reduce refinancing risk). The cost of this maturity profile effectively offsets the favourable margins contained in Envestra’s underlying portfolio.



6 Profile of APA Group

6.1 Background

APA Group is an ASX listed internally managed stapled entity that comprises APT and APTIT. It was formed in June 2000 through the spinoff and ASX listing (as APT) of the gas transmission pipeline assets of The Australian Gas Light Company. It was restructured into a stapled entity effective 4 January 2007 in order to make returns to securityholders more tax effective. Since listing, APA Group has achieved significant growth through the development and expansion of, and the buyout of minority stakes in, its pipeline assets and the acquisition and development of new assets. It has also been transformed from being solely an owner of infrastructure assets to an active operating business.

Today, APA Group is Australia's largest natural gas infrastructure business, is headquartered in Sydney and has over 1,500 employees. APA Group's strategy is to enhance its portfolio of gas infrastructure assets in Australia, facilitate the development of gas related projects that enhance its infrastructure portfolio, capture revenue and operational synergies from its asset base and leverage its asset management and operational skillset. APA Group has a market capitalisation of around \$5.5 billion.

6.2 Business Operations

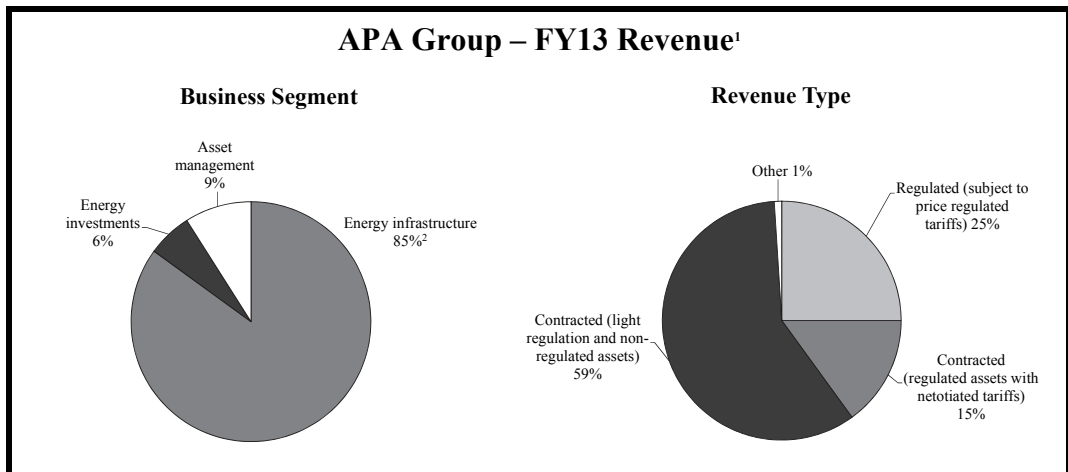
APA Group develops, owns and operates natural gas transportation infrastructure across Australia. It has three business segments as follows:

- **Energy Infrastructure:** APA Group owns:
 - a portfolio of gas transmission pipelines totalling over 14,000 kilometres across all Australian mainland states and territories including:
 - **Moomba Sydney Pipeline:** a 2,028 kilometre pipeline system which delivers gas from Moomba to cities and regional centres in the Australian Capital Territory and New South Wales;
 - **South West Queensland Pipeline:** a 936 kilometre duplicated pipeline which delivers gas between Wallumbilla in south east Queensland to Moomba in north eastern South Australia. It provides the link between the Bowen and Surat Basins and customers in Mount Isa and in the south eastern Australian gas markets in New South Wales and South Australia;
 - **Roma Brisbane Pipeline:** a 582 kilometre pipeline which delivers gas from Wallumbilla (near Roma) to Brisbane and regional centres along its route;
 - **Victoria Transmission System:** a 1,842 kilometre pipeline system which delivers gas throughout Victoria;
 - **Carpentaria Gas Pipeline:** a 944 kilometre pipeline which delivers gas from Ballera in south west Queensland to Mt Isa and the surrounding Carpentaria mineral province;
 - **Amadeus Gas Pipeline:** a 1,671 kilometre pipeline system which delivers gas from the offshore Bonaparte Basin to Darwin, Alice Springs and regional centres in the Northern Territory; and
 - **Goldfields Gas Pipeline (88.2%):** a 1,590 kilometre pipeline which delivers gas from the Carnarvon Basin and Northwest Shelf to the Pilbara, Murchison and Goldfields mining regions in Western Australia;
 - two gas storage facilities (15PJ capacity Mondarra Gas Storage Facility in Western Australia and the 0.7PJ capacity Dandenong LNG Storage Facility in Victoria); and
 - the 80MW Emu Downs Wind Farm in Western Australia;



- **Energy Investments:** APA Group owns equity interests in energy infrastructure entities as follows:
 - **Envestra Limited (33.05%):** an ASX-listed natural gas distribution and transmission company which owns over 22,000 kilometres of distribution networks and approximately 1,120 kilometres of transmission pipelines and services over 1 million customers in South Australia, Victoria, Queensland, New South Wales and the Northern Territory;
 - **SEA Gas Pipeline (50%):** an unregulated 680 kilometre pipeline that delivers gas from the Otway and Bass Basins to Adelaide and other regional markets in South Australia and Victoria;
 - **Energy Infrastructure Investments Pty Limited (19.9%):** an unlisted investment vehicle which owns electricity interconnectors, gas-fired power generation plants, gas transmission pipelines and coal seam gas processing plants. APA Group’s co-investors are Marubeni Corporation (49.9%) and Osaka Gas (30.2%);
 - **Energy Infrastructure Investments 2 Pty Limited (20.2%):** an unlisted investment vehicle which owns the North Brown Hill Wind Farm, a 132MW wind farm in South Australia. APA Group’s co-investors are Marubeni Corporation (39.9%) and Osaka Gas (39.9%);
 - **GDI (EII) Pty Ltd (20%):** an unlisted investment vehicle which owns the Allgas Gas Network, a 2,800 kilometre gas distribution network in south east Queensland servicing customers in Brisbane (south of the river) to the northern New South Wales, with separate networks in Toowoomba and Oakey in Queensland. APA Group’s co-investors are Marubeni Corporation (40%) and funds managed by RREEF (40%);
 - **Ethane Pipeline Income Fund (6.1%):** an ASX-listed managed investment scheme which owns the Moomba to Port Botany Ethane Pipeline, a 1,375 kilometre pipeline which supplies gas from Moomba to a petrochemical facility at Port Botany in New South Wales; and
 - **Diamantina Power Station Pty Limited (50%):** an unlisted joint venture with AGL Energy which is constructing the gas fired 242MW Diamantina Power Station and 60MW Leichardt Power Station at Mount Isa in Queensland; and
- **Asset Management:** APA Group provides commercial, operating services and/or asset maintenance services to most of its energy investments and investment management services to all of its energy investments (other than Envestra and Diamantina Power Station Pty Limited).

In FY13, the composition of APA Group’s revenue was:



Source: APA Group

Note: (1) Excluding pass through revenue and divested businesses.

(2) Revenue of the Energy Infrastructure segment is sourced from Western Australia/Northern Territory (29.4%), Victoria/South Australia (22.4%), Queensland (29.4%) and New South Wales (18.8%).

6.3 Financial Performance

During the five and a half years ended 31 December 2013, APA Group has undertaken significant corporate activity as it has evolved from being an owner of infrastructure assets to an active operating business. In particular, APA Group's revenue and earnings increased significantly in FY13 following the acquisition of the remaining 79.3% of Hastings Diversified Utilities Fund ("HDUF") by December 2012:

APA Group - Financial Performance (\$ millions)						
	Year ended 30 June					Six months ended 31 Dec 2013
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	2013 actual
Total revenue ⁶⁵	921.1	975.6	1,079.2	1,054.3	1,260.5	710.8
Pass through revenue ⁶⁶	(271.4)	(329.9)	(381.7)	(302.6)	(352.7)	(201.8)
Revenue (excluding pass through revenue)	649.7	645.7	697.5	751.7	907.8	509.0
EBITDA⁶⁷	444.4	460.0	489.6	535.5	667.1	398.9
Depreciation and amortisation ⁶⁸	(95.6)	(91.4)	(100.4)	(110.4)	(130.5)	(74.7)
EBIT⁶⁷	348.8	368.6	389.2	425.1	536.6	324.2
Net interest expense	(213.0)	(229.4)	(247.0)	(234.3)	(290.9)	(164.0)
Significant items (as reported)	(21.0)	-	2.5	(9.7)	101.7 ⁶⁹	-
Operating profit before tax	114.8	139.2	144.7	181.1	347.4	160.2
Income tax expense	(35.9)	(38.7)	(35.9)	(50.4)	(51.4)	(39.5)
Operating profit after tax	78.9	100.5	108.8	130.7	296.0	120.7
Outside equity interests	(0.1)	(0.1)	(0.3)	-	2.8	(19.2)
Profit after tax attributable to APA Group stapled securityholders	78.8	100.4	108.5	130.7	298.8	101.5
<i>Statistics</i>						
Basic EPS	16.2¢	19.4¢	19.7¢	20.4¢	38.7¢	14.4¢
Basic EPS (before significant items)	22.7¢	19.4¢	19.7¢	21.9¢	23.1¢	14.4¢
Operating cash flow per security ⁷⁰	48.2¢	51.9¢	52.6¢	52.5¢	56.0¢	24.9¢
Distribution per security	31.0¢	32.8¢	34.4¢	35.0¢	35.5¢	17.5¢
Distribution payout ratio ⁷¹	65.6%	64.4%	65.7%	67.0%	68.2%	67.5%
Interest cover ⁷²	2.1x	2.1x	2.0x	2.5x	2.3x	2.3x

Source: APA Group and Grant Samuel analysis

APA Group derives revenue from a mix of regulated returns and long term negotiated contracts for the transportation of gas and electricity generation and from the provision of investment management and operational services. Approximately 25% of APA Group's revenue (excluding pass through revenue) is currently subject to prices determined under full regulation. The remaining 75% of revenue is largely derived from contracts with set terms.

APA Group pays distributions semi-annually in March and September from operating cash flow after payment of interest, tax and maintenance capital costs. Distributions may comprise after tax dividends (which may be franked) and tax deferred distributions (capital returns) from APT and pre-tax distributions (including tax deferred amounts) from APTIT. Historically, distributions

⁶⁵ Revenue includes pass through revenue, share of net profits of equity accounted associates and jointly controlled entities, finance lease income, dividends, rental income, interest income on investments in Energy Infrastructure Investments Pty Limited and GDI (EII) Pty Limited and revenue from business divested. It excludes other interest income and significant items.

⁶⁶ Pass through revenue is revenue on which no margin is earned and arises predominantly in its asset management operations.

⁶⁷ Includes share of net profits from equity accounted associates and jointly controlled entities.

⁶⁸ Around 96% of depreciation and amortisation relates to the Energy Infrastructure segment with 4% relating to Asset Management.

⁶⁹ Significant items in FY13 primarily relate to the acquisition of HDUF.

⁷⁰ Operating cash flow is net cash from operations after interest and tax payments, adjusted to exclude APA Group identified significant items.

⁷¹ Distribution payout ratio is calculated as total distribution payments divided by operating cash flow.

⁷² Calculated as EBITDA (as reported) divided by net interest expense.

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have exceeded earnings primarily as a result of low maintenance capital expenditure and income tax paid (relative to the accounting charges for depreciation and income tax expense) and significant income tax losses carried forward (see below).

APA Group's performance over the period by operating segment is shown below:

APA Group - Financial Performance (\$ millions)						
	Year ended 30 June					Six months ended 31 Dec 2013
	2009 ⁷³ actual	2010 actual	2011 actual	2012 actual	2013 actual	actual
Revenue (excluding pass through revenue)						
Energy Infrastructure	543.6	566.2	545.1	610.0	741.4	414.5
Energy Investments	11.7	19.4	27.1	41.7	51.2	38.4
Asset Management	60.5	60.1	68.7	69.3	82.3	56.1
Total revenue (continuing)	615.8	645.7	640.9	721.0	874.9	509.0
Divested business ⁷⁴	33.9	-	56.6	30.7	32.9	-
Total revenue	649.7	645.7	697.5	751.7	907.8	509.0
Revenue Growth						
Energy Infrastructure		4.2%	(3.7%)	11.9%	21.6%	
Energy Investments		65.6%	39.7%	53.9%	22.6%	
Asset Management		(0.7%)	14.3%	0.9%	18.8%	
Total revenue (continuing)		4.8%	(0.7%)	12.5%	21.3%	
EBITDA						
Energy Infrastructure	389.1	408.6	423.8	441.7	549.9	326.0
Energy Investments	11.6	19.1	27.1	41.7	51.2	38.4
Asset Management	22.6	32.3	38.7	31.9	45.4	34.5
Total EBITDA (continuing)	423.3	460.0	489.6	515.3	646.5	398.9
Divested business ⁷⁴	21.1	-	-	20.2	20.6	-
Total EBITDA	444.4	460.0	489.6	535.5	667.1	398.9
EBITDA Growth						
Energy Infrastructure		5.0%	3.7%	4.2%	24.5%	
Energy Investments		65.0%	42.1%	54.1%	22.6%	
Asset Management		42.8%	19.9%	(17.6%)	42.4%	
Total EBITDA continuing		8.7%	6.4%	5.3%	25.5%	
EBITDA Margin						
Energy Infrastructure	71.6%	72.2%	77.7%	72.4%	74.2%	78.6%
Energy Investments	98.7%	98.3%	99.9%	100.0%	100.0%	100.0%
Asset Management	37.4%	53.8%	56.4%	46.0%	55.2%	61.5%
Total EBITDA continuing	68.7%	71.2%	76.4%	71.5%	73.9%	78.4%

Source: APA Group and Grant Samuel analysis⁷⁵

The above analysis reveals the transformation of APA Group since 2008. While it has continued to acquire and develop energy infrastructure assets, APA Group has divested assets into unlisted funds (in which it typically retains an interest of around 20%) and grown its third party asset management revenue streams (a less capital intensive business activity).

APA Group has not publicly released earnings forecasts for FY14 or beyond. On 19 February 2014, APA Group confirmed its guidance for FY14 as follows:

- EBITDA of \$730-740 million, including share of profits from associates and jointly controlled entities;

⁷³ Revenue and EBITDA for FY08 is not available in the same format and therefore growth data is not available.

⁷⁴ Revenue and EBITDA of divested business primarily relates to assets owned by APA Group which have been divested to unlisted investment vehicles in which APA Group retains an interest and for which it provides investment and asset management services.

⁷⁵ APA Group has not reported divested business on an EBIT basis and therefore Grant Samuel is unable to prepare this segmental analysis to EBIT level.

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- net interest cost of \$315-325 million; and
- distribution of at least 36.0 cents per security.

In order to provide an indication of the expected future financial performance of APA Group, Grant Samuel has considered brokers' forecasts for APA Group as follows:

APA Group – Financial Performance (\$ millions)				
	Year end 30 June			
	2013 actual	Broker Consensus (Median)		
		2014	2015	2016
Revenue (excluding pass through revenue)	907.8	970.1	1,051.2	1,103.0
EBITDA	667.1	742.4	813.9	877.8
EBIT	536.6	594.7	661.7	725.0
Net profit after tax (before significant items)	178.7	202.0	239.3	270.0
EPS (before significant items)	23.1¢	24.0¢ ⁷⁶	28.4¢	31.9¢
Operating cash flow per security (before significant items)	56.0¢	50.8¢ ⁷⁶	57.0¢	61.4¢
Distributions per security	35.5¢	36.2¢	37.5¢	38.9¢

Source: Grant Samuel analysis (see Appendix 5)

6.4 Cash Flow

APA Group pays distributions from operating cash flow after payment of interest, tax and stay in business capital expenditure:

APA Group – Cash Flow (\$ millions)						Six months ended 31 Dec
	Year ended 30 June					2013 actual
	2009 actual	2010 actual	2011 actual	2012 actual	2013 actual	
Receipts less payments from operations	418.8	439.4	460.7	499.3	644.1	343.4
Net interest paid	(213.3)	(212.7)	(223.8)	(218.2)	(270.6)	(157.8)
Dividends and proceeds from finance leases	28.2	41.0	52.6	54.4	59.3	30.8
Income tax paid	(0.2)	-	0.4	-	(0.1)	0.1
Stay in business capital expenditure	(16.4)	(14.7)	(18.0)	(24.4)	(24.7)	(20.6)
Cash flow from operations	217.1	253.0	271.9	311.1	408.0	195.9
Distributions paid	(143.8)	(160.0)	(183.4)	(208.5)	(269.9)	(154.6)
Cash flow after distributions	73.3	93.0	88.5	102.6	138.1	41.3
Significant items	(7.2)	-	-	-	(58.3)	(8.3)
Growth capital expenditure	(285.3)	(120.7)	(213.1)	(224.7)	(372.7)	(179.6)
Acquisitions	(130.8)	(220.5)	(292.9)	(46.3)	(331.9)	(0.9)
Divestments	545.9	8.2	7.9	476.0	412.0	1.8
Net proceeds from security issues	78.4	141.7	348.7	44.5	74.4	-
Net proceeds from borrowings	(271.0)	70.4	75.3	(117.5)	(110.5)	125.4
Net increase/(decrease) in cash	3.3	(27.9)	14.4	234.6	(248.9)	(20.3)
<i>Opening cash</i>	<i>105.5</i>	<i>108.8</i>	<i>80.9</i>	<i>95.3</i>	<i>329.9</i>	<i>81.0</i>
<i>Closing cash</i>	<i>108.8</i>	<i>80.9</i>	<i>95.3</i>	<i>329.9</i>	<i>81.0</i>	<i>60.7</i>

Source: APA Group and Grant Samuel analysis

Over the period shown above APA Group has invested significant growth capital into existing pipelines (average of around \$240 million per annum), progressively increased its ownership in listed gas sector peers (Envestra and HDUF) and acquired various other energy assets. These investments have been funded through a combination of new equity (e.g. dividend reinvestment

⁷⁶ EPS and operating cash flow per security in the broker forecasts for FY14 reflect the substantial increase in the number of stapled securities on issue following the acquisition of HDUF during FY13. The FY13 per security data is based on the weighted average number of securities on issue during that year (772.3 million) while FY14 is based on the current outstanding number of securities on issue (835.8 million).



plan and a \$300 million institutional placement in FY11), asset divestments (including into unlisted investment vehicles), cash flow from operations and debt.

APA Group has indicated that over the three years to 30 June 2016 growth capital is expected to be around \$400 million per annum with stay in business (maintenance) capital expenditure of around \$25-30 million per annum. Significant growth capital projects in the period include projects already underway as well as additional capacity expansion in the Victorian Transmission System, the southern lateral expansion of the Moomba Sydney Pipeline and additional compression at Moomba and Wallumbilla on the South West Queensland Pipeline.

6.5 Financial Position

The financial position of APA Group as at 30 June 2013 (audited) and 31 December 2013 (reviewed) is summarised below:

APA Group - Financial Position (\$ millions)		
	30 June 2013 (restated⁷⁷)	31 December 2013
Debtors and prepayments	165.5	156.4
Inventories	12.7	18.6
Creditors, accruals and provisions ⁷⁸	(284.9)	(240.2)
Net working capital	(106.7)	(65.2)
Property, plant and equipment (net)	5,280.4	5,397.8
Goodwill	1,150.5	1,150.5
Contract and other intangibles (net)	177.0	174.4
Equity accounted investments	589.1	605.1
Finance lease receivables	39.1	32.0 ⁷⁹
Other financial assets	35.3	205.9 ⁸⁰
Other financial liabilities	-	(231.8) ⁸⁰
Derivative financial instruments (net)	(154.0)	na ⁸⁰
Other payables	(3.7)	(3.8)
Deferred tax liability	(213.9)	(248.3)
Other liabilities (net)	(46.0)	(24.7)
Total funds employed	6,747.1	6,991.9
Cash and deposits	81.0	60.7
Borrowings	(4,314.2)	(4,584.5)
Net borrowings	(4,233.2)	(4,523.8)
Net assets	2,513.9	2,468.1
Outside equity interests	_ ⁸¹	_ ⁸¹
Equity attributable to APA Group securityholders	2,513.9	2,468.1
Statistics		
<i>Securities on issue at period end (million)</i>	835.8	835.8
<i>Net assets per security</i>	\$3.01	\$2.95
<i>NTA per security</i>	\$1.42	\$1.37
<i>Gearing⁸²</i>	62.8%	63.8%
<i>Book gearing</i>	62.7%	64.7%
<i>Market gearing</i>	45.8%	47.4%

Source: APA Group and Grant Samuel analysis

Property, plant and equipment (net) primarily reflects the net written down value of gas transportation systems, meters, compressors and other plant and equipment and at 30 June 2013 included \$494.4 million of work in progress (including expansion of the Goldfields Gas Pipeline,

⁷⁷ Restated by APA Group to reflect the adoption of revised AASB 119 (Employee Benefits) in the six months to 31 December 2013.

⁷⁸ Including capital expenditure accruals and interest payable accruals (\$161.6 million at 30 June 2013).

⁷⁹ Excluding current portion which is not separately disclosed at 31 December 2013.

⁸⁰ Other financial assets and liabilities at 31 December 2013 include derivative financial instruments that are not separately disclosed.

⁸¹ Less than \$100,000.

⁸² Gearing is defined as net debt divided by net debt plus book equity. As calculated and disclosed by APA Group.



augmentation and capacity expansion in the Victorian Transmission System and additional compression at Moomba on the South West Queensland Pipeline). Goodwill increased by around \$700 million in FY13 following the acquisition of Hastings Diversified Utilities Fund) in December 2012.

Equity accounted investments include APA Group’s 50% interest in SEA Gas Pipeline, 50% interest in Diamantina Power Station Pty Limited, 20% interest in GDI (EII) Pty Ltd, 20.2% interest in Energy Infrastructure Investments 2 Pty Limited, 19.9% interest in Energy Infrastructure Investments Pty Limited and 33.05% interest in Envestra. Other financial assets include the 6.1% interest in Ethane Pipeline Income Fund, redeemable ordinary shares in Energy Infrastructure Investments Pty Ltd and redeemable preference shares in GDI (EII) Pty Ltd as well as derivative financial instrument assets. Finance lease receivables relate to the lease of a metering station, natural gas vehicle facilities, the expansion of the X41 power station and two pipeline laterals.

