

AGL Energy Limited 2017  
Investor Day webcast transcript  
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Brett: Thank you, Melissa. It's great to finish in the last presentation with a real focus on numbers, the most important part of the day. Look, thanks, and good afternoon everybody for coming along today. I wanted to look at and I wanted to talk about AGL. AGL in recent history has been driven ... has driven value by doing big stuff. Big stuff like the mergers, major retail in generation acquisitions, developing large scale renewables, and organically building our retail business. We still expect to drive value by doing big stuff. Albeit where and how is evolving.

We're going from an investment thesis for share holders based upon our leverage to rising wholesale prices as a result of some of the big stuff that we've done in the past, to one that's more nuanced. When moving towards an investment thesis that is about ensuring that we use our operating advantages, and our strong financial position to continue to drive returns as the industry transitions, and as we work with the community to curb rising prices.

Our strategy over the past two to three years has been about recognizing that transition, we're possible getting ahead of it, and about turning that very transition into new opportunities to create value for shareholders. Capital allocation during such a transition must be disciplined. We have to make sure that we're both creating value for the long-term while still protecting ongoing returns.

Now, the exact scale of the opportunity to reinvest in our core business as this transition occurs has been hard to articulate, because it's been clouded by policy, uncertainty, and to some degree, immaturity of technology. At the same time, we've been analysing whether there might be opportunities to invest in new markets, but this process has not, and may not ever, yield opportunities that meet our risk and return expectations.

Indeed, we've walked away from large acquisitions in Australia, and from the prospect of entering adjacent sectors to energy. We've looked at ways of returning more capital to shareholders, upping our dividend payout ratio, and buying back our own shares, but we know we can always do a better job at communicating about capital allocation.

I'm going to talk to you for the next 20 minutes or so about three things. How we're thinking about our current investment plans, the scale of potential investment opportunity that we see through to 2020, and the capital allocation framework and principles that we're applying.

Any discussion about capital allocation should begin with the discussion of strategy. You're all familiar with AGL strategic imperatives, which we framed first at last years Investor Day in Sydney, prosper in a carbon-restrained future, and build customer advocacy. The word "imperatives" is key. These are non-negotiable things that drive the long-term development of our industry and our business, whether we like it or not, and they're bigger than AGL. If you like, you can think about them in the context of UN sustainable development goal number seven, affordable and clean energy.

We also talk about four key objectives. These are long-term, but they're more flexible. By other things that subject to our ongoing scenario planning process, are the principal drivers of our strategic activity, and to which we look for opportunities to deploy capital. Of course, basic business hygiene factors such as safety, cost management, and people development, will always get funded too, but in a strategic sense, anything that we are directing resources toward, should drive one of these objectives.

This visual can also be helpful in framing the transition that's occurring, and which often gets drawn on white boards when we're meeting with prospective shareholders. It shows our asset base today, included PPAs, which are off balance sheet. While this asset base is moved away almost entirely from the upstream end of the energy sector in recent years, coal-fired generation assets have underpinned our strength today, and will continue to be extremely important to AGL for years to come.

Having said that, when the value of PPAs is considered alongside our direct renewable generation investment, the chart shows that renewable assets actually exceed coal-fired and gas assets. A trend that will only increase as we invest in the transition of the National Electricity Market.

Now this light blue wave shows very conceptually what the future asset base could look like. I cannot stress enough that this wave is not to scale, it's just conceptual. It will require some redeployment of the wealth generated by our existing business into new energy supply, storage, systems and customer experiences. That is exactly what our current capex plans are about.

No one is sure exactly how risk and return will look in the energy business models of the future some decades out, but our approach to capital allocation as we progress in that direction, is about taking the next best steps of least regret to protect shareholder returns on the way. The consideration of new growth opportunities has to factor into that process, as does the potential to reduce the capital base by returning excess cash to shareholders.

With that introduction, let me provide an update on how our current investment program's linked to our strategic objectives, and how they are driving value. I'll start

with our objective to move from mass retailing to personalized retailing. Our current focus in this area is the customer experience transformation program, which Melissa has just discussed. It comprises a \$300 million investment completing in FY19. At present, no specific further investment programs are under direct consideration, but of course it is a key area for continued innovation as we seek to build customer advocacy over time. Because this program is about systems transformation, it requires substantial up-front investment, but as we've just been talking about, we expect it to be delivering returns above hurdle rates from FY20.

