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Directlink

Stakeholder Meeting 4: Overview of regulatory proposal

4 December 2023



I'd like to begin by acknowledging the Traditional Owners of the land on which we all meet from today and pay my respects to Elders past, present and emerging.

Welcome and purpose

Objective: To set the scene for the meeting.

Agenda for today's meeting

Activity	Lead	Time
Welcome and purpose	Beth Griggs, General Manager Economic Regulation and External Policy, APA Group	1:30pm – 1:35pm
Overview of the 2025 to 2030 proposal	Mark Allen, Senior Regulatory Manager, APA Group	1.35pm – 1.45pm
Capital expenditure for the 2025 to 2030 period	Annie Martyn, Asset Manager, APA Group	1.45pm – 2.00pm
Regulated asset base, depreciation, return on capital and tax	Angelica Austin, Regulatory Specialist, APA Group	2.00pm – 2.20pm
Operating expenditure for the 2025 to 2030	Mark Allen, Senior Regulatory Manager, APA Group	2.20pm – 2.30pm
Revenue Adjustments	Mark Allen, Senior Regulatory Manager, APA Group	2.30pm – 2.40pm
Revenue and price impacts	Mark Allen, Senior Regulatory Manager, APA Group	2.40pm – 2.50pm
Wrap up and thanks	Mark Allen, Senior Regulatory Manager, APA Group	2.50pm – 3.00pm

Overview of the 2025 to 2030 proposal

Objective: To inform stakeholders on the key themes and revenue building blocks for the 2025 to 2030 regulatory period

Operating context



Growth

Helps to meet the electricity needs of the growing population centre south of the Gold Coast and provides important voltage support to increasing solar penetration in Northern NSW



Challenging environment

High rainfall Average annual rainfall of 1,800mm in the Mullumbimby area
Difficult terrain - Easements run through steep terrain, environmentally sensitive land and across different land uses



Energy transition

Directlink assists in stabilising the electricity grid when renewable energy is intermittent. This role will be increasingly critical during the energy transition.



Planning for end of life

Key technology in the original design of Directlink will be obsolete or sub-optimal by approximately 2042. Planning for its end of life has been a key consideration for the 2025-30 period to ensure reliability and affordability is balanced for continued operation to 2042.

Plan on a page

Improving safety and protection



To help protect against the increasing risk of break-ins and loss and damage of key assets, we propose to improve fencing to deter break-ins and improve 24/7 site monitoring through the installation of CCTV. To improve safety, support systems will be installed in high-risk landslide areas.

\$5.0M

Asset monitoring



To ensure Directlink continues to operate reliably, general upkeep and maintenance of existing control systems is required. A feasibility study will also be undertaken to determine if a master controller should be installed to improve monitoring and reliability performance.

\$1.4M

Continue major maintenance



To ensure ongoing safety and compliance of Directlink, we propose to undertake key asset replacements and upgrades including circuit break replacement fire system upgrades, cooling system maintenance and replacement of major structural components.

\$8.6M

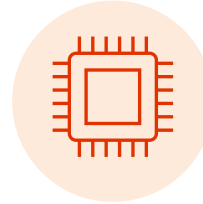
Refreshed Spares strategy



To help protect supply chain vulnerabilities and ensure the ongoing safe and reliable operation of Directlink an updated spares strategy is proposed. Key electrical components have an increasingly long lead time post COVID and some are becoming obsolete with limited notice from the manufacturer.

\$12.5M

Complete Insulated-gate bipolar transistors (IGBT) upgrade



The IGBT upgrade commenced in 2022 and is due to be completed during 2025/26. The total investment is \$25.6M and will ensure this critical infrastructure is operational and there are sufficient spares available for the longer term. This upgrade reduces the risk of prolonged outages.

\$6.0M

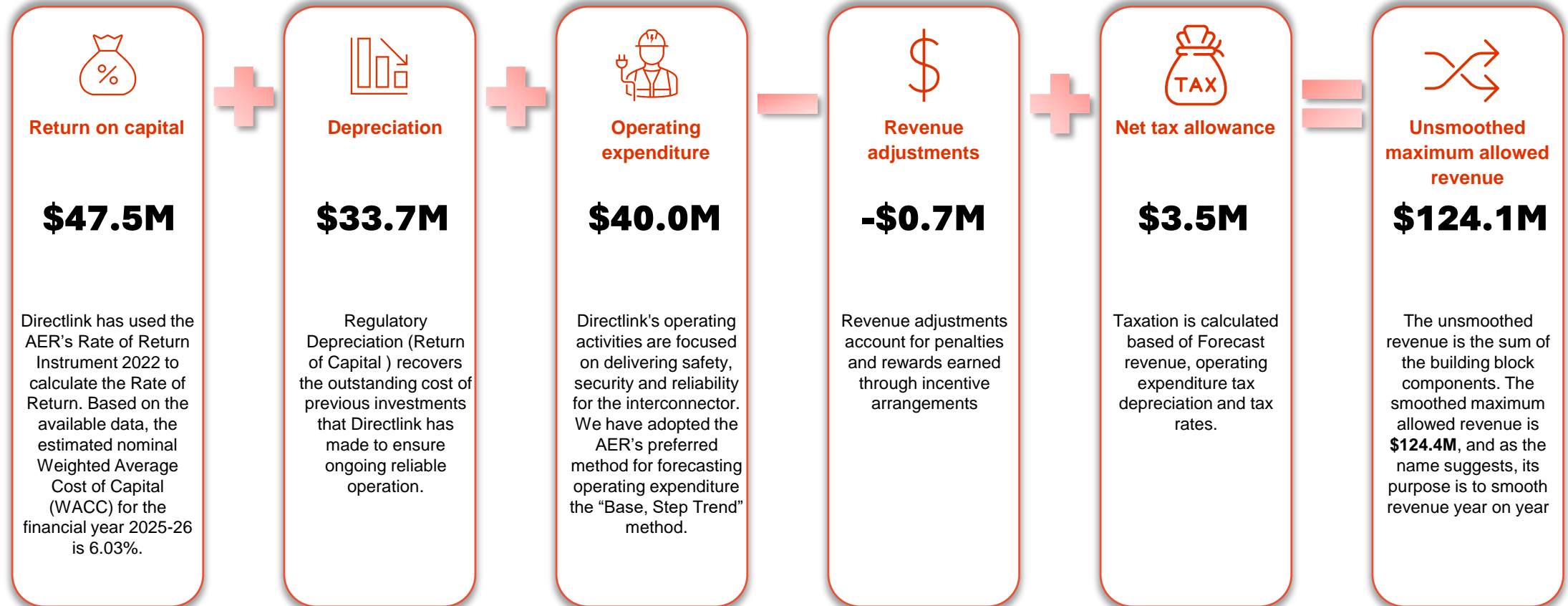
Planning for end of life



An allowance for end-of-life costs is proposed to cover costs associated with removal of equipment and rehabilitation of land for decommissioning of Directlink in the longer term. This ensures current consumers, rather than future consumers, pay for the asset.

