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Aurizon Network Pty Ltd

2 September 2021

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Issuer Outline

Aurizon Network Pty Ltd (Aurizon, Company) controls, operates and manages a largely dedicated and purpose built, heavy haul rail infrastructure, known as the Central Queensland Coal Network (CQCN), under 99 year lease arrangements with the State of Queensland, which commenced in July 2010. The CQCN is the largest coal export rail network in Australia. Aurizon Network operates the CQCN regulated rail infrastructure under a stable and well-established regulatory regime. The economic regulation of CQCN is undertaken by the Queensland Competition Authority (QCA), and the current agreement will be in place until 2027.

Aurizon's ultimate parent company is Aurizon Holdings Limited (AZJ), an ASX listed company which was wholly-owned by the State of Queensland prior to listing.

AZJ, through its operating subsidiaries (including Aurizon), is the world's largest rail transporter of coal from mine to port for export markets and is also the largest rail freight haulage business in Australia by tonnes hauled, operating in key freight sectors and supply chains across the country, focused primarily on large, heavy haul rail tasks such as the transportation of coal, iron ore, other minerals, agricultural products and general freight as well as containerised freight. It also provides a range of specialist rail engineering, construction and maintenance services.

Security
AUD500m 2.90% Sep 2030

ISIN
AU3CB0274173

Currency
AUD

Type
Senior unsecured

Key Financials (AUDm)

LTM (30 Jun)	2021
Revenue	1,224.9
EBITDA	833.9
Net Interest Expense	133.4
Total Assets	5,760.6
Debt	3,242.6
Cash	1.1
Net Debt/EBITDA	3.9x
EBITDA/Net Interest	6.3x

Source: FIIG Securities, Company reports

Key Terms

Coupon Type	Fixed	Amount Issued/Outstanding	AUD500m/AUD500m
Rate	2.90%	Minimum Amount	AUD10,000
Frequency	Semi-annual	Denomination	AUD10,000
Domicile	Australia	AU Withholding Tax Exempt	Yes

Key Dates

Issue Date	2 September 2020	Maturity Date	2 September 2030
Call Dates	Prior to 2 June 2030[1]	From 2 June 2030 onwards @ 100.00	

[1] Subject to redemption premium using a discount rate equal to the relevant swap rate + 50bp

Aurizon Network Pty Ltd

Strengths

- Competitive position: Aurizon's below-rail operations on the CQCN are the sole links for most of Queensland's coal mines to the major coal export terminals on its eastern coast. This monopolistic position and the supportive 'shadow' regulatory framework governing its revenue underpin the Company's solid market position and low business risk.
- Transparent and well-established regulatory framework: The QCA regulatory framework is transparent and well established, giving visibility into future regulatory revenue resets. It provides Aurizon with a window, if necessary, to implement countermeasures to protect the Company's financial profile. Although regulated resets had occurred every four years historically, the most recent agreement reached with customers spans a much longer period (to 2027), providing more long-term certainty, while the more frequent reset of the weighted average cost of capital (next in 2023) will ensure a closer tracking to actual debt costs.
- Predictable cashflows over regulatory period: Aurizon's access revenue is regulated and as such, supports the predictability of its cashflows. In addition, the access charges that Aurizon is permitted to levy are set under a revenue cap mechanism, which removes volume risk exposure due to coal haulage volume fluctuations. The take-or-pay features of the revenue cap provide Aurizon the ability to socialise revenues among existing users in the event that a user's access contract is terminated to an insolvency event.
- Adequate liquidity: As at 30 June 2021, the Company had available cash of AUD1.1m and undrawn facilities of ~AUD910m, which together with operating cash flow in excess of AUD500m, is expected to be sufficient to cover the Company's operating cash needs over FY22. Further, Aurizon has a good track record of proactively refinancing its maturing debt (including undrawn bank lines). Aurizon's next significant maturity is in June 2023, when an AUD750m bank facility (with only AUD370m currently drawn) is due for repayment.

Risks

- Legislation and regulatory risks: Aurizon is exposed to these risks due to the highly regulated nature of infrastructure assets with monopoly characteristics in Australia, limiting the company's financial flexibility as regulated charges do not necessarily reflect actual or projected opex, capex or costs of capital. As such, if regulated charges are lower than Aurizon's costs, this may affect the Company's financial performance. However, these risks are partly mitigated by QCA's well established and transparent regulatory framework, together with the most recent agreement for the current regulatory period which was reached directly between Aurizon and its customers, pointing to the QCA's willingness to take a light handed approach and intervene only when the parties cannot reach an agreement.
- Dependence on the coal sector: Aurizon has a significant dependence on the coal sector. Continued weakness in coal market fundamentals are the main potential source of future credit pressure, notwithstanding the Company's take-or-pay contracts. In large, this scenario would impair the capacity of coal producers to pay access charges, particularly any increases resulting from socialisation due to counterparty failure.
- ESG Pressure: In addition to its largely single sector exposure, Aurizon's coal exposure also introduces risks from an ESG perspective, with a growing number of investors reducing or entirely eliminating any exposure to companies that are operating within the broader coal segment. This is partly mitigated by the fact that Aurizon's coal exposure is weighted towards metallurgical (rather than thermal) coal. In addition, given its position in the logistics chain (rather than a direct producer), we believe ESG concerns will likely translate into marginally higher cost of debt rather than availability of funding.
- Higher than expected capex: Aurizon's business requires significant capital investment, and as such, there is a risk of higher than expected capex spending and associated execution risks. These risks are partly mitigated by the lower need for capex over the current and next regulatory periods, with S&P expecting maintenance capex of around AUD250m-AUD300m per annum over the next few years.
- Interdependency on AZJ's credit quality: Aurizon contributes around a third of AZJ's revenue, but about 50% of AZJ's EBITDA. As such, Aurizon's credit quality is linked to AZJ's credit quality as the below-rail network is a core subsidiary of its

parent company. Consequently, Aurizon's ratings and outlook reflect that of the parent and the Company's ratings could be lowered if AZJ's ratings were downgraded.

Other risks

- Call risk: A decision to call the bonds ahead of the maturity date depends on a number of factors, including the relative cost of entering new debt financing, the company's liquidity position, and the availability and attractiveness of new funding opportunities at the call date.
- Duration risk: The Aurizon Network 2.90% senior unsecured bonds mature in 2030 and carry a relatively long duration. Investors are exposed to a degree of interest rate risk on the bond. For example, a 100bp increase in yields would result in about a 7.51% fall in the capital price of the bond, all other things being equal.
- Interest deferral/cancellation: n/a
- Non-viability trigger: n/a

Summary

Aurizon Network's AUD 2.90% senior unsecured bonds maturing 2 September 2030 provide investors with an opportunity to participate in a regulated below rail network operator with exposure to coal mining counterparties and, indirectly, coal prices. The bonds mature in 2030 and carry a degree of duration risk.

References

- Aurizon Investor Website
- Aurizon Network FY21 Financial Report

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