APA Group 1H FY23 financial results speeches

Speakers: Adam Watson, APA Group CEO and Managing Director, and Kynwynn Strong, APA Group acting CFO

Delivery: Thursday, 23 February 2023

Check against delivery

CEO and Managing Director Adam Watson address

Good morning everyone and thank you for joining the call.

Let me start by acknowledging the Gadigal people of the Eora (E-ORA) nation, Traditional Custodians of the land on which I'm speaking today.

First Nations people have taken care of our lands and waterways for the past 60,000 years and I send my thanks and appreciation to the Gadigal people, and all first nations people, and pay my respects to their Elders past, present and emerging.

It's a great privilege to join you today, for the first time in my capacity as APA's CEO and Managing Director.

Also joining me is APA's acting CFO, Kynwynn Strong and our Investor Relations team.

A quick run through of today's presentation order.

- I'll start with a short summary of our half year results.
- I'll then take you through our performance outcomes against our key areas of focus
- Kynwynn will take you through the financials, before I come back to provide some market insights.
- We'll then allow time for Q&A, before ending with some closing remarks.

But, before I start, I want to begin with what we call here at APA, a "safety share". Let's move to slide 4.

At APA, we start all of our meetings with a discussion on safety, our customers or our behaviours.

The purpose of these discussions is to create an environment and culture where our people feel courageous and safe to share activities that have gone well, or not so well, so that we can continuously learn and improve the way we operate.

In November last year, flooding of the Macquarie River in Bathurst resulted in a gas a leak on our Young-Lithgow Pipeline, that affected gas supply in the Central West of NSW.

We were on the ground within hours, finding innovative short-term solutions to deliver gas to the community, and in particular to the vulnerable.

Over the course of the next few days, we brought together an in-house team of around 200 people from across the country to restore gas supply.

Despite the immense pressure to restore gas as quickly as possible, we never lost sight of safety – and as a result – there were no lost time injuries.

We did have one minor injury where an employee touched a hot weld, and we've taken learnings from this.

The overall outcome - it was a strong demonstration of collaboration with our customers, with emergency services, with government, and with the community.

We communicated early and often to deliver a great result for our stakeholders.

And we did it with safety at the forefront.

Now let's get into today's presentation by starting with a summary of our half year results, which is presented on slide 5.

We've delivered another solid financial performance:

- EBITDA is up 2.5 per cent.
- Distributions are up 4 per cent.
- We've reaffirmed distribution guidance of 55 cents per security for the full year.
- Free cash flow for the half was down 6 per cent, impacted by the timing of a large cash receipt. Without this timing issue, free cash was 2 per cent higher than last year.
- And our balance sheet remains strong, with no material debt refinancing required until 2025.

We've made good progress on our organic growth pipeline.

And we acquired Basslink, which gives us another platform to expand our electricity transmission business.

When we look further forward, our strategy is to be the partner of choice to deliver infrastructure solutions for the energy transition.

As we see our customers' decarbonisation ambitions continue to evolve, we're becoming more and more confident about APA's long term growth outlook.

To slide 6.

Late last year, the Executive Leadership Team and I set three priorities that we want the organisation to rally around.

Our people, operational excellence and creating value.

Across the organisation, we're holding each other to account, to ensure these priorities make a positive difference for our customers, communities, partners and investors.

I'll step through today's results in the context of these priorities.

Let's start with our people – our focus here is to ensure they're safe, well, engaged and motivated.

And we're making good progress, as you can see on slide 7.

In the past six months we achieved a 35% reduction in our total recordable injury frequency rate, or TRIFR, compared with this time last year.

And our total female participation improved over the year, for the first time exceeding 30%.

But despite this progress, we know there's much more to do as we strive for continuous improvement.

Creating a pipeline of talented people is vital to our success.

As you can see on slide 8, we've recently been recognised as a top employer for graduates and ranked first in our industry category for this year's Australian Association of Graduate Employers list.

And we've enhanced our Parental Leave Policy to give all APA employees equal access to 18 weeks' leave.

These are just some examples of what we're focussing on to ensure our people are engaged and motivated.

Turning now to Operational Excellence, which starts on slide 9.

Operational excellence is critical to our social licence and has underpinned today's solid set of results.

As I said in my opening remarks, we continue to grow our earnings, at the same time as making the necessary investments in capability to ensure we can achieve sustainable long-term growth.

Let's move to slide 10.

We're proud of our continued strong operational performances across our energy infrastructure portfolio.

Through the half, our renewable power generation assets were available around 94 per cent of the time, and we delivered our gas transmission nominations 99.9 per cent of the time.

We acquired Basslink during the period and moved quickly to integrate the business and ensure it was operating safely and reliably.