\$4.7M

Revenue building blocks



\$M, 2024-25
Numbers may not add due to rounding

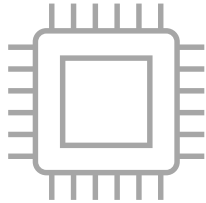
Capital expenditure for the 2025 to 2030 period

Objective: To inform stakeholders on the proposed capital expenditure for the 2025 to 2030 regulatory period and explain how feedback has informed the forecast

What we heard and how we responded

Topic	What we heard	How we responded
Spares management – assets with long lead times	<ul style="list-style-type: none"> • Most stakeholders were largely risk-averse and prioritised reliability, supporting APA’s preference to buy enough spares to reach the end of Directlink’s life. • Some concerns around affordability and the risk of buying too many spares, with some stakeholders preferring APA to buy enough spares to cover expected lead times or enough to reach the end of the regulatory period (2030). 	<ul style="list-style-type: none"> • We will continue to develop our spares strategy with stakeholders through to the AER’s draft determination. • We acknowledge the high level of importance placed on reliability by stakeholders as well as concerns around managing the risks of buying too many spares. • Based on the views put forward by most stakeholders, our revenue proposal will include for assets with: <ul style="list-style-type: none"> • Long lead times, a proposal to buy enough spares to reach the end of Directlink’s life. • A high risk of obsolescence, a proposal to buy enough spares to reach the end of Directlink’s life. • No change in sourcing and obsolescence risk, a proposal to buy enough spares to cover expected lead times or enough to reach the end of the regulatory period.
Spares management – assets with a high risk of obsolescence	<ul style="list-style-type: none"> • Stakeholders were largely comfortable with APA’s preference to buy enough spares to reach the end of Directlink’s life due to uncertainty around future supply. • One stakeholder preferred APA buy enough spares to reach the end of the regulatory period (2030) to limit the risk of buying too many spares. 	
Spares management – assets with no change in sourcing and obsolescence risk	<ul style="list-style-type: none"> • Stakeholders were broadly comfortable with APA’s proposal to buy enough spares to cover expected lead times or enough to reach the end of the regulatory period (2030). 	
Other capex asset categories	<ul style="list-style-type: none"> • Stakeholders were broadly comfortable with the proposed capital expenditure for safety and protection, asset monitoring, major maintenance, and the IGBTs. 	<ul style="list-style-type: none"> • We continue to refine our forecast capital expenditure. • Our revenue proposal will include forecast capital expenditure consistent with the projects set out in our November stakeholder meeting packs.

