Goanna Energy Consulting Pty Ltd

TasNetworks 2019 – 2024 Revenue Determination

TSBC Summary

Tasmanian Small Business Council
Uniting Small Business

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16 May 2018

AGENDA

1. Acknowledgement – TasNetworks approach.
2. Small Business Impacts
3. Network Investment (RAB)
4. Cost of Capital
5. Op Ex
6. Cap Ex
7. The future network and prices
8. Small business engagement

TasNetworks' approach

The TSBC recognizes TasNetworks positive approach, including:

- application of the efficiency factor to opex
- voluntarily reducing the transmission WACC by 0.25%
- continuing to apply the AER WACC parameters when most other NSPs have sought higher ones
- placing more of a focus on reducing network charges in the interests of their customers than other NSPs have been prepared to do
- Leading NSPs in engaging with their customers responding to the feedback on their Directions & Priorities Paper with modifications to revenue requirements in their proposal.

A key theme in the TSBC submission is however that there has been excessive asset investment in the past, and a higher than necessary rate of return, which can and should be addressed in the next regulatory period.

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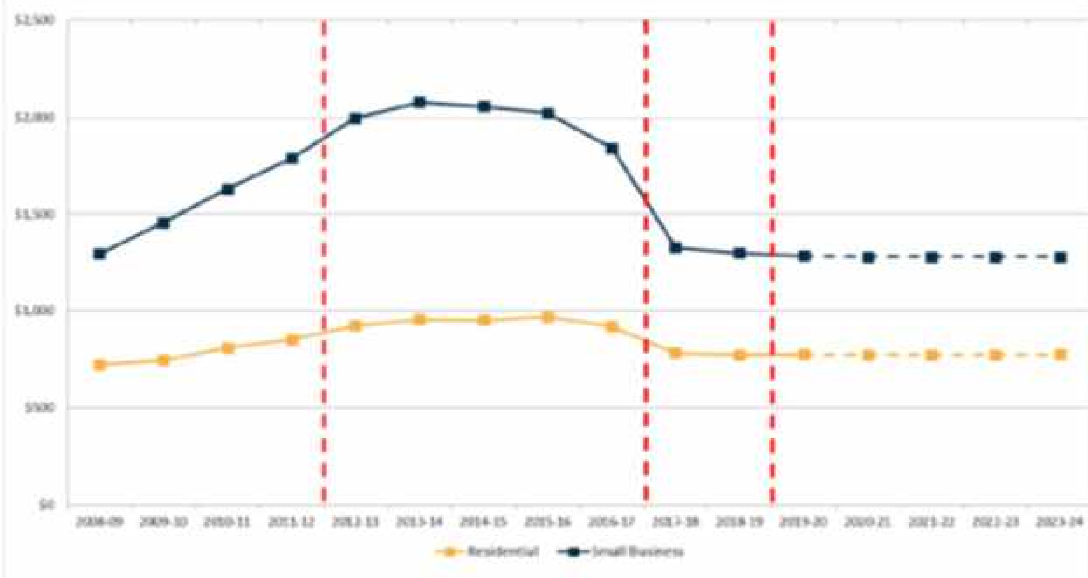
Small Business Impacts

"We have $1M invested in this business and we make a net profit of around $75,000. If our electricity costs are going to go up by $25,000 we will have to seriously consider why we would continue to hold our capital in this business for such a lousy return". Launceston Restaurant Owner, March 2017