Performance to date has been pleasing and we continue to invest in the asset to maximise performance.

Making sure our customers have their energy – when they need it – is key to our role in the energy transition.

We've made good progress with our sustainability initiatives during the period, as you can see on slide 11.

- We appointed our first Reconciliation & First Nations Manager, and started developing our Reconciliation Action Plan.
- We enhanced our ESG related performance disclosures.

- We developed and implemented a Responsible Procurement Strategy.
- And we continued to enhance our modern slavery risk management activities.

Central to sustainability is the progression of our Climate Transition Plan. Our progress for the half is summarised on slide 12.

We've taken on-board feedback from investors, aligning our Group Executive members' remuneration to climate-related performance.

And we've embedded our action plan across the business.

We're on track to deliver our FY23 commitments including the establishment of a methane target.

The progress of our Climate Transition Plan sends a clear message to our customers, communities, and investors about our commitment to play a meaningful part in a lower emissions future.

Moving now to slide 13 and our third focus area … creating value.

This encompasses our growth strategy, operational efficiency, and capital management.

On the growth side, we have brought clarity to our strategy.

Our focus is to be a partner of choice in select markets where we have a competitive advantage.

This approach will be underpinned by being proactive and anticipating the needs of our customers, partnering with them, pursuing unsolicited proposals, and delivering bundled energy solutions.

And we're making the investments necessary to achieve this.

To slide 14.

Our strategy to be the partner of choice will complement the momentum we're already seeing on our existing organic pipeline.

We're making good progress with our projects across Australia, with $465 million invested through the half across our select markets.

We haven't been immune from the escalation of materials costs, supply chain pressures and impacts from weather, but most of this has been successfully shielded by the way we procure our materials and contractors.

We commissioned our Gruyere microgrid during the half, and it's performing very well.

Our Mica Creek Solar Farm is powering ahead with more than 90 per cent of construction now complete.

The expansion of our pipeline routes to southern markets is well underway and on track to help meet peak gas demand this winter.

Pleasingly, this was recognised by the ACCC who recently acknowledged that there is now likely to be sufficient capacity on key pipelines to transport gas to meet the projected supply shortfalls in the southern states in 2023.

On top of this, we've also acquired Basslink, further enhancing our electricity transmission capability, and giving us exposure to new energy markets. We can now support our customers with subsea cable expertise and we've extended our market reach into Tasmanian.

In total, we invested around $1.3 billion during the period in a mix of organic growth and M&A projects, that we're confident will create long term value for our investors, customers and the community.

To slide 15.

We have a strong business, with strong foundations and a great future.

But we also need to continue to invest in our business and in our people.

A great example of this, is the expansion of our Electricity Transmission business.

We can now demonstrate that we have the skills, capability and experience that's necessary to support customers such as the NSW Government with their Renewable Energy Zone ambitions.

Being selected as one of the shortlisted participants in the Central-West Orana initiative is evidence of this.

Our new national state-of-the-art Integrated Operations Centre, or IOC, which you can see on slide 16, is a great example of how these investments in our business will strengthen our foundations and create value over the long term.

Our new IOC was opened in November last year.

We can now support our customers and market operators from one central location. It's a truly impressive capability that we've developed.

Let me emphasise once again, it's investments like this that will ensure APA can support our stakeholders to deliver safe, reliable and affordable energy solutions, and enable APA to be a partner of choice as Australia's energy system transitions.

With that, I'll handover to Kynwynn, to talk to our financial performance.

Thanks Kynwynn.

As I mentioned earlier, I'd like to briefly highlight some of the dynamics we're seeing in the energy market, before taking some questions from the audience.

I'm now on slide 26.

The success of the energy industry going forward will be judged by our nation's ability to deliver reliable and affordable energy for our communities and industry, as the system continues to lower emissions.

Over the last year we've seen what happens when one of these falls out of balance.

Make no mistake, investment in renewable power generation is critical, and must continue to accelerate if we're to achieve our nation's net zero ambitions.

At APA, we're playing our part

- We're developing Australia's largest off-grid solar farm in Mount Isa.
- We've acquired Basslink and we're supporting government to build out the electricity transmission connections required to support these new generators.
- And through the transition, we know that gas will continue to play a central role in ensuring our energy system remains reliable and affordable as we transition to more and more renewables.

More broadly though, Australia needs to ensure that the right policies and regulatory frameworks are in place to ensure the energy transition is orderly, and to promote the necessary investment required to achieve our nation's ambitions.

Moving to slide 27.

As Australia's reliance on coal is winding down, we're seeing renewables generation stepping up, as it should be.

But renewables, unfortunately, can't do all the heavy lifting.

Right now, coal still represents two thirds of the National Electricity Market's energy mix.

