Aurizon Holdings Limited

Appendix 4E
Results for announcement to the market on 13 August 2018
For the year ended 30 June 2018 (FY2018)
Previous corresponding period (pcp) for the year ended 30 June 2017 (FY2017)

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FY2018 IN REVIEW

Result Highlights (Underlying continuing operations)

($m)	FY2018	FY2017	Variance %
Total revenue	3,112.7	3,142.5	(1%)
EBITDA	1,466.1	1,451.5	1%
EBIT	940.6	884.2	6%
Adjustments - Cliffs contract exit	34.5	-	-
- Impairments	(31.7)	(649.0)	nm
- Redundancy costs	22.9	(110.8)	nm
EBIT – statutory	966.3	124.4	677%
NPAT	542.1	494.7	10%
NPAT – statutory	560.1	(37.2)	nm
Free cash flow (FCF)	669.4	703.7	(5%)
Final dividend (cps)	13.1	8.9	47%
Total dividend (cps)	27.1	22.5	20%
Earnings per share (cps)	26.9	24.1	12%
Return on invested capital (ROIC)	10.9%	9.3%	1.6ppt
EBITDA margin (%)	47.1%	46.2%	0.9ppt
Operating ratio (OR) (%)	69.8%	71.9%	2.1ppt
Above Rail Tonnes (m)	267.1	256.5	4%
Above Rail opex / NTK (excluding access) ($/'000 NTK)	18.5	19.2	4%
Gearing (net debt / net debt + equity) (%)	42.3%	39.6%	(2.7ppt)

- EBIT up 6% to $940.6m
  - Coal up $8.6m (2%) with 7% higher volumes and transformation benefits partly offset by higher operating costs due to price escalation and costs associated with installing capacity to deliver additional volumes
  - Bulk up $64.5m due to transformation benefits and lower depreciation from prior year impairments, partly offset by lower volumes
  - Network flat at $480.6m with operating cost savings offset by non-recurrence of UT4 true-ups in prior year
- FCF decreased $34.3m with a 3% increase in net cash from operations more than offset by lower proceeds from asset sales
- $300m buy-back completed in 2HFY2018, distributing surplus capital to investors
- Final dividend of 13.1cps, 60% franked (100% payout of underlying NPAT for continuing operations), an increase of 47% against prior year

Major items

- Achievement of three-year transformation target of $380m with $133.6m in benefits delivered during FY2018, including the removal of Intermodal's FY2017 losses, which principally relate to Intermodal Interstate
- Interstate Intermodal closed during the year. Australian Competition and Consumer Commission (ACCC) has blocked the sale transactions for the Queensland Intermodal business and Acacia Ridge Terminal and has commenced proceedings in the Federal Court. Aurizon will defend these proceedings and seek clearance of the sale of the Acacia Ridge Terminal
- UT5 draft response strategy in execution across multiple pathways being regulatory, commercial and legal activity
- Enterprise strategy re-set in June to provide framework for continued delivery of Enterprise strategic outcomes

Outlook

- Underlying EBIT guidance for above rail business $390m – $430m. Key assumptions as follows:
  - Coal – flat outlook with higher volumes (215 – 225mt) offset by increased maintenance and operating costs
  - Bulk – cessation of Cliffs and Mt Gibson contracts ~$50m impact in FY2019
  - Continued delivery of transformation in the remaining core business
  - No major weather impacts
  - Excludes redundancy costs
- Providing EBIT guidance for Network is challenging due to the uncertain UT5 outcome with a $130m range. Transitional tariffs currently in place until 31 December 2018

CONSOLIDATED RESULTS (Underlying continuing operations unless stated)

1. Year on Year Comparison

Financial Summary

($m)		FY2018	FY2017	Variance %
Total revenue		**3,112.7**	**3,142.5**	**(1%)**
Operating costs				
Employee benefits		(774.6)	(781.8)	1%
Energy and fuel		(252.4)	(236.5)	(7%)
Track access		(191.4)	(204.2)	6%
Consumables		(348.4)	(392.9)	11%
Other		(79.8)	(75.6)	(6%)
EBITDA		**1,466.1**	**1,451.5**	**1%**
	- statutory	1,491.8	691.7	116%
Depreciation and amortisation		(525.5)	(567.3)	7%
EBIT		**940.6**	**884.2**	**6%**
	- statutory	966.3	124.4	677%
Net finance costs		(165.0)	(178.6)	8%
Income tax (expense)/benefit		**(233.5)**	**(210.9)**	**(11%)**
	- statutory	(241.2)	17.0	nm
NPAT		**542.1**	**494.7**	**10%**
	- statutory	560.1	(37.2)	nm
Loss after tax from discontinued operations	- statutory	(77.1)	(150.7)	49%
NPAT (group)	**- statutory**	**483.0**	**(187.9)**	**nm**
Earnings per share[1]		**26.9**	**24.1**	**12%**
	- statutory	27.8	(1.8)	nm
Earnings per share[1] (group)		**25.7**	**22.5**	**14%**
	- statutory	24.0	(9.2)	nm
Return on invested capital (ROIC)[2]		10.9%	9.3%	1.6ppt
Return on invested capital (ROIC)[2] (group)		10.4%	8.7%	1.7ppt
Operating ratio		69.8%	71.9%	2.1ppt
Net cashflow from operating activities		1,307.7	1,273.2	3%
Final dividend per share (cps)		13.1	8.9	47%
Gearing (net debt / net debt + equity) (%) (group)		42.3%	39.6%	(2.7ppt)
Net tangible assets per share ($) (group)		2.3	2.4	(4%)
People (FTE)		4,835	5,024	4%

Operating Metrics

	FY2018	FY2017	Variance %
Above Rail[3] Revenue / NTK ($/'000 NTK)	38.1	38.7	(2%)
Labour costs[4] / Revenue	24.4%	24.7%	0.3ppt
NTK / FTE (MNTK)	13.2	12.5	6%
Above Rail opex / NTK (excluding access) ($/'000 NTK)	18.5	19.2	4%
Above Rail NTK (bn)	63.8	63.0	1%
Above Rail Tonnes (m)	267.1	256.5	4%

[1] Calculated on weighted average number of shares on issue – 2,013.4m FY2018 and 2,051.7m FY2017
[2] ROIC is defined as underlying rolling twelve-month EBIT divided by the average invested capital. The average invested capital is calculated by taking the rolling twelve-month average of net property, plant and equipment including assets under construction plus investments accounted for using the equity method plus current assets less cash, less current liabilities plus net intangibles
[3] Above rail includes both Coal above rail revenue and Bulk freight transport revenue
[4] FY2018 excludes $16.5m redundancy costs (FY2017 excludes $5.1m redundancy costs)

EBIT by Segment

($m)	FY2018	FY2017	Variance %
Coal	428.6	420.0	2%
Bulk	50.1	(14.4)	nm
Network	480.6	480.9	-
Other	(18.7)	(2.3)	(713%)
Group (Continuing operations)	**940.6**	**884.2**	**6%**

Group Performance Overview

EBIT increased $56.4m or 6% due to increased earnings in Bulk resulting from transformation benefits and lower net depreciation. Earnings in Coal increased due to higher volumes and transformation benefits, while Network was flat due to the non-recurrence of UT4 true-ups received in FY2017. Both Coal and Network delivered record tonnages in the year at 212.4mt (7% increase) and 229.6mt (9% increase) respectively. The deterioration in Other EBIT was principally due to the non- recurrence of the UT4 corporate cost true-up from the prior year.