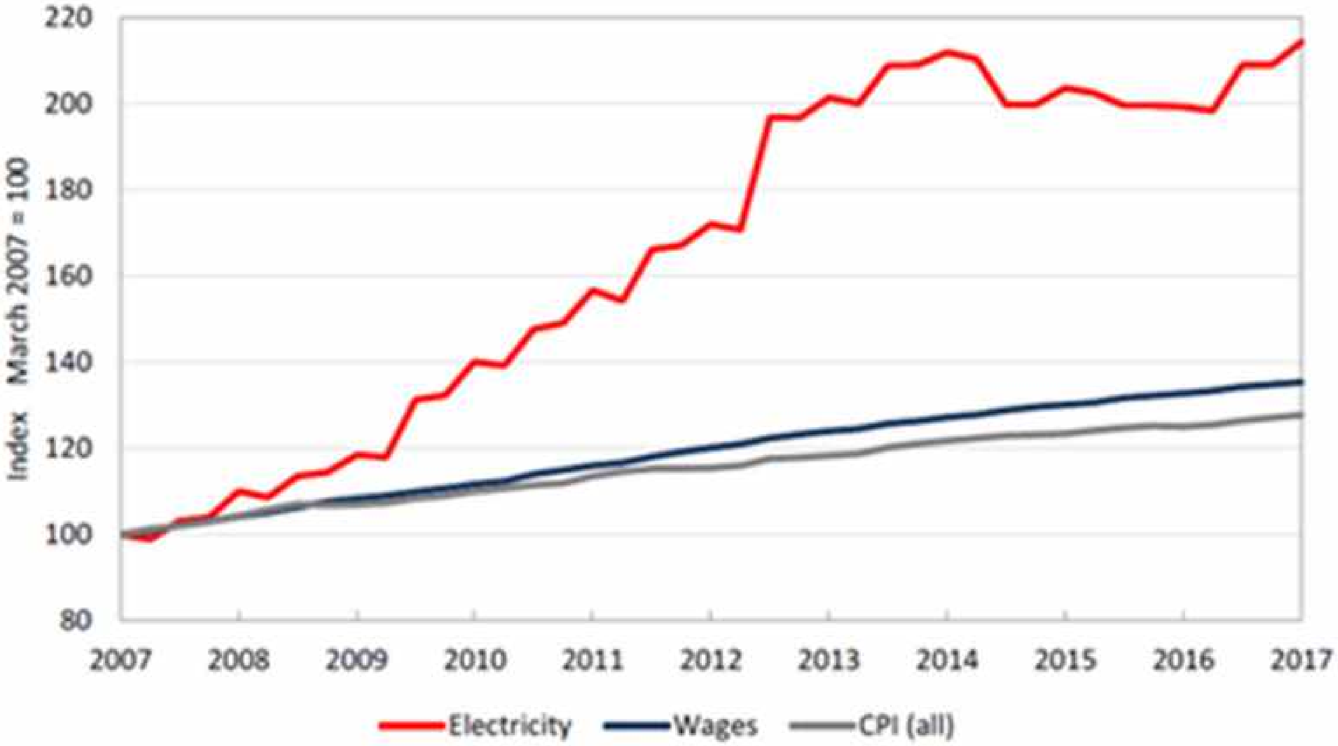
Small Business Impacts

Figure 15.5: Average annual total network charges for distribution customers (June 2019 $)



