Start of Transcript

Andrew Harding: Welcome to the full year 2017 results for Aurizon. In the room with me are - and using their new titles post the functional to business unit restructure implemented on 1 July - Pam Bains, CFO and Group Executive Strategy, Ed McKeiver, Group Executive Coal, Michael Riches, Group Executive Network, Clay McDonald, Group Executive bulk, Mike Carter, Group Executive Technical Services and Planning.

Before we move in more detail through the presentation I would like to make some brief introductory remarks. As you know, I've been at the helm of Aurizon for just over eight months. It has been an interesting period and one that I can summarise into three key points. The first point relates to what I've seen, my assessment of the performance of our company and the market environment, and I can best describe that as challenging. Most notably, of course, we had the extraordinary events of Cyclone Debbie and the subsequent impact that had on the performance of our business and our results. In addition, I will outline shortly challenges in some of our business units that are impacting the performance of our overall business.

The second point relates to what I am doing about it. My aim is to take decisive action, no matter how unpopular or difficult those decisions may be, and delivering on what I said we would do. I will outline this further as we discuss the divestment and closure of our intermodal business, operational reforms, our capital management program, and the introduction of a new business unit structure to deliver greater efficiency and accountability. The third point relates to why I am doing it. As I said, tough decisions, but decisions that needed to be made. My focus is on getting our core business right and commercially sustainable outcomes that deliver the best value for our shareholders and best certainty for our employees and communities.

Now let's turn to the presentation and, as always, start with safety. We have recorded a strong improvement in the key total recordable injury frequency rate metric this year. This is all the more remarkable when you consider the significant amount of change for employees over this time. The improvement is due to focusing on targeted initiatives, such as safety pauses, safety interactions, and high consequence activity monitoring. Technology has always played a part in the improved performance. As an example, I note there has been a 97% reduction in all unsafe driving breaches, including speeding and poor vehicle handling, due to the effective use of the in-vehicle monitoring system.

Driven by the need to continually stretch our safety improvement, we have implemented a new way of determining and measuring our safety data to ensure that it represents best practice. There are two major changes. The numbers captured will include contractors, and secondly, the scope of total recordable injuries has been widened to include all restricted work day injuries. Those changes are not included in the above slide. We will be restating numbers back to 2015. The lack of centralised data capture prior to that time does not support a restatement of numbers from earlier years. Improvement in the new metric will be harder and focus the business on a larger safety improvement challenge.

Turning now to the financial results. It was a challenging year for Aurizon with Cyclone Debbie impacting on underlying EBIT results by $89 million, resulting in a 4% reduction to $836 million. As many of you know, we will be able to recover a sizeable portion of that in 2018 and financial year 2019, some $69 million. The challenge also extended to the need to make some significant impairments during the year, mainly relating to the under-performance of the intermodal and bulk freight businesses. That, combined with other transformation-related impairments and significant items, saw us record a statutory net loss of $188 million.

Today we have announced the disposal of Acacia Ridge and the Queensland intermodal business to Pacific National and the shut-down of the interstate intermodal business. The transaction and the shut-down actions are necessary, given the history of significant losses to the business, for long-term industry sector attractiveness, and my view that in this industry sector we lack some fundamental characteristics for success.

As mentioned earlier, a restructure from a functional model to a business unit approach was implemented on 1 July and all group executive appointments have been completed. Pam will run through in detail our thoughts around capital structure, with that work informing the Board's decision around the final dividend and the share buy-back announced today. We are delivering a final dividend of $0.089 franked at 50% and based on a payout ratio of 100% of underlying NPAT. Shareholders are gaining further distributions through the buy-back program.

Moving now to above rail. As a result of the move to a business unit structure we will separately disclose the results for the coal and the bulk businesses in the future. So this is the last time we will refer to the above rail business. Revenue for above rail was driven by positive coal performance, despite the cyclone, iron ore was lower due to volumes and rate relief, with freight lower due to volumes and lower prices. Freight here includes both bulk and intermodal. In intermodal we had some contract wins, but bulk revenue declined

12%, largely due to a reduction in bulk volumes with the closure of QNI in March 2016 and the Mount Isa freighter ceasing in February 2017. I will outline the plan to address bulk later.

Transformation continues to contribute meaningfully to business performance and I will run through further details shortly. There were a number of strong coal contract wins during the year which collectively account for up to 12.8 million tonnes per annum. In addition, the haulage for AGL commenced in July for 8.7 million tonnes per annum. Weighted average contract life is about 10 years in coal and about eight years in iron ore, although two customers in iron ore are approaching the end of mine life.

Moving to below rail. The restructure to business units has minimal impact for below rail and you will continue to see it disclosed separately in the future. Performance was strong, notwithstanding the cyclone impact, with underlying EBIT down 3% to $490 million. This was due to the true-up of previous year's revenue and we are owed - that we are owed due to the late UT4 decision. The recovery from the cyclone was impressive and showcased the strength of our operations. We achieved an all-time record of 20.5 million tonnes of coal in June, only two months after the cyclone. Cancellations on the network did increase due to the cyclone, but remained below - importantly remained below the five-year average.

The regulatory process with the QCA remains key and we are awaiting a draft outcome from the regulator. For 2018 we are on transitional tariff arrangements, as agreed with customers, until there is a final agreement in place. I will undoubtedly be asked later on the call about my expectations for a date for that decision. The best I can currently offer is it is not weeks away, but months away. This is based on the QCA information requests we have received as recently as last week.

Finally, before handing over to Pam, some summary thoughts on the transformation program. There were some very strong improvements during the year. Labour productivity and operations improved by 10% despite a 4% reduction in net tonne kilometres due to the reduction of 600 FTEs. Longer train operations continue in Goonyella, with 11 out of 16 consists that increased from 124 to 126 wagons. In the Newlands system we have been running one consist over length by 40 wagons at 124 wagons. We also centralised our deployment capability at Brisbane. This saw the consolidation of five above rail, live run areas into a single centre. This consolidation has enabled an uplift in capability, stronger system redundancy, and has reduced FTEs by 31.

