

Envestra Limited
Managing Director's Address
20 October, 2011 Annual General Meeting

Ladies and Gentlemen,

The Chairman has outlined our expectations with regard to the financial performance of the Group, with Profit after Tax forecast to grow from \$45 million in 2010-11 to around \$60 million in the current year.

Regulatory Affairs

Our confidence regarding the Company's future financial prospects is underpinned by the recent regulatory determinations published by the Australian Energy Regulator covering our South Australian and Queensland networks, which in themselves, comprise just over half of our total business. The decisions resulted in significant tariff increases in both jurisdictions, with revenues over the next 5 years expected to be 55% higher than those received in the last 5 year period. That is, an annual increase in revenue of around \$23 million. Whilst price increases to gas consumers are regrettable, the AER recognised the increases in capital funding costs that we, and others, face in the aftermath of the global financial crisis, as well as the substantial capital expenditure program to occur in the next 5 years to replace age-ing assets, to maintain the reliability of the networks and to undertake augmentations to cope with continuing population growth.

Considerable time and resources are used in the modern regulatory environment to address the myriad of issues that arises with the increasingly intrusive approach that the AER has adopted. It is a credit to our Envestra regulatory team that we have enjoyed a sound relationship with the AER. Our submissions to the AER have resulted in improvements in a number of areas – including the WACC, allowed capex and opex levels, and in the approach to forecasting future gas demand. These improvements were essential if investors are to have on-going confidence in the industry and fund the substantial investment program. In addition, it will ensure that existing debt can be effectively re-financed when maturities occur. I believe the AER responded appropriately to many of our contentions and that will certainly facilitate our participation in capital markets in the coming years. It will certainly see a significant improvement in South Australian and Queensland revenues over the next 5 years.

Unfortunately, several matters remain in contention with the AER. These matters are now on appeal to the Australian Competition Tribunal, with a decision expected early in the new year. Whilst we are generally reluctant to engage in litigation of this nature, they are matters of principle that unless corrected will have long-term implications for our business. In addition, there are substantial sums associated with several of the matters.

We are also mindful that the existing Access Arrangements for the Victorian and Albury networks are due to expire on 31 December, 2012 and we would therefore be hopeful that these issues might be clarified by the Australian Competition Tribunal and therefore will not re-appear in the forthcoming Victorian price review process.

Whilst on the subject of the Victorian Access Arrangement, our initial submission to the AER is due on 30 March, 2012. Our expectation is that the Victorian capital expenditure requirements over the next 5 years will be somewhat similar to that recently approved for South Australia. The AER will need to allow for the increased cost of capital that confronts all network owners, post the global financial crisis, in funding this work. We therefore expect to seek tariffs and revenue increases in our Victorian business over the 5 year period, but probably not to the same extent as we have seen in South Australia.

Carbon emissions, the Carbon Tax and government policies

The debate on the Federal Government's carbon tax has occupied the headlines throughout the course of this year. The legislation was introduced to Parliament in September, and the tax is expected to be implemented with effect from 1 July, 2012.

We are often asked what impact this is expected to have on Envestra.

We have reported our emissions to the Government in each of the past 3 years – they roughly amount to some 400,000 tonnes of carbon dioxide equivalent annually, as measured using the Government's required methodology. The emissions arise largely from the small amounts of gas that leaks from older pipes, meters and other equipment that comprise the networks. With a \$23 carbon tax, this is expected to cost some \$9 million initially, but will rise as the tax is increased, or if the ultimate emission trading system produces even higher carbon costs. However, our financial exposure should be limited, in that it is expected that this cost should be recovered through the "pass-through provisions" included in our Access Arrangements.

More generally, and in the longer term, we expect to benefit from the carbon tax in that it is likely to result in gas being in an improved competitive position relative to electricity. The Australian electricity supply is heavily dependent on coal, which is more carbon intensive, therefore domestic electricity prices are likely to rise more as generators are faced with the increasing cost of carbon emissions.

There has been a lot of unhelpful, and at times inaccurate, commentary on emissions during the course of the carbon debate, including that made by certain political interests, questioning the superior position of natural gas in terms of CO₂ emissions compared with that of coal, particularly where the gas is being produced from coal seam methane fields.

There is no doubt that natural gas has a significantly better carbon footprint than any current coal fired generation, with the extent of the improvement largely depending on whether the comparison is being made to black, or brown coal fired power stations. Whilst there is little public data in Australia on the emissions arising from the Coal Seam Methane production processes – simply because this part of the industry is relatively new, and also, is in process of considerable ramp-up, it is unlikely that any methane or CO₂ losses arising from CSM production will have a material impact on the relatively superior emissions performance of natural gas.