Aurizon has achieved its three-year transformation target of $380m with total Group transformation benefits of $133.6m being delivered in the year, including the removal of Intermodal's FY2017 losses, which principally relate to Intermodal Interstate.

Group revenue decreased $29.8m or 1% largely because of the prior period UT4 adjustments more than offsetting a 4% improvement in above rail volumes to 267.1mt.

Operating costs decreased $44.4m or 3% with transformation benefits and lower operating costs in Network and Bulk partly offset by higher costs in Coal relating to increased volumes and cost escalation. Depreciation has decreased $41.8m or 7% largely due to the impact of impairments in FY2017 in Bulk.

ROIC has improved 1.6ppt to 10.9% reflecting both the improvement in EBIT and the full year impact of the impairments taken in FY2017.

Statutory EBIT improved $841.9m to $966.3m reflecting the significant items recognised during the year totalling $25.7m namely, asset impairments of $31.7m offset by the net benefit of the Cliffs contract termination of $34.5m and the release of $22.9m of redundancy provision against total significant items of $759.8m recognised in the prior period.

Reconciliation to Statutory Earnings

Underlying earnings is a non-statutory measure, and is the primary reporting measure used by management and the Group's chief operating decision making bodies for the purpose of managing and assessing the financial performance of the business. Underlying earnings is derived by adjusting statutory earnings for significant items as noted in the following table:

($m)	FY2018	FY2017
Underlying EBIT (Continuing operations)	**940.6**	**884.2**
Significant items (Continuing operations)	**25.7**	**(759.8)**
Bulk contract exit - termination payment	66.3	-
Bulk contract exit - costs	(31.8)	-
Asset impairments	(31.7)	(649.0)
Freight Management Transformation project	-	(64.0)
Impairment of assets in exit of contracts	-	(10.2)
Transformation - assets	-	(48.9)
Bulk	(31.7)	(525.9)
Redundancy costs	22.9	(110.8)
Statutory EBIT (Continuing operations)	**966.3**	**124.4**
Net finance costs	(165.0)	(178.6)
Statutory PBT (Continuing operations)	**801.3**	**(54.2)**
Taxation (expense)/benefit	(241.2)	17.0
Statutory NPAT (Continuing operations)	**560.1**	**(37.2)**
Underlying EBIT (Discontinued operations)	(24.0)	(48.2)
Significant items (Discontinued operations)	**(74.7)**	**(167.2)**
Intermodal	(74.7)	(167.2)
Net finance cost (Discontinued operation)	-	0.1
Income Tax Benefit (Discontinued operation)	21.6	64.6
Statutory NPAT	**483.0**	**(187.9)**

Significant items for the continuing operations of $25.7m were recognised in FY2018 including:

- Cliffs contract termination $34.5m – On 29 June 2018 Cliffs issued a contract termination notice to Aurizon effective 30 June 2018. An early termination payment of $66.3m (ex GST) was payable and recognised as other income. As a consequence of the contract termination, asset impairments of $27.9m have been recognised. In addition, a closure provision of $3.9m has been recognised which includes a redundancy provision of $3.5m for 63 FTEs
- Asset impairment $31.7m – As a result of the Cliffs contract early termination an impairment review of the Western Australia CGU was undertaken and a write down of $31.7m has been recognised in FY2018. Following the impairment, the residual carrying value of the Western Australia CGU is $170.7m
- Redundancy costs $22.9m – A provision for train crew redundancy, recorded as a significant item in FY2017, has been released in FY2018 with the planned transition to a flexible workforce not being implemented at this time due to operational requirements and stronger coal demand

2. Other Financial Information

Balance Sheet Summary

($m)	30 June 2018	30 June 2017
Assets classified as held for sale	108.0	7.3
Other current assets	689.8	722.1
Total current assets	**797.8**	**729.4**
Property, plant & equipment (PP&E)	8,659.9	8,835.0
Other non-current assets	315.7	281.5
Total non-current assets	**8,975.6**	**9,116.5**
Total Assets	**9,773.4**	**9,845.9**
Liabilities classified as held for sale	(12.7)	-
Other current liabilities	(727.2)	(665.2)
Total borrowings	(3,501.9)	(3,376.2)
Other non-current liabilities	(801.5)	(782.4)
Total Liabilities	**(5,043.3)**	**(4,823.8)**
Net Assets	**4,730.1**	**5,022.1**
Gearing (net debt/net debt plus equity) (%)	**42.3%**	**39.6%**

Balance Sheet Movements

Total current assets increased by $68.4m largely due to:

- Net increase in assets held for sale of $100.7m due to the assets relating to the sale and closure of the Intermodal business being included as assets held for sale
- An increase in trade and other receivables of $34.1m due to the recognition of the Cliffs contract termination payment ($66.3m), partly offset by reduction in other receivables

These increases in current assets were partly offset by:

- Reduction in cash and cash equivalents at 30 June 2018 compared to the prior period
- Reduction in current tax receivable to a current tax payable position at 30 June 2018

Total non-current assets decreased by $140.9m largely due to a net decrease in PP&E of $175.1m, including the reclassification of PP&E to assets held for sale, depreciation and impairments, partly offset by capital expenditure and a $37.2m increase in derivative financial instruments (favourable valuation).

Other current liabilities, excluding borrowings, increased by $62.0m due to the recognition of a current tax liability position at balance date and the $45.0m ($35.0m non-refundable) deposit received in relation to the sale transactions for the Queensland Intermodal business and Acacia Ridge terminal.

Total borrowings increased by $125.7m due to the revaluation of medium term notes and net proceeds from borrowings facilities during the year.

Other non-current liabilities have increased by $19.1m due to lower derivative financial instruments (favourable valuations) and other liabilities, offset by recognition of lease incentives that are deferred and will be recognised over the lease term.

Gearing (net debt/net debt plus equity) was 42.3% as at 30 June 2018.

Cash Flow Summary

($m)	FY2018	FY2017
Statutory EBITDA (Continuing operations)	**1,491.8**	**691.7**
Working capital and other movements	(146.9)	75.2
Non-cash adjustments - asset impairments[5]	70.0	678.3
Cash flows from Continuing operations	**1,414.9**	**1,445.2**
Interest received	2.9	2.8
Income taxes paid	(110.1)	(174.8)
Net cash inflow from operating activities from Continuing operations	**1,307.7**	**1,273.2**
Net operating cashflows from Discontinued operations	(25.1)	(34.8)
Net operating cash flows	**1,282.6**	**1,238.4**
Cash flows from investing activities		
Proceeds from sale of property, plant and equipment (PP&E) and associate	19.0	111.4
Payments for PP&E and intangibles	(501.5)	(507.9)
Net cash (outflow) from investing activities from Continuing operations	**(482.5)**	**(396.5)**
Net investing cashflows from Discontinued operations	54.6	(34.7)
Net investing cashflows	**(427.9)**	**(431.2)**
Cash flows from financing activities		
Net proceeds / (repayments) from borrowings	12.2	(55.3)
Payment for share buy-back and share based payments	(302.9)	(7.5)
Interest paid	(155.8)	(173.0)
Dividends paid to Company shareholders	(462.1)	(551.9)
Net cash (outflow) from financing activities from Continuing operations	**(908.6)**	**(787.7)**
Net financing cashflows from Discontinued operations	-	-
Net financing cashflows	**(908.6)**	**(787.7)**
Net increase / (decrease) in cash from Continuing operations	**(83.4)**	**89.0**
Net increase / (decrease) in cash from Discontinued operations	**29.5**	**(69.5)**
Free Cash Flow (FCF)[6] from Continuing operations	***669.4***	***703.7***
Free Cash Flow (FCF)[6] from Discontinued operations	***29.5***	***(69.5)***