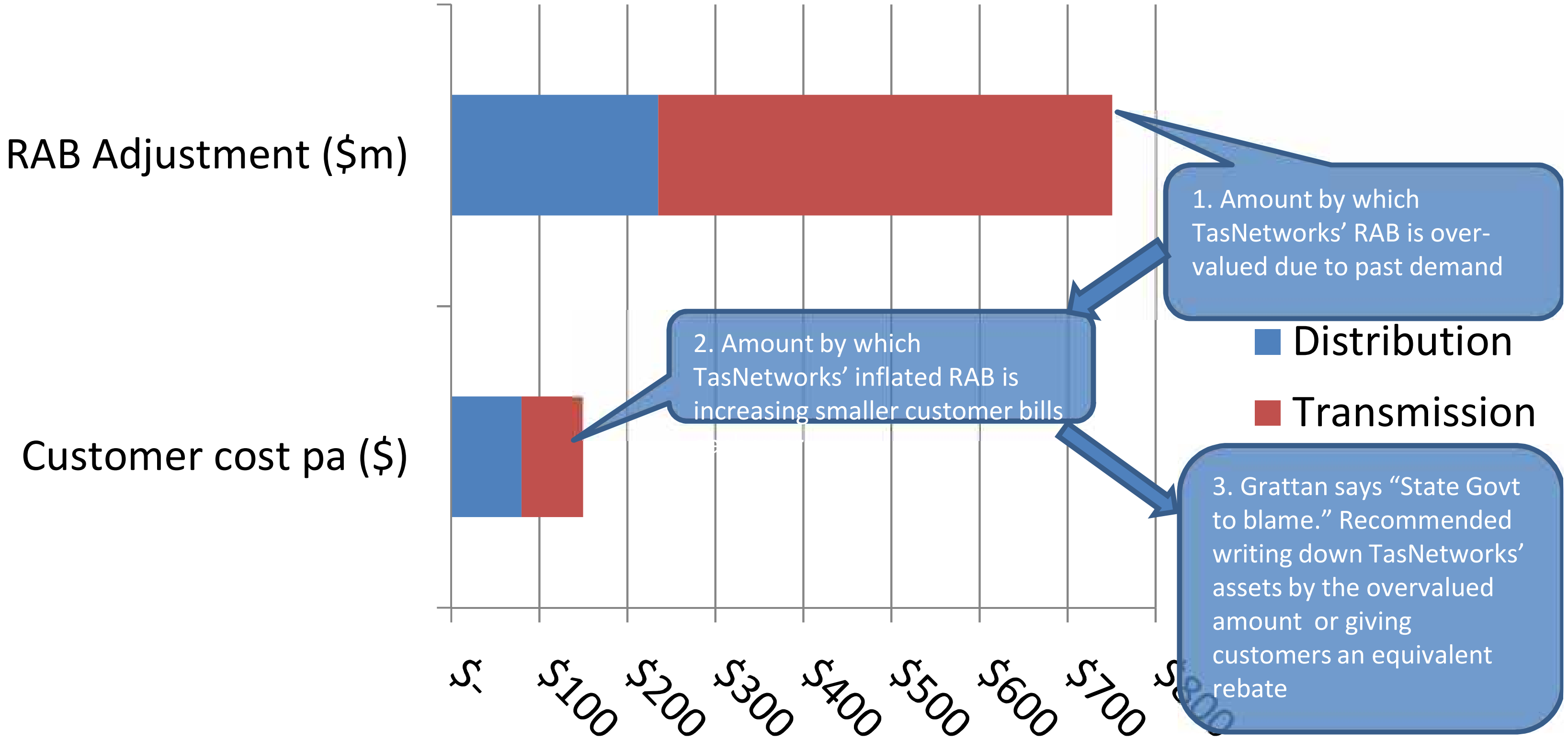
- Price path is flat (good) but could be better (reducing).
- All consumers are still paying too much for past spending
- Previous reductions for small business are mostly due to lower interest rates (input to WACC), with some tariff re-balancing

Electricity Costs V Wages Growth



Source: ABS, Consumer Price Index 6401.0 and ABS, Wages Price index 6345.0, Australia.

