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Dear Johan

Update of debt risk premium using the ERA's debt yield methodology

The purpose of this report is to update the debt risk premium estimates that were set out in our report to the Independent Market Operator (IMO) dated 7 December 2012. That report set out estimates of the debt risk premium that would arise from applying the Economic Regulation Authority of Western Australia's (ERA) "bond yield" methodology. This report provides new debt risk premium estimates for a new averaging period, namely the 20 business days ending with 30 November 2012, inclusive ("updated period"). Other than updating the results for updated period, the method we applied is identical that applied in our earlier report. Regard should be had to that earlier report for a full description of the method we applied and for our related observations.

Results

The tables set out below replicate (and have identical numbering to) the tables that were set out in our earlier report for the updated period.

As shown in Table 1 below, we have derived a debt risk premium of 269 basis points for the updated period when undertaking a strict application of the methodology the ERA applied in the final revised ATCO decision.¹ If we again modify the ERA methodology to restrict the sample of bonds to only BBB rated bonds, we estimate a debt risk premium of 271 bonds. Finally, if we again retain the ERA methodology's original sample, but modify the term to maturity cut-off to three years, we estimate a debt risk premium of 274 basis points.

More detailed tables of the results obtained by applying the ERA's 'bond yield' methodology can be found in Appendix A, which again replicates Appendix A from our earlier report for the updated period.

¹ Economic Regulation Authority (25 June, 2012), *Revised decision pursuant to rule 6.4(4) of the National Gas Rules giving effect to the Economic Regulation Authority's proposed access arrangement revisions for the Mid-West and South-West Gas Distribution System, Revised by reason of and pursuant to orders of the Australian Competition Tribunal made on 8 June 2012,*



Table 1 – Summary of debt risk premium estimates using the ERA’s bond yield methodology – 20 business days to 30 November 2012 (basis points)

Sample	Average term to maturity	Average debt risk premium	Weighted average debt risk premium	Comment
Two year cut-off: BBB – 13 bonds BBB+ – 5 bonds	4.50	269	269	Strict application of ERA approach in its ATCO final revised decision
Two year cut-off: BBB – 13 bonds	4.50	269	271	Constrained to include only BBB rated bonds
Three year cut-off: BBB – 10 bonds BBB+ – 4 bonds	5.07	278	274	Cut-off increased to 3 years to provide more consistency with other WACC parameters

Source: PwC’s analysis of the ERA’s debt yield methodology, Bloomberg

If you wish to discuss further the contents of this note, please do not hesitate to call me on the number provided below.

Yours sincerely

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Appendix A – Detailed debt risk premium estimates

Table 2 – Debt risk premium estimates applying the ERA's debt yield methodology for 20 business days to 30 November 2012 (2 year cut-off, BBB and BBB+ bonds)

Bond	S&P Credit rating	Issue size (\$m)	Maturity date	Term to maturity	Weighting	DRP (bps)	Contributed DRP(bps)
APT Pipeline	BBB	300	22/07/2020	7.67	0.14	301	44
Brisbane Airport	BBB	200	9/07/2019	6.63	0.08	270	23
Holcim Finance	BBB	200	4/04/2019	6.37	0.08	253	20
Caltex Australia	BBB+	150	23/11/2018	6.01	0.06	243	14
Dexus finance	BBB+	120	10/09/2018	5.81	0.04	252	11
Sydney Airport	BBB	100	6/07/2018	5.63	0.04	286	10
Crown group	BBB	300	18/07/2017	4.66	0.09	245	22
Holcim Finance	BBB	250	18/07/2017	4.66	0.07	230	17
Dexus finance	BBB+	210	21/04/2017	4.42	0.06	224	13
United energy distribution	BBB	265	11/04/2017	4.39	0.07	286	21
New terminal financing	BBB	100	20/09/2016	3.83	0.02	293	7
Mirvac Group	BBB	225	16/09/2016	3.82	0.05	319	17
DBCT Finance	BBB+	150	9/06/2016	3.55	0.03	364	12
Goodman	BBB	175	19/05/2016	3.49	0.04	330	13
Santos Finance	BBB+	100	23/09/2015	2.84	0.02	253	5
Sydney Airport	BBB	175	6/07/2015	2.63	0.03	237	7
Holcim Finance	BBB	250	27/03/2015	2.35	0.04	192	7
Mirvac Group	BBB	200	15/03/2015	2.32	0.03	260	8
Simple Average				4.50		269	
Weighted Average							269

Source: PwC's analysis of the ERA's debt yield methodology, Bloomberg



Table 3 – Debt risk premium estimates applying the ERA’s debt yield methodology for 20 business days to 30 November 2012 (2 year cut-off, BBB bonds only)

Bond	S&P Credit rating	Issue size (\$m)	Maturity date	Term to maturity	Weighting	DRP (bps)	Contributed DRP(bps)
APT Pipeline	BBB	300	22/07/2020	7.67	0.18	301	55
Brisbane Airport	BBB	200	9/07/2019	6.63	0.11	270	29
Holcim Finance	BBB	200	4/04/2019	6.37	0.10	253	26
Sydney Airport	BBB	100	6/07/2018	5.63	0.04	286	13
Crown Group	BBB	300	18/07/2017	4.66	0.11	245	27
Holcim Finance	BBB	250	18/07/2017	4.66	0.09	230	21
United Energy Distribution	BBB	265	11/04/2017	4.39	0.09	286	27
New Terminal Financing	BBB	100	20/09/2016	3.83	0.03	293	9
Mirvac Group	BBB	225	16/09/2016	3.82	0.07	319	22
Goodman	BBB	175	19/05/2016	3.49	0.05	330	16
Sydney Airport	BBB	175	6/07/2015	2.63	0.04	237	9
Holcim Finance	BBB	250	27/03/2015	2.35	0.05	192	9
Mirvac Group	BBB	200	15/03/2015	2.32	0.04	260	10
Simple Average				4.50		269	
Weighted Average							271

Source: PwC’s analysis of the ERA’s debt yield methodology, Bloomberg



Table 4 – Debt risk premium estimates applying the ERA’s debt yield methodology for 20 business days to 30 November 2012 (3 year cut-off with BBB and BBB+ bonds)

Bond	S&P Credit rating	Issue size (\$m)	Maturity date	Term to maturity	Weighting	DRP (bps)	Contributed DRP(bps)
APT Pipeline	BBB	300	22/07/2020	7.67	0.16	301	49
Brisbane Airport	BBB	200	9/07/2019	6.63	0.09	270	25
Holcim Finance	BBB	200	4/04/2019	6.37	0.09	253	23
Caltex Australia	BBB+	150	23/11/2018	6.01	0.06	243	16
Dexus Finance	BBB+	120	10/09/2018	5.81	0.05	252	12
Sydney Airport	BBB	100	6/07/2018	5.63	0.04	286	11
Crown Group	BBB	300	18/07/2017	4.66	0.10	245	24
Holcim Finance	BBB	250	18/07/2017	4.66	0.08	230	19
Dexus Finance	BBB+	210	21/04/2017	4.42	0.07	224	15
United Energy Distribution	BBB	265	11/04/2017	4.39	0.08	286	24
New Terminal Financing	BBB	100	20/09/2016	3.83	0.03	293	8
Mirvac Group	BBB	225	16/09/2016	3.82	0.06	319	19
DBCT Finance	BBB+	150	9/06/2016	3.55	0.04	364	14
Goodman	BBB	175	19/05/2016	3.49	0.04	330	14
Simple Average				5.07		278	
Weighted Average							274

Source: PwC’s analysis of the ERA’s debt yield methodology, Bloomberg