Our second objective then moving from being an operator of large assets to an orchestrator of large and small assets, is mostly about new energy, and provides a great case study of our agile capital approach. The biggest area of investment in the past two years has been building up the active stream digital metering business. As you'll be aware, we divested that business for a healthy profit last month. We pivoted away from owning the meter as it became clear that the importance of that ownership would be less than we had once thought. New energy is all about making appropriate bets in new technologies that can be scaled up, or exited, as and when a clear path or opportunity ... or larger opportunity, arises.

In addition to the new energy services business within customer markets, which is mostly a solar installations business, we continue to see a \$50-\$100 million annual run rate of investment in new energy as realistic. We see ongoing investment in pilot projects, such as the virtual power plant, and adventures in investments globally, as we ... that give us more exposure to potentially disruptive start-up technologies. It's one area that we know we will end up winning some and losing some, but net debt is vital to the long-term sustainability of our business.

I'm going to spend a little more time on the next objective, moving from higher to lower emissions technologies. It's the area that we have the most potential opportunity to invest, but also one for which final investment decisions and long-term returns are subject to uncertainty, political intervention ... particularly political intervention, and global energy economics.

Let's start with the PARF, which by any measure has been a great success for AGL. Proof that we can drive the industry to get the big stuff done even when we are not directly funding it. The [inaudible 00:08:48] is presented here includes the up-front development costs of our solar projects, which were sold into PARF, as well as AGL's equity commitment to the program. The outlook for further [inaudible 00:08:59] investment is good. The cost of renewables, particularly solar, continues to fall, and the national energy guarantee provides the prospect of some investment policy stability, which while still allowing state-based renewable targets to continue. Consensus seems to suggest large scale build of renewables will continue with gas peakers providing firming in the short to medium term. The head of storage solutions becoming more economic.

On that front, pumped hydro and batteries are very interesting, but unlikely to present immediate capital investment opportunities. Batteries, we believe, will come down considerably in cost, potentially triggering regulation to recognize the value of

the instantaneous supply that they bring. Sites are available for pumped hydro, but we need to undertake further feasibility studies to assess potential returns. Long-term investment scope for the sector is not just big, it's potentially colossal as I said out in a presentation in May, but the reality is, that this looks like it is unlikely to affect our capital allocation decisions in the short-term, and that even then may be infrastructure like in deployment.

Next shown on the slide, is the Barker Inlet Power Station, which Richard has covered in some detail, and is on track to begin construction in coming months for operation early in the 2019 calendar year. The impact then of our New South Wales generation plan is also shown here, including the approved basal water upgrade from FY19, followed by the New South Wales gas peaker subject to FID. The Crib Point LNG import jetty, if we go ahead, would primarily be an FY19 and FY20 capex requirement totalling about \$250 million, assuming AGL were to fund the onshore work itself. It would have cost entail significant ongoing lease commitments for components like the FSRU. Again, as Richard has said out, the drivers for investment continue to hold and show no real sign of disappearing. The Silver Springs storage expansion were to go ahead would be, on a similar scale of investment, to Crib Point, but again, the best commercial outcome there may not require AGL's full funding, or even long-term ownership of the asset.

In summary, what we have seen is the potential for policy certainty and demand for new supply to provide potential opportunities for AGL to deploy capital at a higher rate in coming years than we did in the last few.

The fourth objective relates to new markets. This has been a very minor driver of investment to date. The combined capex and opex required to drive our expansion into WA through FY17 and FY18 has been about \$30 million, and that effort, as Melissa touched on, is tracking well. We chose not to pursue a major acquisition opportunity in that state and we have also considered and shelved the prospect of a significant expansion of our domestic platform serving energy customers into the Telco or other essential home services sectors. New Energy continues to present opportunities for investment overseas as that is where the majority of energy tech start-ups, or funds, are located.