TasNetworks' inflated RAB is costing customers dearly …



Source: Grattan Institute, Down to the wire, March 2018

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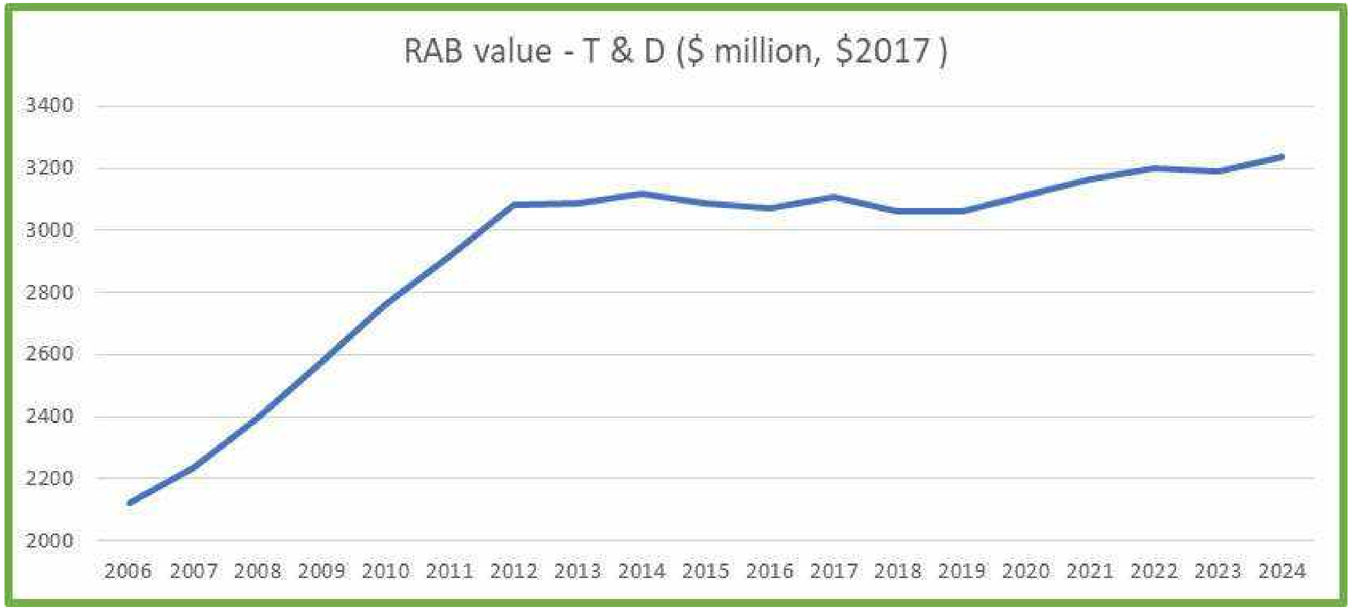
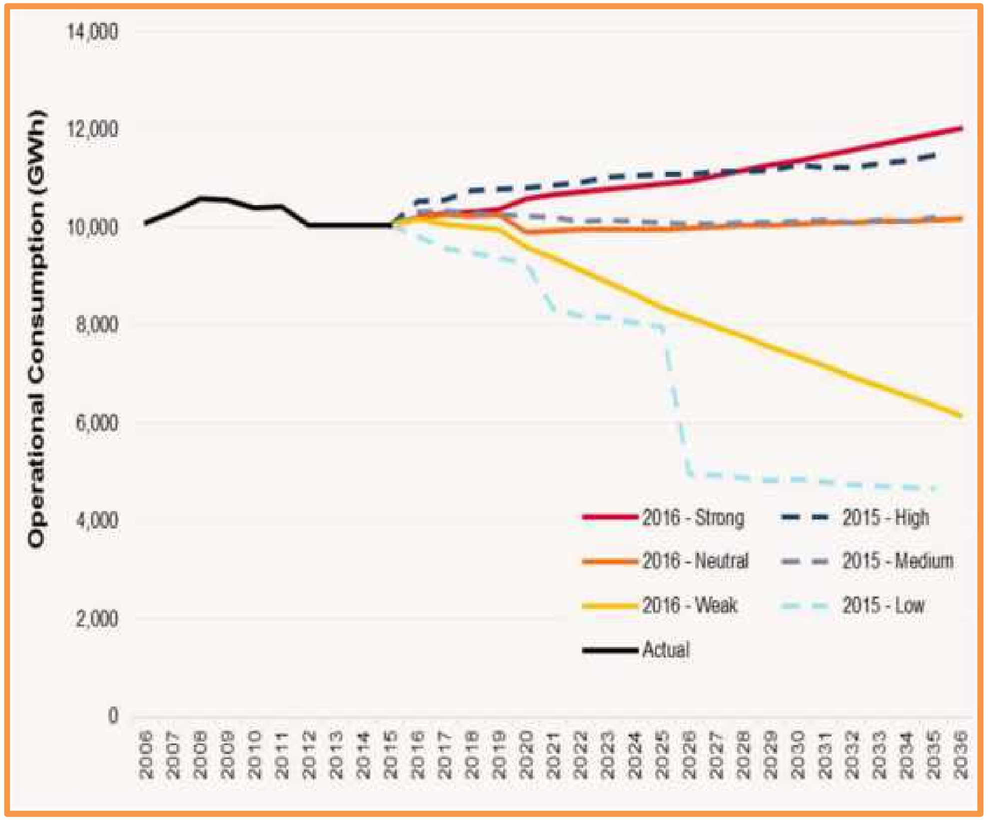
Why is RAB (assets) important