Benefits from significant transformation work under way, for example, the Rockhampton maintenance depot closure and train crew sourcing opportunities, will flow through beyond the financial year 2018. The $380 million target is impacted by the intermodal decision today. The decision permanently removes a significant financial loss through management action and is therefore a transformation benefit and contributes to the target. Of course, with intermodal no longer being part of the portfolio, additional transformation benefits that would have been generated this year are no longer available, but this is offset by the removal of the losses.

Now I will hand over to Pam.

Pam Bains: Thank you, Andrew, and good morning to everyone on the call. The result this year has been challenging for a number of reasons, in particular the impact of Cyclone Debbie and subsequent flooding, which impacted all four of our systems in the Central Queensland coal network for the first time simultaneously. However, we mobilised quickly to recover systems and recommenced railing earlier than communicated. We saw the deterioration in performance of the bulk and intermodal businesses, which clearly impacted the above rail result.

There has been a significant focus on transforming the intermodal and bulk businesses, which Andrew will talk about a little bit later. As we transition to the new business unit structure, we will present our results in the new business units, namely network, coal, bulk, and intermodal, instead of showing above rail and below rail spread, as Andrew touched on. Before the end of this calendar year we will restate prior year results on this basis and communicate that to the market.

So, moving to slide 10, group financial highlights. As you can see, both revenue and costs were flat year-on-year. This reflects the net effect of increased below rail revenue from the UT4 regulatory drop, offset by lower above rail revenue, which reflects a 4% reduction in volumes driven by Cyclone Debbie. Revenue was also impacted by the under-performance and deterioration in outlook for the freight business. Operating costs include $129 million of gross transformation benefits, offset by higher fuel, energy costs, CPI, and higher cost to serve in the intermodal and bulk businesses.

The reduction in access costs of $50 million includes a $30 million credit received from Queensland Rail following the finalisation of its undertaking and there’s a corresponding reduction in revenue. A change in mix as a large customer moved to an end-user contract with the network business directly. Depreciation increased 4%, reflecting an increase in below rail depreciation from sustaining CapEx and the full year impact of worth, offset by lower depreciation in above rail due to a lower CapEx spend, but also the rolling stock impairments from the previous years.

I'll come back to significant items in a moment, but underlying EBIT was in line with guidance at $836 million, but reduced by $35 million on the prior year. Underlying net profit after tax declined 10% due to higher interest costs, due to a combination of higher debt and interest costs. Dividend per share is based on 100% payout ratio of underlying net profit after tax, $0.089 per cent, 50% franked, bringing the total dividend for the year to $0.225 per share.

Moving to the next slide of significant items, as disclosed to the market in late July the result includes impairment and significant items of $927 million. This is shown on the left hand side of the table, $811 of impairments and redundancy costs of $116 million. In the first half, $321 million was taken, so that's the $257 million plus the $64 million. This relates to the intermodal asset impairments, FMT write-off, and redundancy costs of $64 million. This was driven by the deterioration in the trading performance of the intermodal business.

In the second half a further $606 million was recognised, made up of $526 million bulk impairments and $80 million of transformation-related asset impairments and redundancy costs. There were a number of contributing factors to the decision to impair bulk as a result of increased visibility and clarity of financial performance driven by the freight review, exit of certain contracts, deterioration in performance and increased losses, but also challenging market conditions, as we saw increased competition from road. Whilst disappointing, it is important to note that this is a requirement of the accounting standards and our focus remains on continuing to transform the bulk business over the next few years.

We also announced as part of the transformation program the staged closure of our Rockhampton rolling stock maintenance workshops by the end of calendar year 2018. The aim being to reduce maintenance costs and drive more efficiency through work practices across our operations. Also, as we move to more flexible train crewing operations, a number of permanent train crew positions will be phased out with an increase in contractor positions. Redundancy costs for FY17 of $116 million reflects a reduction of 924 roles, primarily in operations, but also across the corporate areas.

Again, consistent with prior years, the large restructuring transformation-related costs have been treated as significant items and there's a supporting slide in the back of your pack showing this. Finally, a further $29 million of impairments are included in the $836 million underlying EBIT. Items such as inventory write-downs, write-off of some minor projects, property costs, and non-transformation related redundancy costs.

So moving to the group underlying waterfall chart on the next slide, this shows the movement from 2016 to 2017, a decrease of $36 million, noting this includes the $29 million of impairments taken above the line I mentioned. I will talk about the volume movement of $10 million and revenue movement of $26 million on the above rail slide. below rail $137 million largely reflects the UT4 drop, which again I'll come back to on below rail. Depreciation energy costs of $45 million include $15 million in relation to high wholesale energy prices and $30 million in relation to depreciation, both of which are recoverable by the regulatory process.

$129 million of transformation benefits, which Andrew talked about in detail, $94 million in above rail and $35 million in centralised support costs. Cyclone costs of $89 million have been well communicated, as $20 million in above rail and $69 million in below rail. Finally, other material items include the $29 million of asset impairments I mentioned earlier, $50 million labour, consumables, CPI, and fuel. This includes 4% uplift for the EBA. $24 million costs to support volume growth in above rail for AGL and K&S, and $16 million lower capital recoveries reflects a change in mix - work mix - from capital to routine maintenance works, as maintenance works are expensed.

Moving to the above rail slide, you can see a decrease year-on-year of $33 million. From a volume perspective coal was down 4%, 8% down in Queensland, but up 9% in New South Wales. The impact of the cyclone has been shown on the right hand side in the $20 million cyclone impact. So for coal the impact of the cyclone was estimated at 11 million tonnes. So if you exclude that component, the volume impact would have been 1% reduction in Queensland, 9% improvement in New South Wales, so an overall 1% improvement. Iron ore and bulk volumes were down 4% and 5% respectively and intermodal volumes were up 9% due to the K&S contract.

Revenue quality. Coal contract utilisation decreased due to the cyclone and customer mix benefits were seen in the year with lower volumes from one of our larger customers which attracts a lower yield, more than offset by additional high-yielding volumes. The yield benefit will unwind in FY18 as contract utilisation improves with additional volumes. Freight yield is down 8%, impacted by a lower yielding freight forwarder for intermodal, lower TSC, and also in relation to iron ore, as we highlighted previously, FY17 includes the impact of restructuring the KML contract.