To date, we have not found opportunities for further offshore investment at the appropriate level of risk and return after detailed review. We believe the hypothesis for AGL to take its energy platform into new markets overseas remains sound, and the basic parameters are unchanged. We're interested in developed countries with a good rule of law and cultural alignment to Australia, where deregulated or deregulating energy markets. We're interested in businesses that reflect our own position in the energy supply chain and align with our strategic imperatives, and we would only proceed if we see a genuine advantage and opportunity to leverage our existing platforms and capabilities to create value for shareholders that can't ... that they can't access themselves simply by investing directly in those target markets. But as it stands, the opportunity set appears to be more limited than we had previously hoped.

This slide brings together the previous slides and includes sustaining capex to provide a complete picture of approved, or advancing through feasibility, capex planning. I won't dwell on it, but it points to a pathway of over half a billion dollars a year of growth and transformation capex, even as we develop further opportunities.

Included here, but not assigned to one of the four strategic objectives, is the \$130 million we are investing in what we call PT3, which is our ERP upgrade. The totals on this slide reconcile to what we published at the FY17 result, adding in new initiatives such as the New South Wales generation plan, and also incorporating non-capex equity investments in areas such as new energy.

We use the last few slides to provide for investors a clearer and more comprehensive summary of our capital allocation principals. First, we will seek to maintain our balance sheet strength consistent with our BAA2 credit rating and to enable optimal response to opportunities as they emerge. Second is our dividend policy. We will seek to maintain our target payout ratio of 75% of annual underlying profit after tax with a minimum franking of 80%. Third is what we had previously defined as our agile capital approach. To drive improved returns on equity over time in a rapidly evolving business environment.

Agile capital, as Andy touched on earlier, has three pillars. Optionality, quantum, and time to value. Optionality means maintaining and maximizing our ability to pivot or exit objectives as objectives evolve. Exactly as we did with active [inaudible 00:15:30]. Quantum means deploying AGL's capital only to the level required to achieve our objectives. Just as we have done with Path, and we may do with other potential energy supply projects. Time to value means requiring returns within an appropriately short time frame given the rapidly evolving environment.

The fourth capital allocation principal relates to our continues application of our threshold hurdle rate. This is supported by ongoing analysis of our cash flows, our cost of capital and the appropriate risk adjustment for competing investment classes. This is especially relevant in the context of my opening remarks. It is not just about driving returns from large transactions, but about managing a range of opportunities, some familiar and some less so, and which may offer ... which may differ substantially in their nature.

Fifth, and finally, we will return excess cash to shareholders if more accretive opportunities are not identified within a reasonable time frame.

This slide speaks to the first of these principles in a little more detail. The chart to the left shows our strong funding capacity as of 30 June 2017, relative to our credit rating. AGL's internal modelling requires funds from operations to net debt of between 22% and 29% to maintain that credit rating. That translated to head room of up to \$2.4 billion at the end of FY17. A year in which we increased our dividend payout ratio and bought back almost half a billion of shares. We expect this position to be at least as strong at the end FY18, even after taking into account that somewhat larger capex for this year.

The chart to the right is our debt maturity profile right now. The financial year to date ... this financial year to date, we've removed about \$280 million of unused bank debt facilities and bought back \$70 million of bonds. We have no refinancing to consider until our \$600 million hybrid becomes callable in June 2019. As we think about capital allocation of the coming years, we have considerable flexibility. To self-fund growth, to retire debt, and to leave open other forms of capital management for shareholders.

My [inaudible 00:18:08] slide updates our discussion of growth and transformation investment opportunities for the New South Wales generation plan and emphasizes the level of advancement and likelihood of the potential overseas investment. The slide is pretty self explanatory, but simply put, the dark blue at the top is stuff we're already doing, and that has a clear path to meet our hurdle rates. The lighter blue in the middle is stuff that feels quite possible, but is subject to pending feasibility studies and investment decision. The pale blue fading to gray at the bottom is stuff at an earlier stage of development, or in the case of offshore, not feeling that likely to occur at scale.

I remind you that other things such as entry into adjacent data driven services like broadband, have been on this list and have been rejected reflecting a continuous search for, and evolution of, opportunities.