- 50% of TasNetwork revenues (which goes into prices) is from RAB X WACC (return, or profit) – RAB is **VERY** important
- RAB up is Ok if demand is up.



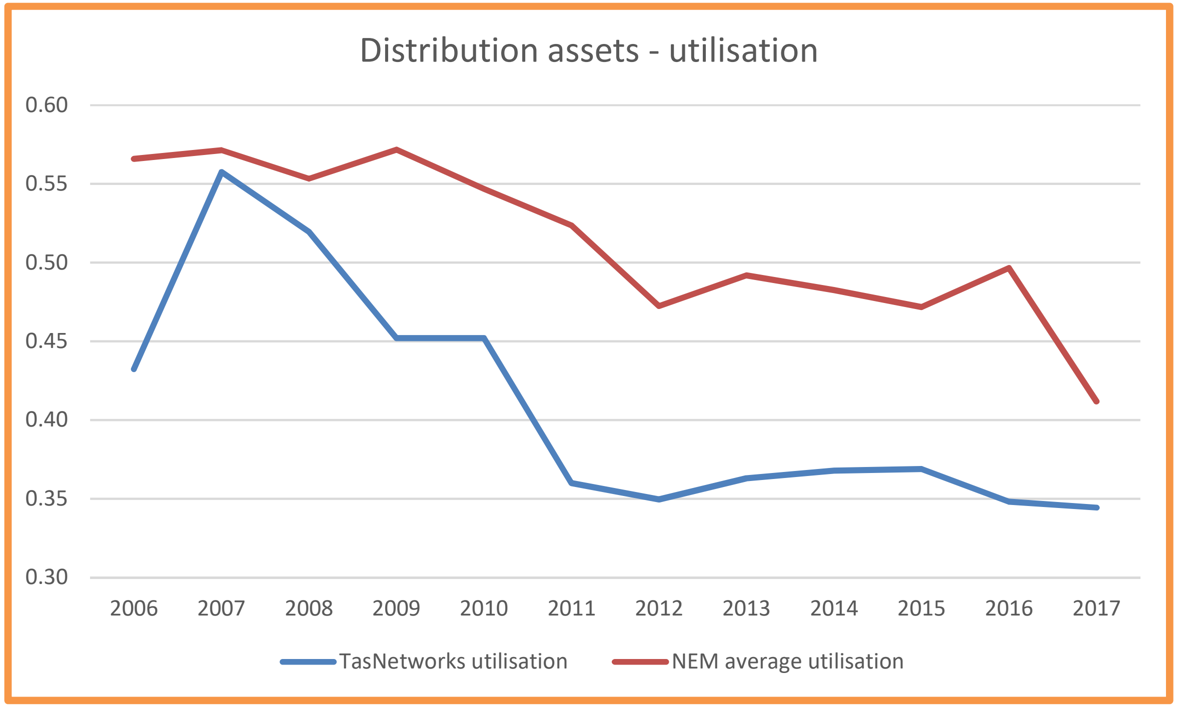
Why is RAB (assets) important

- But.. demand is forecast to be flat:



Why is RAB (assets) important

- And utilization is already down.