As you can see, performance of both bulk and intermodal deteriorated and remain challenging. Andrew will talk about the decisions and actions that have been taken in relation to intermodal. But we also explored the role and the strategic options for bulk as part of the freight review and again Andrew will provide more detail a little bit later.

Costs of $24 million supporting volume growth reflects $9 million for New South Wales coal uplift in demand and also ramp-up costs in preparation for AGL, which commenced in July of this year. $10 million additional lift and terminal charges, largely for the intermodal contract relating to K&S. Transformation benefits of $115 million above rail reflects $94 million in operations and C&M, $21 million in corporate support. As you know, we allocate corporate support costs also to above rail, hence the transformation benefits are also allocated.

Cyclone impact for above rail estimated to be $20 million, approximately 11 million tonnes in coal, with an EBIT impact of $18 million in coal, $2 million in bulk, and $3 million in intermodal, offset by $3 million of savings in fuel, maintenance, and labour. Finally, items - material items and other costs I talked about on the previous page, this is the above rail portion. So, in summary, above rail result, a $33 million decline, $20 million cyclone impact, $115 million benefit from transformation, but with downward pressure on yield from intermodal, bulk and iron ore.

So, moving on to the next slide, below rail. Underlying EBIT for below rail decreased $16 million. The $137 million revenue includes UT4 true-up as a result of revenue under-collected in prior years. As you know, UT4 was finalised in October 2016 with an under-recovery of $89 million. We estimated $80 million was collected during the year due to lower volumes and the remainder will fall into FY19 revenue cap. The true-up for GAPE commercial arrangements and AFD rebates was also communicated at the half as $12 million and is included in the result. $15 million bank guarantee for Bandanna with a first half recovery which is linked to the original work contracts. Also the result includes recovery of $10 million energy costs due to higher energy prices and $7 million in relation to insurance recognised due to the Newlands derailment.

As I mentioned earlier, the cyclone impact on network is estimated at $69 million, approximately $48 million in lower access recovery, and $21 million in flood-related costs that went to the P&L. Flood-related costs will be recovered via a review event. A submission will be put to the regulator in quarter 1 of FY18 and our proposed recovery is in FY18. The revenue cap submission of approximately $48 million will be recovered in FY19. Again, both elements subject to QCA approval. $54 million operating costs reflect $16 million in higher energy prices and $26 million for corporate support costs, which is a true-up following the UT4 decision, and there's a corresponding benefit in other, so nil impact to the group.

$29 million increase in depreciation is due to the timing of WIRP commissioning, which commissioned in December 2016, and also higher rail renewal spend, which is now capitalised. So for FY17 the below rail result includes $130 million of UT4 true-ups which will not be repeated in FY18, offset by $69 million of cyclone-related costs to be recovered in FY18 and FY19. Also note FY18 will include $24 million revenue cap from FY16 over recovery.

Moving to capital structure. We have reviewed the capital structure of Aurizon and determined at this stage a target gearing of 40% is appropriate based on the four key decision criteria as shown on the slide. Noting that gearing has increased largely impacted by the impairments in half 2 resulting in reduction in net assets and therefore equity.

Although sustainability of cash flows through the business cycle implies a high level of gearing, the gearing target also provides flexibility to adapt to changing market conditions and business risks as they arise. A key challenge for us setting this ratio is the uncertainty of the UT5 impact. Also Management need to ensure the FFO to debt metrics are maintained and the Board supports the current credit ratings of BAA1 and BBB+. Minimising the cost of capital is important, as it facilitates access to lower cost capital and a broad range of debt capital markets.

As Andrew talked about in the first half, after capital has been deployed for sustaining CapEx and dividends, target capital structure determines the amount of cash to be deployed to shareholders in the absence of growth projects.

In terms of capital expenditure on the next slide, at the half, we communicated a reduction of CapEx from a range of $550 million to $600 million to approximately $550 million. Actual spend came in $18 million lower at $532 million. The reduction was achieved through focused capital prioritisation following the change in delegations, driving a more disciplined approach on spend in the business. Transformation CapEx reduced by $10 million. This was offset by an increase in growth CapEx of $17 million in relation to Hunter Valley for AGL and Whitehaven tonnes. FY18 and FY19 forecast is in line with previous guidance, reducing to approximately $500 million split equally between below rail and above rail. In FY18 and FY19, sustaining and transformation capital is shown as non-growth CapEx. Transformation CapEx will be dependent on timing and prioritisation.

Moving to cash flow on the next slide. Cash flow continues to be very strong. As previously highlighted, free cash flow steps up significantly this year. As you can see from the slide and uplift from $340 million to $634 million, noting that cash flow in the first half does include $98 million of proceeds from the Moorebank sale. The increasing free cash flow reflects a significant reduction in CapEx compared to FY16, an increase in cash flow from operating activities, but also further improvements in working capital. Free cash flow of $634 million is highlighted post-interest expense and covers dividend payments. Future case benefit of the intermodal transaction will provide further upside. Timing and quantum is subject to regulatory approvals. However, we are aiming for completion before the end of FY18.

Disciplined capital management working capital and continuous improvement remains a focus of the leadership team. Finally, a comment on funding before I hand back to Andrew. Moody's lifted Aurizon's outlook from negative to stable in February of FY17 following the downgrade in early '16. The Board is committed to the current credit rating and metrics are better than 30% with some buffer in FY18 after the $300 million buyback; noting there is further buffer from the intermodal sale proceeds once it completes. In the second half, Aurizon Network issued its second bond in the Australian debt capital market, a seven-year AMTM priced in June at a coupon of 4%. $525 million of below rail bank debt will become current in FY18 and hence we'll look to refinance later this year. With an average interest cost now at 5%, tenure of five years, 93% of debt was hedged in June.

Gearing has increased to 40% and we'll manage gearing around this level, whilst ensuring we do not breach credit metrics. So in summary, the key message is the overall results for the group highlights a strong, stable core. Both network and coal delivered strong results despite the cyclone, offset by a deterioration in bulk and intermodal. Our focus continues to be driving strong financial discipline, increased accountability and maximising benefits from continuous improvement. So on that note, I'll hand back to Andrew.