Cash Flow Movements

Net cash inflow from operating activities for continuing operations increased by $34.5m (3%) to $1,307.7m largely due to a $64.7m reduction in income taxes paid as FY2017 included a significant final tax payment relating to the tax liability for FY2016. This is partly offset by a net increase in working capital due to lower trade and other payables and an increase in trade and other receivables with the recognition of the Cliffs termination payment ($66.3m) at 30 June 2018.

Net cash outflow from investing activities for continuing operations increased by $86.0m (22%) largely due to $98.3m proceeds from the sale of the Moorebank investment in the prior year.

Net cash flow from investing activities for discontinued operations increased by $89.3m due to FY2018 including the deposit received for the sale transactions for the Queensland Intermodal business and Acacia Ridge terminal and proceeds from the sale of plant and equipment as part of the closure of Intermodal Interstate.

Net cash outflow from financing activities for continuing operations increased by $120.9m (15%) to $908.6m due to the on-market share buy-back of $300.0m, partly offset by a reduction in dividends paid and net proceeds from borrowings in FY2018.

[5] Total asset impairments of $10.4m included in underlying EBIT in FY2018
[6] FCF - Defined as net cash flow from operating activities less net cash outflow from investing activities less interest paid

Funding

Aurizon has a target gearing level of ~40%.

The Group continues to be committed to diversifying its debt investor base and increasing average debt tenor. Network repriced and extended an existing $525m bank facility in November 2017, with maturity extended to FY2023 and tranche size decreased to $500m. In respect of FY2018:

- Weighted average debt maturity tenor was 4.7 years. This was lower than FY2017 (5.0 years) due to the majority of the debt portfolio's duration reducing by 12 months which offset the extension of the facility noted above
- Group interest cost on drawn debt decreased to 4.5% (FY2017 5.0%) due to the rolling off of interest rate hedges in June 2017
- Available liquidity (undrawn facilities plus cash) at 30 June 2018 was $0.9bn
- Group gearing (net debt / (net debt + equity)) as at 30 June 2018 was 42.3% (FY2017 39.6%)
- Network gearing (net debt / RAB (excl AFDs)) as at 30 June 2018 was 62.4% (FY2017 54.1%)
- Network gearing (net debt/ RAB (incl AFDs)) as at 30 June 2018 was 57.9% (FY2017 50.2%)
- Credit rating remains unchanged for Network and Aurizon Holdings at BBB+/Baa1

Share Buy-Back

As part of its commitment to return surplus capital to shareholders, on 14 August 2017 Aurizon announced the intention to undertake an on-market buy-back of $300 million. The buy-back was completed on 1 March 2018, with 61.6 million shares bought back and subsequently cancelled.

Dividend

The Board has declared a final dividend for FY2018 of 13.1cps (60% franked) based on a payout ratio of 100% in respect of underlying NPAT for continuing operations.

The relevant final dividend dates are:

- 27 August 2018 – ex-dividend date
- 28 August 2018 – record date
- 24 September 2018 – payment date

Tax

Income tax expense for continuing operations for FY2018 was $241.2m and for the continuing and discontinued operations was $219.6m. The Group effective tax rate[7] for FY2018 was 30.1% which is greater than 30% due to permanent differences in the fixed asset adjustments and a decrease in expenditure eligible for the research and development tax incentive. The cash tax rate[8] for FY2018 was 23.9%, which is less than 30% primarily due to accelerated fixed asset related adjustments.

The effective tax rate for FY2019 is expected to be in the range of 30% to 32% and the cash tax rate is expected to be less than 25% for the short to medium-term.

Aurizon publishes additional tax information in accordance with the voluntary Tax Transparency Code in its sustainability report. Please refer to www.aurizon.com.au/sustainability/overview for a copy of Aurizon's sustainability report (including tax transparency disclosures).

Discontinued Operations

On 14 August 2017 Aurizon announced the intention to exit the Intermodal business through a combination of closure and sale.

Aurizon's Interstate Intermodal business has been closed with the last operational service occurring on 23 December 2017.

Aurizon signed a binding agreement with Pacific National (PN) to sell its Acacia Ridge terminal. Aurizon signed a separate binding agreement to sell its Queensland Intermodal business to a consortium of Linfox and PN. The transactions have been subject to regulatory approval.

The ACCC decision was announced on 19 July 2018. The ACCC decided to oppose both transactions and commenced proceedings against PN and Aurizon in the Federal Court of Australia. The ACCC has sought declarations, pecuniary penalties, orders restraining the existing sale transactions from proceeding and costs. The ACCC has also sought an injunction to prevent Aurizon from closing its Queensland Intermodal business while proceedings are on foot.

Aurizon refutes the ACCC's allegations and will defend the proceedings, including seeking clearance of the Acacia Ridge transaction.

On 12 August 2018 Aurizon provided PN with a notice to terminate the Business Sale Agreement for the Queensland Intermodal business, with effect from 13 August 2018. It is Aurizon's intention to not contest clearance of the transaction through the Federal Court and to exit the business. As clearance has not been obtained for the sale of the Queensland Intermodal business, $10m of the consideration received for the transactions to date (recognised as a liability at 30 June 2018) will be refunded to PN. The

[7] Underlying effective tax rate = income tax expense excluding the impact of significant items / underlying consolidated profit before tax
[8] Underlying cash tax rate = cash tax payable excluding the impact of significant items / underlying consolidated profit before tax

Business Sale Agreement for the Acacia Ridge Terminal remains in place while Aurizon seeks clearance of that transaction, and the remainder of the consideration received for the transactions to date ($35m) is not refundable.

On 10 August 2018 the Federal Court of Australia heard an application from the ACCC for an interlocutory injunction to require Aurizon to continue to operate the Queensland Intermodal business in the ordinary and usual course. The Court reserved judgement on the matter, and judgement is currently expected to be handed down on 13 August 2018.

For the year ended 30 June 2018 the Intermodal business is disclosed as discontinued with Acacia Ridge and Queensland Intermodal assets classified as assets held for sale. Financial information relating to discontinued operations is set out in the appendix.

BUSINESS UNIT REVIEW

Coal

Aurizon's coal business provides a critical link in Australia's major coal chain systems for the majority of Australia's coal producers. The coal transport operation links mines in the Newlands, Goonyella, Blackwater, Moura and West Moreton systems in Queensland and the Hunter Valley, including Ulan and Gunnedah coal systems, in New South Wales to domestic customers and coal export terminals.