Demand for electricity will remain flat,
but network investment will increase again

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Cost of Capital

- It's complicated, but…..
- TasNetworks ask for 5.89%, TSBC suggest 4.76%
- On a total of $3.8 billion – difference of $43 million per year

Component	Debt	Equity
Proportion of capital	60%	40%
	X	x
Cost	5.00	4.40
	=	=
Contribution	3.0	1.76
WACC	4.76	

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Hunger for Efficiency Abates

- In the past five or so years TasNetworks has had some success in becoming more efficient through reducing its opex spending (partly due to the Tas Govt imposed merger)
- But its interest in further efficiencies subsides in the next 5 years
  - Real distribution network opex falls by a mere $1.2 million (-0.3%)
  - Real transmission network opex falls by a mere $1.4 million (-0.7%)
- Its distribution network outspends transmission on opex by >2:1
  - It has chosen a base year (2017/18) that sets distribution opex spending at a higher level
  - Its efficiency factor (0.5-1%) is not as challenging as it could be

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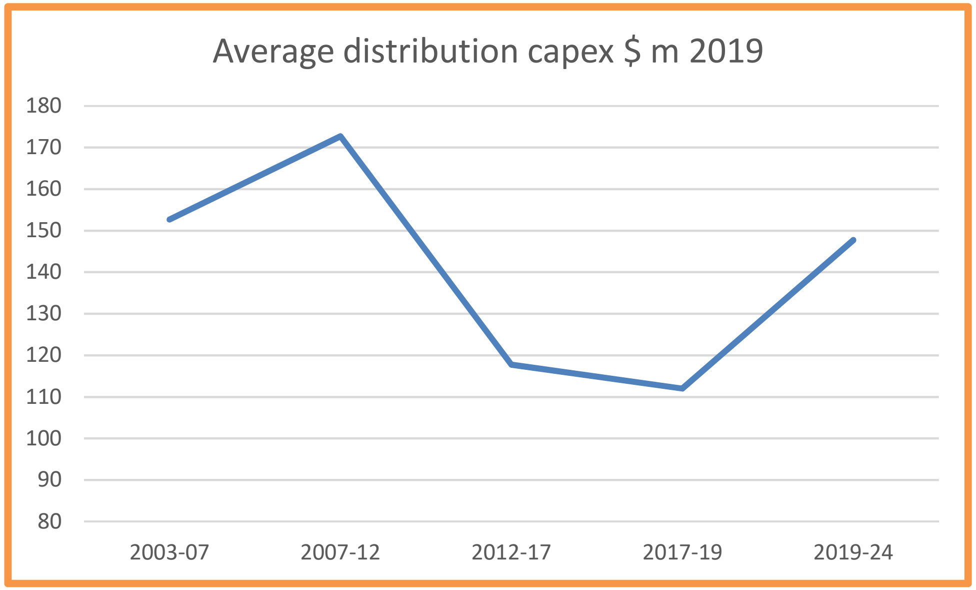
Distribution Capex