AEMO expects about 60% of the current coal fired capacity to be withdrawn by 2030 – that's around 14-gigawatts of capacity that will not be available within 7 years.

The challenge to replace 14-gigawatts of capacity by 2030 is staggering.

Let me try to paint a picture of this challenge.

Snowy 2.0 and the Battery of the Nation are two of Australia's largest renewable projects, but when they eventually come online, they'll only deliver a fraction of what's needed to replace coal.

Technologies such as batteries are no doubt required and have a role to play as well. But if you take, say the Victorian Big Battery – one of the largest in the world – it's likely to only provide enough power for around 1 million Victorian homes for around 30 minutes.

Yes – technology is improving at pace, but it's well short of what's needed to ensure our energy system is secure and reliable when the sun doesn't shine, or the wind doesn't blow.

That's why renewable energy – coupled with firmed gas - is essential.

On to slide 28

We've seen the importance of gas play out in South Australia, Western Australia and other progressive regions of the world.

In the UK, renewables make up 36 per cent of the energy market, gas 40 per cent.

In the Netherlands, renewables make up 33 per cent, gas makes up 46 per cent.

But if we focus back on Australia, right now, when you take South Australia out of the National Electricity Market, it runs on 24 per cent renewables but just 4 per cent gas and 67 per cent coal.

As coal is withdrawn across the NEM at ever increasing rates, gas will be essential to ensure grid stability and support the growth of renewables.

But key to achieving this is ensuring that there's appropriate supply of gas in the market.

Let's look at slide 29.

The UK is an example of what happens when ambition gets ahead of reality, and appropriate domestic supply isn't maintained.

While the Russian and Ukraine conflict has no doubt materially impacted energy prices in the UK, prices were already on the rise in the UK well before the conflict began.

Before the Ukraine conflict, in calendar 2021, UK gas production reduced by 17 per cent, while at the same time, renewable generation output actually fell by 8 per cent owing to poor weather conditions.

With coal generation at an all-time low due to retirements and domestic gas supply down, the UK had to increase its reliance on gas imports to keep the lights on and households warm.

The result - a 189 per cent increase in UK electricity prices over this period, again, before the Ukraine conflict, which then only made matters worse.

Turning to slide 30, this provides an important lesson for Australia.

Reliability and affordability of energy is directly linked to domestic gas supply. And we know that we need to keep energy costs, including gas, affordable for both households and industry.

I think everyone recognises the challenge involved when setting policies to ensure energy costs are kept low. It is not easy.

But committing to domestic gas supply is arguably the single most important initiative we have at our disposal to deliver a smooth, effective, and successful energy transition for Australians.

At APA, we're doing everything we can to make sure that gas can get to where it's needed. We're investing ahead of demand…our East Coast Grid development is a clear example of this.

But developing upstream gas resources and new gas supplies must also be prioritised.

In summary, investment in renewable power generation is critical and must continue to accelerate if we're to achieve our nation's net zero ambitions.

But it's also vital to bring to market new domestic gas supplies to complement renewables and fast-track the energy transition.

I'll now hand over to the moderator to open-up for questions.

Now let me wrap-up with three key take-outs from today's presentation. I'm on slide 33.

First, we've delivered another solid set of results – our distributions are in line with guidance, earnings continue to grow as we continue to invest for a sustainable future, and we have a strong balance sheet.

Second, we're confident about our strategy to be a partner of choice in the energy transition.

And third, our relentless focus on our three priority areas – our people, operational excellence, and creating value - is building momentum.

As I said in December, when I took over leading APA – we are a strong business, with strong foundations and with a great future, and one that's proud to be at the forefront of responsibly transitioning Australia's energy system.

Thank you very much for your time.

Acting CFO Kynwynn Strong address

Thanks Adam and good morning, everyone.

It's my pleasure to address you as APA's Acting Chief Financial Officer.

To echo Adam, we're pleased with our financial performance for the first half of FY23.

I'll jump straight in with today's results, starting with the P&L on slide 18 …

We've delivered another solid financial performance with revenue up 5 per cent and EBITDA up 2.5 per cent.

Our non-operating items are a positive $12 million in total with the two main call outs being:

- Basslink – with interest income, the revaluation of the debt and integration costs taken below the line.
- Partly offset by hedging adjustments and our technology transformation projects.

These details are shown in the appendix.

Depreciation and amortisation are lower, as this half normalises from the higher rate we saw in the first half of FY22.

Net interest expense is lower as we benefited from higher deposit rates.

Tax expense is higher on our higher earnings base.

Free cash flow is down 6 per cent but is up 2 per cent if we exclude the impact of a $41 million receipt that was paid in early January – I'll come back to this shortly, but as Adam said in his remarks earlier, the number I want you to take away is that it's 2 per cent higher.