($m)	FY2018	FY2017	Variance %
Revenue			
Above Rail	1,207.8	1,156.8	4%
Track Access	598.1	630.3	(5%)
Other	7.3	7.9	(8%)
Total revenue	**1,813.2**	**1,795.0**	**1%**
Operating costs	(1,202.0)	(1,191.3)	(1%)
EBITDA	**611.2**	**603.7**	**1%**
Depreciation and amortisation	(182.6)	(183.7)	1%
EBIT	**428.6**	**420.0**	**2%**

Metrics

	FY2018	FY2017	Variance %
Total tonnes hauled (m)	212.4	198.2	7%
CQCN	152.5	143.5	6%
NSW & SEQ	59.9	54.7	10%
Contract utilisation	93%	89%	4ppt
Total NTK (bn)	50.4	47.6	6%
CQCN	38.3	36.8	4%
NSW & SEQ	12.1	10.8	12%
Average haul length (km)	237	240	(1%)
Total revenue / NTK ($/'000 NTK)	36.0	37.7	(5%)
Above Rail Revenue / NTK ($/'000 NTK)	24.0	24.3	(1%)
Operating Ratio (%)	76.4%	76.6%	0.2ppt
Opex / NTK ($/'000 NTK)	27.5	28.9	5%
Opex / NTK (excluding access costs) ($/'000 NTK)	15.4	15.3	(1%)
FTE (monthly average)	1,729	1,698	(2%)
Labour productivity (NTK / FTE)	29.1	28.0	4%
Locomotive productivity ('000 NTK / Active locomotive day)	462.8	468.0	(1%)
Active locomotives (as at 30 June)	308	288	7%
Wagon productivity ('000 NTK / Active wagon day)	16.4	16.3	1%
Active wagons (as at 30 June)	8,568	8,251	4%
Payload (tonnes)	7,447	7,430	-
Velocity (km/hr)	23.2	23.6	(2%)
Fuel Consumption (l/d GTK)	2.91	2.90	-

Coal Performance Overview

Underlying EBIT increased $8.6m (2%) to $428.6m, with increased volumes and ongoing benefits delivered from the transformation program more than offsetting an increase in operating costs due to price escalation and costs associated with installing capacity to deliver additional volumes.

Volumes increased by 14.2mt (7%) to 212.4mt reflecting the FY2017 volume impact of Cyclone Debbie, the commencement of new contracts and the continued strength in coal prices resulting in high levels of customer demand, partly offset by lower network availability in the Central Queensland Coal Network (CQCN) in 2HFY2018. In NSW and South-East Queensland (SEQ), volumes increased by 5.2mt (10%) to 59.9mt driven largely by the commencement of the AGL Macquarie contract in July. Across CQCN, volumes increased by 9.0mt (6%) to 152.5mt, reflecting the FY2017 volume impact of Cyclone Debbie and the commencement of new contracts in late FY2017 and FY2018.

Coal revenue increased $18.2m (1%) to $1,813.2m driven by the growth in volumes offset by lower access revenue.

- Above rail revenue increased $51.0m (4%) compared to FY2017 reflecting the 7% increase in volumes as outlined above
- Coal track access revenue decreased $32.2m (5%). This decrease is largely driven by customers on the Blackwater and West Moreton corridor converting to an End User Access Agreement (where access charges are paid direct to Network or Queensland Rail). As access charges are generally passed through to customers, there is a decrease in track access costs as noted below. This reduction was partly offset by a $29.8m credit from Queensland Rail received in 1HFY2017 following the approval of the access undertaking for the West Moreton system (SEQ) which lowered track access revenue in the prior year. Excluding the impact of this credit, coal track access in CQCN decreased by $62.0m

Total operating costs (including depreciation) increased $9.6m (1%) to $1,384.6m. The transformation program continues to deliver savings, with $46.5m realised in FY2018 across labour, maintenance and overheads. This was offset by an increase in other operating costs with the major drivers noted below:

- Higher labour, fuel and maintenance costs totalling $78.6m including costs to meet additional volumes, wages and consumables escalation, fuel price increase, higher maintenance relating to reinstated fleet capacity in the CQCN, redundancies and other costs
- Track access costs reduced by $35.6m (6%), largely due the impacts discussed above, including Blackwater and West Moreton Corridor customers moving to End User Agreements and one-off impacts of higher take or pay expenses offset by the impact of the 1HFY2017 credit from Queensland Rail
- With the transfer of locomotives from Intermodal Interstate to Coal and the commissioning of new wagons in the Hunter Valley, depreciation modestly increased in 2HFY2018

Key operating metrics remain broadly in line with prior year:

- During the period, labour productivity increased 4% with the additional volumes being delivered with a 2% increase in average FTEs
- Average payloads remained broadly flat from 7,430t to 7,447t
- Average velocity reduced slightly from 23.6km/hr to 23.2km/hr due to increased supply chain constraints and higher NSW volumes
- Average NTK per locomotive fell 1% due to the additional consists installed in both NSW and CQCN in order to meet growth volumes

Market update

The average hard coking coal price in FY2018 was US$204/t (+7% on the previous year), driven by continued growth in steel production in China and India. In the 12 months to June 2018, China crude steel production achieved a record 870mt, increasing by +6%. India recorded its 29th consecutive month in June 2018 of year-on-year growth in steel production. Given a structural deficiency of high quality coking coal, growth in Indian steel production flows directly to seaborne markets. Australia supplies around 90% of India’s imported metallurgical coal and was the number one destination of Australian metallurgical coal exports in FY2018. India is expected to be the single largest driver of seaborne demand for metallurgical coal over the next decades. The Newcastle benchmark thermal coal price in FY2018 was US$99/t (+24% on the previous year), primarily driven by increased import demand from China, the largest importing nation of thermal coal. China’s imports of thermal and lignite coal lifted +9%yr as domestic coal production remained flat (+1%yr) in conjunction with increased domestic thermal power generation (+6%yr).

From a supply perspective, Australian metallurgical and thermal coal exports reached 179mt (+1%yr) and 202mt (+1%yr) in FY2018 respectively. Given upward pressure on coal prices, opportunistic supply from the United States and Indonesia continued to be incentivised to the market. In the 12 months to May 2018, metallurgical coal exports from the United States lifted +33% and total coal export volume from Indonesia (almost entirely thermal coal) increased by +7% against the same period of the prior year.

Contract update

- Baralaba Coal Company entered an agreement for coal haulage from the Baralaba North Mine to the RG Tanna Coal Terminal for 2mtpa. Haulage is expected to commence 1HFY2019 for a term of up to 10 years
- Aurizon’s 2.6mtpa haulage agreement with Yancoal’s Duralie mine ended on 31 August 2017
- Aurizon entered into an agreement with MACH Energy for coal haulage of 8mtpa from the Mount Pleasant Mine to Newcastle ports as well as domestic power stations. The haul is expected to commence late 1HFY2019, for a contract term of 10 years
- Aurizon extended its relationship with the QCoal Group to include coal haulage of up to 10mtpa (5.0mtpa initially) from the greenfield Byerwen Mine to Abbott Point Coal Terminal, for a period of 10 years, which commenced January 2018
- Bounty Mining commenced railings in March 2018 under a new agreement with Aurizon, following its acquisition of the Cook Colliery which was completed during 3QFY2018

Bulk

Aurizon's Bulk business supports a range of customers nationally for bulk materials and commodities (including iron ore), agricultural products and mining and industrial inputs.