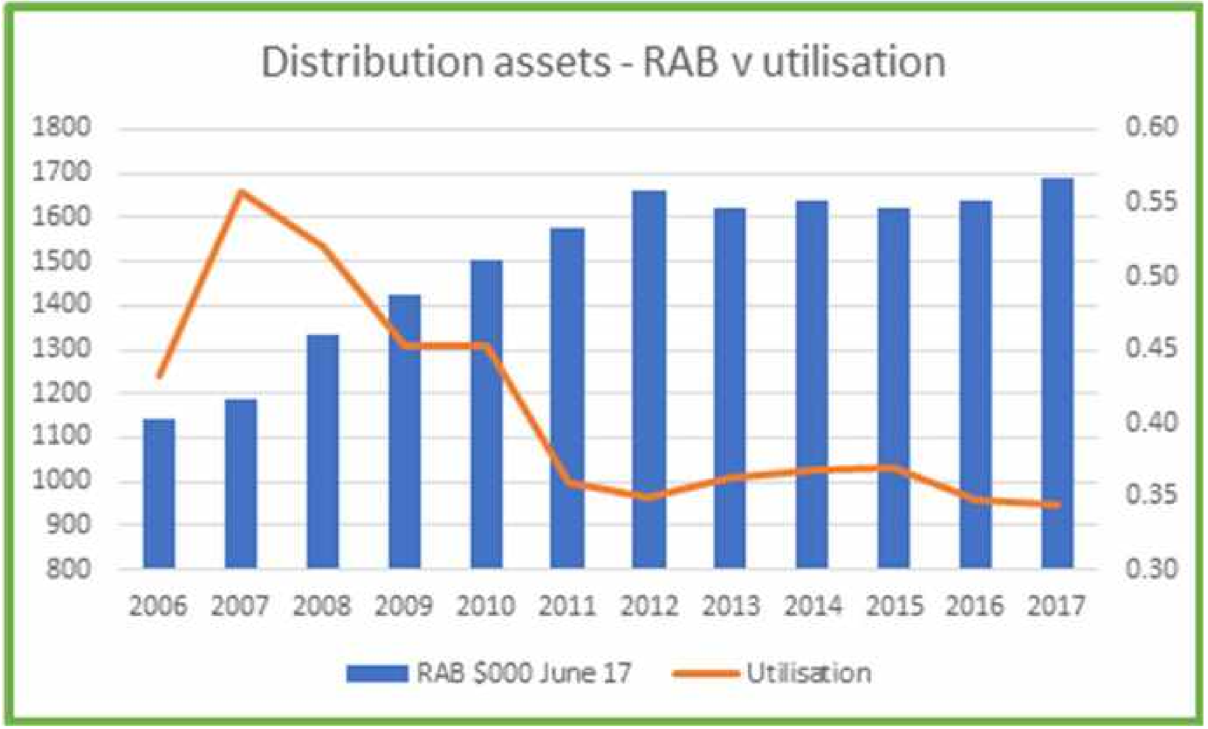
- Distribution capex ask is up for 2019-24, after falling over the previous ten years
- Mostly due to replacement (renewal) and IT
- In a stable network business, TSBC expects replacement and IT expenditure to be relatively stable. But…



What are we missing?

Distribution Assets V Utilization

History to date:



But want to spend more on replacement?