Capital expenditure overview 2025 to 2030



Proposed

1. Safety and protection

\$5.0M

2. Asset monitoring

\$1.4M

3. Major maintenance

\$8.6M

4. Spares management

\$12.5M

5. Insulated-gate bipolar transistors (IGBTs)

\$6.0M

Last meeting

\$5.0M

\$1.5M

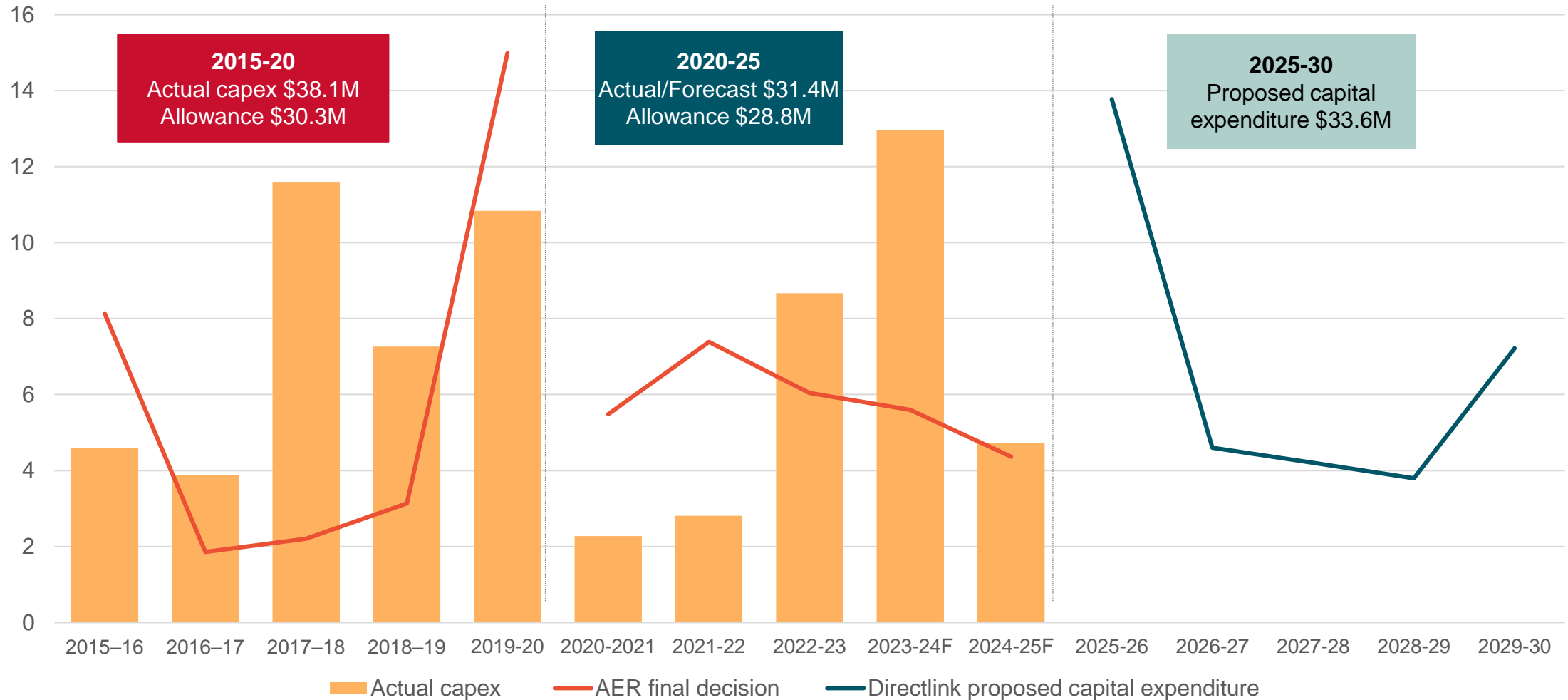
~\$8.6M

Work in progress

\$6.0M

Directlink's capital expenditure forecast

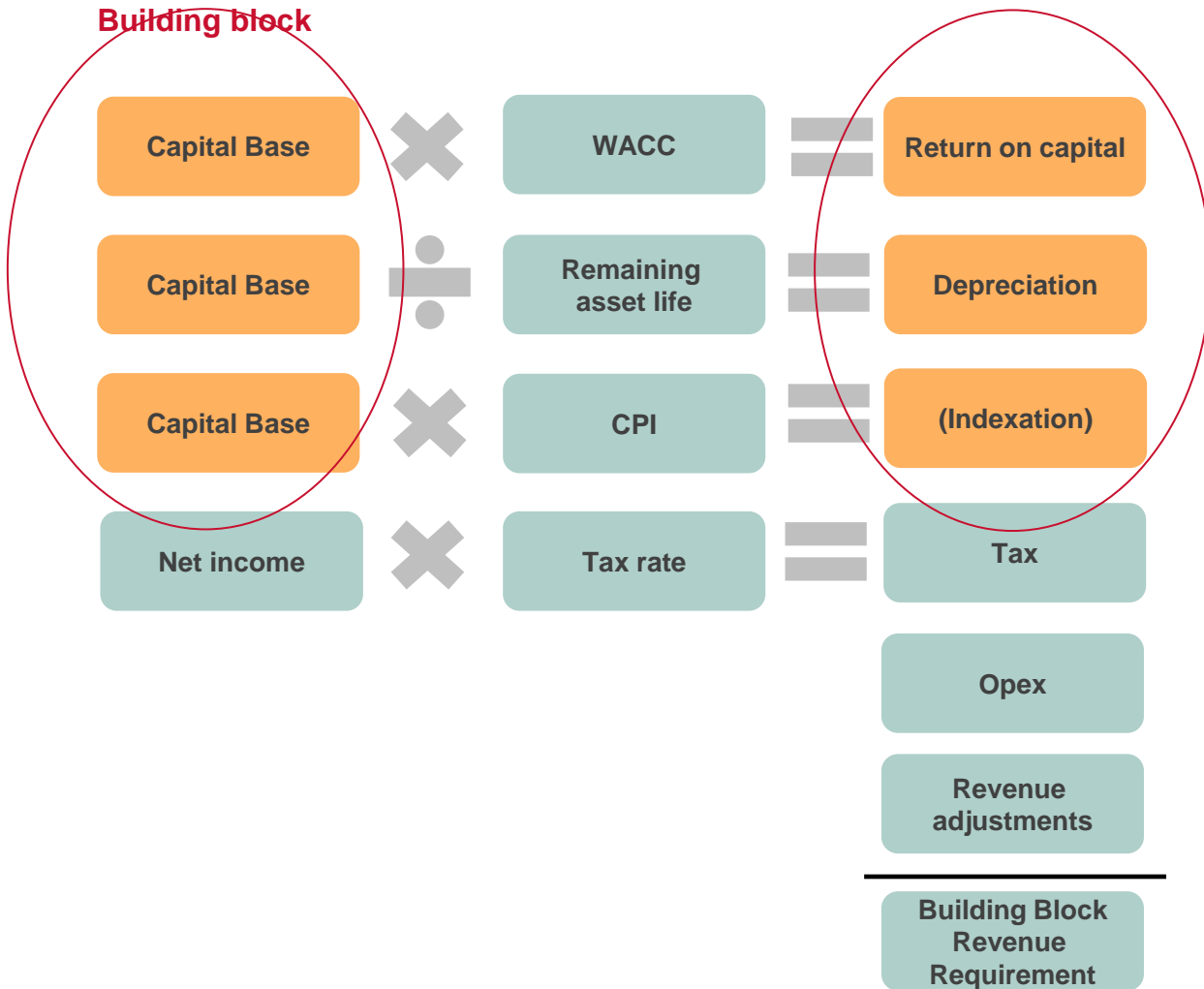
Capital expenditure (\$2024-25, million)



Regulated asset base, depreciation, return on capital and tax

Objective: To inform stakeholders on the regulated asset base, depreciation and return on capital for the 2025 to 2030 regulatory period

Understanding the regulatory building blocks

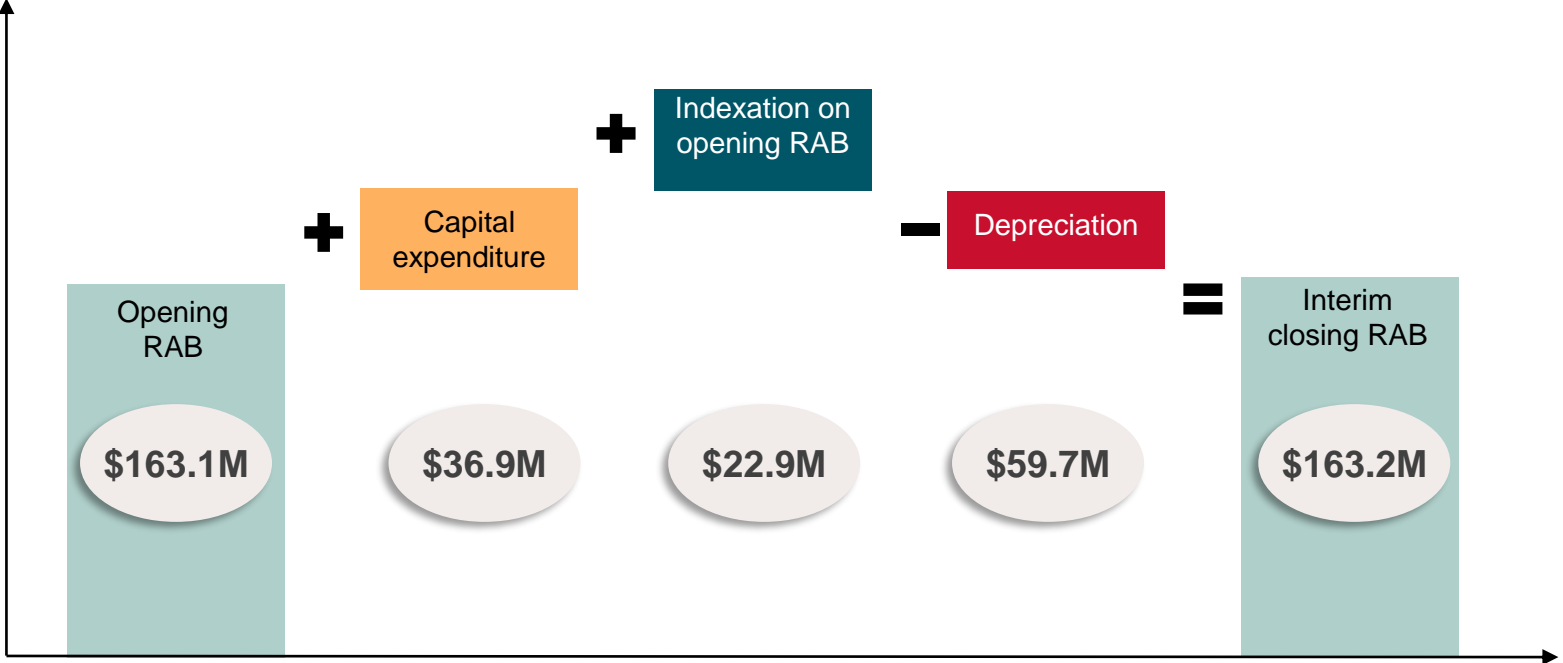


How the regulated asset base, depreciation and return on capital affect revenue?