Our distribution is in line with our guidance at 26 cents per security up 4 per cent, equating to a payout ratio of 63.3 per cent.

I'm proud to say that this is a continuation of almost 19 years of growth in distributions for our securityholders.

And there is no doubt our balance sheet is robust and that we are in a strong position with cash and undrawn facilities of $2.3 billion.

Moving now onto the next slide, where I will take you through the revenue in more detail …

- Segment revenue is up 5%.
- Excluding Orbost it is up 7%.

You can see we have clearly benefited from the majority of our tariffs being linked to inflation.

We have also had some operational improvements in the period …

- About half of the $20 million you can see there under operating revenue is from our east coast assets performing well in the period.
- And the other half is from the non-recurrence of an operating item in the west coast in the prior period.

So overall, it's a solid result, and what you would expect of us – we are a highly contracted energy infrastructure business with inflation linked revenues.

If we now look at our costs …

The biggest item here is our corporate costs which have increased $16 million.

You will recall at our investor day in May and our results in August last year we were explicit that our cost base would increase as we invested in our business to ensure a sustainable future.

And this is what you are seeing.

You are seeing targeted and financially disciplined investment in our people to further build out our capabilities.

This is key to ensuring we create value for our customers, communities and investors as a partner of choice to deliver infrastructure solutions.

While we will remain financially disciplined, we're making these significant investments now to ensure our business will grow sustainably over the longer term – this includes:

- Electricity transmission
- Renewables
- Power generation
- Sustainability and community
- Technology

It is also really important to acknowledge the hard work of our teams who continue to drive operational efficiency improvements

If I could make a specific call out that operating costs have only increased $9m despite a challenging period with floods and an inflationary environment.

As Adam said in his earlier remarks, this goes to the heart of our operational excellence.

Moving to slide 21 which shows EBITDA by segment …I'll call out a few highlights:

On the East Coast, EBITDA is up 5% excluding Orbost.

In addition to our tariffs benefiting from inflation, we saw good performance from a number of our assets – including the South West Queensland Pipeline and Roma Brisbane Pipeline – with new contracts and a colder winter.

This also captures our response to the Young Lithgow repair, which Adam touched on earlier, highlighting our focus on safety and support for vulnerable customers.

The West Coast continues to perform well – up 11 per cent – with around half of this increase being inflation-linked benefits and the other half from an operating provision in the previous period.

The Wallumbilla Gladstone Pipeline is pretty straight forward with a 7 per cent increase due to this contract being inflation linked with a small FX offset, attributable to the Foreign Exchange Contracts we extended this time last year.

Our electricity generation and transmission – which includes Basslink and our generation Assets; both firming and renewable – is up 13 per cent with an initial $8 million contribution from Basslink

Excluding Basslink, EBITDA is up 5%.

Moving on to cash flow on the next slide.

As I mentioned earlier, free cash flow is down 6 per cent but the number I want you to take away is that it's 2 per cent higher.

You can see in this waterfall chart, the largest movement is a $41 million increase in working capital with this payment falling into early January as a result of the thirty-first of December falling on a Saturday.

There is also a $24 million movement in working capital from a handful of smaller items. We have not separated these out but the dynamic is similar.

Without this $41 million, our free cash flow increased 2 per cent, broadly in line with EBITDA and inclusive of the benefit we continue to receive from the Federal Government's accelerated depreciation allowance for capital projects.

I would also call your attention to the net interest line which is only $1 million higher than the first half of FY22 – as we continue to benefit from the liability management exercise we executed in March 2021 – with all our drawn debt fully hedged or fixed.

Turning now to our balance sheet.

This slide clearly demonstrates the strong foundations of our business – and I will make just two points …

First, our balance sheet is strong with our average cost of debt at 4.4 per cent and $2.3 billion of cash and undrawn facilities to fund growth and pursue the opportunities in front of us.

Second, it highlights that we continue to have an organic pipeline of capex opportunities still in excess of $1.4 billion.

So, to conclude and before I hand back to Adam, I want to summarise how we think about our disciplined capital allocation.

First and foremost, we must make sure our people are safe and our assets are safe – with our stay in business capex.

We’re focussed on continuing to improve our technology, protecting our assets, and delivering on our net zero commitments.

We have risk adjusted hurdle rates for both M&A and organic growth to ensure we create long-term value for our securityholders.

We know distributions are important to our securityholders, and we always look to ensure we have an appropriate balance between growing our distributions and efficient funding of our growth.

And finally, we continue to ensure we have the options available to us for capital management – so that we can act when we see an opportunity to create value.

I look forward to your questions later – I’ll now hand you back to Adam to take you through the energy market dynamics.