To summarize, what does an investment and agile mean today in terms of capital allocation and returns? It all starts with delivering against our strategic imperatives. Clearly, as Andy has discussed earlier this afternoon, the present day is all about managing key uncertainties. Largely regulatory, but also technological. Affecting our ability to invest with confidence in our existing business. We are also focused on exploring the potential risk and opportunities associated with other expansion opportunities, which we'll only pursue where a truly compelling picture of shareholder value creation emerges.

Medium term, we can categorize these into three potential buckets of capital allocation as in investing in new products and markets, investing in the existing business, and returning excess capital to shareholders. As I presented, there is more certainty emerging relating to the investment in the existing business and some visibility of the likely recurring scope of that investment, and we will continue to demand a higher level ... a higher rate of return to things that are less certain or less familiar, which may mean we may not do these things at all.

If opportunities do not arise, we are in a very strong position to drive returns by capital management. Combined, this approach should continue to drive strong outcomes for shareholders, including improved return on equity over time. This emphasis on improved returns is embedded in our long-term incentive plan, which targets increasing return on equity from last year's 10.3%, to a range of 11.5% to 14% in FY20, and we will continue to target our dividend payout ratio at 75% of underlying profit after tax.

In summary, our CapEx plans reflect a broad spectrum of investment opportunities. Our capital allocation principals are governing our approach to investment in capital management, and we continue to target improved return on equity and a 75% dividend payout ratio.

Thank you for your time today, and for your ongoing interest and support. You will also find in the supplementary information and guidance slide, exactly restated as it was at the FY17 result in the AGM and unchanged. The ongoing support of our investors is essential to our license to operate and a priority of which we will not lose sight. Thank you and happy to take on questions.

Shawn: Thanks Brett. My question relates ... I'm Shawn [inaudible 00:21:58], I'm a bond investor from Vanguard, so my question relates to slide 51.

Brett: I'll try to remember the slide numbers.

Shawn: Sorry, it's to do with your hybrids.

Brett: Cool.

Shawn: Part one. What are your thoughts regarding the hybrid that is due to call in [inaudible 00:22:25], whether you want to move it up or down to cover the structure. Secondly, your issuance diversification. What are your thoughts around issuing in other markets, diversifying your issuance? I know there isn't much need for that immediately, but what are your thoughts around issuing in the US and [inaudible 00:22:45] market.

Brett: This is in the hybrid, I think it was an instrument that had its place at a place in time a few years ago, and is somewhat dated in today's markets. The benefits of it, which were particularly about dealing to some your credit metrics, have changed since we issued that hybrid. I think it's unlikely, but never say never that we would go on to increase or issue another hybrid like it. Never say never, because some ... everything may have its place again. In terms of reducing it, that'll be a decision as we get closer to June 2019, which is our first opportunity to call that instrument. On diversity of funding, clearly in an environment where we've been spinning off quite a bit of cash and we haven't been spending as much in the last couple of years, so our debt book has been reducing. What we've been doing is trying to make sure that we maintain diversity of funding. We did things like the bond issue up in Asia last year that went very well, we continue to look at other markets around the world.

We have no fixed view as to which is the best market to tap. We want to stay open to all markets while still maintaining good relationships with our banking group so that when the time comes, that perhaps an opportunity comes along for invest ... for the business to invest more, to use up some of that head room, we've got good active positions in a variety of debt markets around the world, or at least we're keeping good track of them, so that on the day, whatever makes the most sense, we'll push forward into it. What I would not like to see is this shrink down to a couple of

markets, or a couple of providers of debt. I think that's a much riskier position to be in.

Nick: Thanks Brett. Just there's been a lot of talk about the closure of Liddell and replacing the output with a variety of different technologies. Liddell, at the moment, is clearly a good source of profits for the company. They could roll forward and whilst the plan is to replace the output with the new technologies. If we take a view of that, all of the growth goes ahead as in that line, and it does hit your requisite rate of return. How confident are you that the earnings coming through from this new set of growth initiatives will offset the Liddell closure?