- Capital expenditure is added to the existing capital base - otherwise known as the Regulated Asset Base (RAB)
- The RAB substantially impacts revenue because it is a key input into the calculation of:
 - the return on capital
 - depreciation
 - indexation
- Increases in the RAB generally means that both the return on capital and depreciation will also increase

The return on capital, depreciation and indexation are calculated using the AER's methodologies and models

Regulated asset base



RAB roll forward presented in nominal\$
Numbers may not add due to rounding

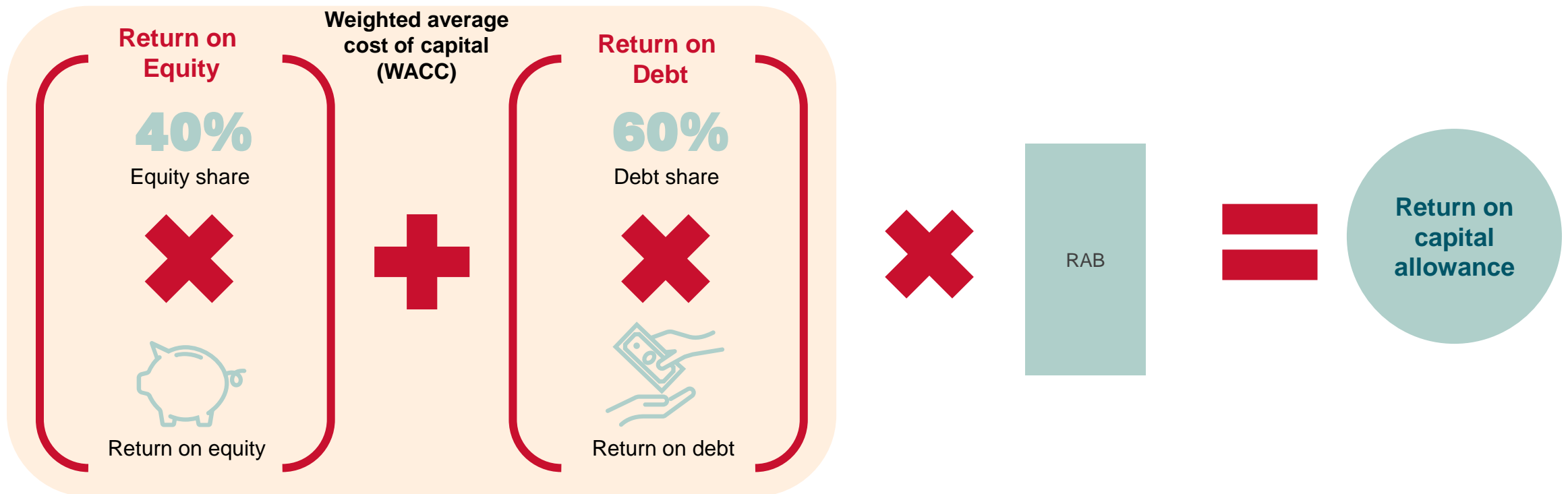
Return on capital

What is Return on Capital?

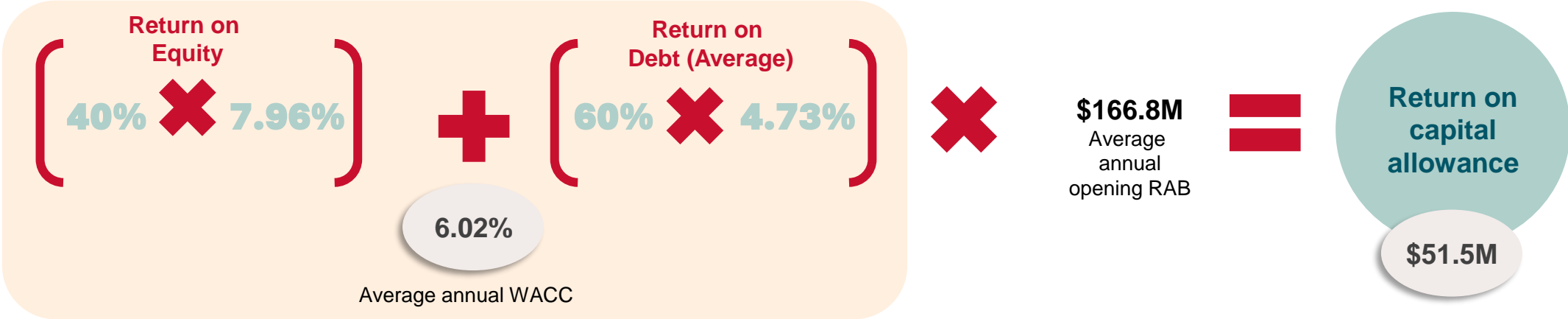
Return on capital is an allowance that allows businesses to receive a return on its Regulated Asset Base. The return on capital is usually a key driver of revenues.

How is Return on Capital calculated?

The AER's Post Tax Revenue Model and the Rate of Return Guideline is used to calculate the return on capital. The formula below is calculated for each financial year.



Return on capital



Return on capital and depreciation presented in nominal\$

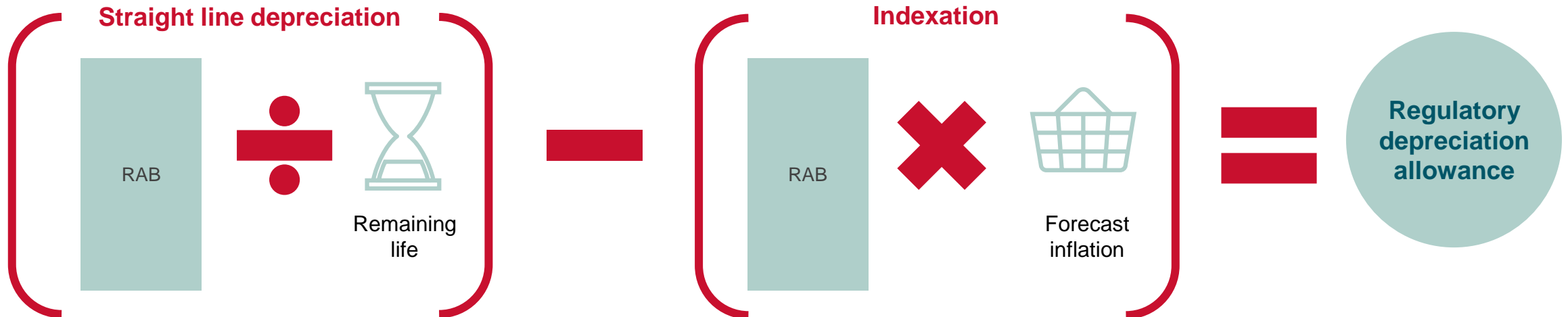
Depreciation and indexation

What is depreciation?