Natural gas is widely recognised as the key to achieving significant reductions in CO₂ emissions towards the middle of this century. With the long-life nature of energy investments, and the long lead times for new generation developments, I believe gas will play an increasing role in substituting for higher carbon emitting energy sources over the course of the next 20 years and beyond.

Operations

Our networks performed admirably in 2010-11, particularly given the severe flooding that occurred in Queensland, Victoria and to a lesser extent, in southern New South Wales.

Whilst operating costs rose by \$9 million or 8% over the previous year, \$6 million of the increase was associated with the newly acquired Country Energy business, together with additional provisioning for potential land remediation activities. Underlying operating costs increases were essentially held to 3%, a reflection in part on APA's business improvement initiative (known as Project LEAP) aimed at improving the efficiency of key operational processes.

Our Staff and Contractors

Our contractor, APA, continued to provide a high level of service with a safety record, both in respect to employee and contractor injuries, and in respect to public incidents, only being marred by relatively minor occurrences. On behalf of our Board and management, I take this opportunity to record our appreciation of the effort put in by APA staff and contractors during 2010-11 to ensure our networks operated reliably and commercial matters were appropriately managed. In particular, we thank those personnel who assisted under most trying conditions during the flooding and cyclone events that occurred during the year and which provided significant challenges to the safe and continuing operation of the networks.

Natural Gas Marketing

Many of you in this room may have noticed the natural gas advertisements that have appeared on TV, been on radio and featured in newspapers. I am regularly asked why Envestra, given it is not a retailer of natural gas, assumes this role.

A feature of the reformed energy utility sector in Australia is that each of the major retailers have major interests in both electricity and gas businesses, and as such, are not generally inclined to promote one, or other of the products. Whilst marketing is not so important for electricity, since all houses or businesses require electricity; for gas, which is essentially a fuel of choice, it presents a challenge for gas network owners, as without active promotion, natural gas would progressively lose its competitive position. This background underlies our submissions to various regulators over the years to allow a certain level of funding to the gas network owners to support increasing penetration and usage of natural gas.

Whilst we curtailed our marketing spending during the GFC, we have over the past 18 months expanded and re-targeted the program. This move received support from the AER in our recent South Australian regulatory decision, with additional funds allowed to support these activities. The program is carefully directed, with a focus on varying customer channels tailored to local market conditions. South Australian shareholders in particular will be well aware of the TV and radio ads, and the appliance incentive (or rebate) programs aimed at growing connections. Indeed, 2010-11 saw a record 27,000 new consumers added to our business. This compares with 24 and 23,000 in each of the preceding two years and is a testament to the success of the marketing initiatives. For shareholders who are interested, I commend to you the "make the connection" website.

Envestra's strategic direction

Envestra is a natural gas transporter, with long-term revenue growth dependent on network expansion, rather than volume growth. Whilst we are affected by volume outcomes in the midst of 5-yearly regulatory periods, longer term revenue growth is dependent on network (or regulatory asset base) expansion, particularly with the development of new housing subdivisions in Victoria and South Australia and to a lesser extent in Queensland.

We expect average domestic volumes to decline, as indeed it has been in recent years, due to warming weather patterns, improving energy efficiency standards, public energy conservation awareness and the increasing penetration of Government sponsored solar hot water. However, this is not expected to have a significant impact on long-term revenue growth due to the structure of the regulatory regime which allows tariffs to increase to compensate for changes in consumption patterns.

We do not see much opportunity to engage in acquisition activity as an avenue for growth. We intend to remain in our niche segment – natural gas distribution – and focus on the considerable capital expenditure opportunities that are available to secure future revenue growth.

Some \$200 million of projects will be undertaken this year, and it is likely that this will increase to \$230 million in 2012-13. This type of spending (which we firmly believe is in the interest of gas consumers) can also be expected to generate substantial increases in future Envestra revenues given a stable regulatory environment.

We will continue to focus on regulatory strategy, in particular liaising with the AER and Governments, to seek improvements in the current regulatory structure so that there is an appropriate balance between the interests of gas consumers and those of the investment community, including our shareholders.

We will also continue to focus on our financing strategy, with the aim of:

- Improving our credit rating;
- Reducing re-financing risks; and
- Achieving long-term financial stability.

As I said last year, our Company is in a sound financial position and I believe we have an encouraging future, with regulatory decisions in place that provide a reasonable level of confidence that we will be able to grow the business and provide improving returns to our shareholders.

Thank you ladies and gentlemen. I'll now hand you back to our Chairman.