Derivative financial instruments include cross currency interest rate swaps, equity forward contracts foreign exchange contracts, forward foreign exchange contracts. Other liabilities (net) include linepack gas, gas in storage and other assets less unearned revenue, retirement benefit obligations and non-current employee provisions.

APA Group targets gearing⁸² in the range of 65% to 68% and its borrowings comprise both capital market instruments and bank facilities. As at 31 December 2013, APA Group had \$5,295 million in debt facilities of which \$4,543 million was drawn as follows:

APA Group – Borrowings (\$ millions)			
Facility	As at 31 December 2013		Maturity
	Amount Committed	Amount Drawn	
Bank borrowings	1,517.0	765.0	Various to 2018
Guaranteed Senior Notes	3,263.0	3,263.0	Various to 2024
Subordinated Notes	515.0	515.0	30 September 2072
	5,295.0	4,543.0	
Deferred borrowing costs and adjustments	-	(41.5)	
Total	5,295.0	4,584.5	

Source: APA Group

At 31 December 2013, APA Group’s senior facilities had an average maturity of 5.4 years. The guaranteed senior notes include notes denominated in Australian dollars, United States dollars, Japanese Yen, Canadian dollars and British Pound. The subordinated notes are long dated, unsecured, subordinated and cumulative. They can be redeemed by APA Group on 31 March 2018 or any interest payment date (quarterly) thereafter or if a change of control event, tax event or capital event occurs.

APA Group’s financing entity (APT Pipelines Ltd) has a S&P long term credit rating of “BBB/Stable” and a Moody’s long term credit rating of “Baa2/Stable”. On 17 December 2013, S&P and Moody’s announced that these credit ratings were not immediately affected by the announcement of the non-binding proposal for Envestra.

Under the Australian tax consolidation regime, APT and its wholly owned Australian resident entities have elected to be taxed as a single entity. At 30 June 2013, APA Group had carried forward income tax losses of approximately \$896 million (\$269 million of tax shield), all of which were recognised in the balance sheet. In addition, APA Group had carried forward Australian capital losses of approximately \$100 million (\$30 million of tax shield), none of which are recognised in the balance sheet. APA Group does not expect to pay income tax in the short to medium term due to the proportion of its income that is not assessable for taxation purposes, accelerated tax depreciation and the ability to utilise carried forward income tax losses.

6.6 Capital Structure and Ownership

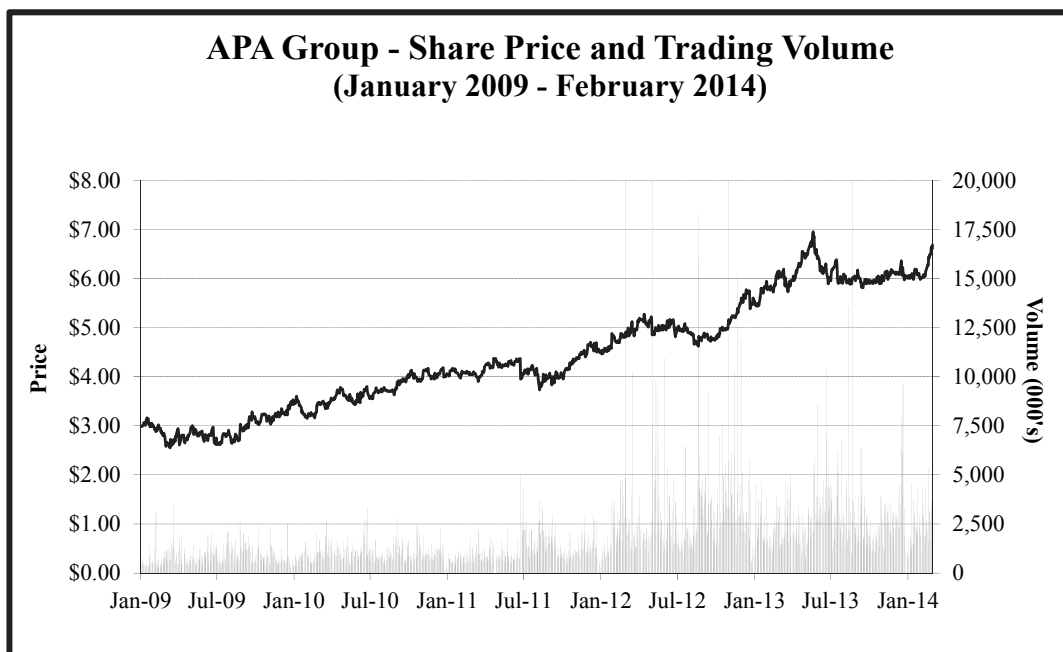
APA Group has 835,750,807 stapled securities on issue. There are over 80,000 registered



securityholders in APA Group. It has a significant retail investor base with approximately 90% of registered securityholders holding 10,000 or fewer securities although this represents only around 20% of securities on issue. APA Group has two substantial securityholders, UniSuper Ltd (6.9%) and Deutsche Bank AG (5.3%). APA Group operates a distribution reinvestment plan but it was suspended in June 2013.

6.7 Security Price Performance

APA Group securities listed at a slight premium to the offer price of \$2.00 in June 2000 and gradually increased to around \$5.00 (unadjusted) by mid 2006 before decreasing to \$3.00 by the end of 2008 (largely in line with the stockmarket as the implications of the global financial crisis for world economic activities and capital markets emerged). The following graph illustrates the movement in the APA Group security price and trading volumes since January 2009:



Source: IRESS

Notes: (1) Security prices are on an adjusted basis reflecting various returns of capital paid prior to May 2004 and the renounceable rights issue of November 2006.

- (2) Only four times in this period has more than 20,000,000 securities traded in a day: 29 February 2012 for no apparent reason but likely to do with APA Group's offer for HDUF, 2 May 2012 when Petronas Australia Pty Limited sold its 17.41% interest in APA Group, 30 October 2012 the day prior to the then scheduled closure of the offer for HDUF and 21 August 2013 upon release of positive FY13 results and guidance for FY14. This volume is not shown on the graph.

During the first half of 2009, APA Group's security price was volatile before settling in the range \$2.70-3.00. Over the next two years the security price predominantly mirrored or slightly outperformed the broader market to reach an intraday high of \$4.43 in April 2011. In June 2011, APA Group announced a \$300 million capital raising and the acquisition of the Emu Downs Wind Farm and its security price declined to \$3.90. However, by December 2011 the APA Group security price increased to around \$4.55 following completion of a \$1.45 billion debt refinancing program.

On 14 December 2011, APA Group announced a takeover offer for HDUF. Despite the offer being rejected, APA Group securities traded in the range \$4.50-4.70 for the remainder of the month. During 2012, the APA Group security price was influenced by the takeover activity around HDUF (including the announcements by the Australian Competition & Consumer Commission and a competing bid from Pipeline Partners Australia Pty Limited announced on 2 July 2012) and gradually increased to trade broadly in the range \$4.80-5.20. On 21 August 2012, a revised takeover offer by APA Group was recommended by HDUF and APA Group's security price closed at \$4.82. Over the next 11 months, APA Group's security price steadily rose from

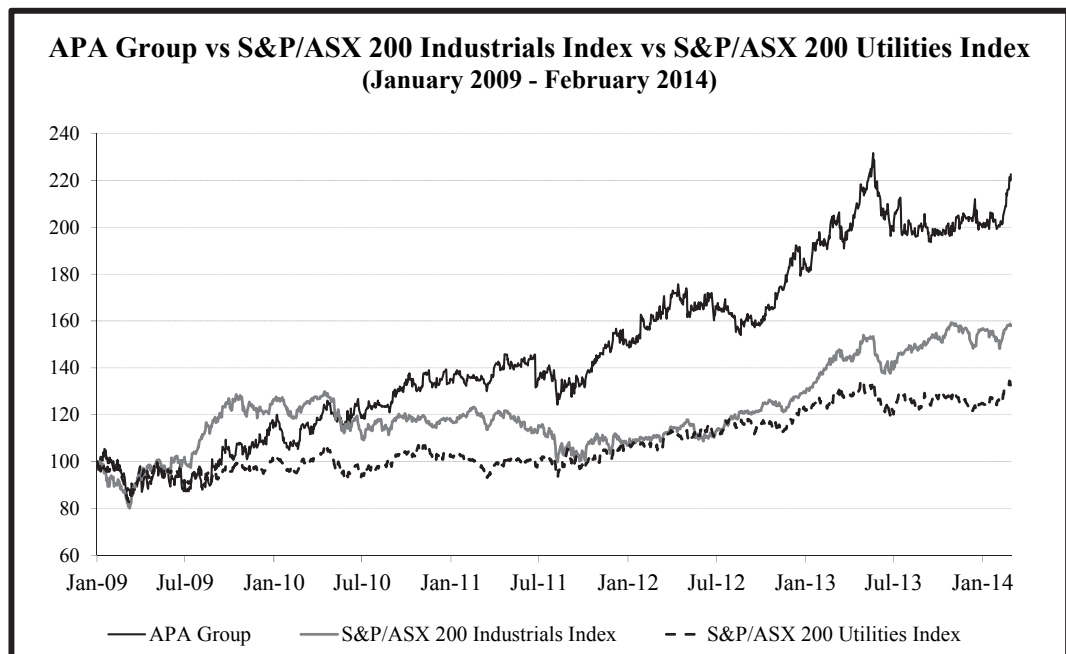


\$4.82 to a record high of \$6.97 in mid May 2013 following positive FY12 and FY13 half year results which were above market expectations, before declining to trade broadly in the range \$6.00-6.30 in June 2013 (with a general market correction).

In the month prior to the announcement of APA Group’s initial approach to Envestra on 16 July 2013, APA Group securities traded in the range of \$5.85-\$6.43 (at a VWAP of \$6.13) and closed at \$6.38 on 15 July 2013. Until the revised proposal to Envestra on 17 December 2013, the APA Group security price traded lower at a VWAP of \$6.00 but rose to close at \$6.36 on 16 December 2013. Subsequently, APA Group securities traded around \$6.00 but since mid February 2014 the security price has risen by around 10% and closed at \$6.68 on 28 February 2014. Notwithstanding some uncertainty concerning contracted revenue expiries after FY16, this increase appears to reflect a positive reaction to APA Group’s interim FY14 results (which showed emerging earnings from the HDUF assets and the Mondarra Gas Storage Facility expansion) and the decision to undertake a feasibility study into a link between the eastern and northern gas pipeline systems.

APA Group has no restrictions on free float. Average weekly volume has more than doubled since 2009 and APA Group is a reasonably liquid security. Average weekly volume over the twelve months prior to the announcement of the initial proposal to Envestra represented approximately 2% of average securities on issue or annual turnover of around 107% of average issued capital. This is not unusual for energy infrastructure entities from which investors seek stable distributions.

APA Group is a member of various indices including the S&P/ASX 50 Index, S&P/ASX 200 Industrials Index and S&P/ASX 200 Utilities Index. Its current weighting in these indices is approximately 0.48%, 0.49% and 20.74% respectively. The following graph illustrates the performance of APA Group securities relative to the S&P/ASX 200 Industrials Index and S&P/ASX Utilities Index:



Source: IRESS

In the period since 2008, APA Group has generally outperformed both indices. In particular, there have been periods of outperformance due to positive earnings results which were at or above market expectations (e.g. period from August 2011 to December 2011 associated with the FY11 result and the period from August 2012 to December 2012 associated with the FY12 result) and corporate activity (i.e. period from December 2011 to August 2012 associated with APA Group’s takeover offer for HDUF and the period post July 2013 associated with APA Group’s initial approach to Envestra). In the last two weeks APA Group has outperformed the market.



7 Valuation of the Consideration under the Proposal

7.1 Summary

Under the Proposal, Envestra shareholders will have the option to receive either:

- 0.1919 APA Group securities for each Envestra share; or
- combination of APA Group securities and cash, where the cash component will be offered through a “mix and match facility” subject to an overall cap of \$241 million and a maximum cash payment of \$1.17 per share.

Grant Samuel has attributed a value to the scrip consideration of \$1.15-1.25 per Envestra share (to two decimal places) based on a value range for APA Group securities of \$6.00-6.50.

The value of the scrip consideration will vary with movements in the APA Group stapled security price. Accordingly, if the Proposal is implemented Envestra shareholders are exposed to events or other factors that impact the APA Group security price until the securities are issued. The actual value of the consideration could therefore ultimately exceed, or be less than \$1.15-1.25 per Envestra share. Depending on the circumstances, significant (and sustained) movements in the APA Group stapled security price could change the evaluation of the Proposal.

Envestra shareholders will have the option to receive a combination of APA Group securities and cash subject to an overall cap of \$241 million on the amount of cash available. If all Envestra shareholders elected to receive cash, they would receive \$0.20 per Envestra share (i.e. around 16-17% of the assessed value of the consideration). However, the amount of cash per Envestra share received by shareholders may be higher depending on the take up of this consideration alternative.

7.2 Approach

The Proposal involves a change of control of Envestra. For the purposes of takeover analysis, to the extent that Envestra shareholders receive APA Group stapled securities under the Proposal, the relevant test for Envestra shareholders is the expected market value of the APA Group securities. This involves an estimation of the trading price for APA Group after the Proposal is implemented (rather than a pre bid price).

It is normal practice to use the post announcement market price as the starting point for estimating the value of an offer with a scrip component. An alternative method is to estimate the underlying value of the combined entity and then to apply a discount to reflect a portfolio interest. However, access to the detailed financial and operational information (such as earnings and operational forecasts or asset plans) of both parties is required to undertake such a fundamental analysis of the value of the consideration. Furthermore, the consensus view of a well traded market is likely to be a more reliable estimate than that of a single external observer. Market prices (particularly for large entities such as APA Group that are closely followed by a wide range of market analysts) usually incorporate the influence of all publicly available information on an entity’s prospects, future earnings and risks.

Grant Samuel has had regard to the market price of APA Group and addressed the following questions:

- is there any reason why the market price is not a true reflection of the fair market value of APA Group stapled securities? For example, there could be:
 - important information about the entity and its business/assets which would affect the security price but is not in the public domain;
 - mispricing by the market; and/or
 - abnormal trading activity in APA Group stapled securities; and



- will the proposed transaction, if implemented, have a material impact on APA Group's financial metrics, growth prospects, risk profile or other factors that would be likely to result in a change in the security price?

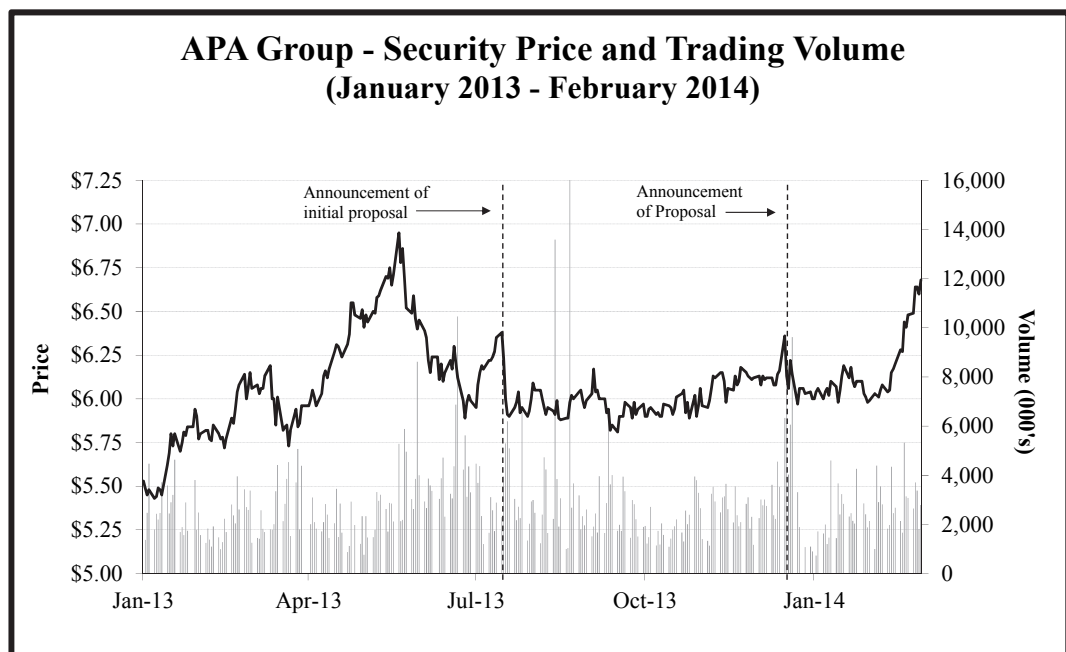
In considering these questions, Grant Samuel has:

- analysed the recent trading in APA Group stapled securities;
- reviewed broker analyst research on APA Group; and
- analysed the impact of the Proposal on APA Group's key financial metrics.

7.3 Analysis of the Market for APA Group Securities

APA Group is a top 50 ASX listed entity and a member of major indices. APA Group's security price performance since January 2009 is discussed in Section 6.7 of this report.

Since mid 2013 APA Group's security price has been relatively stable. Trading in APA Group securities between 1 January 2013 and 15 July 2013 (the last day of trading prior to announcement of APA Group's initial proposal to Envestra) was in the range \$5.39-6.97, at a VWAP of \$6.11. In April/May 2013 APA Group's stapled security price rose to trade above \$6.25 (peaking at \$6.97 in intraday trade on 20 May 2013) before declining to around \$6.00 in late June 2013. This decline was broadly in line with a global stockmarket correction that occurred over the same period:



Source: IRESS

Notes: (1) Only once in this period has more than 16,000,000 securities traded in a day (i.e. 21 August 2013 upon release of positive FY13 results and guidance for FY14). This volume is not shown on the graph.

On 16 July 2013 (the day of the announcement of APA Group's initial proposal to Envestra), APA Group securities closed down 2.4% (at \$6.23) compared to a prior day close of \$6.38. However, the APA Group security price had risen by around 6% in the two weeks prior to this announcement in comparison to a 2.8% increase in the market in that period.

Trading between 16 July 2013 and 16 December 2013 (the day prior to announcement of the Proposal) was in the range \$5.80-\$6.38 (at a VWAP of \$6.00) and closed at \$6.36. Over this period, APA Group's security price increased 2.1%, in line with the market in the same period (S&P/ASX 200 Industrials Index increase of 1.8%).



On 17 December 2013 (the day the Proposal was announced), APA Group securities closed down 3.6% (at \$6.13) on a day when the stockmarket was flat. Since then, APA Group securities have traded in the range \$5.93-\$6.68 (at a VWAP of \$6.14) and closed at \$6.68 on 28 February 2014. It should be noted that APA Group securities:

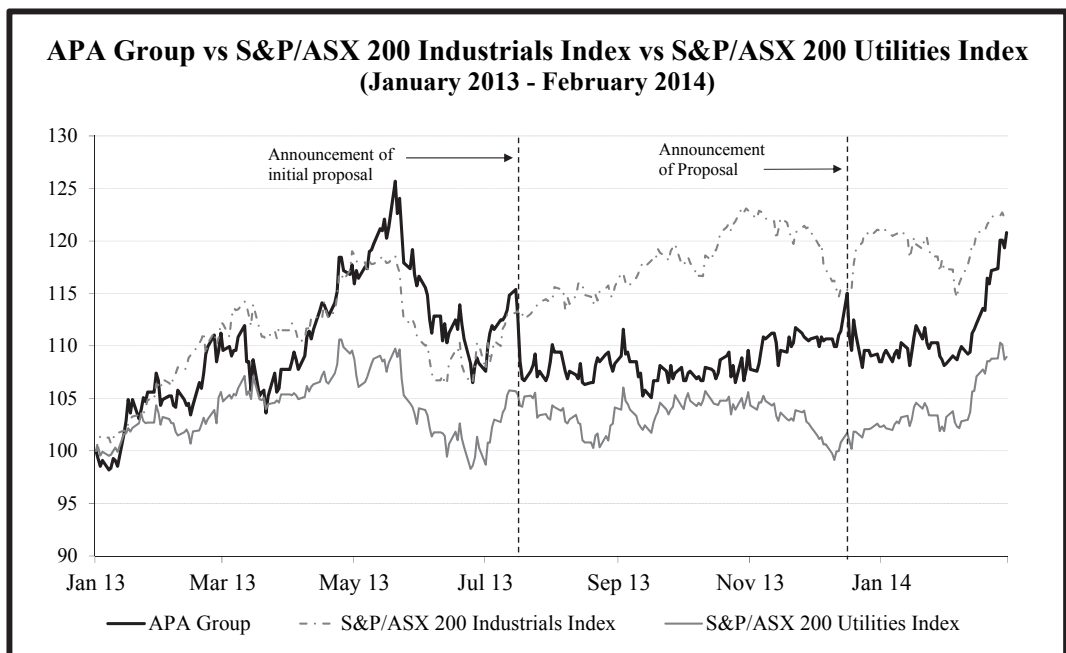
- commenced trading ex-distribution on 23 December 2013 (for a distribution of 17.5 cents payable on 12 March 2014), declining 17 cents on that day; and
- since 11 February 2014 have risen by around 10% ahead of the stockmarket in the same period (3%). This appears to reflect a positive response to APA Group’s interim FY14 results (released 19 February 2014), an expectation of further earnings emerging from the HDUF assets and the expansion of the Mondarra Gas Storage Facility and the announcement of a feasibility study for a project to link the eastern and northern gas pipeline systems.

However, although APA Group is reasonably liquid, security price movements of around 2% on a day to day basis are not uncommon. The important question is whether the recent performance and current price reflect the rational view of a well informed market or, alternatively, whether APA Group is out of line with its peers or the market.