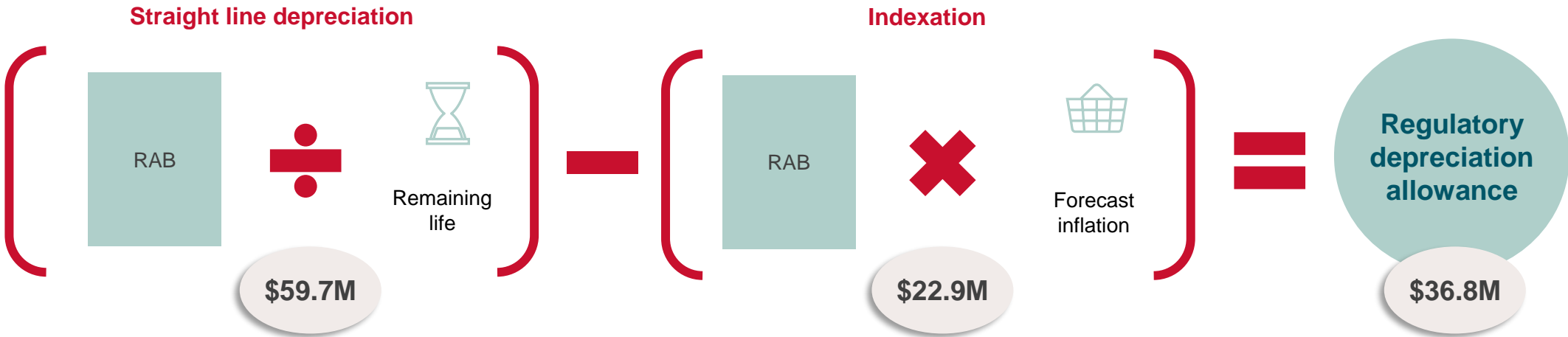
Depreciation is an allowance that allows capital investors to recoup their investment over the life of an asset – just like principal being paid back on a home loan.

How is depreciation calculated?

The AER's Post Tax Revenue Model is used to calculate the depreciation allowance. The formula below is calculated for each financial year.



Depreciation



Return on capital and depreciation presented in nominal\$



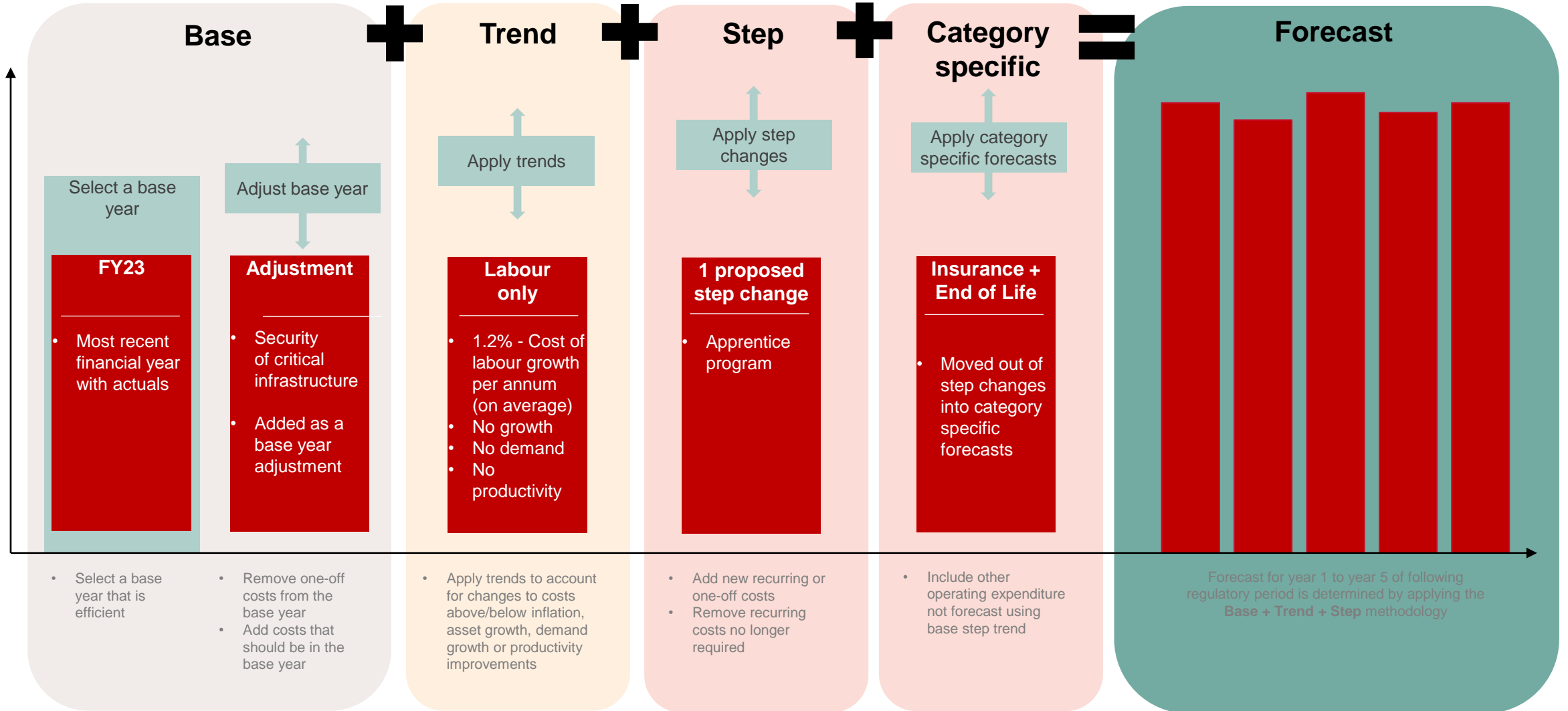
Operating expenditure for the 2025 to 2030 period

Objective: To inform stakeholders on the proposed operating expenditure for the 2025 to 2030 regulatory period and explain how feedback has informed the forecast

What we heard and how we responded

Topic	What we heard	How we responded
<p>Proposed opex step changes</p>	<ul style="list-style-type: none"> Stakeholders supported the proposed step change for labour resilience. Stakeholders noted that the end of life step change sounded logical and there was broad support for spreading the costs of the program across multiple years. However, some raised concerns around energy affordability and the importance of ensuring the expenditure set aside for the program was used for that purpose. No concerns around the proposed step change for security of critical infrastructure. One stakeholder queried the appropriate excess level insurance for the insurance step change. 	<ul style="list-style-type: none"> We continue to refine our forecast operating expenditure step changes and intend to put forward one step change relating to apprentice program and two category specific forecasts relating to insurance and end of life costs in our revenue proposal. We will continue to work with the AER on our proposed end of life costs on ways to limit customer impacts, provide greater certainty around how this expenditure will be used, and ensure the program is flexible as forecasts are refined. We are no longer proceeding with the step change on security of critical infrastructure as this will be incorporated into our base year costs.
<p>Draft forecast operating expenditure for 2025 to 2030</p>	<ul style="list-style-type: none"> Stakeholders were largely supportive of APA's draft forecast operating expenditure, however some noted consumers are focused on reducing immediate financial burdens. 	<ul style="list-style-type: none"> We remain focused on affordability and will continue to look for opportunities to limit our proposed operating expenditure where possible.