($m)	FY2018	FY2017	Variance %
Revenue			
Freight Transport	592.1	622.3	(5%)
Other	26.0	22.9	14%
Total revenue	**618.1**	**645.2**	**(4%)**
Operating costs	(542.9)	(586.1)	7%
EBITDA	**75.2**	**59.1**	**27%**
Depreciation and amortisation	(25.1)	(73.5)	66%
EBIT	**50.1**	**(14.4)**	**nm**

Metrics

	FY2018	FY2017	Variance %
Total tonnes hauled (m)	54.7	58.3	(6%)
Total NTK (bn)	13.4	15.4	(13%)
Average haul length (km)	245	264	(7%)
Total revenue / NTK ($/'000 NTK)	46.1	41.9	10%
Operating Ratio (%)	91.9%	102.2%	10.3ppt
Opex / NTK ($/'000 NTK)	42.4	42.8	1%
Opex / NTK (excluding access) ($/'000 NTK)	30.3	31.1	3%
FTE (monthly average)	904	1,066	15%
Labour productivity (NTK / FTE)	14.8	14.4	3%
Order Fulfilment (%)	98.0%	98.2%	(0.2ppt)
Fuel Consumption (l/d GTK)	3.01	3.06	2%

Bulk Financial Performance Overview

EBIT increased $64.5m to $50.1m, due to benefits from the transformation program and lower net depreciation from the impairments in FY2017 partly offset by lower volumes.

Revenue decreased $27.1m (4%) to $618.1m with a 6% reduction in volumes (13% in NTK terms):

- Iron Ore revenue decreased $3.9m (1%) predominately due to lower Cliffs volumes
- Bulk revenue decreased $23.2m (6%) due to the cessation of the Mt Isa Freighter in January 2017 and lower QLD/NSW grain volumes due to dry conditions and supply being directed to the domestic market (all Aurizon volumes are export). This was offset marginally by growth in bauxite volumes and the commencement of the Minerals and Metals Group Limited (MMG) contract on the Mt Isa corridor

Bulk revenue per NTK increased 10% predominately due to lower contract utilisation and the commencement of new contracts in Bulk East.

Total costs (including depreciation) decreased $91.6m (14%) driven by transformation savings and lower depreciation expense. The transformation program continued to deliver savings with $31.6m realised in FY2018. Rail access costs reduced by $18.4m due to the lower volumes, principally the cessation of the Mt Isa Freighter and lower Cliffs volumes. The direct cost savings from the cessation of the Mt Isa Freighter service were $14.5m through a reduction in crewing maintenance and terminal services costs. Depreciation expense reduced by $48.4m due to the bulk impairment in FY2017, with $10.4m of capital expenditure written off in FY2018 and included in operating costs resulting in a net benefit of $38.0m. Partly offsetting this were other cost increases including labour and consumables escalation and redundancy costs ($10.9m).

Market update

Iron ore

The average iron ore price in FY2018 was US$69.0/t, remaining relatively flat against the previous year's average of US$69.4/t. China, the world's largest steel producer (and importer of iron ore) continued to drive demand, with hot metal production growing +2% in the 12 months to June 2018, against a backdrop of supply ramping up from Vale's S11D project in Brazil and Roy Hill in the Pilbara.

China's demand shift towards higher grade iron ore continued during FY2018, with prices for lower grade iron ore products remaining at historically lower levels compared to the 62% Fe benchmark price. Supported by higher steel prices and a pursuit for productivity, Chinese steel mills have an incentive to use better quality iron ore (and hard coking coal) to maximise efficiencies in

steel production. In addition, China's increasing focus on reducing pollution and environmental regulation is favouring the use of higher grade ores.

Freight

Aurizon's Bulk business includes haulage of bulk commodities including base metals, minerals, grains and livestock in Queensland, New South Wales (East) and Western Australia (West). Despite stronger prices across the year for a number of commodities that Aurizon hauls, the ongoing challenge of market competitiveness remains.

Contract update

› Executed a contract extension for IPL's acid and fertilizer hauls on the Mt Isa corridor, commencing January 2020
› Executed a 10-year contract extension for the Cement Australia East End to Fisherman's Landing limestone haul which commenced January 2018
› Commenced a 7.4-year contract with MMG for the transport of zinc deposits on the Mt Isa corridor during November 2017
› Executed a 2+2 year contract extension for the Queensland Rail services contract, covering both infrastructure trains and supporting the Inlander passenger train
› Executed a short-term extension with Alcoa to rail additional bauxite export volumes into the Kwinana Bulk Terminal
› Contract variation for Mt Gibson Mining to rail additional volumes under the existing Rail Haulage Agreement. This contract will end in December 2018 in line with the end of mine life
› Cliffs Asia Pacific Iron Ore Pty Ltd (Cliffs) terminated its rail haulage agreement with Aurizon on 30 June 2018. This resulted in the closure of Aurizon's Esperance operations and triggered an early termination payment of $66.3m, which was subsequently received in July 2018. As a consequence of the contract termination, asset impairments of $27.9m have been recognised. In addition, a closure provision of $3.9m has been recognised which includes a redundancy provision of $3.5m for 63 FTEs
› Aurizon was unsuccessful in recontracting the existing QLD Graincorp contract from December 2019

Network

Network refers to the business of Aurizon Network Pty Ltd (Network) which operates the 2,670km CQCN. The open access network is the largest coal rail network in Australia and one of the country's most complex, connecting multiple customers from more than 40 mines to five export terminals located at three ports. The CQCN includes four major coal systems (Moura, Blackwater, Goonyella and Newlands) and a connecting link (Goonyella to Abbot Point Expansion (GAPE)).

Financial Summary

($m)	FY2018	FY2017	Variance %
Revenue			
Track Access	1,167.1	1,199.9	(3%)
Services and other	51.6	62.2	(17%)
Total revenue	**1,218.7**	**1,262.1**	**(3%)**
Operating costs	(430.1)	(481.7)	11%
EBITDA	**788.6**	**780.4**	**1%**
Depreciation and amortisation	(308.0)	(299.5)	(3%)
EBIT	**480.6**	**480.9**	**-**

Metrics

	FY2018	FY2017	Variance %
Tonnes (m)	229.6	210.8	9%
NTK (bn)	56.9	53.2	7%
Operating Ratio (%)	60.6%	61.9%	1.3ppt
Maintenance / NTK ($/'000 NTK) (excluding rail renewals)	2.2	2.3	4%
Opex / NTK ($/'000 NTK)	13.0	14.7	12%
Cycle Velocity (km/hr)	23.5	23.5	-
System Availability (%)	82.0%	83.7%	(1.7ppt)
Average haul length (km)	247.7	252.3	(2%)

Network Financial Performance Overview

EBIT declined marginally to $480.6m in FY2018, with reductions in operating costs ($51.6m) offset by decreased revenue ($43.4m), mainly due to the non-recurrence of the UT4 true-up of regulatory revenue in FY2017 and increased depreciation ($8.5m).