Andrew Harding: Thanks, Pam. I wanted to remind you of the priority areas I outlined six months ago and give a progress update. The work of the freight review has been completed. The intermodal losses I spoke of being stemmed in some way by fixing the business or other options ranging from sale to closure now have a firm pathway to being removed. The bulk freight business has a detailed plan for remediation and a leadership team solely focused on the plan's execution. The way in which capital is managed has moved beyond the theory outlined at the half, with the action of starting a buyback. The suitability of a functional structure for Aurizon's future was reviewed as indicated and a more appropriate business unit structure implemented on 1 July. Transformation continues to be driven with further improvements possible after this financial year.

Progress on a UT5 decision remains with the regulator, but we continue to make it very clear that there needs to be an appropriate return given the risk level. The five areas of focus from the top of the slide are: levers and enablers to defining the strategy. In parallel with progressing these activities, we've been undertaking the necessary deep dives, market analysis and strategic conversations that inform the strategy. When this is finished, I will present it to investors. Moving on to a discussion of the bulk business turnaround. The bulk business performance was disappointing in FY2017. As I outlined last time, we do have a number of good contracts and bulk does have a part in Aurizon's portfolio with very similar capabilities to the successful coal business required to execute the contracts.

There needs to be a different focus and a much better customer service and cost management. The new bulk structure is much leaner. The team is placed regionally to best provide strong visible leadership and clearer accountability. Clay's immediate priorities are shown on the right. Internally, they have been broken down into bite size pieces on a monthly, quarterly and six-monthly basis. They cover items such as improving our reliability in customer service levels, fixing and/or protecting the revenue base, reducing costs and taking a more realistic view of growth options. Nonetheless, given some of the key legacy contracts have onerous termination provisions, the turnaround timeframe is realistically at least three years.

Turning next to the background behind the intermodal exit decision. You would not be surprised to hear that I've spent a great deal of time thinking about what to do with the intermodal business. With the benefit of recently arriving and a fresh set of eyes, this is what I saw: the intermodal business has made a loss in all but three of the last 10 years. The last two years were the first and third largest loss years. The market conditions are also not favourable. Market volume growth is forecast to be sub-GDP and the long-term dynamics are shifting to shorter hauls, favouring road transport as Australian manufacturing volumes are replaced by imported volumes. Outside of Queensland, Aurizon lacks scale and is third in the east-west corridor, which is the largest profit pool. Aurizon has considerable skills in bulk haulage and below rail operations.

However, it has huge capability gaps in trucking and logistic systems. It was not a complex decision to make, because I do not consider it practical to turn the business around. I need to pursue the next best alternative. The market testing process led to the outcome shown on the slide. That is the disposal of Acacia Ridge and Queensland intermodal for $220 million and, as difficult a decision as it is to make, when considering the employee impact the shutdown of the interstate business. The shutdown will result in costs associated with contracts and other liabilities, but it also creates additional value through the transfer of new, standard gauge locomotives into growth areas like the Hunter Valley Coal and we will sell the Forrestfield site at some stage in the future.

Moving on to a few words on capital allocation, I will not spend much time on this slide, as Pam went through the detail earlier. My key message is that in the absence of growth capital, surplus capital will be returned to the shareholder; a practice we have demonstrated today. Each year we will revisit our turnover projections and make an assessment about capital returns.

Turning to the business structure slide. We announced the move to a new structure in March, with an implementation date of 1 July. Most importantly, in addition to having the structure and a team in place, is the relocation of the group executive role for the bulk business to Perth and for the coal business to Mackay. This allows our leadership to be closer to customers, operations and to play the regional role our communities expect. The previous functional structure served a very useful purpose in allowing the rapid removal of duplicated costs in the previous structure. It had one large pitfall however in that it hid the poor performance of our freight business and the strong performance of our coal business.

The point I would make here is that the new structure is actually a hybrid structure, as we have kept central accountability for activities like fleet management, maintenance planning, real estate and IT. This ensures that the business units will not go back to duplicating in these areas. Finally, to the 2018 guidance. As far as guidance for the financial year 2018 goes, it is complicated by being the first year of UT5. We do not yet have a decision from the QCA, therefore for budgeting purposes and to allow the provision of guidance to our investors, we have assumed the current transitional tariff supply for the full year. Once UT5 is finalised, we will determine whether we need to update guidance. The guidance range is $900 million to $960 million for underlying EBIT and we note some of the key assumptions for Above and below rail.

For above rail, we've excluded the intermodal losses and associated costs due to the exit process. Therefore, it is important to note with our guidance that the transformation benefits assumed in the EBIT range of $900 million to $960 million only represent those delivered by the remaining core business, because the intermodal losses have been excluded. If we were to achieve the top end of the EBIT range, this would mean that an operating ratio of 70% would likely be achieved due to the removal of the intermodal business, which increases EBIT and also reduces revenue. Thank you and we're now happy to take some questions.

Operator: Thank you. If you wish to ask a question, please press star-1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star-2. If you are on a speakerphone, please pick up the handset to ask your question. Your first question comes from Simon Mitchell from UBS Investment Bank. Please go ahead.

Simon Mitchell: (UBS Investment Bank, Analyst) Good morning. I just wanted to clarify your comments on the transformation program in the context of the intermodal sale. It looks like you've today achieved $260 million of the $380 million, leaving $120 million. I think, if my interpretation of your comments was correct, you - the $60 million foregone loss for the intermodal, you're allocating the amount against the $120 million. So therefore the underlying business or the core business you're expecting to generate something like $60 million of gain.

Andrew Harding: Okay. Pam, do you want to handle that…

Pam Bains: Sure.

Andrew Harding: …[help] with the bridge.

Pam Bains: Sure. Of the remainder of the transformation benefits that we are due to deliver last year, I wouldn't take the loss of intermodal as an offset. Not all the costs - all the losses will be offset against that $120 million, because there are some costs in the business that remain sticky. So, for example, IT related costs of SAP or property costs where we have shared facilities, so part of the reduction will go through the transformation target.