Base Trend Step application to Directlink



Adjustments, step changes and category specific forecasts



Security of Critical Infrastructure (SoCI)

Through adjustment to base year

FY26	FY27	FY28	FY29	FY30
\$240k	\$240k	\$240k	\$240k	\$240k



Insurance

Category specific forecast

FY26	FY27	FY28	FY29	FY30
\$1.00m	\$1.02m	\$1.07m	\$1.09m	\$1.09m



End of life program

Category specific forecast

FY26	FY27	FY28	FY29	FY30
\$940k	\$940k	\$940k	\$940k	\$940k

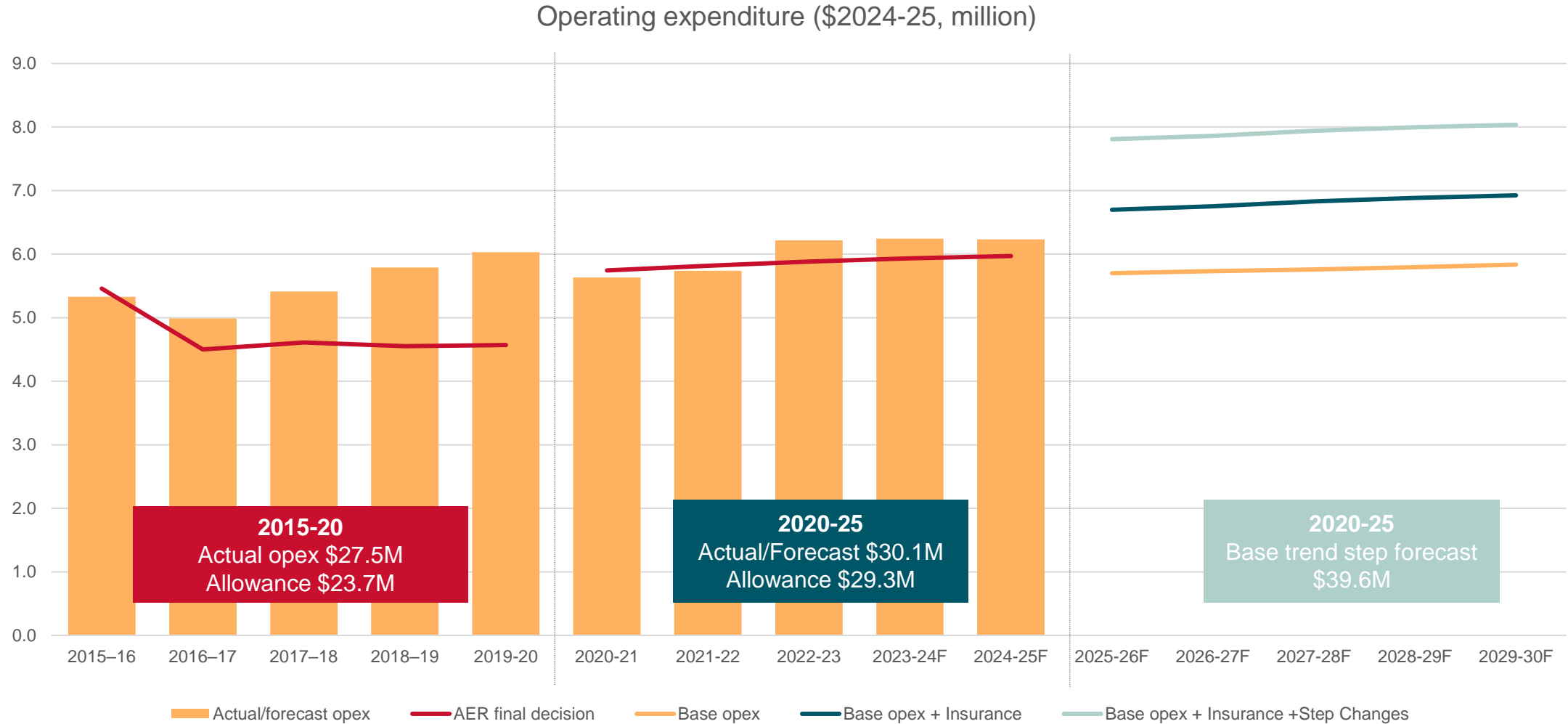


Apprenticeship program

Step change apprenticeship program compared to FY23 base year

FY26	FY27	FY28	FY29	FY30
\$170k	\$170k	\$170k	\$170k	\$170k

Directlink's operating expenditure forecast



Operating expenditure forecast excludes debt raising costs (\$400k for the 2025-2030 period)

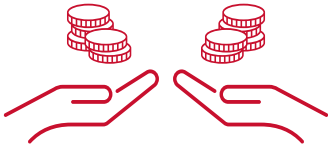
Revenue Adjustments

Objective: To inform stakeholders on the revenue adjustments for the 2025 to 2030 regulatory period

What we heard and how we responded

Topic	What we heard	How we responded
<p>CESS proposal for IGBT project</p>	<ul style="list-style-type: none"> •There were a range of stakeholder views on APA's proposal to separate out the IGBT replacement project from the CESS. •One stakeholder noted that APA's CESS proposal was reasonable as the ability of APA to manage the risk around changes in the IGBT contract were outside of its control. •There were concerns from some stakeholders around setting precedents for other network businesses and the risks of weakening the incentives under the CESS. •Others noted the complexity of this issue and noted the AER was best placed to make the decision on how the IGBT project should be treated. 	<ul style="list-style-type: none"> •We acknowledge the complexity of this issue and the risks of setting precedents for other network businesses. •We intend to put forward our proposal to separate out the IGBT replacement project from the CESS due to our limited ability to manage contractual changes by the manufacturer. •We will continue to discuss this proposal with the AER and consider any ways we could limit similar risks from occurring in the future.

What is the efficiency sharing benefits scheme (EBSS)?



The EBSS provides financial rewards for network service providers whose operating expenditure becomes more efficient and financial penalties for those that become less efficient.

Consumers benefit from improved efficiency through lower regulated prices.