In addressing this issue the following factors have been considered:

APA Group Compared to the Market

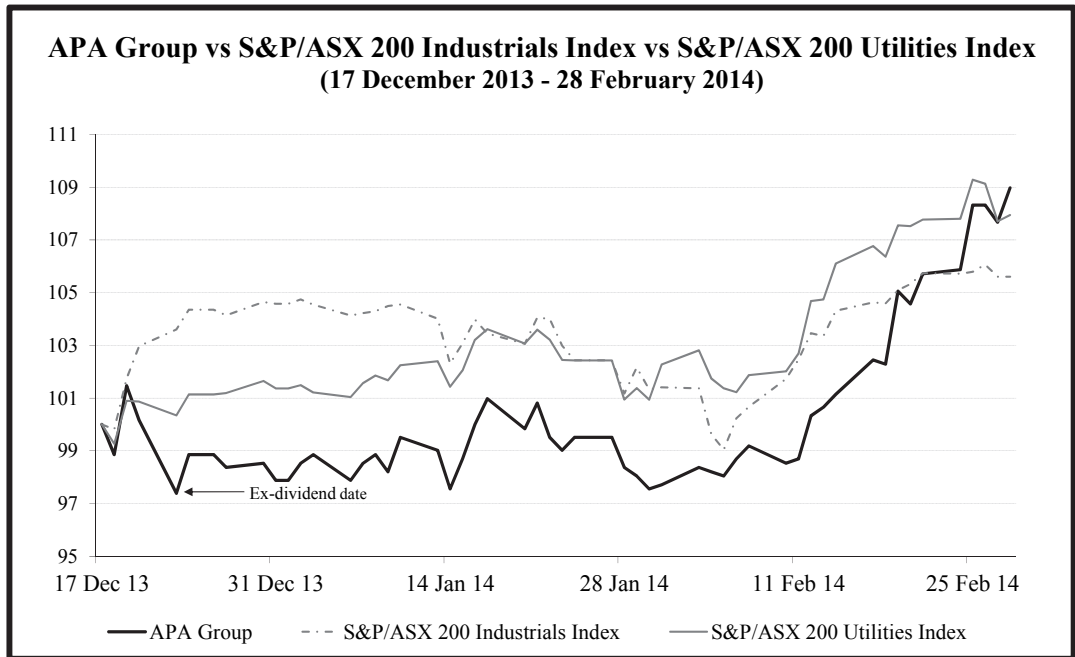
The following graph illustrates the performance of APA Group securities since 1 January 2013 relative to the S&P/ASX 200 Industrials Index and S&P/ASX 200 Utilities Index:



Source: IRESS

This graph shows that until the announcement of the initial proposal to Envestra, APA Group securities broadly mirrored movements in the market, although it outperformed the S&P/ASX 200 Utilities Index post mid-March 2013. On each announcement in relation to Envestra, the APA Group security price has fallen while the market was broadly flat on both days (although it should be noted that the security price closed higher on the day prior to each announcement).

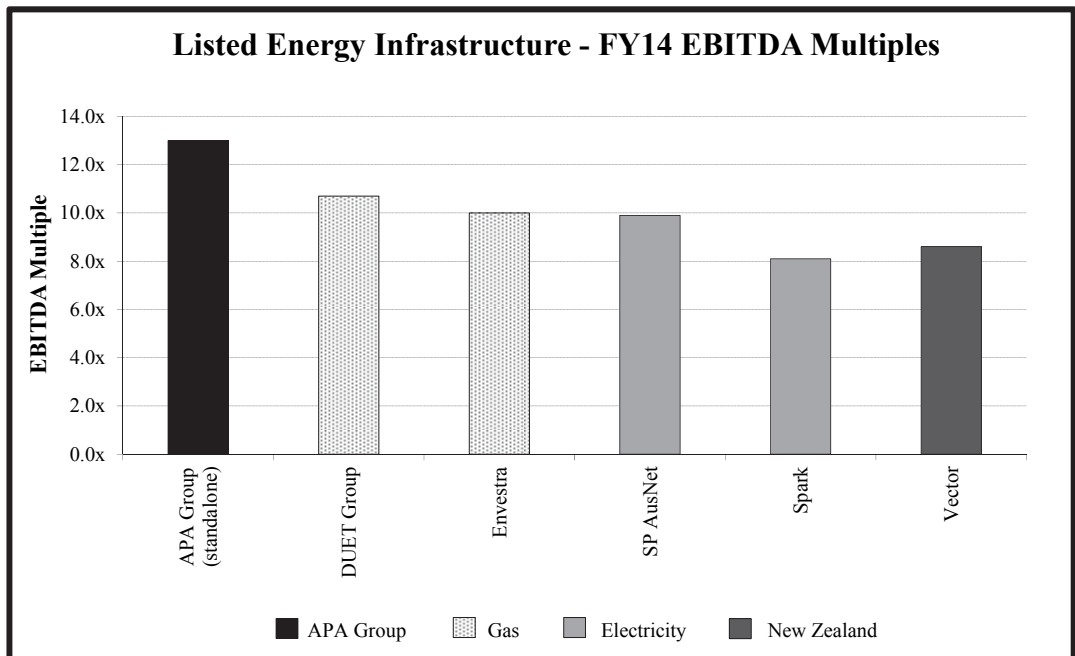
Following the commencement of ex-distribution trading on 23 December 2013, the APA Group security price performance mirrored movements in the market until mid February 2014 since which time it has outperformed the market:



Source: IRESS

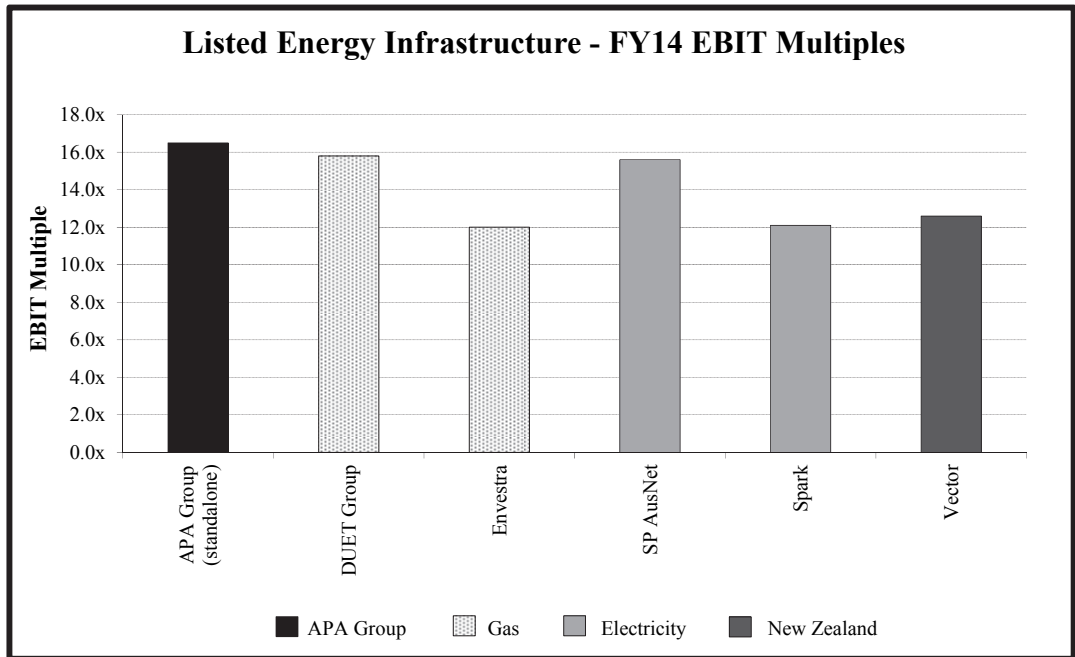
APA Group Compared to its Peers

APA Group’s market ratings (in terms of EBITDA multiples, EBIT multiples and NTA multiples) relative to its peers are illustrated below:

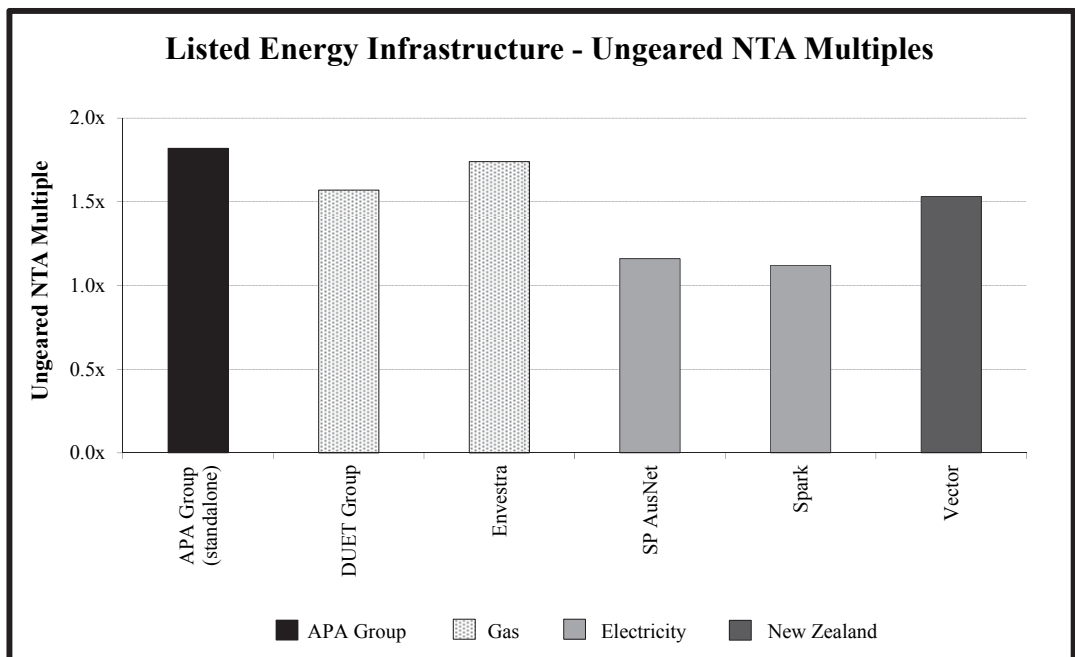


Source: Grant Samuel analysis (see Appendix 4)

- Notes:
- (1) Based on sharemarket prices as at 28 February 2014 except for Envestra which is shown as at 15 July 2013 (the day prior to the announcement of APA Group’s initial proposal). The closing prices of Envestra on 16 December 2013 (the day prior to announcement of the Proposal) was not materially different (\$1.06 vs. \$1.07).
 - (2) All of the listed entities have a 30 June year end, except Spark and SP AusNet which have a 31 December and 31 March year end, respectively. Therefore, for these entities FY14 equates to the year ended 31 December 2014 and 31 March 2014, respectively.
 - (3) As pro forma merged entity data has not yet been released for APA Group, APA Group is only presented in the graphs on a standalone basis.



Source: Grant Samuel analysis (see Appendix 4)



Source: Grant Samuel analysis (see Appendix 4)

Note: Ungearred NTA as at latest balance date.

APA Group is the largest gas transmission infrastructure owner in Australia and has direct management and operational control over its assets. It also owns and develops other energy infrastructure (e.g. gas storage facilities, wind farms and gas fired power stations), holds a range of equity interests in energy infrastructure entities, and provides a range of asset management services to those entities. Its earnings multiples reflect the blend of its activities and its extensive portfolio of pipelines. In considering APA Group’s relative market ratings the following should be noted:

- none of the listed peers is directly comparable to APA Group:
 - Envestra is primarily involved in ownership of regulated gas distribution networks;



- DUET Group owns and operates majority interests in a regulated gas transmission asset, a regulated gas distribution network and a regulated electricity distribution network. Approximately 65% of DUET Group's proportionate EBITDA is derived from its gas assets and therefore its metrics reflect the blend of its activities; and
- SP AusNet, Spark and, albeit to a lesser extent, Vector are primarily electricity distribution and transmission businesses;
- gas distribution businesses are relatively more capital intensive than gas transmission businesses, which supports a lower EBITDA multiple. In this regard, stay in business capital generally represents 5-6% of EBITDA for Envestra while it has generally represented around 4-5% of APA Group's EBITDA (based on its energy infrastructure and asset management segments). In comparison, DUET Group's stay in business capital expenditure (on a proportional basis) represents a higher proportion of EBITDA (of around 12-13%) reflecting its electricity distribution network as well as its regulated gas transmission and distribution assets;
- electricity infrastructure businesses are generally more capital intensive than gas infrastructure businesses and therefore trade at EBITDA multiples lower than the gas entities. Furthermore, the pure electricity sector entities (SP AusNet and Spark) trade at lower multiples of ungeared NTA compared to gas sector entities reflecting the longer useful lives of gas distribution and transmission infrastructure;
- similar to APA Group, DUET Group, Spark and Vector are fully internally managed (i.e. neither the assets nor entity management are outsourced). In comparison, management of the assets of Envestra and SP AusNet is outsourced (as is the entity management for SP AusNet); and
- unlike APA Group, DUET Group, Envestra, SP AusNet and Spark do not have a third party management business (although all derive some non-regulated revenue). Vector's multiples are higher due to its non-electricity activities (i.e. gas wholesale, gas haulage and technology).

Of the energy infrastructure peers, DUET Group is most comparable to APA Group. Both entities own, manage and operate gas assets. However, around 90%⁸³ of DUET Group's revenue is from regulated activities (compared to only 25% for APA Group), only 65% of its proportionate EBITDA is derived from gas assets and it does operate a third party asset management business. Consequently, APA Group trades at a premium to DUET Group although the extent of the premium decreases as earnings emerge for APA Group from the acquired HDUF assets and the commissioning of other assets over the period to FY16.

At current share prices APA Group's EBITDA multiples are materially above its peer group but this can be justified as a result of the scale and strategic importance of APA Group's assets (including the flexibility provided by its extensive east coast pipeline system), its lower capital intensity, the low proportion of regulatory assets, its third party management business and the earnings to emerge over the period to FY16. On an EBIT multiple basis it is more in line with its peers (albeit still at the higher end).

Based on the above analysis, there is no evidence to suggest that APA Group is trading on a basis relative to its peer group that is not sustainable.

Broker Target Prices

At its closing price on 28 February 2014 of \$6.68, APA Group is trading above median broker 12 month target prices:

⁸³ Excluding Dampier Bunbury Pipeline which (although a regulated asset) derives revenue on a contractual basis, 60% of DUET Group's revenue is regulated.



APA Group – Broker Target Prices					
Broker	Date of Last Report	Target Price⁸⁴			
		Pre 16 July 2013 Announcement	Post 16 July 2013 Announcement and FY13 Results	Post 17 December 2013 Announcement	Post 19 February 2014 (FY14 Interims)
Broker 1	20 February 2014	na	na	\$7.17	\$7.19
Broker 2	19 February 2014	\$6.20	\$6.25	\$6.12	\$6.24
Broker 3	19 February 2014	restricted	restricted	restricted	restricted
Broker 4	19 February 2014	na	\$6.11	\$6.33	\$6.17
Broker 5	19 February 2014	\$5.80	\$5.80	\$6.05	\$6.45
Broker 6	19 February 2014	\$5.10	\$5.50	\$5.60	\$5.70
Broker 7	19 February 2014	\$7.00	\$6.50	\$6.50	\$6.75
Broker 8	19 February 2014	\$6.05	\$6.25	\$6.55	\$6.80
Broker 9	19 February 2014	\$6.25	\$6.10	\$6.05	\$6.25
Broker 10	19 February 2014	\$6.10	\$6.30	\$6.40	\$6.85
Broker 11	19 February 2014	\$6.18	\$6.29	\$6.72	\$7.10
Broker 12	19 February 2014	\$6.20	\$6.19	\$6.12	nm ⁸⁵
Broker 13	19 February 2014	\$5.84	\$5.96	\$5.96	\$6.23
<i>Low</i>		<i>\$5.10</i>	<i>\$5.50</i>	<i>\$5.60</i>	<i>\$5.70</i>
<i>High</i>		<i>\$7.00</i>	<i>\$6.50</i>	<i>\$7.17</i>	<i>\$7.19</i>
Median		\$6.14	\$6.19	\$6.23	\$6.45

Source: Brokers' reports and Grant Samuel analysis (see Appendix 5)

The review of APA Group's target prices is made difficult by the timing of the announcements in relation to Envestra relative to its FY13 results announcement. As far as Grant Samuel is aware, brokers have only adjusted target prices since the announcement of the Proposal on 17 December 2013 to reflect changes to their views based on APA Group's standalone earnings and not as a consequence of the potential acquisition of Envestra (except for Broker 12 following the FY14 interim results). In addition, it is noted that median broker target prices pre and post announcement of the Proposal (particularly post FY13 results announcement) are broadly similar. However, following announcement of the FY14 interim results on 19 February 2014 broker target prices for APA Group have risen.

APA Group's current security price exceeds the median broker target price (\$6.45) but falls within the range of broker target prices. While there is no clear conclusion that can be drawn from this analysis, at a minimum, there is no evidence to suggest APA Group stapled securities are currently materially out of line with broker target prices.

Liquidity

APA Group is a reasonably liquid stock. Average weekly volume over the twelve months prior to announcement of the initial proposal to Envestra represented approximately 2% of average securities on issue or annual turnover of around 107% of average issued capital.

Over the past three years, APA Group has been involved in extended takeover activity in relation to HDUF (which occurred over the period from 14 December 2011 to 13 December 2012) and to Envestra (since 16 July 2013). Average weekly volume and transactions for APA Group securities for a different period over the last three years are summarised below:

⁸⁴ Restricted brokers are acting as advisers to either Envestra and APA Group.

⁸⁵ Broker 12's target price post 19 February 2014 assumes APA Group completes the acquisition of Envestra.



APA Group – Stapled Security Trading		
Period	Average Weekly Volume (000s)	Average Weekly Transactions
<i>Period post the Proposal</i>		
17 December 2013 to 28 February 2014	13,694	18,060
<i>Periods post Initial Proposal to Envestra</i>		
16 July 2013 to 28 February 2014 (<i>post initial proposal to Envestra</i>)	14,460	19,357
17 November 2013 to 16 December 2013 (<i>four weeks prior to Proposal</i>)	14,412	22,097
16 July 2013 to 16 December 2013 (<i>period from initial proposal to Proposal</i>)	14,920	20,102
<i>Periods without Takeover Activity</i>		
13 December 2012 to 15 July 2013 (<i>period from close of offer for HDUF to initial proposal to Envestra</i>)	13,165	21,864
14 December 2010 to 13 December 2011 (<i>year prior to announcement of takeover offer for HDUF</i>)	5,944	8,164

Source: IRESS and Grant Samuel analysis

APA Group’s takeover of HDUF was completed with consideration comprising cash and scrip. As result APA Group issued 175.7 million stapled securities, a 27% increase in its issued capital. As a consequence, trading in APA Group securities increased from around 5.9 million securities and 8,000 transactions per week to around 13.2 million securities and 22,000 transactions per week.

While average weekly volume of securities traded increased by 13% following the initial proposal approach to Envestra (while the number of trades have decreased implying an increase in the size of trades), this is not atypical when a transaction is anticipated. Although the average weekly volume of securities traded and the number of transactions have decreased since the announcement of the Proposal in December 2013, the implied size of the trades has not changed. This may reflect that the IBC is yet to recommend the Proposal and, other than the increase in the exchange ratio and the inclusion of the opportunity to receive some of the consideration in cash, no further financial information in relation to the Proposal has yet been made available to the market.

In summary, while the volume of trading activity in APA Group securities has generally increased since the initial proposal to Envestra, there is nothing to indicate any specific abnormal trading in APA Group stapled securities.

Non Public Information

Under ASX Listing Rules, APA Group is required to keep the market informed of events and developments in a timely manner as they occur. Once APA Group becomes aware of any information concerning it that a reasonable person would expect to have a material effect on the price or value of its securities, it must inform the market of that information.

On 14 November 2013, APA Group held an investor day, the presentations for which were designed to provide insight into its business operations, key priorities of APA Group and the business outlook. In this regard, APA Group addressed matters such as:

- near term growth driven by the committed expansions of the South West Queensland Pipeline, Victorian Transmission System, and the Goldfields Gas Pipeline;
- potential for further continued growth (e.g. exposure to additional gas demand from the Queensland LNG export projects via its integrated east coast pipeline system and the potential gas supply to the Gove Alumina Refinery via its Amadeus Gas Pipeline);



- the implications of changes in east coast gas dynamics including upward pressure on domestic gas prices which may reduce domestic demand for gas but may also facilitate the development of further unconventional gas resources (particularly in the Cooper Basin); and
- customer recontracting risk, particularly in relation to the Moomba to Sydney Pipeline. In this regard, APA Group is actively marketing the pipeline’s capacity in order to replace contracts expiring in FY16 and exploring other revenue opportunities (e.g. storage services).

APA Group announced its interim FY14 financial results and reaffirmed its FY14 guidance on 19 February 2014. It also announced a feasibility study into the development of a link between the Northern Pipeline System and the Eastern Pipeline System, the objective of which would be to further increase the flexibility of APA Group’s existing pipeline network.

Consequently, there is no reason to consider that any information relating to APA Group’s standalone business that would have a material impact on its security price has not been publicly disclosed.

7.4 Impact of Proposal

It could be argued that the market is not yet fully informed about the Proposal and its impacts for APA Group. No detailed financial information on the merged APA Group was provided at announcement of the Proposal and some market participants are of the view that APA Group has not clearly set out its strategic rationale for the acquisition of Envestra. Such information will only be made available when the Scheme Booklet is released (if the Envestra IBC decides to recommend the Proposal) and the extent to which information will be made available is unknown.

However, analysis of the impact of the Proposal on APA Group is reasonably straightforward insofar as it is a conventional 100% acquisition. In any event, there is no real change in the nature of APA Group other than the level of its interest in Envestra, the reduction in third party management revenue and the increase in the proportion of revenue that is directly derived from regulated assets. On the other hand:

- the “mix and match” facility means there is a range of outcomes in relation to gearing and issued capital depending on the extent to which the alternative is taken up;
- APA Group’s interest in Envestra will increase from 33.05% to 100% and its interest will be consolidated and not equity accounted. The unravelling of the equity accounting complicates the financial analysis based on publicly available financial information; and
- the extent of estimated cost savings and transaction costs for APA Group in relation to the Proposal is unknown.

However, both APA Group and Envestra are relatively transparent entities and widely followed by brokers (some of which have undertaken the merger analysis). It is reasonable to believe that the market has had time to assess the Proposal and its implications for APA Group and that the estimated impacts are reflected in current trading in APA Group securities.

7.5 Conclusion

It is over seven months since APA Group’s initial proposal to Envestra. In this time, trading in APA Group securities has been impacted by:

- the release of its FY13 financial results, FY14 guidance and interim FY14 results; and
- market uncertainty as to whether the Proposal will proceed and implications for APA Group of the acquisition.