Simon Mitchell: (UBS Investment Bank, Analyst) Right. Okay. But we don't know how much that - how much of the $120 million is actually coming from the sale of the intermodal business.

Pam Bains: Not at this stage.

Simon Mitchell: (UBS Investment Bank, Analyst) Right. Okay. Just secondly, just staying with the freight business, you talked to - a fair bit about the bulk business and talked about a three-year turnaround. How should we think about turnaround? Should we think about it as being just a breakeven or to actually generating a cost of capital return on the asset base? Actually, on that point, are you able to give us the current written down value of the bulk business?

Andrew Harding: So I'll just remind you, the bulk business is a bundle of contracts and the - ranging from very good performing contracts at the top end to obviously quiet performing contracts at the bottom end of the performance range. Overall, it makes a loss. What I - having Clay McDonald in the room now with a clear idea of the turnaround plan, I'll hand over to him.

Clay McDonald: Thanks for the question, Simon. We'll be looking to demonstrate progress as soon as possible, but realistically we are looking at a minimum three-year turnaround. That's mainly due to the recontracting pipeline has a number of the longer running legacy contracts that are due to be renegotiated in FY20 and another tranche in FY21. But - and the success of that turnaround will very much depend on our performance in those renegotiating opportunities of those legacy contracts. In the cost base, though, they are still a number of short and longer-term opportunities that we're pursuing, many of which were commenced under Mike Carter's leadership. So we'll pursuing those with vigour and, like I said, trying to demonstrate that progress as soon as possible.

Pam Bains: Simon, in relation to the question of written down value, it's in the notes to the account, so $254 million.

Simon Mitchell: (UBS Investment Bank, Analyst) Okay. Thank you. Just one last if I could for Andrew, just recognising that changes in ownership amongst your coal haulage competitors and obviously noting that you have a rather privileged maturity profile on your contract, can you just touch on how you're seeing the competitive environment at the moment in coal haulage?

Andrew Harding: Yes. Look, the coal haulage market - and I think I said this six months ago - has been competitive for a substantial period of time and it remains quite strongly competitive and I can't see anything that would actually change that moving forward. I have in the room with me Ed McKeiver in his new role as the group executive for coal, and I might led Ed make a few further comments.

Ed McKeiver: Yes. Thank you, Andrew. Good morning, Simon. Look, certainly acknowledge the competitive environment and the changing ownership of our competitors. It's not - while it's a new situation, we haven't yet really seen an impact. It's early days. I'd characterise our posture as alert, but not alarmed. We've had - and we're going to focus on what we can control, which is transforming our operation and pursuing market share as evidence by the contract wins we've announced today; all won in the last six months.

Andrew Harding: Thanks, Ed.

Simon Mitchell: (UBS Investment Bank, Analyst) Okay. Thank you.

Operator: Thank you. Your next question comes from Owen Birrell from Goldman Sachs. Please go ahead.

Owen Birrell: (Goldman Sachs, Analyst) Hi, guys. Just a quick question for Pam on the true-ups and make-goods that were applied to the below rail business for FY18. So for FY17 we saw roughly what is $124 million of, I guess, true-ups and make-goods. Can you just provide a bit of a breakdown of what you were expecting for FY18? I know you went through numbers but I lost some of them - and whether these are actually known or just expected.

Pam Bains: So in terms of the recovery from the flood? Yes. So in FY18 we will submit the $21 million of flood recovery cost to the regulator. So subject to the approval, we'll look to recover all proposed recovery in FY18 and then in FY19 the revenue cap, which is the shortfall in access revenue, we'll submit $48 million. So that will be recovered in FY19.

Owen Birrell: (Goldman Sachs, Analyst) Are there any true ups coming through in FY18?

Pam Bains: The only other component is $24 million, which is the revenue cap over-recovery we had in FY16, so you'll see a reduction in FY18 for that.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Outside of those [unclear] recovery in true ups there's nothing else that we can think about in terms of bank guarantees, recovery of energy costs, any of those lines?

Pam Bains: Not at this stage.

Owen Birrell: (Goldman Sachs, Analyst) Okay. A quick question for you, Andrew, on the capital management. You've got - and more particularly the $300 million buyback. You guys currently have 100% payout policy at your 40% gearing. I'm just wondering where the cash flow's coming from to fund to fund this $300 million buyback.

Andrew Harding: So I might get Pam to talk through the cash flow again.

Pam Bains: Sorry. Would you mind repeating the question, Owen?

Owen Birrell: (Goldman Sachs, Analyst) Sure. You pay out 100%...

Pam Bains: Yes.

Owen Birrell: (Goldman Sachs, Analyst) …payout. You're at 40% gearing already. Your target is 40%. I'm just wondering where the additional cash flow is coming from to fund this $300 million buyback.

Pam Bains: It's transformation and obviously improvements in cash flow. We have the cash flow in the first half from the Moorebank sale, but largely driven by transformation and CapEx. I think I touched on that as well. So there's a $200 million approximately - approximate reduction FY16 through to FY17 in CapEx and working capital improvement as well.

Owen Birrell: (Goldman Sachs, Analyst) Okay. All right.

Operator: Thank you. Your next question comes from Matt Spence from Merrill Lynch. Please go ahead.

Matt Spence: (Merrill Lynch, Analyst) Hi, Andrew. FY18 cost-outs and it might extend into - beyond that as well, but what are your big areas of cost-out that are still remaining? Is it still the corporate line? Can you talk about the benefit that will come from the new work agreements that you're doing on the train crewing site?

Andrew Harding: So look - and thank you for the question. The big areas of cost-out that are notable are continued move to driver only operation in coming years. Why we've announced the Rockhampton workshop closure, it's actually a process that runs through to end of next year. So the real value from a closure activity like that actually doesn't take place until - I've got to get my calendar years right - so '19. Yes, to '19. So there's a long-term value flowing from that of improvement. The flexible train crew work, while announced and obviously quite heavily in the press in recent months, has still got a process of consultation that has to be gone through and then actually working through the implementation side of those sort of changes. So you're looking at impacts from that not taking place until likely the next calendar year.