Calculate the incremental efficiency gains or losses

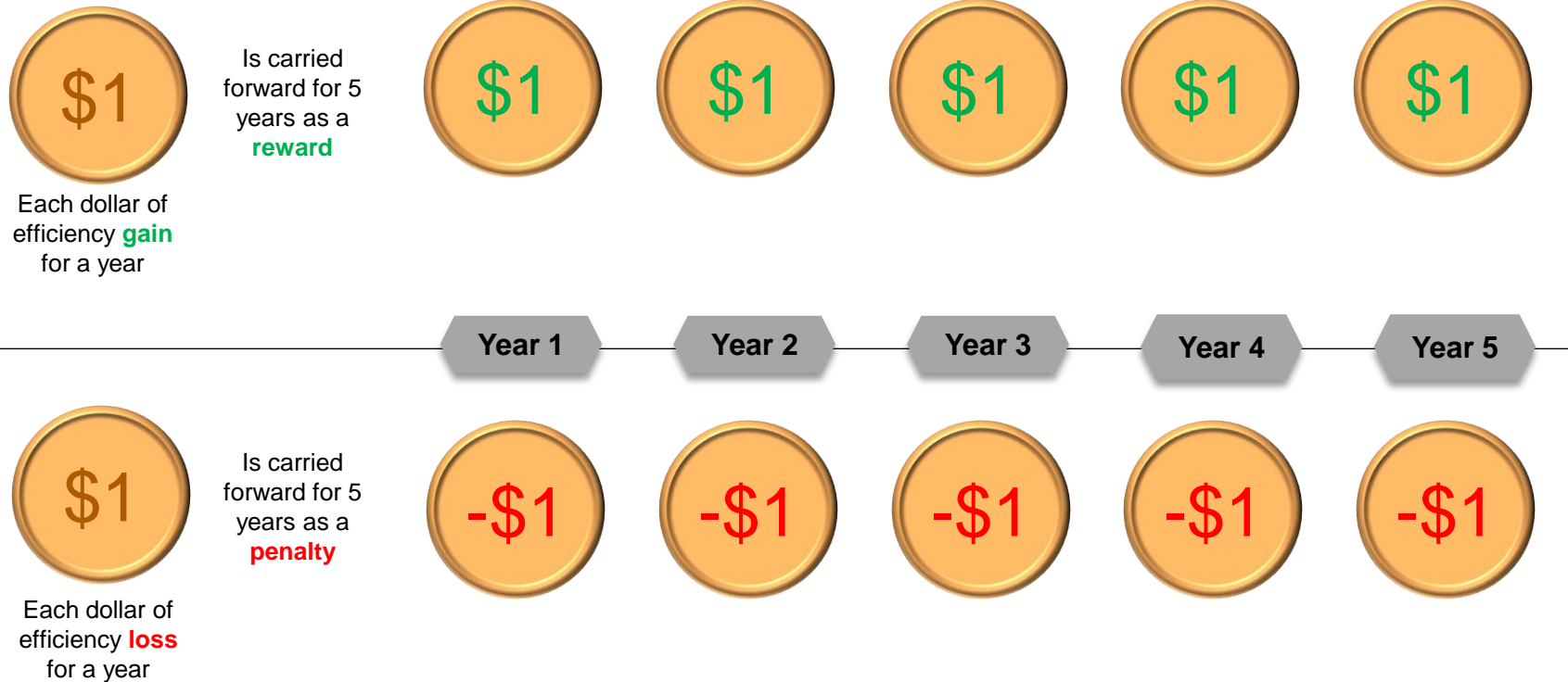
For each year determine

Opex allowance Actual opex

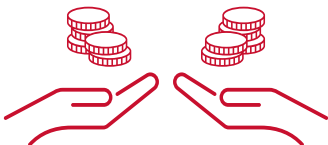
Subtract the previous year

Opex allowance Actual opex

= Incremental efficiency gain (+) or loss (-)



What is the Capital Expenditure Sharing Scheme (CESS)?



The CESS provides financial rewards for network service providers whose capital expenditure becomes more efficient and financial penalties for those that become less efficient.

Consumers benefit from improved efficiency through lower regulated prices.



- A network business:
- Retains 30 cents of an under spend
 - Is penalised 30 cents for an over spend



For every dollar of **efficient** actual capital expenditure above or below the AER's allowed capital expenditure



- A customer:
- Retains 70 cents of an under spend
 - Pays 70 cents for an over spend



- A network business:
- will be penalised by the full \$1
 - capital expenditure may not be allowed to be added to the RAB



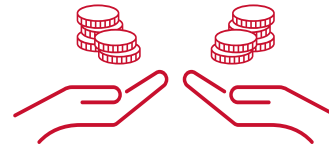
If the AER determines an over spend is **inefficient**



- A customer does not pay

Revenue adjustments arising from incentive schemes

Efficiency Benefits Sharing Scheme



Capital Expenditure Sharing Scheme

Proposed EBSS **penalty** of \$630k

Proposed CESS **penalty** of \$36k
(excluding IGBT capital expenditure)

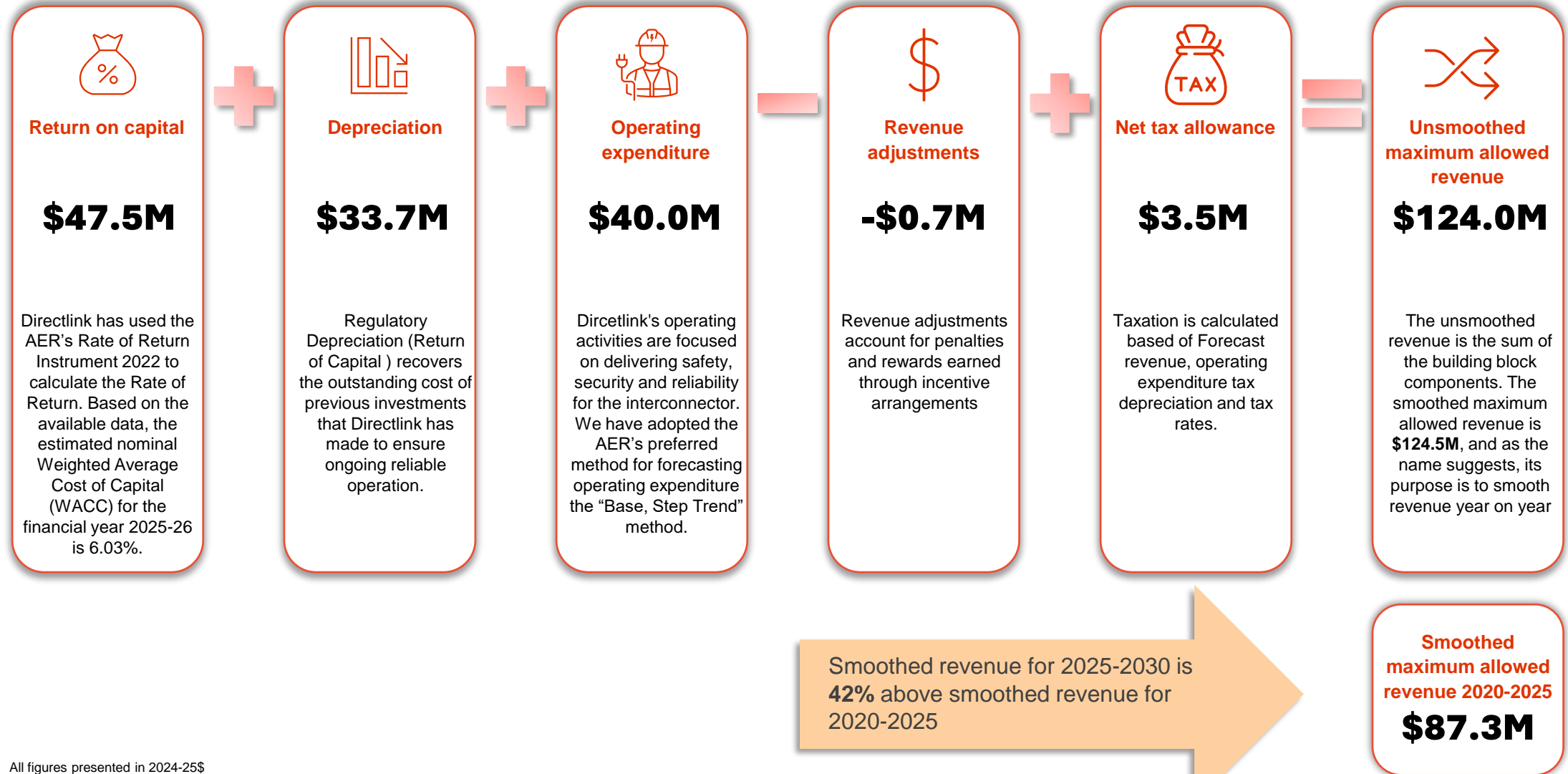
FY26	FY27	FY28	FY29	FY30	Total
-\$250k	\$310k	\$460k	\$0k	\$110k	\$630k