Nevertheless:

- there is no evidence to suggest that the APA Group security price does not reflect the rational

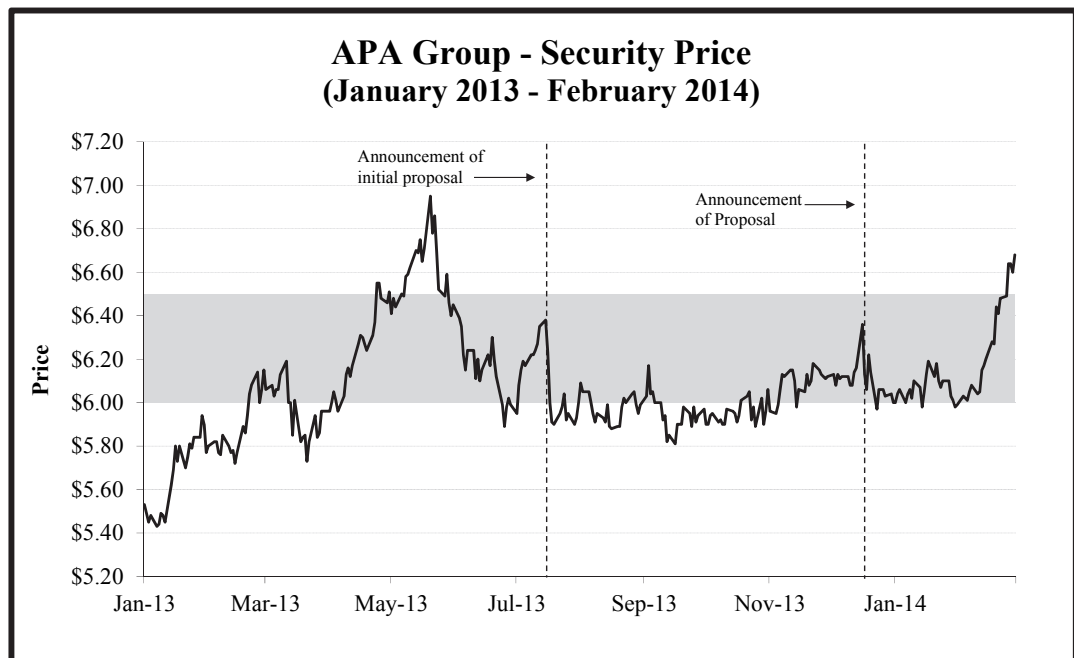


view of an informed market or that APA Group is trading on a basis relative to its peer group that is not sustainable; and

- energy infrastructure entities such as APA Group and Envestra are relatively transparent and the market has had sufficient opportunity to absorb and analyse the impact of the transaction. Therefore, the impact of the acquisition of Envestra should be reflected in APA Group’s current security price although there is some uncertainty at this time as to the operational and financial implications of the Proposal for APA Group.

Grant Samuel’s judgement is that, for the purposes of assessing the Proposal, an APA Group security price of \$6.00-6.50 is a reasonable estimate in current market conditions. This range takes into account the performance of APA Group securities since the initial proposal to Envestra, the limited information available in relation to the merged entity and current market conditions.

The selected value range relative to recent APA Group stapled security prices is shown below:



Source: IRESS

The low end of the range (\$6.00) broadly reflects sharemarket trading since July 2013 until mid February 2014 and APA Group has not traded below this level for any length of time since November 2013.

The top end of the selected range (\$6.50) is below the closing price on 28 February 2014 of \$6.68. Prima facie, the current security price represents the value of the consideration under the Proposal. However, Grant Samuel considers that, for the purposes of assessing the Proposal, some conservatism is warranted given:

- the substantial rise (10%) in the APA Group security price in a very short period of time (since 11 February 2014);
- APA Group securities have only traded above \$6.50 on five days (out of the eight) since the release of its interim FY14 results;
- the current security price exceeds the current median broker target price; and
- combined group financial information is not yet available,

If the security price is sustained at levels above \$6.50, it may be appropriate to revise (upwards) the value range attributed to APA Group securities for the purposes of assessing the Proposal in the Shareholder Report.



8 Evaluation of the Proposal

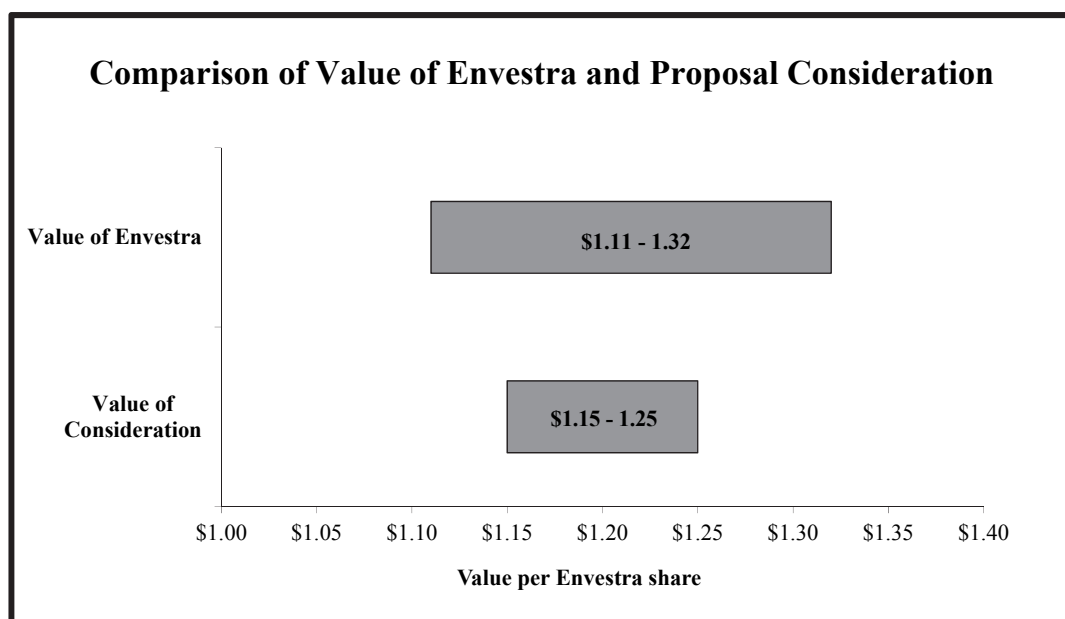
8.1 Conclusion

In Grant Samuel’s opinion, the Proposal is in the best interests of Envestra shareholders other than APA Group, in the absence of a superior proposal.

8.2 Fairness

Grant Samuel has estimated the full underlying value of Envestra, including a premium for control, to be in the range \$1,994.4-2,373.4 million which corresponds to \$1.11-1.32 per share. The value is the aggregate of the estimated market value of Envestra’s business operations together with other assets less external borrowing and non-trading liabilities. The value range exceeds the price at which, based on current market conditions, Grant Samuel would expect Envestra shares to trade on the ASX in the absence of a takeover offer in the short term. The valuation is set out in Section 5 of this report.

The value attributed to the scrip consideration (\$1.15-1.25 per share) falls within Grant Samuel’s estimate of the full underlying value for Envestra. Accordingly, the Proposal is fair. The bottom of the valuation range represents the relevant threshold for fairness. Any price above the bottom of the range is, by definition, fair.



However, the value of the consideration under the Proposal will vary with movements in the APA Group stapled security price. Accordingly, until the APA Group securities are issued under the Proposal, Envestra shareholders are exposed to changes in overall equity market conditions and specific events that could impact the APA Group security price. The actual value received could therefore ultimately exceed, or be less than, \$1.15-1.25 per Envestra share.

8.3 Reasonableness

As the Proposal is fair, it is also reasonable. In any event, there are a number of other factors that support the reasonableness of the Proposal and which Envestra shareholders should consider in determining whether or not to vote for the Proposal. These factors are set out in the following sections.



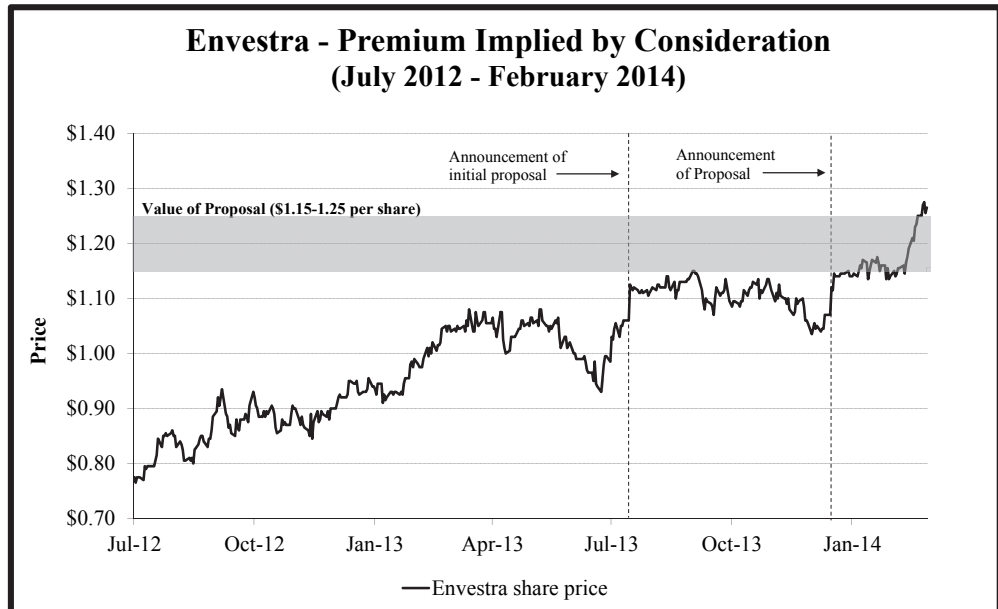
8.3.1 Premium for Control

The Proposal represents the following premiums over pre announcement prices when measured relative to the value attributed to the consideration by Grant Samuel (\$1.15-1.25 per share):

Envestra – Premium Implied by Value of Consideration			
Period	Value of Proposal Consideration	Envestra Price/VWAP	Premium
16 December 2013 – Pre-Proposal price	\$1.15-1.25	\$1.07	7.5-16.8%
15 July 2013 – Pre-initial proposal price	\$1.15-1.25	\$1.06	8.5-17.9%
1 week prior to 15 July 2013 (VWAP)	\$1.15-1.25	\$1.05	9.3-19.0%
1 month prior to 15 July 2013 (VWAP)	\$1.15-1.25	\$1.00	15.0-25.0%
3 months prior to 15 July 2013 (VWAP)	\$1.15-1.25	\$1.02	12.7-22.5%
6 months prior to 15 July 2013 (VWAP)	\$1.15-1.25	\$1.02	12.7-22.5%
12 months prior to 15 July 2013 (VWAP)	\$1.15-1.25	\$0.96	19.8-30.2%

Source: IRESS and Grant Samuel analysis

The announcement of the initial proposal from APA Group on 16 July 2013 resulted in a 6% jump in the Envestra share price (to \$1.125). Although the Envestra share price had declined to around \$1.07 on the day prior to the announcement of the Proposal on 17 December 2013 (in line with a decline in the market), it had traded at a VWAP of \$1.10 in the period between announcements. Consequently, the relevant benchmarks for the implied premium are the unaffected Envestra share prices prior to 16 July 2013 as illustrated in the following graph:



Source: IRESS and Grant Samuel analysis

The level of premiums observed in takeovers varies depending on the circumstances of the target and other factors (such as the potential for competing offers) but for industrial companies tends to fall in the range 20-35%. However, in the case of energy infrastructure entities with a primary focus on ownership of regulated assets there is little scope for large premiums over pre-bid prices as cash flows are stable and predictable with security prices underpinned by the distribution yield and typically there are limited synergies available to a purchaser.



The Proposal represents premiums of around 8-25% to unaffected Envestra share prices. The premium is significant given Envestra is an investor in regulated gas distribution assets with no other operating business. High premiums for control are not expected as Envestra:

- has stable and predictable cash flows with long run growth generally limited to economic growth and inflation;
- is reasonably transparent to investors;
- distributions represent a substantial proportion of available cash flow; and
- there is limited scope for an acquirer to achieve synergies or to enhance returns by increasing debt.

Another, and perhaps better, way of looking at the premium represented by the Proposal is to compare the value of the Proposal based on the APA Group stapled security price for a particular date or period to the price of Envestra shares on the same date or period. On this basis, the Proposal represents premiums of around 14-20%:

Envestra – Premium over Pre-announcement Prices				
Period	APA Group Price/VWAP	Implied Consideration	Envestra Price/VWAP	Premium
16 December 2013 – Pre-Proposal price	\$6.36	\$1.22	\$1.07	14.0%
15 July 2013 – Pre-initial proposal price	\$6.38	\$1.22	\$1.06	15.1%
1 week prior to 15 July 2013 (VWAP)	\$6.28	\$1.20	\$1.05	14.3%
1 month prior to 15 July 2013 (VWAP)	\$6.13	\$1.18	\$1.00	18.0%
3 months prior to 15 July 2013 (VWAP)	\$6.34	\$1.22	\$1.02	19.6%
6 months prior to 15 July 2013 (VWAP)	\$6.16	\$1.18	\$1.02	15.7%
12 months prior to 15 July 2013 (VWAP)	\$5.52	\$1.06	\$0.96	10.4%

Source: IRESS and Grant Samuel analysis

8.3.2 Share Trading in the absence of any Takeover Offer

In the absence of the Proposal or a similar offer, shareholders could only realise their investment by selling on market at a price which does not include a premium and which would incur transaction costs (e.g. brokerage). In these circumstances (assuming no speculation as to an alternative or revised offer), it is likely that Envestra shares, under current market conditions and its current ownership and operating structure, would trade at prices below the value of the Proposal (\$1.15-1.25 per share). However, any drop in the price is unlikely to be substantial as the premia implied by Grant Samuel’s value range (8-25%) are relatively limited and the share price will be supported by its dividend yield.

8.3.3 Existing APA Group Interest

As the Proposal is fair it is also reasonable. However, it should be noted that an acquisition proposal by any other party could not succeed without the agreement of APA Group (as Envestra’s largest shareholder with a 33.05% shareholding). The level of this shareholding means that an offer by APA Group which was not fair may still be reasonable depending on the circumstances. On the other hand, CKI’s interest in Envestra (17.46%) is such that it may be difficult for APA Group to make an offer that was not fair.

Nevertheless, it should be noted that under the Corporations Act, APA Group can increase its interest by up to 3% every six months without making a full takeover offer (i.e. without paying a premium for control). However, there is a risk that a change of control may be considered “unacceptable” to financiers party to the Intercreditor Deed Poll and therefore an event of default. This may result in early repayment of Envestra’s debt and substantial payments above face value and other costs.



8.4 Other Advantages, Disadvantages and Risks

Under the Proposal, shareholders will exchange their Envestra shares for stapled securities in APA Group (and if they select the “mix and match facility” some portion in cash). In doing so, Envestra shareholders:

- will realise their investment in Envestra at a value that incorporates a premium for control (and will, if they elect to receive some cash, receive some of that value in cash⁸⁶) but the actual value received will only be determined when the APA Group stapled securities are issued. Some shareholders may not want to hold APA Group stapled securities and would have preferred to crystallise their investment in Envestra in cash. However, Envestra shareholders will be able to sell into a liquid market for APA Group stapled securities, although there is no certainty that they will be able to realise the scrip received for an amount equivalent to the value attributed to the consideration (e.g. due to transaction costs and the risks associated with any stockmarket investment). On the other hand, ineligible foreign shareholders and unmarketable parcel securityholders will receive cash proceeds from the sale of the APA Group securities they would otherwise have received;
- incur no transaction costs (i.e. brokerage) to acquire APA Group stapled securities. Moreover, as the exchange ratio under the Proposal reflects a premium for control, their interest in APA Group will be greater than if they had realised their Envestra shares on market and used the sale proceeds (net of transaction costs) to acquire APA Group stapled securities on market (also net of transaction costs); and
- if eligible, may be able to defer some of the capital gains consequences of accepting the Proposal to the extent capital gains tax scrip for scrip rollover relief is available (see Section 8.6). If shareholders elect to receive some cash, the cash amount received may be used to meet some or all of any capital gains tax liability.

The decision to hold APA Group stapled securities received under the Proposal is a decision independent of a decision to vote for the Proposal. However, if the APA Group stapled securities are retained, Envestra shareholders will:

- retain an economic interest in the Envestra assets, albeit on a diluted basis. The eventual interest of Envestra shareholders in APA Group depends on shareholder elections in relation to the maximum cash consideration alternative but will be in the range of 18.6-21.6% of the enlarged APA Group;
- gain exposure to APA Group, a member of the S&P/ASX 50 Index and Australia’s largest natural gas infrastructure business. However, Envestra shareholders will no longer be invested in an entity with primary focus on investment in regulated gas distribution assets as APA Group is an active operator of gas infrastructure assets which has ownership interests in and operates \$12 billion of energy infrastructure. Consequently, Envestra shareholders will be exposed to a more diversified and less regulated portfolio of assets (although still predominantly gas infrastructure assets) and the general operational risks of APA Group’s activities. There will be no change in their exposure to APA Group’s asset management expertise as Envestra’s assets are currently operated by APA Group;
- be entitled to distributions on a pari passu basis with APA Group securityholders (i.e. they will be entitled to all distributions paid by APA Group after the date of issue of the stapled securities under the Proposal), including for the six months ended 30 June 2014 if the Proposal is implemented prior to 30 June 2014; and
- be exposed to integration risk although the risk will be mitigated to some degree by APA Group’s confirmatory due diligence process and the fact that it currently operates Envestra’s networks.

⁸⁶ The maximum amount of cash that a shareholder could receive is \$1.17 per share. Depending on the elections for the maximum cash consideration, shareholders elections will be scaled back to cap the total cash payment by APA Group to \$241 million.



8.5 Prospect of a Superior Alternative Proposal

The Proposal is fair and reasonable. However, in weighing up any proposal, shareholders need to have regard to the alternatives that are realistically available to them.

Since the announcement of the initial proposal on 16 July 2013 and the Proposal on 17 December 2013, there has been an opportunity for any other interested party to make a competing offer. No such offer has been made at the date of this report. Although a competing offer may be made at any time before the meetings for the Proposal, there appears little likelihood that an alternative bidder will make a more attractive offer for Envestra.

However, an acquisition proposal by any other party could not succeed without the agreement of APA Group (33.05% interest) and CKI (17.46% interest). A potential acquirer may also be deterred by the fact the O&M Contracts are long term (expiry June 2027) and not easily terminable by Envestra.

It would be open to shareholders to vote against the Proposal in the hope that APA Group would make a subsequent higher offer. However, this involves significant risks. There is no evidence that APA Group would be prepared to pay a higher price. It has increased the consideration since July 2013, has engaged with Envestra for over seven months and has incurred costs. Moreover, shareholders could not be confident of realising a price as high as \$1.15-1.25 if they wished to sell on market at a later date.

In any event, the consideration offered under the Proposal represents a fair price for Envestra.

8.6 Other Matters

Taxation Consequences

If the Proposal is recommended by the IBC and then receives shareholder approval, shareholders will be treated as having disposed of their Envestra shares for tax purposes. A capital gain or loss may arise on disposal depending on the cost base of the Envestra shares, the length of time held, whether the shares are held on capital or revenue account and whether the shareholder is an Australian resident for tax purposes. A summary of the taxation consequences will be set out in the Scheme Booklet. In particular, it should be noted that under the Proposal, capital gains tax scrip for scrip rollover relief may only be available to eligible shareholders in relation to a portion of their investment. Shareholders should consult their own professional adviser in relation to the taxation consequences.

Transaction Costs

If the Proposal is not recommended by the IBC, it is estimated that Envestra will meet costs (including legal and other adviser's fees) of \$2.5 million as a standalone entity (<0.5 cents per share) of which \$1.2 million had been incurred prior to 31 December 2013. If the Proposal is recommended and put to shareholders for approval but does not proceed it is estimated that these costs will increase to \$3.0 million (including additional legal and adviser's fees as well as printing and mailing costs) (<0.5 cents per share).

Ineligible Foreign Shareholders

Ineligible foreign shareholders (i.e. Envestra shareholders with registered addresses outside of Australia and its external territories and New Zealand) (unless otherwise determined by Envestra and APA Group) will not be entitled to receive APA Group stapled securities under the Proposal. However:

- the APA Group securities which they would otherwise receive will be sold on market and they will receive the cash proceeds of sale (after payment of any applicable brokerage, taxes and costs) in Australian dollars;
- they can acquire APA Group securities through the ASX if they wish to retain an exposure to the merged entity; and
- shareholders representing a relatively small percentage of Envestra's issued shares are expected to be impacted by these provisions.



Unmarketable Parcel Securityholders

Under either consideration option, Envestra shareholders can elect to have the APA Group stapled securities to which they become entitled sold under a cash out facility in the event that they receive an unmarketable parcel. Based on the closing price on 28 February 2014 of \$6.68, shareholders holding less than 400 Envestra shares will receive a less than marketable parcel of APA Group securities (i.e. a parcel of APA Group securities with a market value of less than \$500). If they elect for the securities to be sold, APA Group will arrange for those securities to be sold and remit the proceeds to the shareholder. In this context, they can acquire APA Group securities through the ASX if they wish to retain an exposure to the merged entity. In any event, only a relatively small percentage of Envestra's issued capital will be impacted.



9 Qualifications, Declarations and Consents

9.1 Qualifications

The Grant Samuel group of companies provide corporate advisory services (in relation to mergers and acquisitions, capital raisings, debt raisings, corporate restructurings and financial matters generally) and provides marketing and distribution services to fund managers. The primary activity of Grant Samuel & Associates Pty Limited is the preparation of corporate and business valuations and the provision of independent advice and expert's reports in connection with mergers and acquisitions, takeovers and capital reconstructions. Since inception in 1988, Grant Samuel and its related companies have prepared more than 500 public independent expert and appraisal reports.

The persons responsible for preparing this IBC Report on behalf of Grant Samuel are Caleena Stilwell BBus FCA F Fin and Stephen Wilson BCom MCom (Hons) CA(NZ) SF Fin. Each has a significant number of years of experience in relevant corporate advisory matters. Ross Grant BSc (Hons) MComm (Hons), Sophie Whitlam BCom BSc and Chapman Li BCom assisted in the preparation of the report. Each of the above persons is a representative of Grant Samuel pursuant to its Australian Financial Services Licence under Part 7.6 of the Corporations Act.

9.2 Disclaimers

It is not intended that this IBC Report should be used or relied upon for any purpose other than as an expression of Grant Samuel's opinion as to whether the Proposal is fair and reasonable and in the best interests of shareholders other than APA Group. Grant Samuel expressly disclaims any liability to any Envestra shareholder who relies or purports to rely on the report for any other purpose and to any other party who relies or purports to rely on the report for any purpose whatsoever.