Brett: Yeah. We haven't published a detailed view of will one replace the other in an exact amount in earnings. I think it's reasonable to say the New South Wales generation plan in isolation in comparing to Liddell, you have an asset that's fully written off versus investing in new assets that will start to depreciate. It's hard to imagine that that alone will be the offset in an earning sense. That's why we are continuing to push forward and look for other ways to grow and other ways to improve earnings. Whether it's the push into newer energy and new technologies, which are early days today, but in five years' time and beyond, we think we'll start to see those expand.

Whether it's testing other markets. Whether it's thinking about new forms of large scale things coming into our market, like storage. All of these things are all about making sure that we're looking for good quality ways to reinvest, so that as those future dips in our future start to come out, and we've got other things that will replace them. I guess, about looking more broadly than just the New South Wales generation plan for an exact dollar for dollar replacement. I think maybe Robert was first, and then Andrew.

Robert: Let Andrew go first. [inaudible 00:26:34].

Andrew: Oh, thanks. Andrew [inaudible 00:26:37]. Actually, it ties into Nick's question, which is ... I was just curious to get some comments on how you think your cost of capital is going to transitions for that same period, given that ... Say for example, expressively of Nick's question, the earnings risk out of Liddell versus the earnings of risk out of your ... As you move from being owner of the musical to head conductor.

Brett: Yes. I don't know if everyone was picking up on it, but for me, when we put together these slides, one of the most interesting ones was that one with the [inaudible 00:27:12], and making the point that when you take into account the off balance sheet PPAs, we have, which in many ways, you're on the hook in the same way as if you owned it directly. We have more in renewable generation right now than we do exposed to coal-fired assets. When I think about cost to capital, when we think about cost to capital and we were hitting, there's a fair blend of that future already there, and so we're 50/50 coal, gas, thermal, and renewables. We'll see coal's going down, maybe we'll see some more gas-fired in the firming sense. There's no question we'll see more renewables coming into that mix. While we'll trend in that direction, I don't think you should look at Liddell and go, "Wow. There's a big step change there in the company portfolio." It's been subtle, but we've actually got a big exposure.



Reflective of, for a very long time, we've been the biggest private developer of renewables. We got big exposure to renewables already, so there is a glide path inherent already in the way people view us and cost us.

Robert: Me? Yeah. Sorry. Rob from Morgan Stanley, once again. Just a question about how we should be thinking about the franking balance and that level of franking. I guess you've still got techs losses that at your generation [inaudible 00:28:38], and a lot of IT spend, which I guess you'd depreciate reasonable quickly. We should probably be thinking about 80 little fill out [inaudible 00:28:47].

Brett: Yeah, I think about the 80% franking for Farewell to come. We thought long and hard before we both upped the dividend payouts, or the cash payout, from ... it was tracking 60%-65% up to 75%. When we did that, though, we felt looking at our million to longer term forecast, and we just couldn't hold the franking, and it wasn't a one-year thing, it was many year thing. Otherwise, it was only a one-year thing where variety-wise, to go back through a one-year dip. I think about 80% for the foreseeable future. When you're forecasting though, those [inaudible 00:29:22] tax losses particularly will come to an end at some point. That may be the point where you start to revisit, is there an opportunity to tune back up. If we have franking, we'll pass it on obviously.

Speaker 7: Just on new energy, you're putting \$100 million, and you put a bit ... Probably a couple hundred million already in there. How are you getting your mind around getting a return out of this and how you actually justify it? I'd appreciate this need to make the investment for the future, but it's actually starting to build up to be a large amount of money over time. When do you turn around to him and say, "I want some cash back."

Brett: I do that every day. I think, and I'll let Elisabeth build on this as well, I think when you dig into the data of how we're investing, it's a little bit like that agile capital thing that we were talking about, quantum comes into it. A \$5 million investment in a piece of technology, it's [inaudible 00:30:24], and so we don't overthink it in that sense. We're more forgiving, if you like, in terms of will we see a return. What we want to see is capability development. [inaudible 00:30:35] in South Australia is a case in point. At the other end of the spectrum, as we start to invest tens of millions, and maybe \$50-\$100 million, and there's been a couple lately like the commitment to the EIP fund, which is a venture fund by established states.