FY26	FY27	FY28	FY29	FY30	Total
\$7k	\$7k	\$7k	\$7k	\$7k	\$36k

Revenue and price impacts

Objective: To inform stakeholder views on the proposed revenue and price impact outcomes for the 2025 to 2030 regulatory period

Revenue building blocks

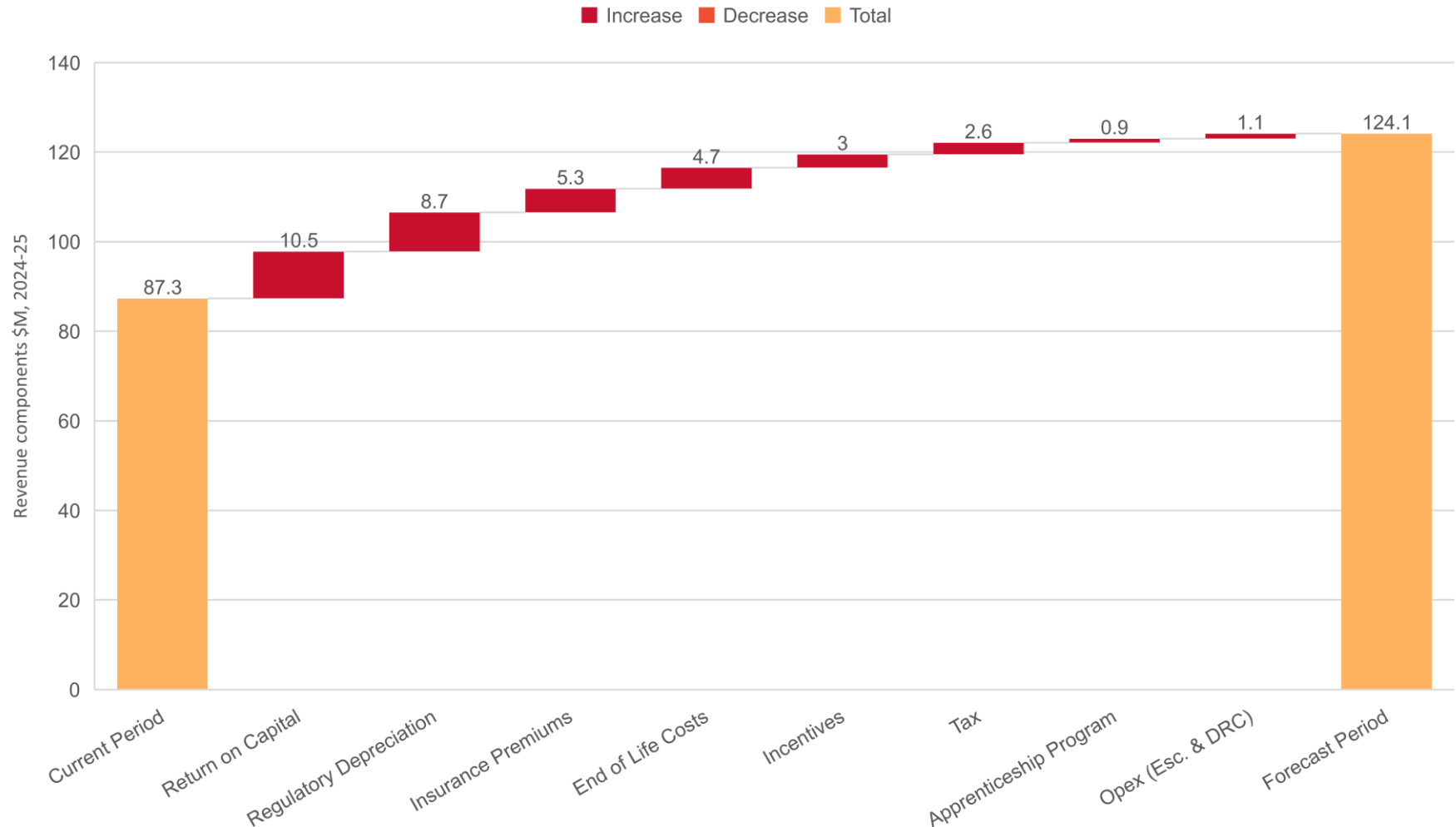


All figures presented in 2024-25\$

Drivers of the change between 2020-25 and 2025-30

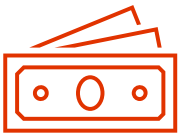
Compared to the 2020-25 period, revenue for the 2025-30 period is proposed to increase by \$36.8M, key drivers include:

- Return on capital (\$10.6M) driven by higher interest rates and inflation
- Regulatory depreciation (\$8.7M) driven by the remaining life of the asset base of 16 years
- Insurance premiums (\$5.3M) driven by tightening insurance markets
- End of life costs (\$4.7M)
- Incentives (\$3.0M) driven by penalties this period being lower than last period



All figures presented in 2024-25\$

Revenue and price impacts



~\$24.8M

Annual average revenue for the period 2025 to 2030



10.31%

Annual average change in revenue (real)



0.28%

of NSW customers' total electricity bills



\$1.24

Increase in the annual cost for a typical residential customer by 2029-30 (assuming market offer of \$1,203 per year)

All figures presented in 2024-25\$

Wrap up and next steps

Objective: To thank participants and explain next steps.

Next steps

- **Stakeholder group to:**
 - Complete evaluation survey for today's meeting
 - Review of the overview document to be sent out in January will be greatly appreciated
- **APA to:**
 - Confirm payment arrangements for meeting attendance so far
 - Inform stakeholders next year of potential future meetings as the AER's review of the Directlink proposal progresses



Questions

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Thank you