This IBC Report has been prepared by Grant Samuel with care and diligence and the statements and opinions given by Grant Samuel in this report are given in good faith and in the belief on reasonable grounds that such statements and opinions are correct and not misleading.

9.3 Independence

Grant Samuel and its related entities do not have at the date of this IBC Report, and have not had within the previous two years, any business or professional relationship with Envestra or APA Group or any financial or other interest that could reasonably be regarded as capable of affecting its ability to provide an unbiased opinion in relation to the Proposal. Grant Samuel advises that it prepared an independent expert's report dated 3 August 2012 for HDUF in relation to a takeover offer by Pipeline Partners Australia Pty Limited. HDUF was eventually taken over by APA Group.

Grant Samuel had no part in the formulation of the Proposal. Its only role has been the preparation of this IBC Report. If the Proposal is recommended to shareholders Grant Samuel will prepare the Shareholder Report.

Grant Samuel will receive a fixed fee of \$475,000 for the preparation of this IBC Report. This fee is not contingent on the conclusions reached or the outcome of the IBC's deliberations in relation to the Proposal. Grant Samuel's out of pocket expenses in relation to the preparation of this IBC Report will be reimbursed. Grant Samuel will receive no other benefit for the preparation of this IBC Report.

Grant Samuel considers itself to be independent in terms of Regulatory Guide 112 issued by the ASIC on 30 March 2011.



9.4 Declarations

Envestra has agreed that it will indemnify Grant Samuel and its employees and officers in respect of any liability suffered or incurred as a result of or in connection with the preparation of the IBC Report. This indemnity will not apply in respect of the proportion of any liability found by a court to be primarily caused by any conduct involving gross negligence or wilful misconduct by Grant Samuel. Envestra has also agreed to indemnify Grant Samuel and its employees and officers for time spent and reasonable legal costs and expenses incurred in relation to any inquiry or proceeding initiated by any person. Any claims by Envestra are limited to an amount equal to three times the fees paid to Grant Samuel. Where Grant Samuel or its employees and officers are found to have been negligent or engaged in wilful misconduct Grant Samuel shall bear the proportion of such costs caused by its action.

Advance drafts of this IBC Report were provided to Envestra and its advisers. Advance drafts of Section 6 and Appendix 5 of the IBC Report were also provided to APA Group by Envestra. Certain changes were made to the drafting of the report as a result of the circulation of the draft IBC Report. In particular, following the provision of the full final draft IBC Report on 13 February 2014, Grant Samuel has:

- adjusted the net borrowings for valuation purposes to reflect fair value adjustments at 31 December 2013. This resulted in an \$0.5 million increase in the overall value of Envestra but did not result in any change in the value on a per share basis; and
- increased the value of the consideration under the Proposal from \$1.11-1.17 to \$1.15-1.25 per Envestra share reflecting the substantial increase in the APA Group security price since circulation of the full final draft IBC Report. This change did not result in any change in Grant Samuel's assessment of the fairness of the Proposal.

There was no alteration to the methodology, evaluation or opinion as a result of issuing the drafts.

9.5 Consents

Grant Samuel consents to the lodging of this IBC Report with the ASX for public release. Neither the whole nor any part of this report nor any reference thereto may be included in any document without the prior written consent of Grant Samuel as to the form and context in which it appears.

9.6 Other

Grant Samuel has prepared a Financial Services Guide as required by the Corporations Act. The Financial Services Guide is set out at the beginning of this IBC Report.

GRANT SAMUEL & ASSOCIATES PTY LIMITED

3 March 2014

Grant Samuel & Associates

Appendix 1

Envestra - Broker Consensus Forecasts

Envestra has not publicly released earnings forecasts for FY14 or beyond. However, on 12 December 2013 Envestra announced that it expects to record profit after tax for FY14 of around \$145 million, reflecting lower than expected borrowing costs and higher than expected gas volumes to residential and commercial markets. Envestra has also announced an increase in the annual rate of dividends paid from 5.9 cents per share paid in FY13 to 6.4 cents per share declared in FY14. On 20 February 2014, Envestra increased its guidance for FY14 net profit after tax to between \$145 million and \$150 million.

In order to provide an indication of the expected future financial performance of Envestra, Grant Samuel has considered brokers' forecasts for Envestra. Set out below is a summary of forecasts prepared by brokers that follow Envestra in the Australian stockmarket:

Broker		Revenue (\$millions)		EBITDA ¹ (\$millions)		EBIT ² (\$millions)		NPAT ³ (\$millions)		EPS ⁴ (cents)		DPS ⁵ (cents)							
		2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016			
1	21-Feb-14	543.0	562.3	578.3	393.1	410.1	419.4	328.5	340.8	345.3	142.4	149.8	148.1	7.9	8.3	8.2	6.4	6.7	7.1
2	20-Feb-14	556.2	585.6	609.9	404.0	419.0	444.0	342.4	354.5	379.0	147.6	146.9	161.9	8.2	8.2	9.0	6.4	7.5	8.7
3	20-Feb-14	557.3	575.3	610.1	409.0	421.0	448.0	348.9	356.0	382.9	148.3	149.6	157.9	8.3	8.3	8.8	6.4	7.3	8.4
4	20-Feb-14	550.1	567.1	587.9	401.0	414.1	425.9	338.6	347.1	354.8	148.0	149.1	151.5	8.2	8.3	8.4	6.4	6.6	7.0
5	20-Feb-14	560.6	580.4	606.5	397.7	410.9	430.2	335.1	343.7	359.4	149.4	148.2	149.3	8.3	8.2	8.3	6.4	6.6	6.8
6	20-Feb-14	555.6	575.8	596.6	403.8	417.4	433.2	341.0	350.0	362.0	147.8	145.8	147.2	8.2	8.1	8.2	6.4	6.7	7.4
7	20-Feb-14 ⁶	522.0	566.0	618.0	377.0	411.0	453.0	320.0	351.0	391.0	143.0	160.0	183.0	7.8	9.1	10.0	6.4	6.5	7.0
	<i>Minimum</i>	522.0	562.3	578.3	377.0	410.1	419.4	320.0	340.8	345.3	142.4	145.8	147.2	7.8	8.1	8.2	6.4	6.5	6.8
	<i>Maximum</i>	560.6	585.6	618.0	409.0	421.0	453.0	348.9	356.0	391.0	149.4	160.0	183.0	8.3	9.1	10.0	6.4	7.5	8.7
	<i>Median</i>	555.6	575.3	606.5	401.0	414.1	433.2	338.6	350.0	362.0	147.8	149.1	151.5	8.2	8.3	8.4	6.4	6.7	7.1

Source: Brokers' reports, Grant Samuel analysis

When reviewing this data the following should be noted:

- as far as Grant Samuel is aware, Envestra is followed by 14 brokers of which seven are presented above. Six of the remaining seven brokers have not released research on Envestra since the interim FY14 results were reported on 20 February 2014, while the report of the other broker is not yet available to Grant Samuel;
- the forecasts presented above represent the latest available broker forecasts for Envestra and all were published after Envestra announced its results for the interim FY14 on 20 February 2014; and
- as far as is possible to identify from a review of the brokers' reports, Grant Samuel believes that the earnings forecasts do not incorporate any one-off adjustments or non-recurring items.

¹ EBITDA is earnings before net interest, tax, depreciation and amortisation, other income and non-recurring items.

² EBIT is earnings before net interest, tax and other income and non-recurring items.

³ NPAT is net profit after tax.

⁴ EPS = earnings per share.

⁵ DPS = dividends per share.

⁶ Broker 7 released a report on 20 February 2014 following Envestra's interim FY14 results announcement but provided no update to its forecasts published in a report on 29 January 2014.



Appendix 2

DCF Model Assumptions

1 General Assumptions

The following general assumptions have been made in the DCF Model:

- a discount rate of 6.5-7.0% is applied to nominal ungeared after tax cash flows;
- inflation of 2.5% per annum;
- a cost for carbon is included but is fully recovered in revenue;
- corporate tax rate of 30%;
- no significant changes in legislation or in the policies or procedures of regulatory bodies;
- no changes in working capital due to the long term, stable nature of the cash flows; and
- no acquisitions or divestitures occur.

2 Operational Assumptions

The key operational assumptions underlying Case A are set out below:

- for the current Access Arrangement periods, regulated revenue is determined by multiplying tariffs set by the AER and volumes forecast by Envestra;
- for subsequent determination periods:
 - regulated revenue has been modelled using the building block approach. That is, revenue is the sum of:
 - the rate of return multiplied by the starting period regulated asset base (“RAB”) subject to annual inflation and straight line depreciation;
 - regulatory allowed operating expenditure; and
 - tax payable less an allowance for the implied value of imputation credits; and
 - the rate of return has been determined by reference to the AER guidelines released in December 2013. On this basis, it is assumed that for all of Envestra’s regulated assets the rate of return is 7.58%¹ and gamma is 0.5 (which compares to the current South Australian/Queensland rate of return of 10.28% and gamma of 0.25 until 30 June 2016, the Victoria/Albury rate of return of 7.39% and gamma of 0.25 until 31 December 2017 and the Wagga Wagga rate of return of 9.72% and gamma of 0.65 until 30 June 2015);
- allowance is made for Envestra’s history of performance relative to operating expenditure regulatory targets;
- RAB is calculated by taking start of regulatory period RAB, allowing for inflation, adding capital expenditure and subtracting straight line depreciation;
- an Efficiency Carryover Mechanism allowance is allowed for in the current and next access arrangement period;
- 2.5% per annum growth in non-regulated revenue;
- operating costs are estimated on a project by project basis, where individual major projects, cost initiatives and mains replacement impact on operating costs are separately identified in the short to medium term. In the long term, operating costs are assumed to increase by 2.5% per annum;
- capital expenditure has been forecast in the medium term on a project by project basis based on Envestra’s 2013 Strategic Plan. In the longer term, capital expenditure is forecast based on

¹ Based on Envestra assumptions: risk free rate of 4.26%, market risk premium of 6.5%, equity beta of 0.7, gearing of 60% and debt risk premium of 2.5%.



connection costs (increasing by 2.5%) and connection numbers based on third party projections, observed market trends and management insights.

- specific assumptions on a region by region basis are as follows:

South Australia/Northern Territory

- the current Access Arrangement period ends on 30 June 2016;
- capital expenditure reflects the 2013 Strategic Plan with the major expenditure being the mains replacement program for the Adelaide network. An accelerated mains replacement program is underway to replace the remaining 12% of the network that utilises cast iron and unprotected steel mains and is scheduled to be completed by FY17; and
- terminal value based on perpetual growth rate of 2.5%.

Victoria

- the current Access Arrangement period ends on 31 December 2017;
- capital expenditure in the current Access Arrangement period (largest component of which is the mains replacement programme) has been delayed relative to the 2013 Strategic Plan as a consequence of the delay in the AER decision. The mains replacement program is to replace the remaining 4% of the network that utilises cast iron and unprotected steel mains and is scheduled to be completed by FY20; and
- terminal value based on perpetual growth rate of 3.0%.

Queensland

- the current Access Arrangement period ends on 30 June 2016;
- capital expenditure in the current Access Arrangement period (the largest component of which is the mains replacement programme for the Brisbane network) reflects the 2013 Strategic Plan. The mains replacement program is to replace the remaining 6% of the network that utilises cast iron and unprotected steel mains and is scheduled to be completed by FY18; and
- terminal value based on perpetual growth rate of 2.5%.

New South Wales

- the New South Wales region consists of two regulated networks, Wagga Wagga and Albury
- the current Access Arrangement period for Wagga Wagga ends on 30 June 2015;
- the current Access Arrangement period for Albury ends on 31 December 2017; and
- terminal value based on a perpetual growth rate of 2.5%.



Appendix 3

Selection of Discount Rate

1 Overview

A discount rate in the range of 6.5-7.0% has been selected as appropriate to apply to the forecast nominal ungeared after tax cash flows of the business operations of Envestra Limited (“Envestra”).

Selection of the appropriate discount rate to apply to the forecast cash flows of any business enterprise is fundamentally a matter of judgement. The valuation of an asset or business involves judgements about the discount rates that may be utilised by potential acquirers of that asset. There is a body of theory which can be used to support that judgement. However, a mechanistic application of formulae derived from that theory can obscure the reality that there is no “correct” discount rate. Despite the growing acceptance and application of various theoretical models, it is Grant Samuel’s experience that many companies rely on less sophisticated approaches. Many businesses and investors use relatively arbitrary “hurdle rates” which do not vary significantly from investment to investment or change significantly over time despite interest rate movements. Valuation is an estimate of what real world buyers and sellers of assets would pay and must therefore reflect criteria that will be applied in practice even if they are not theoretically correct. Grant Samuel considers the rates adopted to be reasonable discount rates that acquirers would use irrespective of the outcome of any particular theoretical model.

The discount rate that Grant Samuel has adopted is reasonable relative to the rates derived from theoretical models. The discount rate represents an estimate of the weighted average cost of capital (“WACC”) appropriate for these assets. Grant Samuel has calculated a WACC based on a weighted average of the cost of equity and the cost of debt. This is the relevant rate to apply to ungeared cash flows. There are three main elements to the determination of an appropriate WACC. These are:

- cost of equity;
- cost of debt; and
- debt/equity mix.

WACC is a commonly used basis but it should be recognised that it has shortcomings in that it:

- represents a simplification of what are usually much more complex financial structures; and
- assumes a constant degree of leverage which is seldom correct.

In selecting the discount rate range, we utilised the capital asset pricing model (“CAPM”) as the starting point in our analysis to determine a cost of equity. However, it is easy to credit the output of models with a precision it does not warrant. The reality is that any cost of capital estimate or model output should be treated as a broad guide rather than an absolute truth. The cost of capital is fundamentally a matter of judgement, not merely a calculation. In this context, regard was also had to other methods such as the implied cost of equity based on the Gordon Growth Model (or perpetuity formula), market evidence that suggests that equity investors have substantially repriced risk since the global financial crisis and the fact that interest rates are at low levels by comparison with historical norms.

The CAPM is probably the most widely accepted and used methodology for determining the cost of equity capital. There are more sophisticated multivariate models which utilise additional risk factors but these models have not achieved any significant degree of usage or acceptance in practice. However, while the theory underlying the CAPM is rigorous the practical application is subject to shortcomings and limitations and the results of applying the CAPM model should only be regarded as providing a general guide. There is a tendency to regard the rates calculated using CAPM as inviolate. To do so is to misunderstand the limitations of the model. For example:

- the CAPM theory is based on expectations but uses historical data as a proxy. The future is not necessarily the same as the past;
- the measurement of historical data such as risk premia and beta factors is subject to very high levels of statistical error. Measurements vary widely depending on factors such as source, time period and sampling frequency;



- the measurement of beta is often based on comparisons with other companies. None of these companies is likely to be directly comparable to the entity for which the discount rate is being calculated and may operate in widely varying markets;
- parameters such as the debt/equity ratio and risk premium are based on subjective judgements; and
- there is not unanimous agreement as to how the model should adjust for factors such as taxation. The CAPM was developed in the context of a “classical” tax system. Australia’s system of dividend imputation has a significant impact on the measurement of net returns to investors.

In this context, the Australian Energy Regulator (“AER”) undertakes detailed analysis of rates of return based on WACC including analysis of the relevant variables. In December 2013, the AER released new rate of return guidelines setting out how it will determine the return that regulated energy infrastructure entities can earn on their investments. The new guidelines followed extensive consultation with market participants and enable greater flexibility in responding to changing market conditions and changes in financing practices in the industry. Grant Samuel has had regard to the AER’s analysis and guidelines but in Grant Samuel’s view it can give a misleading impression of the precision about what is, in reality, a relatively crude tool of unproven accuracy that gives, at best, a broad approximation of the cost of capital.

In addition, the market upheaval since 2007 has seen a repricing of risk by investors and global interest rates, including long term bond rates, are at very low levels by comparison with historical norms. The CAPM methodology does not readily allow for these types of events.

The cost of debt has been determined by reference to the pricing implied by the debt markets in Australia. The cost of debt represents an estimate of the expected future returns required by debt providers. In determining the appropriate cost of debt over this forecast period, regard was had to debt ratings of comparable companies.

Selection of an appropriate debt/equity mix is a matter of judgement. The debt/equity mix represents an appropriate level of gearing, stated in market value terms, for the business over the forecast period. The relevant proportions of debt and equity have been determined having regard to the financial gearing of the industry in general and comparable companies, and judgements as to the appropriate level of gearing considering the nature and quality of the cash flow stream.

The following sections set out the basis for Grant Samuel’s determination of the discount rates for Envestra’s business operations and the factors which limit the accuracy and reliability of the estimates.

2 Definition and Limitations of the CAPM and WACC

The CAPM provides a theoretical basis for determining a discount rate that reflects the returns required by diversified investors in equities. The rate of return required by equity investors represents the cost of equity of a company and is therefore the relevant measure for estimating a company’s weighted average cost of capital. CAPM is based on the assumption that investors require a premium for investing in equities rather than in risk free investments (such as Australian government bonds). The premium is commonly known as the market risk premium and notionally represents the premium required to compensate for investment in the equity market in general.

The risks relating to a company or business may be divided into specific risks and systematic risks. Specific risks are risks that are specific to a particular company or business and are unrelated to movements in equity markets generally. While specific risks will result in actual returns varying from expected returns, it is assumed that diversified investors require no additional returns to compensate for specific risk, because the net effect of specific risks across a diversified portfolio will, on average, be zero. Portfolio investors can diversify away all specific risk.

However, investors cannot diversify away the systematic risk of a particular investment or business operation. Systematic risk is the risk that the return from an investment or business operation will vary with the market return in general. If the return on an investment was expected to be completely correlated with the return from the market in general, then the return required on the investment would be equal to the return required from the market in general (i.e. the risk free rate plus the market risk premium).



Systematic risk is affected by the following factors:

- financial leverage: additional debt will increase the impact of changes in returns on underlying assets and therefore increase systematic risk;
- cyclicity of revenue: projects and companies with cyclical revenues will generally be subject to greater systematic risk than those with non-cyclical revenues; and
- operating leverage: projects and companies with greater proportions of fixed costs in their cost structure will generally be subject to more systematic risk than those with lesser proportions of fixed costs.

CAPM postulates that the return required on an investment or asset can be estimated by applying to the market risk premium a measure of systematic risk described as the beta factor. The beta for an investment reflects the covariance of the return from that investment with the return from the market as a whole. Covariance is a measure of relative volatility and correlation. The beta of an investment represents its systematic risk only. It is not a measure of the total risk of a particular investment. An investment with a beta of more than one is riskier than the market and an investment with a beta of less than one is less risky. The discount rate appropriate for an investment which involves zero systematic risk would be equal to the risk free rate.

The formula for deriving the cost of equity using CAPM is as follows:

$$Re = Rf + Beta (Rm - Rf)$$

Where:

- Re* = the cost of equity capital;
- Rf* = the risk free rate;
- Beta* = the beta factor;
- Rm* = the expected market return; and
- Rm - Rf* = the market risk premium.

The beta for a company or business operation is normally estimated by observing the historical relationship between returns from the company or comparable companies and returns from the market in general. The market risk premium is estimated by reference to the actual long run premium earned on equity investments by comparison with the return on risk free investments.

The formula conventionally used to calculate a WACC under a classical tax system is as follows:

$$WACC = (Re \times E/V) + (Rd \times (1-t) \times D/V)$$

Where:

- E/V* = the proportion of equity to total value (where $V = D + E$);
- D/V* = the proportion of debt to total value;
- Re* = the cost of equity capital;
- Rd* = the cost of debt capital; and
- t* = the corporate tax rate

The models, while simple, are based on a sophisticated and rigorous theoretical analysis. Nevertheless, application of the theory is not straightforward and the discount rate calculated should be treated as no more than a general guide. The reliability of any estimate derived from the model is limited. Some of the issues are discussed below:

■ **Risk Free Rate**

Theoretically, the risk free rate used should be an estimate of the risk free rate in each future period (i.e. the one year spot rate in that year if annual cash flows are used). There is no official “risk free” rate but rates on government securities are typically used as an acceptable substitute. More importantly, forecast rates for each future period are not readily available. In practice, the long term Commonwealth Government Bond rate is used as a substitute in Australia and medium to long term Treasury Bond rates are used in the United States. It should be recognised that the yield to maturity of a long term bond is only an average rate and where the yield curve is strongly positive (i.e. longer



term rates are significantly above short term rates) the adoption of a single long term bond rate has the effect of reducing the net present value where the major positive cash flows are in the initial years. The long term bond rate is therefore only an approximation.

The ten year bond rate is a widely used and accepted benchmark for the risk free rate. Where the forecast period exceeds ten years, an issue arises as to the appropriate bond to use. While longer term bond rates are available, the ten year bond market is the deepest long term bond market in Australia and is a widely used and recognised benchmark. There is a very limited market for bonds of more than ten years. In the United States, there are deeper markets for longer term bonds. The 30 year bond rate is a widely used benchmark. However, long term rates accentuate the distortions of the yield curve on cash flows in early years. In any event, a single long term bond rate matching the term of the cash flows is no more theoretically correct than using a ten year rate. More importantly, the ten year rate is the standard benchmark used in practice.

■ **Market Risk Premium**

The market risk premium ($R_m - R_f$) represents the “extra” return that investors require to invest in equity securities as a whole over risk free investments. This is an “ex-ante” concept. It is the expected premium and as such it is not an observable phenomenon. There is no generally accepted approach to estimating a forward looking market risk premium and therefore the historical premium is used as the best available proxy measure. The premium earned historically by equity investments is usually calculated over a time period of many years, typically at least 30 years. This long time frame is used on the basis that short term numbers are highly volatile and that a long term average return would be a fair indication of what most investors would expect to earn in the future from an investment in equities with a 5-10 year time frame.

In the United States it is generally believed that the premium is in the range of 5-6% but there are widely varying assessments (from 3% to 9%). Australian studies have been more limited and mainly derive from the Officer Study¹ which was based on data for the period 1883 to 1987 (prior to the introduction of dividend imputation) and indicated that the long run average premium was in the order of 8% using an arithmetic average but subject to significant statistical error². More recently, the Officer Study has been updated to 2011³ with the long term average declining to around 6%. However, due to concerns about the earlier market data, Officer now includes the average risk premium since 1958 which is estimated to be 5.9% ignoring the impact of imputation⁴.