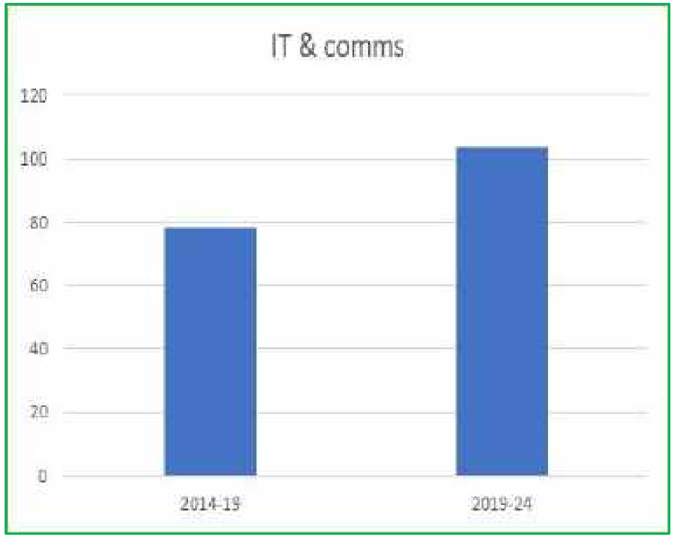
Distribution IT capex spend

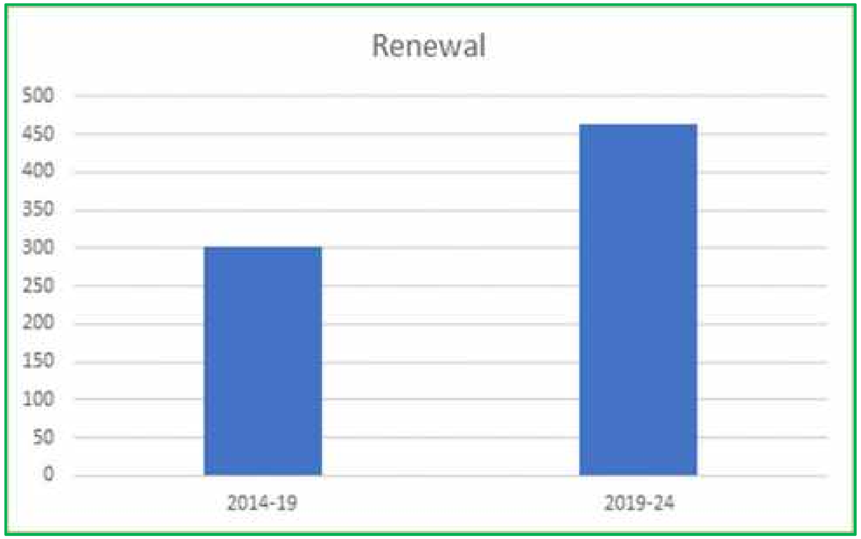
- A large increase in overall IT spend is proposed – from $110.5M to $125.9M
- Of that – "IT & comms" – goes from $78.5M to $103.8M – a 32% increase
- For business systems, customer information systems, enterprise architecture evolution, etc. Another $103.8M after spending $78.5M!
- TSBC position – consumers should not be expected to pay multiple times for changes in IT direction (several changes already)

Distribution IT capex	2014/15	2015/16	2016/17	2017/18	2018/19	2014-2019	2019/20	2020/21	2021/22	2022/23	2023/24	2019-2024
Network control	3.8	2	0.8	3.3	2	11.9	0.8	0.8	0.8	0.5	2.4	5.3
AMS	0.7	1.3	2.3	12.9	2.9	20.1	3.9	3.5	3.6	3.6	2.2	16.8
Operational support	4.5	3.3	3.1	16.2	4.9	32.0	4.7	4.3	4.4	4.1	4.6	22.1
IT & comms	7	19.4	24.8	15	12.3	78.5	20.7	16.4	10.4	27	29.3	103.8
Total distribution IT	11.5	22.7	27.9	31.2	17.2	110.5	25.4	20.7	14.8	31.1	33.9	125.9

Distribution IT and renewal spend summary

- Significant increase in IT & comms spend – up 32%.
- Renewal (replacement) expenditure up 53% on an already inflated base – up $161M over five years
- TSBC does not accept either of those – wants AER to review and reduce





The sleeper – contingent capex projects

- Total of $935M – on an (inflated) asset base of $3.8B as at 2024.
- Second interconnector – TasNetworks share $550M capital, $8M per year opex
- All to be paid for by electricity consumers, when demand is flat
- Which means – prices go up
- How much?? Not clear which customers will bear the cost
- TSBC wants the price implications for small business to be made public as part of the discussions around the second interconnector, now.

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The future network and prices

- As network and energy prices rise, the cost of the bus has become too expensive and people are simply choosing to avoid the bus.
- Instead they are opting to invest in their own Micro-grid solution whilst in the short term still expecting the network to carry the peaks and troughs.
- The cost of solar, wind, batteries and micro grids will continue to decline
- Sellers of these products bear no responsibility for the impacts their products have on the cost of maintaining a stable network
- Very little evidence of how this will be addressed in the TasNetworks proposal

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Small Business Engagement

- TasNetworks are getting better at engagement
- Still opportunity for improvement:
  - Less advertorial/informercial
  - More evidence that what consumers (us) are saying has been heard and acted on (as happened with revenue)
  - More information about new tariffs – how will they work, what can we do to reduce our bills
- TSBC happy to work directly with TasNetworks as well as participate in (value adding) forums.

Thank you

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