Track access revenue decreased $32.8m (3%). Regulatory access revenue in FY2018 is based on transitional tariffs pending approval of the UT5 Access Undertaking. This is lower than the FY2017 Allowable Revenue which included approximately $90m of regulatory revenue pertaining to the UT4 true-up for FY2014 to FY2015 which was recognised in FY2017 following the UT4 final decision. In addition, FY2017 also included non-recurring true-ups in relation to GAPE (non-regulated revenue) and AFD rebates totalling $11.4m. Volumes in FY2018 were higher than Cyclone Debbie impacted FY2017 resulting in approximately $53m additional revenue. FY2018 also included higher Electric Charge (EC) revenue of $30.1m (there is an increase in EC operating expenses) and flood cost recovery of $18.4m mainly relating to Cyclone Debbie. This was partially offset by a $21.6m negative Revenue Cap Adjustment Amount relating to FY2016 which was repaid to Access Holders via tariffs.

Services and other revenue decreased $10.6m (17%) mainly due to the recognition of the Bandanna Group's $15.3m bank guarantee and a $6.0m insurance claim recovery in FY2017, partly offset by the recognition of $10.0m for the Caledon WIRP Deed bank guarantee held as security in FY2018.

Operating costs decreased $51.6m (11%) with a $45.6m reduction in consumables, mainly due to the non-recurrence of the FY2017 UT4 true-up for corporate costs ($26.4m), and reduced maintenance costs ($12.8m) which were impacted by Cyclone Debbie in the prior year. This was partially offset by higher energy and fuel costs ($2.4m) from an increase in EC expense ($24.4m) from higher wholesale electricity prices and environmental rates, offset by lower electric connection expense ($20.2m) and increased fuel rebates ($1.8m).

Labour costs increased $8.8m (7%) primarily due to salary escalation and higher headcount. Other expenses decreased $17.3m (59%) due to the prior period impacts of inventory obsolescence, asset disposals and write offs. Depreciation increased $8.5m (3%) mainly from Ballast.

The Regulated Asset Base (RAB) roll-forward value is estimated to be $5.8bn (including all deferred capital but excluding AFDs of $0.4bn) at 1 July 2018.

Regulation Update

- Transitional tariffs are in place for the whole of FY2018 and the first half of FY2019 using the UT4 tariffs with appropriate one-off adjustments
- On 15 December 2017, the QCA released its Draft Decision on Network's UT5 proposal
- The QCA's Draft Decision proposes a MAR of $3.893bn over the four-year period with a proposed 5.41% Vanilla Nominal Post Tax WACC (2.97% Vanilla Real Post Tax WACC), using an averaging period of 20 days up to 30 June 2017. Primary drivers behind the reduction from Network's MAR proposal are:
  - A risk free rate of 1.90% based on the 4 year government bond rate
  - An inflation rate of 2.37% applying an inflation methodology using a geometric average of the RBA forecasting methodology
  - Reduction in equity beta to 0.73 (with an asset beta of 0.42)
  - Significantly higher Gamma with only a 0.01 reduction from UT4 to 0.46
  - A reduction in maintenance and operating expenditure allowances of $104m and $112m respectively over the four-year regulatory period
- The UT5 Draft Decision issued by the QCA is extremely disappointing in its current form, causing damage to Network, customers and the Queensland economy. The QCA view of return and allowances for maintenance and operating costs has resulted in Network implementing changes to its business decisions and operating practices in order to align with the position advocated by the QCA and its consultants in the UT5 Draft Decision. Network has estimated that the net impact of the changes implemented to date could be a reduction of system throughput of approximately 20 million tonnes annually.
- Network submitted a detailed response to the QCA's UT5 Draft Decision on 12 March 2018. This submission proposed an updated MAR of $4.75bn over the four-year regulatory period with a proposed 7.03% Vanilla Nominal Post Tax WACC (4.62% Vanilla Real Post Tax WACC). Primary drivers behind the revised MAR include:
  - Change in the risk free rate from 2.13% at the time of the November 2016 submission, to 2.76% at the time of the submission in response to the Draft Decision. This change reflects a change in market rates at the time of submitting its response. Inflation however changed from 1.22% to 2.30%. This change reflects changes in market conditions and a revised methodology that better aligns the risk free rate and inflation calculations to derive a realistic real risk free return
  - Change in gamma from 0.25 in the November 2016 submission to 0.31. This change reflects using the QCA methodology but updated to reflect the appropriate and latest ATO tax statistics at the time of the submission
  - An increase from the QCA's Draft Decision Maintenance Allowance of $111m to $928m, to reflect the change in the QCA's base year to FY2017 whilst addressing anomalies omitted from the Draft Decision, providing a more appropriate mechanised plant allowance and removal of the QCA's proposed efficiency factor applied to General Maintenance activities
  - Inclusion of the WIRP deferred capital across the Moura system as well as all the deferred WIRP capital across the Blackwater system due to known forecast railings in the Moura system that will utilise that capital.
- On 29 May 2018, the QCA published a Consultation Paper on Network's UT5 Maintenance Allowances and Practices. The Consultation Paper provided a preliminary view from the QCA that it was 'favourably disposed' to accepting Network's Draft

Decision response on maintenance costs. Recognition of the correctness of Network's maintenance allowance is important, however Network has outlined concerns to the QCA that viewing the maintenance allowance independently of the other components of its operation (and the consequent build-up of the MAR) remains a flawed regulatory practice. There are inherent and interdependent linkages between the maintenance allowance, the WACC and operating costs. A lower WACC will generally drive lower investment likely resulting in greater reactive maintenance and hence even higher maintenance costs. Network's revised maintenance allowance was part of an overall maximum allowable revenue submission. The maintenance regime underlying the allowance was based on the other components of its submission being approved as those components supported the maintenance regime as part of Network's operating business model. Different outcomes in those components will necessarily require changes to the overall operations of the Network business and a subsequent impact on maintenance. Network has impressed on the QCA that it cannot consider critical components of business operations in isolation.

- The QCA is yet to confirm the timing for a final decision on UT5.

Operational Update

Performance

During FY2018 the network operational performance remained strong and five monthly railing records were achieved. Highlights include:

- Tonnes delivered over the CQCN increased 18.8mt (9%) from the Cyclone Debbie affected FY2017 to a record 229.6mt. Five new monthly records were achieved during FY2018 with each new record being over 19.0mt while June 2018 achieved 20.6mt, the highest ever monthly volume
- Performance to plan improved 3.5ppt to 90.3%
- Cancellations due to the Network increased marginally from 1.5% to 1.7%
- Cycle velocity averaged 23.5km/h and remains unchanged from the prior year

Following the release of the QCA's Draft Decision on Network's UT5 Draft Access Undertaking in December 2017, and in order to reduce costs, Network changed some of its operating practices and business decisions to align with a) the position effectively advocated by the QCA through its adoption in the Draft Decision of the maintenance allowance proposed as by its consultants based on applying different maintenance regimes and b) the maintenance and operating cost allowances and WACC proposed by the QCA in its Draft Decision. This is because when the QCA's Final Decision on UT5 is released, it will apply retrospectively from 1 July 2017 (when the UT5 regulatory period commenced). At this time the Draft Decision is the best reflection of the Final Decision and therefore the appropriate basis for Network to modify its operating practices and business decisions to recognise the application of the Final Decision from 1 July 2017.