So those are three big buckets of - without talking about corporate improvements, but those are three key sizeable operational changes that still have ways to play out. I will say that there are still many more ideas that we consider and have in our implementation plans.

Matt Spence: (Merrill Lynch, Analyst) Then two line items for FY18, redundancy costs, to the extent that they're in FY18, are they above or below the line and if you could give us any idea on amount? Also, you talked to depreciation in FY18. Just whether - I assume that declines, but what's the moving parts between? Is network depreciation still rising versus above rail being lower because of the write-downs?

Andrew Harding: Okay. I might hand that over to Pam for a detailed explanation.

Pam Bains: Yes. So in relation to redundancy costs, generally speaking above the line; hard to determine the value of that until we work through the transformation projects that we'll deliver in FY18. But for intermodal, they will be below the line. Then to your second point, in terms of depreciation, FY18 depreciation does pick up in Network and absolutely it's lower in above rail as a result of some of the impairments.

Matt Spence: (Merrill Lynch, Analyst) Okay. Just one last quick one. So, Andrew, management LTIs, if I read it right in the annual report, they haven't changed. So your ROIC is still 10.5% for the next three and four years. So what happens - how does the intermodal and bulk write-down play into that?

Andrew Harding: You finished the question? Sorry.

Matt Spence: (Merrill Lynch, Analyst) Yes, okay.

Andrew Harding: Sorry there's this speaker that clicks in and out while you're talking and it cuts you off.

The impairments will not be considered as part of achieving a ROIC target so the Board is very, very clear on that.

Matt Spence: (Merrill Lynch, Analyst) Okay, your 8.7% this year. You've got to average 10.5% over the next three and four years. Yeah, okay so there's a stretch target you'd say?

Andrew Harding: That's the whole purpose of them. You can't just be giving the incentives.

Matt Spence: (Merrill Lynch, Analyst): Good. That's it for me. Thanks.

Operator: Thank you. Once again if you wish to ask a question please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request please press star two. If you are on a speaker phone or using a hands-free set please pick up the handset to ask your question.

Your next question comes from Anthony Moulder from Citigroup. Please go ahead.

Anthony Moulder: (Citigroup, Analyst) Good morning all. Just following on from that line of questioning around the impairment impacts what sort of depreciation impact should we think of for the latest round of impairments that you've taken, please?

Andrew Harding: Okay. Pam, do you want to handle that?

Pam Bains: Yes, so I'd say broadly net about $20 million.

Anthony Moulder: (Citigroup, Analyst) $20 million on [unclear] from FY17?

Pam Bains: In FY18.

Anthony Moulder: (Citigroup, Analyst) Yes, FY18. I look at the CapEx profile that you outlined. Obviously we've not seen the level of transformation CapEx detailed in this slide pack but obviously saw that in the first half 2017. Is there anything that would change the levels provided back then for 2018, 2019 of around that $150 million, $160 million?

Pam Bains: Yes, transformation as part of the CapEx prioritisation we go through will be subject to the timing of the relevant transformation projects so again can vary but still remains part of that mix. That's why we haven't shown the split.

Anthony Moulder: (Citigroup, Analyst) Right but nothing changes? Is that just timing as opposed to quantum?

Pam Bains: It's more likely to go down than increase on the past.

Anthony Moulder: (Citigroup, Analyst) Right, okay. Just looking at the coal contract expiry profile. Obviously you've pushed some contracts further out into the future. Can you talk to the negotiations on average that you went through with those customers or with customers and what they're looking for? Is it pricing? Is it flexibility? Can you give some sort of comments on how those contract renegotiations went please?

Andrew Harding: Yes, you can imagine it's not particularly helpful to get into a great deal of detail about how we actually win contracts but suffice it to say customers are interested in all of the categories that you mentioned and none of them were easily won but we're very confident about our position and the common sense of what we undertook.

Anthony Moulder: (Citigroup, Analyst) Related to that obviously the profile starts to step up from 2020. When would you expect some of those coal contracts or coal customers to talk to you about a renewal of those contracts?

Andrew Harding: I'll hand over to Ed for that.

Ed McKeiver: Thank you for the question. We ordinary see enquiries about 18 months prior to the roll off, 18 months to two years. From the profile slide you can see in the pack we could expect contracts for FY20 being put to the market next year.

Anthony Moulder: (Citigroup, Analyst) Okay. Excellent, thank you.

Operator: Thank you. Your next question comes from Scott Ryall from Rimor. Please go ahead.

Scott Ryall: (Rimor, Analyst) Thank you very much. Andrew, two questions. One related to intermodal and one related to slide 20. In terms of intermodal could you just detail any costs of closure. I don't know if I missed that in the commentary but I didn't see anything around the cost of your interstate closure.

Andrew Harding: I'll ask Pam to just talk through our thinking around the costs.

Pam Bains: Yes so obviously the timing is subject to regulatory approvals but broadly speaking the costs - sorry, back on the Queensland side but interstate it'll be redundancy costs. It'll be contract liabilities in relation to customer contracts that we have, property leases, locomotive leases and access commitments.

Scott Ryall: (Rimor, Analyst) Yes so could you quantify those please?

Pam Bains: We haven't at this stage because again we still need to have discussions with our customers in relation to timing of delivering their contracts so a busy period coming up with December. We want to commit to ensuring we deliver on their requirements so we need to work through those details.

Scott Ryall: (Rimor, Analyst) Okay so are you expecting them presumably to be less than the $220 million of gross proceeds right?

Pam Bains: Yes and we also have rolling stock in the interstate business which we will look to redeploy in area such as the Hunter Valley where we are seeing growth so there will be some positive upside from that. At the same time we're looking to sell the Forrestfield facility as well so there'll be an upside from both of those.

Scott Ryall: (Rimor, Analyst) Okay and then in terms of the short term incentives EBIT target, Andrew you made some comments around the fact that taking away the losses in the intermodal business accounted as transformation benefits which presumably means they count towards the EBIT target for short term incentives?

Andrew Harding: Absolutely. If you think about the intermodal business it is actually a whole lot of customers that we have contracts with to deliver goods. As we've improved contracts in the past to make them better and improved performance to make it better that's all been part of the transformation program. So yes, it's part of the transformation.