In addition, the market risk premium is not constant and changes over time. At various stages of the market cycle investors perceive that equities are more risky than at other times and will increase or decrease their expected premium. Indeed, prior to 2008 there were arguments being put forward that the risk premium was lower than it had been historically while today there is evidence to indicate that current market risk premiums are above historical averages. However, there is no accepted approach to deal with changes in market risk premia for current conditions.

■ **Beta Factor**

The beta factor is a measure of the expected covariance (i.e. volatility and correlation of returns) between the return on an investment and the return from the market as a whole. The expected beta factor cannot be observed. The conventional practice is to calculate an historical beta from past share price data and use it as a proxy for the future but it must be recognised that the expected beta is not necessarily the same as the historical beta. A company’s relative risk does change over time.

The appropriate beta is the beta of the company being acquired rather than the beta of the acquirer (which may be in a different business with different risks). Betas for the particular subject company

¹ R.R. Officer in Ball, R., Brown, P., Finn, F. J. & Officer, R. R., “Share Market and Portfolio Theory: Readings and Australian Evidence” (second edition), University of Queensland Press, 1989 (“Officer Study”).

² The “true” figure lies within a range of approximately 2-10% at a 95% confidence level.

³ Dr. S. Bishop and Professor R.R. Officer, “Review of Debt Risk Premium and Market Risk Premium” (February 2013), prepared for Aurizon Holdings Limited.

⁴ Where the market return explicitly includes a component for imputation benefits of 1.0 the market risk premium over the same period is around 6.5%.



may be utilised. However, it is also appropriate (and may be necessary if the investment is not listed) to utilise betas for comparable companies and sector averages (particularly as those may be more reliable).

However, there are very significant measurement issues with betas which mean that only limited reliance can be placed on such statistics. There is no “correct” beta. For example:

- over the last three years Envestra’s beta as measured by the Australian Graduate School of Management (“AGSM”) has varied between 0.49 and 0.87 and, at June 2013 was measured at 0.49; and
- the standard error of the AGSM’s estimate of the Envestra beta has generally been in the order of 0.2, meaning that for a beta of, say, 0.49 even at a 68% confidence level, the range is 0.29 to 0.69.

■ **Debt/Equity Mix**

The tax deductibility of the cost of debt means that the higher the proportion of debt the lower the WACC, although this would be offset, at least in part, by an increase in the beta factor as leverage increases.

The debt/equity mix assumed in calculating the discount rate should be consistent with the level implicit in the measurement of the beta factor. Typically, the debt/equity mix changes over time and there is significant diversity in the levels of leverage across companies in a sector. There is a tendency to calculate leverage at a point in time whereas the leverage should represent the average over the period the beta was measured. This can be difficult to assess with a meaningful degree of accuracy.

The measured beta factors for listed companies are “equity” betas and reflect the financial leverage of the individual companies. It is possible to unleverage beta factors to derive asset betas and releverage betas to reflect a more appropriate or comparable financial structure. In Grant Samuel’s view this technique is subject to considerable estimation error. Deleveraging and releveraging betas exacerbates the estimation errors in the original beta calculation and gives a misleading impression as to the precision of the methodology. Deleveraging and releveraging is also incorrectly calculated based on debt levels at a single point in time.

In addition, the actual debt and equity structures of most companies are typically relatively complex. It is necessary to simplify this for practical purposes in this kind of analysis.

Finally, it should be noted that, for this purpose, the relevant measure of the debt/equity mix is based on market values not book values.

■ **Specific Risk**

The WACC is designed to be applied to “expected cash flows” which are effectively a weighted average of the likely scenarios. To the extent that a business is perceived as being particularly risky, this specific risk should be dealt with by adjusting the cash flow scenarios. This avoids the need to make arbitrary adjustments to the discount rate which can dramatically affect estimated values, particularly when the cash flows are of extended duration or much of the business value reflects future growth in cash flows. In addition, risk adjusting the cash flows requires a more disciplined analysis of the risks that the valuer is trying to reflect in the valuation.

However, it is also common in practice to allow for certain classes of specific risk (particularly sovereign and other country specific risks) in a different way by adjusting the discount rate applied to forecast cash flows.

3 Calculation of WACC for Envestra

3.1 Cost of Equity Capital

The cost of equity capital has been estimated by reference to the CAPM. Grant Samuel has adopted a cost of equity capital in the range 7.8-8.4%.



■ **Risk Free Rate**

Grant Samuel has adopted a risk free rate of 4.2%. The risk free rate approximates the current yield to maturity on ten year Australian Government bonds.

■ **Market Risk Premium**

Grant Samuel has consistently adopted a market risk premium of 6% and believes that this continues to be a reasonable estimate. It:

- is not statistically significantly different to the premium suggested by long term historical data;
- is similar to that used by a wide variety of analysts and practitioners (typically in the range 5-7%); and
- makes no explicit allowance for the impact of Australia’s dividend imputation system.

■ **Beta Factor**

Grant Samuel has adopted a beta factor in the range 0.60-0.70 for the purposes of valuing Envestra’s business operations.

Grant Samuel has considered the beta factors for a range of Australian and New Zealand energy infrastructure entities in determining an appropriate beta for Envestra’s business operations. The betas have been calculated on two bases relative to each entity’s home exchange index and relative to the Morgan Stanley Capital International Developed World Index (“MSCI”), an international equities market index that is widely used as a proxy for the global stockmarket as a whole. A summary of betas for selected comparable listed entities is set out in the table below:

Equity Beta Factors for Selected Energy Infrastructure Entities						
Entities	Market Capitalisation ⁵ (millions)	Monthly Observations over 4 years			Weekly Observations over 2 years	
		AGSM ⁶	Bloomberg ⁷		Bloomberg	
			Local Index	MSCI ⁸	Local Index	MSCI
Envestra	A\$1,905	0.52	0.67	0.60	0.71	0.59
Australia – Gas						
APA Group	A\$5,332	0.60	0.79	0.68	0.59	0.52
DUET Group	A\$2,749	0.45	0.61	0.46	0.49	0.46
Australia – Electricity						
SP AusNet	A\$4,487	0.45	0.78	0.68	0.74	0.58
Spark	A\$2,269	0.10	0.35	0.41	0.57	0.52
New Zealand						
Vector	NZ\$2,430	na	0.43	0.39	0.47	0.32

Source: AGSM, Bloomberg

The evidence suggests that relatively low betas are appropriate for energy infrastructure entities. However, considerable caution is warranted in selecting a beta for Envestra:

⁵ Based on share prices as at 28 February 2014, except Envestra and APA Group which are based on share prices as at 15 July 2013 (being the day prior to announcement of the APA Group’s initial approach).

⁶ The Australian beta factors calculated by the Australian Graduate School of Management (“AGSM”) as at September 2013, except for Envestra which is calculated up to June 2013. Beta factors are calculated over a period of 48 months using ordinary least squares regression or the Scholes-Williams technique where the stock is thinly traded.

⁷ Bloomberg betas have been calculated up to 28 February 2014, except for Envestra and APA Group which are calculated up to 15 July 2013. Grant Samuel understands that betas estimated by Bloomberg are not calculated strictly in conformity with accepted theoretical approaches to the estimation of betas (i.e. they are based on regressing total returns rather than the excess return over the risk free rate). However, in Grant Samuel’s view the Bloomberg beta estimates can still provide a useful insight into the systematic risks associated with companies and industries. The figures used are the Bloomberg “adjusted” betas.

⁸ MSCI is calculated using local currency so that there is no impact of currency changes in the performance of the index.



- individual company betas (for the same source/period) fall in a reasonably wide range. For example, Bloomberg Four Year Local Index betas range from 0.35 (for Spark) to 0.78 (for SP AusNet);
- all of the data is subject to significant statistical error. For example, Envestra’s AGSM beta has a standard error of approximately 0.17 (i.e. even at a 68% confidence level it lies somewhere between 0.35 and 0.69) and APA Group’s AGSM beta has a standard error of approximately 0.16; and
- the betas vary somewhat, depending on the measurement source (AGSM and Bloomberg), with the Bloomberg Four Year Local Index betas being higher than the AGSM betas for all the selected companies with the exception of Vector (which does not have an AGSM beta).

Having regard to the factors above, Grant Samuel has selected a beta factor in the range of 0.60-0.70 for Envestra.

A beta factor range of 0.60-0.70 is higher than the evidence in the above table would suggest, in particular for entities involved primarily in the gas sector (Envestra, APA Group, DUET Group). However, this range encompasses the new AER rate of return guidelines (December 2013) which indicate a range of betas from 0.4-0.7 but under which the AER proposes to adopt a beta of 0.7.

■ **Calculation**

Using the estimates set out above, the cost of equity capital can be calculated as follows:

Low	High
$Re = Rf + Beta (Rm-Rf)$	$Re = Rf + Beta (Rm-Rf)$
$= 4.2\% + (0.6 \times 6.0\%)$	$= 4.2\% + (0.7 \times 6.0\%)$
$= 7.8\%$	$= 8.4\%$

3.2 Cost of Debt

A cost of debt of 7.0% has been adopted based on a margin of 2.8% over the risk free rate. This figure represents the cost of borrowings with a ten year tenor.

3.3 Debt/Equity Mix

The selection of the appropriate debt/equity ratio involves perhaps the most subjectivity of discount rate selection analysis. In determining an appropriate debt/equity mix, regard was had to gearing levels of Envestra and the peer group entities used in the beta analysis.

Gearing levels for these entities for the past four years are set out below:



Gearing Levels for Selected Listed Energy Infrastructure Entities							
Entity	Year End	Net Debt/(Net Debt + Market Capitalisation)					
		Financial Year Ended				Current ⁹	4 Year Average
		Historical 4	Historical 3	Historical 2	Historical 1		
Envestra	30 Jun	74.0%	65.8%	63.2%	53.1%	51.5%	64.0%
Australia - Gas							
APA Group	30 Jun	59.9%	52.0%	44.5%	45.8%	44.8%	50.5%
DUET Group	30 Jun	75.8%	72.9%	68.6%	67.5%	65.9%	71.2%
Australia - Electricity							
SP AusNet	31 Mar	61.4%	63.7%	59.2%	54.1%	54.2%	59.6%
Spark	31 Dec	79.0%	71.0%	69.0%	65.6%	65.9%	71.2%
New Zealand							
Vector	30 Jun	52.9%	47.2%	46.8%	46.7%	49.7%	48.4%

Source: Company Reports, IRESS, Bloomberg, Grant Samuel analysis

The selection of gearing levels is highly judgemental. The table shows a range of gearing levels, but generally between 50-70%. The debt levels should actually be the weighted average measured over the same period as the beta factor rather than just at the current point in time. Moreover, these do not always bear any relationship to the betas of the individual companies. In some cases highly geared companies still have equity betas towards the lower end of the range (e.g. Spark).

Having regard to the above, the debt/equity mix has been estimated as 35-45% equity and 55-65% debt. This is regarded as being broadly consistent with a beta factor of 0.60-0.70.

3.4 WACC

On the basis of the parameters outlined and assuming a corporate tax rate of 30%, the nominal WACC is calculated to be in the range 5.9-6.5%.

Low

$$\begin{aligned} WACC &= (Re \times E/V) + (Rd \times (1-t) \times D/V) \\ &= (7.8\% \times 35\%) + (7.0\% \times 0.7 \times 65\%) \\ &= 5.9\% \end{aligned}$$

High

$$\begin{aligned} WACC &= (Re \times E/V) + (Rd \times (1-t) \times D/V) \\ &= (8.4\% \times 45\%) + (7.0\% \times 0.7 \times 55\%) \\ &= 6.5\% \end{aligned}$$

This is an after tax discount rate to be applied to nominal ungeared after tax cash flows. However, it must be recognised that this is a calculation based on statistics of limited reliability and involving a multitude of assumptions. In this regard, Grant Samuel's view is that the selected cost of capital should incorporate a margin over the calculated WACC range to reflect:

- alternative approaches for estimating the cost of equity such as the Gordon Growth Model¹⁰ suggest higher rates than the 7.8-8.4% implied by the CAPM. Analysis of the entities most comparable to Envestra (i.e. DUET Group, SP AusNet, APA Group and Spark) using the Gordon Growth Model suggests costs of equity capital in the range 9.0-11.3% (yields mostly around 6.5-8.3% and dividend growth of 2.5-4.5% with medians of around 6.6% and 3.0% respectively). A cost of equity of 9.0-11.3% would imply a WACC of 6.3-7.8% if all other parameters above are held constant. The Gordon Growth Model is an alternative approach to estimating the cost of equity under which it is calculated as the current forecast yield plus the expected long term growth rate. This approach is particularly useful when valuing assets which generate long term stable growth cash flows such as energy infrastructure assets. However, caution is warranted in considering this analysis because of the difficulties of

⁹ Current gearing levels are based on the most recent balance sheet information and on share market prices as at 28 February 2014, except Envestra which is based on share prices as at 15 July 2013 (day prior to the announcement of APA Group's initial approach).

¹⁰ Under the Gordon Growth Model, the implied cost of equity is calculated as the current forecast yield plus the expected long term growth rate (i.e. $Re = (Dividends/Price) + g$, where Re is the cost of equity capital and g is the perpetual growth rate).



putting the yields of the energy infrastructure entities on a comparable basis because of differing tax treatments;

- anecdotal information suggests that equity investors have repriced risk since the global financial crisis and that acquirers are pricing offers on the basis of hurdle rates above those implied by theoretical models. However, this has yet to be translated into the measures of market risk premium (at least based on longer term historical data). In this regard, an increase in the market risk premium of 1% (i.e. from 6% to 7%) would increase the calculated WACC range to 6.1-6.8%;
- global interest rates, including long term bond rates, are at low levels by comparison with historical norms reflecting the very substantial amounts of liquidity being pumped into many advanced economies (particularly Western Europe and the United States) to stimulate economic activity. Effective real interest rates are now low. We do not believe this position is sustainable and, in our view, the risk is clearly towards a rise in bond yields. Conceptually, the interest rates used to calculate the discount rate should recognise this expectation (i.e. they should be forecast for each future period) but for practical ease market practice is that a single average rate based on the long term bond rate is generally adopted for valuation purposes. Some academics/valuation practitioners consider it to be inappropriate to add a “normal” market risk premium (e.g. 6%) to a temporarily depressed bond yield and therefore a “normalised” risk free rate should be used. On this basis, an increase in the risk free rate to (say) 5% would increase the calculated WACC range to 6.6-7.2%; and
- analysis of recent research reports on Australian entities involved in the energy infrastructure sector (i.e. APA Group, Envestra, DUET Group, Spark and SP AusNet) indicates that brokers are currently adopting costs of equity capital in the range 8.5-11.2%, with a median of 9.6% and WACC in the range 6.0-8.8%, with a median of 7.5%.

Having regard to these matters and the calculations set out above, Grant Samuel’s judgement is reasonable discount rates to apply to discounted cash flow analysis for regulated energy assets in current market conditions would be anywhere in the range 6.5-8.0%. However, for the purposes of valuing Envestra’s gas distribution networks, Grant Samuel has selected a discount rate range of 6.5-7.0% (i.e. towards the lower end of the range) in order to ensure that the fairness assessment for the Proposal is robust (i.e. higher NPVs are generated).

4 Dividend Imputation

The conventional WACC formula set out above was formulated under a “classical” tax system. The CAPM model is constructed to derive returns to investors after corporate taxes but before personal taxes. Under a classical tax system, interest expense is deductible to a company but dividends are not. Investors are also taxed on dividends received. Accordingly, there is a benefit to equity investors from increased gearing.

Under Australia’s dividend imputation system, domestic equity investors now receive a taxation credit (franking credit) for any tax paid by a company. The franking credit attaches to any dividends paid out by a company and the franking credit offsets personal tax. To the extent the investor can utilise the franking credit to offset personal tax, then the corporate tax is not a real impost. It is best considered as a withholding tax for personal taxes. It can therefore be argued that the benefit of dividend imputation should be added into any analysis of value.

There is no generally accepted method of allowing for dividend imputation. In fact, there is considerable debate within the academic community as to the appropriate adjustment or even whether any adjustment is required at all. Some suggest that it is appropriate to discount pre tax cash flows, with an increase in the discount rate to “gross up” the market risk premium for the benefit of franking credits that are on average received by shareholders. On this basis, the discount rate might increase by approximately 2% but it would be applied to pre tax cash flows. However, not all of the necessary conditions for this approach exist in practice:

- not all shareholders can use franking credits. In particular, foreign investors gain no benefit from franking credits. If foreign investors are the marginal price setters in the Australian market there should be no adjustment for dividend imputation;



- not all franking credits are distributed to shareholders; and
- capital gains tax operates on a different basis to income tax. Investors with high marginal personal tax rates will prefer cash to be retained and returns to be generated by way of a capital gain.

Others have proposed a different approach involving an adjustment to the tax rate in the discount rate by a factor reflecting the effective use or value of franking credits. If the credits can be used, the tax rate is reduced towards zero. The proponents of this approach have in the past suggested a factor in the range 50-65% as representing the appropriate adjustment (γ). Alternatively, the tax charge in the forecast cash flows can be decreased to incorporate the expected value of franking credits distributed.

There is undoubtedly merit in the proposition that dividend imputation affects value. Over time dividend imputation will become factored into the determination of discount rates by corporations and investors. In Grant Samuel's view, however, the evidence gathered to date as to the value the market attributes to franking credits is insufficient to rely on for valuation purposes. More importantly, Grant Samuel does not believe that such adjustments are widely used by acquirers of assets at present. While acquirers are undoubtedly attracted by franking credits there is no clear evidence that they will actually pay extra for them or build it into values based on long term cash flows. The studies that measure the value attributed to franking credits are based on the immediate value of franking credits distributed and do not address the risk and other issues associated with the ability to utilise them over the longer term. Accordingly, it is Grant Samuel's opinion, that it is not appropriate to make any adjustment.

Appendix 4

Market Evidence

1 Valuation Evidence from Transactions

There have been a large number of transactions in the energy sector in Australia in the last decade. However, many involved entities holding a range of energy businesses and assets and therefore the multiples implied by these transactions are not meaningful in assessing valuation parameters appropriate for Envestra Limited (“Envestra”). The number of transactions primarily focused on gas transmission and distribution infrastructure is more limited but these transactions are useful in reviewing the valuation of Envestra. Set out below is a summary of transactions involving gas transmission and distribution businesses in Australia since 2003 for which there is sufficient information to calculate meaningful valuation parameters:

Recent Transaction Evidence – Gas Transmission and Distribution in Australia										
Date	Target	Regulation ¹	Transaction	Consideration ² (millions)	EBITDA Multiple ³ (times)		EBIT Multiple ⁴ (times)		Ungearred NTA Multiple ⁵ (times)	RAB Multiple ⁶ (times)
					Historical	Forecast	Historical	Forecast		
<i>Gas Distribution</i>										
Dec 11	Allgas Network	F	Acquisition by GDI (EII) Pty Limited	\$540	15.0	14.4	na ⁷	na	0.7	1.23
Jul 11	WA Gas Networks	F	Acquisition by ATCO Group	\$312	12.5	10.3	18.9	na	1.7	1.20
Jun 11	Multinet Gas	F	Acquisition of 20.1% by DUET Group	\$149	7.9	7.9	10.2	na	1.6	1.13
Oct 10	Country Energy Gas Networks	F	Acquisition by Envestra	\$109	na	11.3	na	na	1.2	1.25
Apr 07	Envestra	F	Acquisition of 17.2% by APA Group	\$990	12.7	13.1	16.7	16.7	1.9	1.50
Oct 06	Allgas Energy Pty Ltd	F	Acquisition by APA Group	\$521	na	18.1	na	25.5	na	1.64
<i>Gas Transmission</i>										
Apr 13	Moomba Adelaide Pipeline	U	Acquisition by QIC Global Infrastructure	\$401	10.8 ⁸	10.8	na	11.8	1.1	na
Aug 12	Hastings Diversified Utilities Fund	U	Acquisition by APA Group	\$1,385	26.2 ⁹	17.7 ⁹	33.0 ⁹	22.6 ⁹	1.8	na
Jul 11	Tasmanian Gas Pipeline	U	Acquisition by Palisade Diversified Infrastructure Fund	\$200	11.0	na	16.4	na	0.7	na
Jul 11	Dampier Bunbury Pipeline	F	Acquisition of 20% by DUET Group	\$840	9.6	9.2	13.2	na	1.3	0.95
Jun 11	Amadeus Gas Pipeline	F	Acquisition by APA Group	\$63	2.6	4.2	7.9	7.5	0.6	0.68
Nov 10	SEA Gas Pipeline	U	Acquisition of 16.7% by APA Group and 16.7% by REST	\$278	na	10.9	na	na	na	na

¹ F = full regulation; L = light regulation; U = unregulated

² Implied equity value if 100% of the company or business had been acquired.

³ Represents gross consideration divided by EBITDA. EBITDA is earnings before net interest, tax, depreciation, amortisation, investment income and significant and non-recurring items.

⁴ Represents gross consideration divided by EBIT. EBIT is earnings before net interest, tax, investment income and significant and non-recurring items.

⁵ Represents gross consideration divided by ungeared net tangible assets (that is, net assets less intangibles plus borrowings (including derivatives) less cash as at latest balance date).

⁶ Represents gross consideration divided by RAB. RAB means regulated asset base and is the value of the fixed assets set by the regulator as the basis for determining tariffs.

⁷ na = not available

⁸ Performance from 9 October 2012 to 1 May 2013, annualised.

⁹ Calculated based on earnings for Epic Energy only.