That's when we would look at that with, perhaps, tougher eyes, and so, no, we actually expect there to be a reasonable path to see money coming back. That's a good quality, well run fund that believes that unbalanced, it should deliver superior returns. Even as we acknowledge the risk because it's in a technology area. Horses for courses, and the bigger the investment the tougher we'll be on saying when will we see our money back, but I'll let Elisabeth build on that.

Elisabeth: What? Hello? Thank you for your question, and thank you Brett. That's exactly right. We're looking at different time horizons to maintain the principles of agile capital, so

optionality is a very important one. Some of the investments are smaller bets that we see, perhaps, maybe more futuristic, but yet crucial to overall strategy of the business. For example, if you looked at the smart house, and you saw the sense technology, that is very, very fundamentally disruptive. It enables orchestration like we've talked about in the future. It really enables customers participation, us to have a very clear understanding of the actualities of the curves, of the load shape of the house, and to think about that in terms of our hedge book and what Richard's trying to do with his business. It's really powerful technology. They're our portfolio company of EIP. What we are doing is, we are leveraging that investment in EIP, through then the piloting, being able to bring that technology here, which mitigates disruption risk for the company down the line. That has a smaller risk for us, but it's a longer time horizon.

If you think of the slide that Melissa presented in terms of where the personalized retailer, where the retail business of AGL is going, and cross different time horizons, we're looking at then getting returns across those different time horizons and sizing the bets accordingly. Thinking about some of the technologies, for example, is not that newest technology, but it's being applied in different ways that create new business models. That's how we're thinking through this very thoughtfully, and also with a very aggressive, clear path to make sure that the strategy is aligned, and that also that the technology. If you see from everything we're talking about, this is not crazy stuff. It's not technology that is actually first generation. All the things we're talking about have been proven in another market, and they're actually in their second or third iteration of the actual technology maturity as it's being applied to energy, so IOT may be applied to other markets. They've had proof in use cases there, and now they're coming into application and energy. That lowers our risk as well.

Robert: A couple of questions on the web chat, which are a little bit more linked to Richard's presentation, we might just go through those now. The first one related to, Richard, what your views were on pumped hydro in a five-minute pricing environment? The second one was, could you expand on why reciprocating engine technology is better than classic OCGT?

Richard: Second one first. Second one first. Start time. OCGTs are more efficient than reciprocating action, so [inaudible 00:34:09] slightly less fuel burning than OCGT. It's not a massive step change in this difference, but it is a reasonable change, but the start times. In a market with very high [inaudible 00:34:22] of renewables, the ability to get generation on the bars, and on the bars very quickly, is exceedingly valuable. If we move to a five-minute market price, well, we are moving to a five-minute marketplace at speed to get assets on. Two 10-minutes at \$14,000 is a lot of money not to have generation running. Getting those price ... that generation on it absolutely critical. Reciprocating over OCGT is absolutely speed over response to marketplace. OCGTs, although they're working on the technology to increase that speed, I'm sure Dave can answer some questions for the room about that. It's not anywhere near the same level of reciprocating engine.

In terms of pumped hydro, hydro generation is not so much pumped hydro, it's actually hydro speed to market. How fast you can get the water through your

turbines. Hydro works very, very fast. Now it depends on all the different assets to that true response times, but we are ... they are fast return assets. The problem with hydro is it's not the actual technology itself, the technology is reasonably simple and well managed [inaudible 00:35:28]. It's actually sites for hydro. You need a head level, so you've gotta drop to create the generation. You need places to store the water.

They tend to be National Parks, unfortunately, and people get very touchy about flooding National Parks for some reason. Actually finding sites for hydro is critical, but there are good investments and obviously AGL has hydro in its portfolio that can respond very quickly to marketplace. I didn't put them up on the screen because they're very niche investment opportunities, so rather looking at the screen to look at what we would be investing in going forward. Recognizing those assets, actually [inaudible 00:36:06] incredibly flexible in responding to a five-minute marketplace. Hopefully that answers your question.

Brett: All right. Well, I think we've exhausted questions on that topic. I'm so happy to take anyone's over a drink, and I'll hand off to Andy to wrap up.