Scott Ryall: (Rimor, Analyst) Yes, okay. Then in terms of the slide 20 and the last point on it with respect to the presentation of strategy could you confirm when we will hear back from you please?

Andrew Harding: Yes, I'm still working through the strategy itself at the moment. As you can see I've been working much more diligently and focused on those enablers that are no regrets decisions that support a strategy in the come what may and I'll continue to do that as we move forward. I will deliver a strategy at some point in the future. I'm just not exactly picking which month I'm going to do that.

Scott Ryall: (Rimor, Analyst) Right, okay. Could you just give me a short term comment though around I guess medium to long term goals? You've mentioned a lot about value creation and value drivers as opposed to much discussion around growth. You've talked about a difficult operating environment in both coal and bulk, the optionality I guess around freight in the medium and very long term if you believe inland rail goes ahead is now gone.

When you come back to the Board with a strategy and the market with your strategy is this now a business with no top line growth and should we be thinking about costs and cash flow only as your value drivers?

Andrew Harding: I wouldn't be thinking of the business that way. Clearly there are a number of important areas which we've detailed some considerable success on today that just needed to be cleaned up and set right and we're doing that. Then we'll be continuing to do that going forward. The coal industry itself from when I started in this role in December to now has gone from something that I would have described as green shoots to something that is stronger than that. I think many people are surprised by the improved performance from a growth in coal. I wouldn't want you to run away with that as being the only high growth but there is absolutely some growth coming through and an improved confidence in the industry with the demands for coal, metallurgical and thermal, in Asia.

What I said last time and what I'll repeat today is growth outside of that is difficult to immediately see. I'll be working my way through opportunities for growth as we move forward.

Hopefully that answers your question.

Scott Ryall: (Rimor, Analyst) Okay, mate, thank you. That's all I had.

Operator: Thank you. Your next question comes from Ian Miles from Macquarie. Please go ahead.

Ian Myles: (Macquarie Group, Analyst) Good morning guys. On the below rail can you maybe give us an idea under the transitional tariff what the maximum allowable revenue will be for FY18?

Andrew Harding: Ian, that sounds definitely like a question I should hand to Pam.

Pam Bains: The transitional tariffs, I don't actually have the number on me, Ian, and we can certainly get that to you. It's public. It will be in the submission that we made to the regulator. Essentially it was very much a roll forward taking out all the one-offs from the previous year.

Ian Myles: (Macquarie Group, Analyst) Okay. On the CapEx side it looks like it's stubbornly quite high, that total CapEx number for the circa $500 million. Is there any sort of - another round of programs to bring that broader number down to a materially lower base?

Andrew Harding: Ian, we are working a lot in improving our CapEx spend going forward. Some of the activities that I spoke of like the closure of the Rockhampton workshop - which doesn't take place for some time fully - will yield benefits quite a lot in the CapEx space as well because there's a lot of the wagon repair type activities that will go from presently high cost to a much lower cost per unit of repair. Just in the general efficiency by which we actually execute on CapEx to support the business - and that's just one example - that will be improving over time.

Then of course you've got the whole how we look at the tightness with which we actually allocate capital and as difficult as the large impairment in the bulk business has been, what it does enable for bulk and flowing back into coal - it's one of the natures of having a joined up business - is it allows the business units to look much more stringently at their future and how they achieve that in a lower CapEx environment.

Ian Myles: (Macquarie Group, Analyst) Okay and one final thing. On bulk you talked about onerous contracts. How come you haven't written an onerous contract provision against these large contracts which are fully loss leading and not likely to be profitable?

Pam Bains: In terms of the accounting standards there is no requirement in terms of avoidable cost to provide for those onerous contracts. Where we have needed to we have provided.

Ian Myles: (Macquarie Group, Analyst) Okay, that's great. Thanks.

Operator: Thank you. Your next question comes from Paul Butler from Credit Suisse. Please go ahead.

Paul Butler: (Credit Suisse, Analyst) Hi guys. I just wonder if you could comment on your assessment of whether ACCC approval is going to be an issue at all with these asset sales you're looking at.

Andrew Harding: I'm sure you can understand, Paul, the safest thing for me to do is stay away from any commentary about ACCC process other than the transaction that we detailed. We acknowledged that it is subject to their approval.

Paul Butler: (Credit Suisse, Analyst) Okay and in terms of the timing. When are you expecting that that process might be complete?

Andrew Harding: Yes, we've given the process or the completion of the whole transaction through to the end of the financial year.

Paul Butler: (Credit Suisse, Analyst) And in the remaining bulk business can you give us a sense of what the financial result was for 2017? Obviously it was a loss.

Pam Bains: It was a loss. We will be providing numbers just prior to the end of this calendar year in terms of the new segments and bulk will be one of those segments. That will include bulk east, bulk west and iron ore as a group of contracts. We will provide that prior year comparative.

Paul Butler: (Credit Suisse, Analyst) Okay. You have the numbers now though right?

Pam Bains: Not in a way - because we've restructured the business not in a way that we're comfortable with disclosing at this stage because we're going through a restructure of the numbers from prior year. That's why we will provide something before the end of the calendar year.

Paul Butler: (Credit Suisse, Analyst) Okay and when you look at the three year plan to turn around the bulk business and you've talked about these onerous contracts, do they tend to be iron ore contracts or are they non-iron ore contracts or is it sort of a mix?

Andrew Harding: Again you'd have to appreciate, Paul, going into any great detail at an individual contract by contract level would be very unwise for us to do. But what I will say is that the iron ore business despite the fact that some of the mines that we're servicing are short life is a very profitable part of the business.

Paul Butler: (Credit Suisse, Analyst) Okay and then just finally I just wonder if you could comment on the Board's decision to go ahead with the $300 million buyback. What metrics were considered in making that decision and what metrics might be considered going forward? Will there be a regular process looking at surplus capital and returning that?