GRANT SAMUEL

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Recent Transaction Evidence – Gas Transmission and Distribution in Australia										
Date	Target	Regulation ¹	Transaction	Consideration ² (millions)	EBITDA Multiple ³ (times)		EBIT Multiple ⁴ (times)		Ungearred NTA Multiple ⁵ (times)	RAB Multiple ⁶ (times)
					Historical	Forecast	Historical	Forecast		
Mar 10	Berwyndale to Wallumbilla Pipeline	U	Acquisition by APA Group	\$83	na	32.9	na	na	1.0	na
Aug 08	Central Ranges Pipeline	F	Acquisition by APA Group	\$24	na	32.2	na	na	1.0	0.45
Jun 08	North Queensland Gas Pipeline	U	Acquisition by Victorian Funds Management Corporation	\$202	na	na	8.0	na	1.3	na
Apr 07	SEA Gas Pipeline	U	Acquisition of 33.3% by APA Group	\$400	na	14.5	na	na	na	na
Nov 06	Alinta Infrastructure Holdings	F/U	Acquisition by Alinta	\$956	14.3	14.5	22.9	24.2	2.0	na ¹⁰
Aug 06	GasNet Australia Group	F/U	Takeover by APA Group	\$452	13.9	13.3	19.5	18.3	1.3	2.19 ¹¹
Feb 05	Carpentaria Gas Pipeline	L	Acquisition of 30% by APA Group	\$327	na	na	11.8	11.4	na	na ¹⁰
Aug 04	Dampier to Bunbury Natural Gas Pipeline	F	Acquisition by DUET Group/Alinta/Alcoa Consortium	\$1,860	na	11.1	na	na	na	1.20
Aug 04	45% of Southern Cross Pipelines and 100% of Parmelia Gas	F	Acquisition by APA Group	\$206	8.3	na	na	na	na	1.47
Apr 04	Epic Energy	U	Acquisition by HDUF Epic Trust	\$ ⁻¹²	8.2	8.8	10.8	na	1.0	na
Mar 04	Duke Energy Australian and New Zealand assets	F/U	Acquisition by Alinta	\$1,690	17.0	15.5	na	na	na	na ¹⁰
Energy Infrastructure										
May 13	SP AusNet	F	Acquisition of 19.9% by State Grid Corporation of China	\$4,141	9.1	8.6	13.6	12.9	1.1	1.17
May 13	SPI (Australia) Assets Pty Ltd	F/U	Acquisition of 60% by State Grid Corporation of China	\$8,714	12.2	na	17.7	na	1.4	na
Nov 12	ElectraNet	F	Acquisition of 41.1% by State Grid Corporation of China	\$1,217	9.8	na	13.8	na	1.4	1.32
Dec 08	Various energy infrastructure assets of APA Group	F/U	Acquisition by Energy Infrastructure Investments Pty Limited	\$165	na	10.6	na	na	1.0	na ¹⁰
May 07	Alinta Limited	F/U	Acquisition by Babcock & Brown/Singapore Power Consortium	\$8,041 ¹³	15.4 ¹⁴	14.5	20.8 ¹⁴	19.6	1.8	na ¹⁰
Apr 06	AGL Infrastructure Assets	F/U	Acquisition by Alinta Limited	\$6,500	13.0	12.6	18.4	18.1	7.3	1.41-1.52 ¹⁵

Source: Grant Samuel analysis¹⁶

¹⁰ Only a portion of assets are regulated and, therefore, RAB multiples are not meaningful.

¹¹ RAB multiple is 1.64 times if adjusted for unregulated assets which are assumed to represent approximately 25% of enterprise value.

¹² Equity consideration paid was nominal (\$4) and \$662 million of borrowings were assumed (i.e. gross consideration of \$662 million).

¹³ The final terms of the transaction announced in May 2007 valued Alinta at approximately \$8 billion (\$16.06 per Alinta share). As a result of movements in the value of the scrip portions of the consideration, the value received by Alinta shareholders on completion of the transaction on 31 August 2007 had declined to \$7.6 billion.

¹⁴ Multiples shown as historical are for the year ending 31 December 2007 (i.e. current year) as no historical earnings were available.

¹⁵ Based on the valuation attributed to gas and electricity networks by independent expert in its report dated 28 August 2006.



A brief summary of each transaction is set out below.

Gas - Distribution

Allgas Distribution Network / GDI (EII) Pty Limited

In December 2011, APA Group announced the sale of its Queensland Gas Network business (“Allgas”) into a newly established joint venture, GDI (EII) Pty Limited (“GDI”). APA Group retained a 20% equity interest in GDI with Marubeni Corporation and RREEF Infrastructure each holding a 40% interest. APA Group remained as asset manager and operator of the network under a 10 year agreement, with two five year extension options. The net proceeds of the transaction totalled \$478 million (enterprise value of \$526 million after transaction costs of \$22.5 million). Allgas was one of two gas distribution businesses in South East Queensland and had 2,942 kilometres of regulated gas network spanning Brisbane, the Gold Coast, Northern New South Wales, Toowoomba and Oakey. The network delivered 10.5PJ of gas annually to around 82,000 customers and had a regulated asset base at 30 June 2011 of \$440 million.

WA Gas Networks / ATCO Group

In July 2011, ATCO Group (“ATCO”) announced that it has signed a conditional agreement to acquire a 74.1% interest in WA Gas Networks (“WAGN”) from WestNet Infrastructure Group. ATCO also acquired the remaining 25.9% interest in WAGN from DUET Group, giving it 100% ownership of WAGN for total consideration of approximately \$1.0 billion. WAGN is a natural gas distribution network utility that connects more than 620,000 customers through 12,800 kilometres of natural gas pipelines and associated infrastructure. It provides service throughout the Perth metropolitan area including Mandurah, as well as the surrounding regions of Geraldton, Bunbury, Busselton, Kalgoorlie, Albany, Harvey, Pinjarra, Brunswick Junction and Capel. At 30 June 2011, WAGN had \$848 million of regulated assets.

Multinet Gas (20.1%) / DUET Group

In July 2011, DUET Group announced that it had acquired a further 20.1% interest in Multinet Gas for \$30 million, bringing its total interest to 100%. Multinet Gas was Victoria’s largest gas distribution network (by number of customers) with 670,573 connections. It carried 60.6PJ of gas annually through 1,940 square kilometres of gas pipelines and had a regulated asset base of \$978 million at 30 June 2011.

Country Energy Gas Networks / Envestra Limited

In October 2010, Envestra announced that it had entered into an agreement with Country Energy to acquire its gas networks business, Country Energy Gas Networks Pty Ltd, for \$107 million, split 70/30% between regulated and unregulated assets. The networks comprised 1,160 kilometres of gas distribution pipelines and 65 kilometres of transmission pipelines in the Wagga Wagga and surrounding southern New South Wales region. The networks deliver 3PJ annually to 26,000 consumers. The majority of the operations were in Wagga Wagga and were regulated. The gas networks in the remaining towns were unregulated. The regulated business contributed \$10 million of revenue, delivered 1.6PJ of gas to 19,500 users and had a regulated asset base of \$60 million in July 2010. The unregulated network generated \$4 million revenue per annum, delivered 1.4PJ of gas to around 6,600 users.

Envestra Limited (17.2%) / APA Group

In April 2007, APA Group announced it had entered into a conditional agreement with Origin Energy to acquire its 17.2% stake in Envestra for \$170.4 million. This represented a 4.4% discount to the closing price at 3 April 2007. At the time of the acquisition, Envestra was Australia’s largest natural gas distributor with 19,100 kilometres of natural gas distribution networks and 1,029 kilometres of natural gas transmission pipelines. Over 95% of Envestra’s revenue was regulated. APA Group became Envestra’s largest shareholder on completion of the acquisition. As the transaction involved a minority interest the implied multiples do not include a premium for control. However, the interest acquired was strategic.

¹⁶ Grant Samuel analysis based on data obtained from IRESS, Capital IQ, company announcements, transaction documentation and, in the absence of company published financial forecasts, brokers’ reports. Where company financial forecasts are not available, the median of the financial forecasts prepared by a range of brokers has generally been used to derive relevant forecast value parameters. The source, date and number of broker reports utilised for each transaction depends on analyst coverage, availability and corporate activity.



Allgas Energy Pty Ltd / APA Group

In October 2006, APA Group announced it would acquire Allgas Energy Pty Ltd (“Allgas Energy”) from ENERGEX Limited for \$521 million. Allgas Energy was one of two gas distribution businesses in South East Queensland and had a 2,300 kilometre regulated gas network spanning Brisbane, the Gold Coast, Northern New South Wales, Toowoomba and Oakey that supplied approximately 65,000 customers. The Allgas Energy network was supplied by APA Group’s Roma to Brisbane Pipeline and was a complementary infrastructure to APA Group’s gas transmission businesses. APA Group planned to expand the Allgas Energy distribution network and increase network utilisation.

Gas - Transmission

Moomba to Adelaide Pipeline System / QIC Global Infrastructure

In April 2013, APA Group announced the sale of the Moomba Adelaide Pipeline System (“MAPS”) to QIC Global Infrastructure (“QIC”) for \$400.6 million. MAPS was acquired by APA Group as part of its takeover of Hastings Diversified Utility Fund (“HDUF”) in October 2012. As part of the acquisition, APA Group made an undertaking to the Australian Competition & Consumer (“ACCC”) to divest MAPS. After taking into account stamp duty payable by the buyer, the transaction represents an enterprise value of \$423 million for MAPS. MAPS is an unregulated 1,184 kilometre pipeline system with capacity of 253TJ per day. It services the South Australian market, with the main line from Moomba to Adelaide and two major laterals to the regional centres of Port Pirie/Whyalla and Angaston. The historical EBITDA multiple is calculated based on earnings from October 2012 to 1 May 2013, annualised. As these earnings exclude the winter period, the historical EBITDA may be understated (i.e. the historical EBITDA multiple may be overstated).

Hastings Diversified Utilities Fund / APA Group

On 14 December 2011, APA Group announced an off market takeover offer for all of the HDUF securities that it did not already own. A competitive bidding process with Pipeline Partners Australia Pty Limited (“Pipeline Partners”)¹⁷ followed. On 17 August 2012 APA Group increased its takeover offer for HDUF to \$0.72 cash and 0.390 APA Group securities for each HDUF security (\$0.80 cash and 0.390 APA Group security if compulsory acquisition was reached). APA Group proceeded to compulsory acquisition in November 2012. The terms of the transaction (under compulsory acquisition) valued HDUF at \$1,385 million (\$2.61 per HDUF security). As a result of movements in the value of the scrip portions of the consideration, the value received by HDUF shareholders on completion of the transaction on 13 December 2012 had increased to \$1,615 million (\$3.05 per HDUF security). HDUF’s sole asset was 100% of Epic Energy which owned and operated three major unregulated gas transmission pipeline systems in Australia: MAPS, the South West Queensland Pipeline (including the QSN Link) and the Pilbara Pipeline System. In addition, it owned and operated a 70 kilometre pipeline in South Australia, the South East Pipeline. Excluding HDUF’s other assets (net) of \$299.4 million and adding back corporate expenses of \$55 million¹⁸, the transaction implied a value of 100% of the equity of Epic Energy of \$1,141 million (or an enterprise value of \$2,763 million, including Epic Energy’s borrowings of \$1,591 million and other liabilities (net) of \$30.5 million). The multiples implied by the transaction are high as there were substantial uplift in earnings to emerge in the period to 2015 (capital expenditure for which had already been incurred) and the strategic location and growth optionality of each of Epic Energy’s pipelines.

Tasmanian Gas Pipeline / Palisade Diversified Infrastructure Fund

In August 2011 Palisade Diversified Infrastructure Fund acquired the Tasmanian Gas Pipeline from WestNet Infrastructure Group for \$200 million. The Tasmanian Gas Pipeline transports gas from the Gippsland Basin in Victoria across Bass Strait to Tasmania. The pipeline is a 734 kilometre, unregulated subsea and onshore gas pipeline system which was commissioned in 2002. Construction of the pipeline was underpinned by long term take or pay contracts (out to 2016-2018) to major users in Tasmania and it is understood to have spare capacity.

¹⁷ A consortium of Australian and Canadian infrastructure investors. The major investors in Pipeline Partners are Caisse de dépôt et placement du Québec and the Hastings managed unlisted Utilities Trust of Australia.

¹⁸ Based on midpoint of value range from the independent expert’s report for HDUF securityholders.

***Dampier Bunbury Pipeline / DUET Group***

In July 2011, DUET Group acquired a 20% interest in Dampier Bunbury Pipeline (“DBP”) from AET&D Holdings No. 2 Pty Ltd for \$168 million, taking its interest from 60.0% to 80.0%. DBP is the owner/operator of Western Australia’s principal gas transmission pipeline, the Dampier to Bunbury Natural Gas Pipeline (“DBNGP”). DBNGP is the only pipeline connecting the natural gas reserves of the Carnarvon and Browse basins with industrial, commercial and residential customers in Perth and surrounding regions and is regulated by the Economic Regulatory Authority of Western Australia (“ERA”). DBP completed the last stage of a \$1.8 billion three stage expansion of the DBNGP in April 2010. The purchase price implies a RAB multiple of 0.95 times based on DBP management calculations as at the time of the transaction ERA was reviewing RAB as part of the 2010-2015 Access Arrangement.

Amadeus Gas Pipeline / APA Group

In June 2011, APA Group announced that it had acquired the 1,630 kilometre Amadeus Gas Pipeline in the Northern Territory for \$63 million. Since the Amadeus Gas Pipeline was commissioned in 1986 it has been leased by Amadeus Gas Trust from a consortium of financial institutions and NT Gas as trustee for the Amadeus Trust has managed and operated the pipeline. APA Group held a 96% interest in NT Gas and the Amadeus Gas Trust. APA Group acquired the pipeline and associated assets (represented by the residual balance of the lease) from the consortium at the end of the lease. APA Group has entered into a long term gas transportation agreement with Power and Water Corporation, the Northern Territory’s government owned electricity provider. The Amadeus Gas Pipeline is regulated by the Australian Energy Regulator (“AER”) which issued the 2011-2016 Access Arrangement in July 2011. Earnings multiples have been calculated by reference to earnings set out in the AER’s regulatory decision (i.e. historical earnings are the estimate for the year ended 30 June 2011 and the forecast earnings are the average over the five year regulatory period). The purchase price implies a RAB multiple of 0.68 times based on RAB at 30 June 2011. The multiples implied by the transaction are low even allowing that the pipeline is regulated and has a limited growth outlook. It is uncertain if the purchase price reflects the price that a third party acquirer may pay for the Amadeus Gas Pipeline.

SEA Gas Pipeline / APA Group (16.7%) and Retail Employees Superannuation Trust (16.7%)

On 11 November 2010 International Power plc announced that it had sold its 33.3% equity interest in SEA Gas Pipeline for \$92.5 million plus a working capital adjustment. The SEA Gas Pipeline is a 114PJ per annum capacity, 680 kilometres unregulated pipeline linking the Victorian gas fields to South Australian markets. The interest was sold in two tranches, 16.7% to APA Group (which exercised its pre-emptive right over International Power’s interest to increase its interest to 50%) and 16.7% to Retail Employees Superannuation Trust (which increased its interest to 50%). APA Group operates the SEA Gas Pipeline.

Berwyndale to Wallumbilla Pipeline / APA Group

In March 2010, APA Group announced the acquisition of the Berwyndale to Wallumbilla Pipeline in Queensland for \$82.6 million. The Berwyndale to Wallumbilla Pipeline was commissioned in 2009 and is a 112 kilometre pipeline extending from the Berwyndale coal seam gas fields in the Surat Basin to the Wallumbilla hub in Central Queensland. The acquisition was underpinned by a long term gas transportation agreement with AGL Energy which retains an option for increased capacity and an option to extend its term.

Central Ranges Pipeline / APA Group

On 11 August 2008 APA Group announced the acquisition of Country Pipelines Pty Limited, the owner of the Central Ranges Pipeline and associated distribution network, for \$23.5 million. The Central Ranges Pipeline runs from Dubbo (where it connects to APA Group’s Central West Pipeline) to Tamworth in the Central Ranges region in New South Wales. The pipeline was commissioned in August 2006 at a total cost of \$66 million and consists of 294 kilometres of transmission pipeline and approximately 180 kilometres of distribution network in Tamworth.

North Queensland Gas Pipeline / Victorian Funds Management Corporation

On 30 June 2008 Victorian Fund Management Corporation entered into an agreement with the 50/50 joint venture between AGL Energy Limited (“AGL Energy”) and Arrow Energy Limited to acquire the North



Queensland Gas Pipeline for \$201.8 million. The North Queensland Gas Pipeline was commissioned in 2004 and comprises a 370 kilometre pipeline from the Moranbah Gas Processing Facility to Yabulu Power Station in Townsville and the Queensland Nickel Industries refinery plus a 22 kilometre lateral to the Stuart industrial precinct. The Joint Venture had acquired the pipeline as part of their acquisition of the Enertrade merchant gas and pipeline businesses from the Queensland Government on 1 August 2007. The sale of the pipeline is consistent with the intentions of the Joint Venture at the time of that acquisition. The historical EBIT multiple has been calculated by grossing up AGL Energy's disclosed share of earnings for 30 June 2008 on an annualised basis and the ungeared NTA multiple is calculated by reference to AGL Energy's disclosure of net assets disposed.

SEA Gas Pipeline / APA Group

In April 2007, APA Group announced it had entered into a conditional agreement to acquire Origin Energy 33.3% interest in SEA Gas Pipeline for \$133.2 million. The SEA Gas Pipeline is a 114PJ per annum capacity, 680 kilometres pipeline linking the Victorian gas fields to South Australian markets. APA Group operates the pipeline.

Alinta Infrastructure Holdings / Alinta Limited

On 15 November 2006, Alinta Limited ("Alinta") announced an unconditional cash takeover offer for the 80% of securities in Alinta Infrastructure Holdings ("AIH") that it did not already own. Alinta formed AIH in August 2005 from a portfolio of nine gas transmission infrastructure and power generation assets that had been acquired from Duke Energy in March 2004 (see below). The initial public offering of AIH in October 2005 took the form of a partly paid issue, with \$2.00 per stapled security payable on application and \$1.20 per stapled security payable on 29 December 2006 ("the second instalment"). Alinta retained a 20% interest in AIH at listing, with an agreement to maintain an interest of at least 15%. Alinta's offer was \$2.06 cash per partly paid security (pre second instalment) or \$3.26 post the second instalment.

GasNet Australia Group / APA Group

In June 2006, Babcock & Brown Infrastructure ("BBI") announced, in association with APA Group, it would make a scrip takeover offer for GasNet Australia Group ("GasNet"). The consideration offered was 1.545 BBI stapled securities for each GasNet stapled security not already owned by BBI and APA Group (together 14.2%). The offer represented \$2.45 per GasNet stapled security, excluding the estimated 6.75 cents final distribution announced by BBI (\$2.55 cum dividend). GasNet directors rejected the offer on the basis that it materially undervalued the company and was highly conditional. On 15 August 2006, Colonial First State Global Asset Management announced a recommended counter offer of \$2.88 cash per stapled security (\$2.77 after adjusting for the proposed 11 cent distribution for the six months to 30 June 2006). On 22 August 2006, BBI and APA Group announced the termination of their joint bidding agreement and their bid lapsed. In addition, APA Group announced an offer of \$3.10 cash per stapled security valuing GasNet at \$452 million. GasNet owned and operated 1,930 kilometres of gas transmission pipelines and a LNG storage facility in Victoria as well as a 450 kilometre pipeline in Western Australia.

Carpentaria Gas Pipeline / APA Group

In February 2005, APA Group purchased the remaining 30% of Carpentaria Gas Pipeline that it did not already own from Santos Limited, Origin Energy and Delhi Petroleum for \$98 million cash. Carpentaria Gas Pipeline was an 840 kilometres gas pipeline which connected the Ballera gas fields in south west Queensland to Mt Isa in north west Queensland.

Dampier to Bunbury Natural Gas Pipeline / DUET Group / Alinta / Alcoa Consortium

In August 2004, the receivers and managers of the DBNGP announced that a consortium comprising DUET Group (60%), Alinta (20%) and Alcoa of Australia Limited (20%) had been named as the preferred bidder for the purchase of 100% of DBNGP and its associated assets. The consortium's bidding price was approximately \$1.86 billion (excluding transaction costs and proposed capital expenditure). The acquisition further diversified DUET Group's portfolio of regulated energy utility businesses by adding a strategic gas transmission asset.



Southern Cross Pipelines and Parmelia Gas Business / APA Group

In August 2004, APA Group purchased the remaining 45% of Southern Cross Pipelines (“SCP”) that it did not already own and 100% of the Parmelia Gas business (“Parmelia”) from CMS Energy for \$206 million. SCP was the 88.2% owner of the 1,380 kilometre Goldfield Gas Transmission Pipeline in Western Australia. Parmelia owned and operated a transmission pipeline, a gas processing facility and storage facilities in Western Australia.

Epic Energy Pty Limited and Epic Energy (Pilbara Pipeline) Pty Ltd / HDUF Epic Trust

In April 2004, Hastings Funds Management Limited, as responsible entity of the HDUF Epic Trust, agreed to acquire the entities that owned four unregulated natural gas pipelines and the associated services company for an enterprise value of \$662 million (representing \$4 equity consideration plus \$662 million of assumed borrowings, excluding transaction costs). The pipelines were Moomba to Adelaide Pipeline System, South West Queensland Pipeline, Pilbara Pipeline System and South East Pipeline. These assets formed the seed assets for HDUF’s initial public offering in December 2004.

Duke Energy’s Australian and New Zealand Assets / Alinta Limited

In March 2004, Alinta announced that it had reached an agreement to purchase the Australian and New Zealand gas assets of Duke Energy, following Duke Energy’s decision to exit the Asia-Pacific region. The assets acquired were three gas transmission pipelines and three gas-fired power stations in Australia and one gas-fired power station in New Zealand. The pipelines had a combined length of 2,156 kilometres and the power plants had a combined capacity of 686MW. The acquisition provided Alinta with a stable and secure income stream and strong potential for volume growth, particularly from the pipeline assets on Australia’s east coast.

Energy Infrastructure

SP AusNet (19.9%) / State Grid Corporation of China

In May 2013, Singapore Power Limited (“Singapore Power”) announced that its wholly owned subsidiary, Singapore Power International (“SPI”), had entered into an agreement to sell a 19.9% interest in SP AusNet to State Grid Corporation of China (“State Grid”) for \$824 million. SPI would retain a 31.1% interest in SP AusNet. Concurrently, Singapore Power sold a 60% interest in SPI (Australia) Assets Pty Limited (the owner of Jemena Group and Zinfra Group) to State Grid. SP AusNet owns three Victorian regulated energy networks: electricity transmission, electricity and gas distribution and non-regulated Select Solutions which provides a range of energy, water and environmental services to the utilities industry. It had regulated and contracted assets of \$7.6 billion at 31 March 2013. Although the transaction was for a 19.9% interest in SP AusNet, the sale of this interest reduced Singapore Power’s interest from 51% to 31.1% and the concurrent sale of a majority interest in Jemena means that Singapore Power was giving up unfettered control of SP AusNet and therefore the multiples implied by the transaction reflect at least strategic value (if not control value).