Key changes included:

- Prioritised adherence to the initially formulated plan for planned maintenance and capital works
- Modified rail defect maintenance practices to reduce Network's risk on long-term track reliability and productivity
- Major maintenance activities being provided over longer production blocks

Transformation initiatives delivered:

- Tranche 2 of the Network Asset Management System went live in December 2017, delivering a core asset management system for the control systems, electrical assets and mechanised production activities
- Contractor management initiatives including the setting up of pre-approved panel members for wet hire and vegetation management activities. This has delivered improved safety performance and cost benefits
- A variety of initiatives in relation to electric traction which will deliver significant cost benefits through FY2019 and beyond

Wiggins Island Rail Project (WIRP)

- The QCA in its UT4 Final Decision applied a revenue deferral for WIRP customers who were not expected to rail during the UT4 period resulting in approximately $260m of WIRP capital expenditure being excluded for pricing purposes from the UT4 MAR, on an NPV neutral basis
- The UT5 Draft Decision issued by the QCA now includes approximately $235m of the WIRP capital expenditure deferred during UT4 in the UT5 RAB for pricing purposes
- Network has proposed in its response to the UT5 Draft Decision that the remaining deferred WIRP capital expenditure relating to Moura be included in the RAB for pricing purposes. This is subject to the QCA's UT5 Final Decision
- The legal proceedings continue in relation to the notices received by Network from the WIRP customers purporting to exercise a right under their WIRP Deeds to reduce their financial exposure in respect of payment of the non-regulated component of the WIRP fee. Network maintains its position that the notices issued by the WIRP customers are invalid and the full non-regulated component of the WIRP fee is payable. Network issued proceedings in the Supreme Court of Queensland on 17 March 2016 to assert its rights in respect of the payment of the full non-regulated component of the WIRP fee. A trial is scheduled to commence in the Supreme Court of Queensland on 10 September 2018
- The Customers have initiated other disputes under their respective WIRP Deeds which will be the subject of an expert determination in November 2018. Those disputes go to various matters relating to the completion of the WIRP construction works and have the potential to impact recovery of the portion of WIRP non-regulated revenue payable. These disputes relate to the same component of WIRP revenue as the Supreme Court proceedings and should not impact recovery of the regulated access charge component of WIRP capital expenditure

- Due to the ongoing dispute, no WIRP fee revenue in respect of the non-regulated component of the WIRP fee has been recognised in FY2018

Other

Other includes the provision of maintenance services (e.g. rail grinding) to internal and external customers and central costs not allocated such as the Board, Managing Director & CEO, Investor Relations, Strategy and Company Secretariat.

($m)	FY2018	FY2017	Variance %
Total revenue	**90.8**	**107.0**	**(15%)**
Operating costs	(99.7)	(98.7)	(1%)
EBITDA	**(8.9)**	**8.3**	**nm**
Depreciation and amortisation	(9.8)	(10.6)	8%
EBIT	**(18.7)**	**(2.3)**	**(713%)**

Performance Overview

EBIT decreased $16.4m mainly due to:

- Non-recurrence of $26.4m benefit from the UT4 corporate cost allocation true-up included in FY2017
- $16.2m reduction in other revenue predominantly due to external construction work of $7.0m, and sale of workshop inventories of $9.0m that both took place in FY2017

This was partly offset by:

- $20.9m of asset write offs and minor inventory impairments in FY2017 (nil in FY2018)
- Reduction in central support costs including $7.5m of transformation benefits

TRANSFORMATION UPDATE

Aurizon achieved its three-year transformation target by delivering $133.6m in transformation benefits during FY2018, resulting in total transformation since July 2015 of $393.6m including Intermodal's FY2017 losses, which principally relate to Intermodal Interstate, removed. The exit of the Intermodal business contributed to transformation by permanently removing the financial losses. The continuing operations generated $85.6m in benefits in FY2018. Further examples of transformation initiatives are detailed below:

Precision Railroading Operations

This initiative is focussed on driving precision planning and disciplined delivery with the objective to improve on time departure and arrival of above rail services across CQCN. Centred around three principles; plan with precision, disciplined delivery and continuous improvements, this initiative will be a multiyear journey that will target ways to improve on time running performance. This initiative is targeted to deliver at least $50m in financial benefits by FY2021.

Restructure of Support Areas

Aurizon continues its transformation agenda focussing on support areas by providing innovative, flexible and lower cost services. Commencing in 2HFY2018 and continuing into FY2019 is the restructure of the Technical Services and Planning business unit. This restructure will focus on reducing headcount, further footprint consolidation and the transfer of certain functions to the Coal and Bulk business units where appropriate. It is expected that this initiative will deliver around $20m in cost reductions by FY2021.

Rockhampton Rollingstock Workshop

The Rockhampton Workshop closed for production on 29 June 2018 in line with the original announcement in June 2017 and reflects the staged closure of Locomotive, Brake, Wheel and Wagon Shops throughout FY2018. The successful transition of Aurizon's heavy haul maintenance activities from in-source to outsource maintenance providers throughout Australia has been enabled through Aurizon's investment in technologies such as condition monitoring equipment and Shopfloor II (rollingstock maintenance planning and scheduling tool) and process improvements to its in-bound supply chain and procurement processes. A small team will remain on site during the next six months to decommission the facility and site master planning is underway to determine its future use.

Asset Maintenance

A key dependency for the achievement of Aurizon's strategy and an enabler for the Optimise and Excel strategic levers is continued investment in technology. Aurizon continues to advance its condition monitoring program. These advances allow Aurizon to

automate routine maintenance inspections, predict when components will fail, thereby reducing cost and increase reliability to keep assets in productive use for longer. Developments in these key initiatives include:

› Approval has now been received from ARTC for the installation of a wayside condition monitoring (WCM) super site in the Hunter Valley. Construction has commenced and the site is expected to be operational by December 2018. The deployment will support the extension of maintenance inspection intervals for wagons in the Hunter Valley and is the foundation step in moving the NSW predictive maintenance capability in line with CQCN
› iTrigger technology – has been deployed across two terminals in the CQCN. This technology is part of the suite of predictive maintenance initiatives and identifies the lead indicator of door faults in wagons which contributes to around 14% of cancellations by wagons in the CQCN
› Treadview technology - this provides a full 3D model of a wheel profile and will be deployed across the WCM supersites in Blackwater and Goonyella during FY2019. This technology will fundamentally change the way Aurizon manages wheel health by examining the entire surface of the wheel rather than just its profile, and is an enabler for the extension of rollingstock reliability examinations from 42 to 84 days
› On train repair facilities are now in place across the CQCN and Hexham in the Hunter Valley. This allows key maintenance activities on wagons (e.g. wheel change outs) to be performed without breaking trains, requiring spare rollingstock or shunting of consists
› The Locomotive and Operational Data Acquisition and Management project (LODAM) is now being initiated across the coal locomotive fleet. LODAM will deliver a step change in both the quality and quantity of operational and sensor data, allowing Aurizon to better optimise and standardise how the fleet is operated and managed. LODAM will provide real time visibility of train handling and equipment performance, improved fleet performance, reliability and energy consumption and in cab monitoring. LODAM sensor data will allow locomotive failures to be predicted earlier and further improve our maintenance strategies
› Shopfloor II is now fully deployed across all rollingstock maintenance facilities. The project was completed ahead of time and under budget. The key benefits to be delivered as part of this project include increased maintenance planning capability and accuracy, supply chain integration, warranty management, serialisation and lifecycle management of major components and improved operational efficiency through standardising business processes and metrics.