Andrew Harding: I'd make the point that a one-off buyback in itself is obviously a useful and good thing but the research that I've done shows that if you're able to a regular or consistent or sense of buyback coming through year-on-year builds a greater sense of commitment and belief in management action. That's not saying that's always possible but it is saying that a single one by itself doesn't actually demonstrate - it demonstrates more than just saying something but it doesn't actually demonstrate an ongoing commitment. It's the ongoing commitment itself that's actually what people can build in to your performance.

Having said all that I might hand over to Pam for…

Pam Bains: Yes so with reference to the buyback we take into account the target gearing, we look at capital plans and other considerations such as having flexibility in the business to deal with operating conditions and UT5 is obviously a key challenge in terms of understanding how that might impact and obviously our credit metrics.

Paul Butler: (Credit Suisse, Analyst) So given that we don't know how UT5 is going to play out yet and it strikes me that there is some competition risk - it might be small - around these asset sales how did the Board arrive at that decision then?

Pam Bains: There's sufficient capacity in this year. The challenge is beyond this year at this stage.

Paul Butler: (Credit Suisse, Analyst) Okay. Thank you very much.

Pam Bains: Yes.

Operator: Thank you. Your next question comes from Rob Koh from Morgan Stanley. Please go ahead.

Rob Koh: (Morgan Stanley, Analyst) Good morning. Just a quick question on the Forrestfield terminal which is I guess the remaining asset to be divested there. Are you able to give us an indication of book value on that asset?

Pam Bains: It's about $25 million.

Rob Koh: (Morgan Stanley, Analyst) $25 million, okay. Alright and then next question is I guess just thinking about the range of outcomes for UT5, if and when that comes through. Are you able to tell us if the WACC - the window for setting the WACC has passed or is that still to be done?

Andrew Harding: Pam, do you want to talk about the UT5 window?

Pam Bains: Sure. With regard to - if you look at history when the regulator sets WACC generally speaking just prior to an undertaking commencing what that will do is set the risk-free rate, more the cost of debt. There's still opportunity to talk about the cost of equity such as components such as beta, MRP, et cetera.

Rob Koh: (Morgan Stanley, Analyst) Yes so I guess I was just asking if the UT5 - well to the extent that the risk-free rate can be set has it been set?

Pam Bains: Not yet.

Rob Koh: (Morgan Stanley, Analyst) Not yet. Okay, cool. That's fine. We can think about bond yields going forward. Final question just in relation to your target gearing ratio of 40% which I guess is an incremental clarity on that front, should we still be thinking that below rail you'll target the regulatory gearing of 55% and then the above rail gearing would be the residual to approach your target ratio through the cycle? Something like that?

Pam Bains: Yes, that's right.

Rob Koh: (Morgan Stanley, Analyst) Great. Cool. Thank you very much.

Operator: Thank you. Your next question comes from Nathan Lead from Morgans Financial. Please go ahead.

Nathan Lead: (Morgans Financial, Analyst) Good morning. Just a couple of questions. First up you've obviously called out the post FY18 benefits coming through from the train crewing and from Rockhampton closure. Do you mind just putting a number on that in terms of what sort of dollar value benefit you expect coming through?

Andrew Harding: No. No, we won't be putting a dollar value on that at this moment.

Nathan Lead: (Morgans Financial, Analyst) Okay and secondly EBAs. My understanding is they expire middle of next year so I'm assuming you're starting to think fairly seriously about what you are hoping to get out of the next round of negotiations. Could you maybe chat through that and particularly thinking about the 4% wage escalation you've got at the moment? Wage growth's obviously a lot lower now. Yes, just chat through your thoughts there?

Andrew Harding: Yes, clearly you're right, we have been working on the negotiating strategy and business requirements and all those things that you'd expect prior to actually sitting down and having a discussion. It's not a useful thing for us to actually talk about the outcomes or the strategy itself in advance of actually having the negotiation. Suffice it to say that we will be doing that. We recognise we will be positioning EBAs in the ongoing reality that we work in a very competitive environment.

Nathan Lead: (Morgans Financial, Analyst) Just a final one too, tax and franking just with the impairments, et cetera. Where do you expect the tax rate to go and the franking side of things go?

Andrew Harding: I might hand over to Pam for that one.

Pam Bains: In terms of franking the challenge has been in relation to - it's at about 50% but as we start paying dividends moving from 50% to 100% the cash tax rate will be significantly lower so ability to fully frank is difficult due to the lower taxes paid post privatisation and also the accelerated fixed asset adjustments that we have.

Nathan Lead: (Morgans Financial, Analyst) Yes, thanks.

Operator: Thank you. Your next question is a follow up question from Owen Birrell from Goldman Sachs.

Owen Birrell: (Goldman Sachs, Analyst) Hi, I just wanted a quick follow up on the closure of the interstate intermodal business. Just wondering what happens with the port shuttle service that you guys have just started between Port Botany and Enfield and what that implies for all your leases at Enfield.

Pam Bains: We'll continue to use the service with the bulk business.

Owen Birrell: (Goldman Sachs, Analyst) Okay.

Pam Bains: Enfield, sorry. Mike, do you want to…

Andrew Harding: Just hold on a sec. I'm going to hand over to Mike Carter.

Mike Carter: Hi, Mike Carter here. The intention is that the shuttle service will be transitioned out. We need to be mindful of our obligations to customers as was mentioned earlier so that needs to be worked through into a detailed transition plan. However the terminal there, Enfield has some medium term opportunities for bulk so we want to have a look at that as part of the work that Clay and his team are doing in the bulk business and think of how we can leverage that site not only for purposes that it was initially designed for, which may involve some of our customers and others but also potentially for the bulk business going forward.

Owen Birrell: (Goldman Sachs, Analyst) So from my read on that it's not an immediate exit from Enfield but the port shuttle will effectively be - the contracts will be sold off or transitioned to someone else.

Mike Carter: That's correct. That's the theme.

Owen Birrell: (Goldman Sachs, Analyst) Okay, thank you.

Operator: Thank you. There are no further questions at this time.

Andrew Harding: Okay, well thank you very much for taking time to actually be on the call and hear about all the challenging year we've had but the many tough decisions that we've made to actually improve the business going forward and solid belief in our ability to execute against our plans. Thank you.

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