SPI (Australia) Assets Pty Ltd / State Grid Corporation of China

In May 2013, Singapore Power announced the sale of a 60% interest in SPI (Australia) Assets Pty Limited (“SPIAA”) to State Grid for an undisclosed price. SPIAA owns the Alinta Assets (see below) acquired by Singapore Power in 2007. At the time of announcement SPIAA’s operations included:

- Jemena Group, the owner and manager of a portfolio of energy infrastructure assets including regulated gas and electricity distribution networks and gas transmission and storage assets; and
- Zinfra Group, a provider of engineering, design, construction, operational and maintenance services to owners of electricity, gas and water infrastructure assets.

As a consequence of the transaction, SPIAA recognised an impairment to the carrying value of its assets of \$407 million. The multiples have been calculated assuming the consideration paid by State Grid reflects a 60% interest in SPIAA’s assets at 31 March 2013 (i.e. SPIAA’s represent the value of the business). Although a relatively crude approach, the resulting multiples appear realistic given the nature of SPIAA’s business.

***ElectraNet Pty Ltd (41.1%) / State Grid Corporation of China***

In November 2012, State Grid acquired a 41.1% interest in ElectraNet Pty Ltd (“ElectraNet”) from the Queensland Government for \$500 million. ElectraNet owned and operated a regulated electricity transmission network in South Australia. It had 5,591 kilometres of line length and a regulated asset base of \$1,869 million at 1 July 2012. It was due for regulatory reset on 1 July 2013. All shareholder loans have been treated as equity.

Various Energy Infrastructure Assets of APA Group / Energy Infrastructure Investments Pty Limited

In May 2008 APA Group announced its intention to establish an unlisted investment vehicle for annuity style assets within its existing asset portfolio in order to reduce gearing. On 15 December 2008 APA Group announced the establishment of Energy Infrastructure Investments Pty Limited (“EII”) in conjunction with Marubeni Corporation (49.9%) and Osaka Gas (30.2%). APA Group is to hold a 19.9% interest in EII and to continue to manage and operate the assets under a long term agreement with a market based fee structure. The assets transferred to EII at the equivalent of \$696 million for 100% were electricity interconnectors (Murraylink and Directlink), gas fired power stations (Daandine and X41), coal seam gas processing plants (Tipton West and Kogan North), Telfer/Nifty Pipeline and pipelines under construction and due to be commissioned in 2009 (Bonaparte Pipeline and Wickham Point Pipeline). This transaction implies a pro forma forecast EBITDA multiple of 10.6 times. This multiple represents a blend of the businesses acquired.

Alinta Limited / Babcock & Brown/SPI Consortium

On 11 May 2007 Alinta announced that it had signed a scheme implementation agreement with a consortium comprising Babcock & Brown Limited (“Babcock & Brown”) and Singapore Power International Pte Limited (“SPI”) (a wholly owned subsidiary of Singapore Power) (“the Consortium”). Under the scheme proposal the Consortium would acquire 100% of the issued capital of Alinta for cash and scrip in three ASX listed energy infrastructure entities managed by Babcock & Brown plus the APA Group stapled securities owned by Alinta would be distributed directly to Alinta shareholders. Alinta owned 29 energy businesses and assets including gas transmission and distribution assets, electricity distribution assets, power generation assets, energy retail assets and asset management businesses. Under the proposal the assets and liabilities of Alinta were to be distributed between SPI, the listed Babcock & Brown entities and Alinta shareholders.

The terms of the transaction valued Alinta at approximately \$8 billion (\$16.06 per Alinta share) and implied a current year multiple of 15.4 times EBITDA. As a result of movements in the value of the scrip portions of the consideration, the value received by Alinta shareholders on completion of the transaction on 31 August 2007 had declined to \$7.6 billion (a current year multiple of EBITDA of 14.8 times). The transaction was the result of a competitive bidding process and the multiples reflect the blend of Alinta’s various businesses.

SPI owned a 51% interest in ASX listed energy and utility investment SP AusNet which is managed by Singapore Power. SP AusNet has a first chance to consider any electricity and gas transmission and distribution investment opportunity in Australia and New Zealand identified by Singapore Power. On 20 September 2007, SP AusNet announced that it had agreed to acquire the Alinta Assets acquired by SPI for \$7.2 billion (being \$8.142 billion less \$975 million of existing debt). The Alinta Assets included the New South Wales Gas Distribution Network, the Alinta Victorian Electricity Network, a 50% interest in ActewAGL Distribution Partnership, a 34.1% interest in United Energy Electricity Distribution Network, the Queensland Gas Pipeline, the Eastern Gas Pipeline, the VicHub Interconnect Facility and the Eastern States Asset Management business. The proposed acquisition implied a multiple for the Alinta Assets for the year ending 31 March 2008 (forecast) of around 13.4 times EBITDA (on a see through basis). In December 2007 this transaction was cancelled and did not proceed due to the impact on capital markets of the commencement of the global financial crisis. Nevertheless, it is indicative of valuation metrics for transmission and distribution assets at the time.

AGL Infrastructure Assets/Alinta Limited

On 26 April 2006, The Australian Gas Light Company (“AGL”) and Alinta announced an agreement to merge and restructure their respective businesses to create two separated listed companies, Alinta Limited (“New Alinta”) (focused on the ownership and management of energy infrastructure assets) and AGL

Energy Limited (focused on energy retailing, trading and generation). One component of the transaction involved the acquisition of AGL's infrastructure and asset management businesses for \$6.5 billion. The businesses acquired included a gas network in New South Wales, an electricity network in Victoria and 50% of the ActewAGL Distribution Partnership, the Agility infrastructure management and services business, Wattle Point Wind Farm in South Australia, the Cawse Cogeneration facility in Western Australia, Gas Valpo (a regional gas distribution and retailing business in Chile) and a 30% interest in APA Group. The gas and electricity networks (including ActewAGL) represented 65-70% of the value attributed to the AGL Infrastructure Assets and the New South Wales gas network was the major component of those assets.

The multiples calculated for the transaction reflect the blend of businesses (including a substantial asset management business), that the network assets were substantial, high quality assets and that the AGL Infrastructure business on a standalone basis had a lower relative tax cost base than its peers.

2 Valuation Evidence from Sharemarket Prices

The valuation of Envestra has been considered in the context of the sharemarket ratings of listed Australian and New Zealand energy infrastructure entities. Whilst none of these companies is precisely comparable to Envestra, the sharemarket data provides some framework to assess valuation parameters for Envestra. The Australian entities have been categorised based on whether they are primarily involved in gas or electricity infrastructure.

Sharemarket Ratings of Selected Listed Entities – Energy Transmission and Distribution												
Company	Year End	Market Capitalisation ¹⁹ (millions)	EBITDA Multiple ²⁰ (times)				EBIT Multiple ²¹ (times)				Ungearred NTA ²² Multiple (times)	RAB Multiple ²³ (times)
			Historical	Forecast Year 1	Forecast Year 2	Forecast Year 3	Historical	Forecast Year 1	Forecast Year 2	Forecast Year 3		
Envestra	30 Jun	AS\$1,905	10.9	10.0	9.6	9.2	13.1	12.0	11.4	11.0	1.74	1.42
<i>Australia - Gas</i>												
APA Group (standalone)	30 Jun	AS\$5,583	14.4	13.0	11.7	10.8	18.2	16.5	14.8	13.6	1.82 ²⁴	nmf ²⁵
APA Group (merged entity)	30 Jun	na	na	na	na	na	na	na	na	na	na	na
DUET Group	30 Jun	AS\$2,749	10.7	10.7	10.0	9.8	15.7	15.8	14.5	14.1	1.57	1.30
<i>Australia - Electricity</i>												
SP AusNet	31 Mar	AS\$4,487	9.8	9.9	9.5	na	15.0	15.6	14.9	na	1.16	1.31
Spark	31 Dec	AS\$2,469	8.2	8.1	8.8	na	11.7	12.1	14.3	na	1.12	1.43
<i>New Zealand</i>												
Vector	30 Jun	NZ\$2,430	7.9	8.6	8.5	8.3	10.9	12.5	12.6	12.2	1.53	1.47

Source: Grant Samuel analysis²⁶

Note: APA Group (merged entity) data not yet available

The multiples shown above are based on sharemarket prices as at 28 February 2014 (except Envestra which is shown as at 15 July 2013, the day prior to the announcement of APA Group's initial proposal) and do not reflect a premium for control. All of the entities have a 30 June year end except for

¹⁹ Market capitalisation based on sharemarket prices as at 28 February 2014 except Envestra which is shown as at 15 July 2013 (the day prior to the announcement of APA Group's initial proposal). The closing price for Envestra on the day prior to the announcement of the Proposal were not materially different to these prices (\$1.06 vs \$1.07).

²⁰ Represents gross capitalisation (that is, the sum of the market capitalisation adjusted for minorities, plus borrowings less cash as at the latest balance date) divided by EBITDA. EBITDA is earnings before net interest, tax, depreciation, amortisation, investment income profit after tax from associates, and significant and non-recurring items. For Spark, earnings from associates are proportionately consolidated.

²¹ Represents gross capitalisation divided by EBIT. EBIT is earnings before net interest, tax, investment income, profit after tax from associates, and significant and non-recurring items. For Spark, earnings from associates are proportionately consolidated.

²² Represents gross capitalisation divided by ungeared net tangible assets (that is, shareholders' funds less intangibles, plus borrowings (including derivatives) less cash as at the latest balance date).

²³ Represents gross capitalisation divided by RAB. RAB is as calculated by each of the entities (i.e. not per the access arrangements).

²⁴ The NTA of APA Group has been adjusted to remove the book value of energy investments which have also been excluded from the calculation of gross capitalisation.

²⁵ nmf = not meaningful

²⁶ Grant Samuel analysis based on data obtained from IRESS, Capital IQ, company announcements and, in the absence of company published financial forecasts, brokers' reports. Where company financial forecasts are not available, the median of the financial forecasts prepared by a range of brokers has generally been used to derive relevant forecast value parameters. The source, date and number of broker reports utilised for each company depends on analyst coverage, availability and recent corporate activity.



SP AusNet which has a 31 March year end and Spark Infrastructure Group (“Spark”) which has a 31 December year end.

The data analysed for each entity included the last two annual historical results plus the subsequent three forecast years. However, the data presented above represents an alignment of the financial data to allow direct comparison between the entities as well as to Envestra’s financial information which is on a June year end. Under this alignment, the earnings forecast for SP AusNet for the year ending 31 March 2014 and for Spark for the year ending 31 December 2013 have been treated as their Historical Year. While this is a relatively crude adjustment it is arguably more useful than leaving the data unadjusted.

A brief description of each company is set out below:

APA Group

APA Group primarily develops, owns and operates natural gas transportation infrastructure across Australia. It is the largest gas transmission pipeline owner in Australia. Its businesses are:

- Energy Infrastructure: APA Group owns and operates a portfolio of gas transmission pipelines totalling over 14,000 kilometres across all Australian mainland states and territories including all its assets which, two gas storage facilities in Western Australia and Victoria, and wind farm in Western Australia;
- Energy Investments: APA Group owns equity interests in energy infrastructure entities (both listed and unlisted) including Envestra (33.05%), gas pipelines (SEA Gas Pipeline (50%), Ethane Pipeline (6%)), GDI (EII) Pty Ltd which owns the Allgas Gas Network (20%), Diamantina Power Station Pty Limited (50%), and other energy infrastructure including electricity interconnectors, gas fired power stations and coal seam gas processing plants; and
- Asset Management; APA Group provides commercial, operating services and/or asset maintenance services to most of its energy investments and investment management services to all of its energy investments (other than Envestra and Diamantina Power Station Pty Limited).

APA Group’s multiples reflect the blend of its businesses and, in particular, the increasing income stream from asset management. In FY13, only 25% of revenue was sourced from regulated assets and therefore multiples of RAB are not meaningful.

DUET Group

DUET Group (“DUET”) owns 100% of Multinet Gas (gas distribution in Victoria), a 66% interest in United Energy (electricity distribution in Victoria) and an 80% interest in Dampier Bunbury Pipeline (gas transmission in Western Australia), all of which are regulated assets (although revenue of Dampier Bunbury Pipeline is subject to contracts not regulatory decisions). DUET is seeking to increase the proportion of income it derives from non-regulated sources and has recently expanded its services business to own and operate two new gas transmission pipelines in Western Australia which it is developing. In FY13, 93% of DUET’s revenue was attributable to regulated activities. During 2012 DUET internalised its management. All of DUET’s businesses now have internalised core functions including engineering, asset management and corporate support.

SP AusNet

SP AusNet is a utility infrastructure asset vehicle which owns Victoria’s primary electricity transmission network, an electricity distribution network located in eastern Victoria and a gas distribution network located in central and western Victoria. All of these businesses are regulated. In the year ended 31 March 2013, 83% of SP AusNet’s revenue was attributable to regulated activities. Singapore Power and State Grid currently have a 31.1% and 19.9% interest in SP AusNet respectively (after State Grid acquired its 19.9% interest from Singapore Power in 2013). SP AusNet is managed by SPI Management Services Pty Limited (a subsidiary of Singapore Power) under a Management Services Agreement, the initial period for which ends on 30 September 2015 (but which continues for two further ten year periods unless terminated by either party giving no less than one year’s notice prior to the expiry of the applicable ten year period). In November 2013, SP AusNet advised that it intends that the agreement will be terminated on or before 30 September 2015 and that discussions to this effect with Singapore Power are underway. If terminated on 30 September 2015 a termination fee equal to the previous financial year’s services charge will be paid. If terminated prior to 30 September 2015, a negotiated fee would be



payable. If no agreement for early termination is reached before 31 March 2014, SP AusNet will recognise a \$24.6 million provision for termination (equal to the present value of the estimated termination fee payable if the agreement is terminated on 30 September 2015).

In recent times, there has been a degree of uncertainty around SP AusNet including a dispute with the AER, a tax dispute and bushfire litigation. There is an expectation that earnings of two of SP AusNet's assets will decrease across the forecast period as its regulatory reset dates arise, however, as its reset periods are staggered the impact on forecast earnings are less clear (although earnings multiples are higher in Forecast Year 1.)

Spark Infrastructure Group

Spark owns 49% interests in Victoria Power Networks (comprising Citipower and Powercor whose principal activities are electricity distribution in Victoria) and SA Power Networks (whose principal activity is electricity distribution in South Australia), all of which are regulated assets. The remaining 51% interests are held by Cheung Kong Infrastructure Ltd and Power Asset Holdings Ltd. In the year ended 31 December 2013, 77% and 11% of Spark's revenue was sourced from regulated and semi-regulated activities, respectively. The management of Spark was internalised in 2011 and both of Spark's businesses have internalised core functions.

The calculation of underlying multiples for Spark is complex because of the minority holdings and form of investment. In calculating EBITDA and EBIT multiples, adjustments has been made to reflect Spark's proportionate share of EBITDA and EBIT from its equity accounted investments as well as proportionate share of external debt. RAB multiples are based on Spark's proportionate share of RAB. Revenue and profits of Spark are expected to decline during the year ended 31 December 2015 as there is expected to be a reduction in the regulatory rate of return for SA Power Networks from 1 July 2015 and for Victoria Power Networks from 1 January 2016. This is reflected in the earnings multiples for Spark which are lower in the near term (i.e. higher earnings) and higher in Forecast Year 2 (i.e. lower earnings).

Vector Limited

Vector Limited ("Vector") owns and manages a portfolio of energy infrastructure networks in New Zealand including electricity distribution (approximately 55% of EBITDA), gas transmission (25%), gas distribution (9%) and electricity and gas metering installations and telecommunications (11%). In addition, Vector owns a 22% share of NZ Windfarms Limited, a 50% share in Treescape (New Zealand's largest vegetation management company). In FY13, around 64% of revenue was sourced from regulated assets (which comprised 88% of Vector's assets). Vector's earnings are expected to decline in FY14 as a result of regulatory changes impacting electricity and gas transportation earnings, before growing modestly from 2015. Vector has a restricted free float, with The Auckland Energy Consumer Trust holding a 75.1% interest.

Appendix 5

APA Group - Broker Consensus Forecasts

- APA Group has not publicly released earnings forecasts for FY14 or beyond. However, on 11 December 2013 APA Group announced:
- full year EBITDA guidance for FY14 of \$730-740 million, including its share of profits from associates and jointly controlled entities; and
 - net interest cost guidance for FY14 of \$315-325 million.

Furthermore, on 17 December 2013, APA Group announced an estimated interim distribution for FY14 of 17.5 cents per security (with a payment date of 12 March 2014) and distribution guidance for FY14 of at least 36.0 cents per security. APA Group reaffirmed its FY14 guidance on 19 February 2014.

In order to provide an indication of the expected future financial performance of APA Group, Grant Samuel has considered brokers' forecasts for APA Group. Set out below is a summary of forecasts prepared by brokers that follow APA Group in the Australian stockmarket:

APA Group – Broker Forecasts for the Year ending 30 June																				
Broker	Report Date	Revenue ¹ (\$millions)			EBITDA ² (\$millions)			EBIT ³ (\$millions)			EPS ⁴ (cents)			OCF ⁵ (cents)			DPS ⁶ (cents)		Target Price	
		2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015	2016	2014	2015		2016
1	20-Feb-14	968.2	1,025.2	1,073.3	731.8	773.9	836.7	593.8	628.9	678.7	23.9	24.9	28.1	52.0	53.8	59.0	36.5	38.5	41.5	\$7.19
2	19-Feb-14	1,001.0	1,064.0	1,090.0	736.0	816.0	869.0	604.0	678.0	726.0	22.9	27.7	30.9	49.5	56.6	61.1	36.2	37.0	37.7	\$6.24
3	19-Feb-14	1,012.5	951.5	957.4	744.9	809.3	873.1	594.7	650.2	705.2	24.8	29.1	31.4	52.4	59.4	63.5	36.0	37.0	38.0	R ⁷
4	19-Feb-14	900.0	978.0	1,031.0	738.0	814.0	860.0	586.0	649.0	687.0	23.0	25.0	27.0	48.1	54.5	58.8	36.0	38.0	39.0	\$6.17
5	19-Feb-14	926.0	987.0	1,013.0	743.0	820.0	876.0	594.0	670.0	724.0	23.2	26.1	30.0	45.5	52.4	56.5	36.5	37.0	38.9	\$6.45
6	19-Feb-14	910.0	984.0	1,085.0	741.0	810.0	919.0	591.0	652.0	756.0	24.0	30.0	37.0	48.9	57.5	61.7	36.0	37.0	42.0	\$5.70
7	19-Feb-14	966.1	1,045.7	1,137.0	751.5	812.6	879.6	600.7	654.7	715.0	24.4	27.0	29.7	56.1	59.8	62.9	36.8	40.0	42.0	\$6.75
8	19-Feb-14	994.9	1,072.7	1,171.5	742.4	813.7	906.0	603.0	668.7	755.9	25.0	29.4	35.7	59.4	66.2	74.4	36.0	37.5	39.5	\$6.80
9	19-Feb-14	970.1	1,067.2	1,117.3	739.3	813.3	856.9	602.1	668.9	711.1	24.7	29.3	32.6	52.6	60.1	62.2	36.0	36.9	37.8	\$6.25
10	19-Feb-14	976.0	1,100.0	1,147.0	746.0	836.0	921.0	580.0	650.0	726.0	22.7	26.7	32.3	56.6	55.6	58.3	37.0	38.0	40.0	\$6.85
11	19-Feb-14	959.0	1,056.6	1,116.0	739.5	827.8	880.1	585.5	676.2	728.0	24.0	29.0	32.5	50.8	57.4	60.1	36.0	37.5	38.5	\$7.10
12	19-Feb-14	973.0	nmf ⁸	nmf	752.0	nmf	nmf	600.0	nmf	nmf	24.5	nmf	nmf	48.6	nmf	nmf	36.5	nmf	nmf	nmf
13	19-Feb-14	1,010.0	1,114.0	1,255.0	761.0	828.0	927.0	611.0	674.0	769.0	26.3	29.6	36.4	47.4	54.3	65.1	36.5	38.0	40.0	\$6.23
	<i>Minimum</i>	900.0	951.5	957.4	731.8	773.9	836.7	580.0	628.9	678.7	22.7	24.9	27.0	45.5	52.4	56.5	36.0	36.9	37.7	\$5.70
	<i>Maximum</i>	1,012.5	1,114.0	1,255.0	761.0	836.0	927.0	611.0	678.0	769.0	26.3	30.0	37.0	59.4	66.2	74.4	37.0	40.0	42.0	\$7.19
	<i>Median</i>	970.1	1,051.2	1,103.0	742.4	813.9	877.8	594.7	661.7	723.0	24.0	28.4	31.9	50.8	57.0	61.4	36.2	37.5	38.9	\$6.45

Source: Brokers' reports, Grant Samuel analysis

1 Excluding pass through revenue.
 2 EBITDA is earnings before net interest, tax, depreciation and amortisation, other income and non-recurring items. Includes share of profits of equity accounted associates and jointly controlled entities.
 3 EBIT is earnings before net interest, tax and other income and non-recurring items. Includes share of profits of equity accounted associates and jointly controlled entities.
 4 EPS = earnings per share
 5 OCF = operating cash flow per security
 6 DPS = distribution per security
 7 R = broker subject to research restrictions
 8 nmf = not meaningful. Broker 12's target price and forecast earnings beyond FY14 assume APA Group completes the acquisition of Envestra.



When reviewing this data the following should be noted:

- as far as Grant Samuel is aware, APA Group is followed by 15 brokers, of which 13 are presented above. The other two brokers have not published a report since the announcement of APA Group's interim FY14 results and therefore are not presented;
- the broker forecasts are not prepared on a consistent basis in relation to the treatment of pass through revenue. In the table above, Grant Samuel has attempted to present the broker earnings forecasts on a common basis by adjusting certain broker forecasts for estimated pass through revenue of \$400 million in FY14, \$450 million in FY15 and \$500 million in FY16; and
- as far as is possible to identify from a review of the brokers' reports, Grant Samuel believes that the earnings forecasts do not assume acquisition of Envestra (except for Broker 12 beyond FY14, which has been excluded) and do not incorporate any one-off adjustments or non-recurring items.