ADDITIONAL INFORMATION

Risk

Aurizon promotes a risk-aware culture with an emphasis on frontline accountability for effective risk management. The consideration of risk features heavily in Aurizon's thinking, from the framing of strategy through to informing decision making. Aurizon's Enterprise Risk Management Framework is based on the international standard for risk management (AS/NZS ISO 31000:2009) and supports the identification, assessment and reporting of risk across the business, and includes both financial and non-financial risks.

Risks to the delivery of strategy have been categorised into the three strategic levers of Optimise (accelerate the competitiveness of Aurizon), Excel (achieve regulatory reform, secure contract wins, and gain competitive advantage through asset efficiency) and Extend (position Aurizon for growth, value creation and the next phase of Enterprise evolution).

Optimise Strategic Lever

› Queensland Intermodal and Acacia Ridge Terminal Sale Transactions

The ACCC has opposed the sale of Aurizon's Queensland Intermodal business to a consortium of Linfox and Pacific National, and the sale of its Acacia Ridge Terminal to Pacific National and commenced proceedings against Pacific National and Aurizon in the Federal Court of Australia. The ACCC has sought declarations, pecuniary penalties, orders restraining the existing sale transactions from proceeding and costs. The ACCC has also sought an injunction to prevent Aurizon from closing its Queensland Intermodal business while proceedings are on foot. While Aurizon refutes the ACCC's allegations and will defend the proceedings, including seeking clearance of the Acacia Ridge transaction, there is a risk that the Acacia Ridge transaction will be prevented from completing and/or Aurizon incurs orders for pecuniary penalties and costs. There is also the risk that, in the interim whilst the matter is being determined by the Court, Aurizon is injuncted from closing the Queensland Intermodal business.

› Delivery of Optimise Initiatives

Aurizon maintains a pipeline of transformation initiatives that are expected to deliver a cost effective and customer aligned model. Continued focus is required on these initiatives to ensure benefits are delivered as planned and flow through to improved financial performance.

› Operational Agility

A lack of operational agility would result in Aurizon's inability to flex operations and support an alignment between costs and revenue. If operational agility is not achieved it may result in missed revenue during market upturns due to a lag in accessing the required resources, or static costs during downturns eroding financial performance.

› Enterprise Agreement Renegotiations

Enterprise Agreement renegotiations are underway to support sustainable business transformation. There are risks that prolonged industrial action impacts Aurizon's critical operations or final agreements do not support business objectives.

› Business Interruption

Aurizon may experience business interruption and consequential financial impact from a range of circumstances including but not limited to:

- Road Vehicle Fatality - death or injuries to our people from operating road vehicles
- Process Safety Fatality - major process safety event leading to fatality or loss of license to operate
- Adverse weather events and climate change which could impact on Aurizon's operations, assets, customers and employees
- Cyber security incidents in relation to Aurizon's corporate and operational systems

Excel Strategic Lever

› Regulatory Risk of the Access Undertaking (UT5)

Aurizon continues to work with the Queensland Competition Authority (QCA) and industry stakeholders to secure acceptable and sustainable regulatory outcomes for the CQCN in accordance with the processes set out in the Queensland Competition Authority Act 1997 (Qld). In particular, Network's Maximum Allowable Revenue (MAR) and the nominal (vanilla) WACC used in deriving Network's MAR is typically reset every four years as part of the access undertaking approval process with the QCA and the reference tariffs are reset annually based on projected system volumes and other variables. Not attaining appropriate pricing and policy regulatory settings will adversely impact revenue, and may have an adverse effect on operational flexibility, capital investment and recovery of operational and administrative costs. The WACC of 5.41% proposed by the QCA in its UT5 Draft Decision, together with the proposed UT5 maintenance and operational expenditure allowances, if reflected in its Final Decision, will not adequately compensate Network for its regulatory and commercial risks, which will lead to a material adverse impact on the Network business, operational performance and financial results.

Further risks arising from UT5 include:

- The network business's immediate response to implementing the Draft UT5 determination may materially impact above rail volumes and EBIT plus damage relationships with key stakeholders which may impact future contracts, transformation and reform
- The network business credit rating may be downgraded due to insufficient cashflows based on the Draft UT5 determination
- The network business may be unable to achieve regulatory reform beyond UT5, impacting future company performance
- The network business unsuccessfully adopts a new operating model and the final ruling is unchanged from the draft

› General Regulatory Risk

Aurizon's operations and financial performance are subject to legislative and regulatory oversight. Unfavourable changes may be experienced with respect to access regimes, safety accreditation, taxation, carbon reduction, environmental and industrial (including occupational health and safety) regulation, government policy, and approval processes. These changes may have a material adverse impact on project investment, Aurizon's profitability and business in general, as well as Aurizon's customers.

Aurizon is also exposed to the risk of material regulatory breaches resulting in the loss of operating licences and financial penalties. In the event of a loss of licence, critical business operations may not be supplied to customers, impacting profitability and reputation.

Regulatory approval is a prerequisite to support the Extend strategy, including growth opportunities with adjacent assets. In the event regulatory approval is not forthcoming, Aurizon's ability to deliver the strategy and associated value will be limited.

› Competition in Current Markets

Aurizon may face competition from parties willing to compete at reduced margins and / or accept lower returns and greater risk positions than Aurizon. This may potentially negatively impact Aurizon's competitiveness. Aurizon's most significant customer contracts are secured on long-dated terms, however failure to win or retain customer contracts at commercial rates will always be a risk to future financial performance. Increased competition may be experienced from new entrants to Aurizon's core markets in both above and below rail, and includes existing customers in-sourcing Aurizon's services.

› Adverse Basin, Corridor Economics and General Economic Conditions

Aurizon's earnings are concentrated in commodity markets across a relatively small number of customers and may be impacted by deterioration in counterparty credit quality, mine sale to a lower tier party, mine profitability, contract renewals, supply chain disruptions and / or macro-industry issues.

Aurizon's customers in core and adjacent markets are reliant on demand from large export markets such as China, India, Japan and South Korea. Increased volatility in coal and bulk commodity markets due to factors such as material change in government policies or economic slowdown or the increasing use of renewable energy may cause fluctuations in demand, which in turn impact commodity prices, product volume and investment in growth projects. Although Aurizon develops its own long-term outlook for seaborne coal demand, it also considers the best known and most widely used Sustainable Development Scenario produced by the International

Energy Agency (IEA) through the annual release of the *World Energy Outlook (WEO)*. Whilst long term demand is expected to increase, there may be variances in volumes, contract profitability and growth that impact on Aurizon's financial results.

Extend Strategic Lever

› Competition in New Markets

Extending expertise into adjacent activities including strategic partnerships with road operators, new target basins, and optimisation of the supply chain may not deliver the expected benefits. Competition from incumbents in these markets has the potential to reduce the expected returns as they respond to a new entrant. In addition, market dynamics may change and reduce the attractiveness of these activities prior or during the extension period.

› WIRP Non-Regulated Revenue Dispute

Aurizon has received notices from WIRP customers purporting to exercise a right under the WIRP Deed to reduce their financial exposure in respect of the non-regulated revenue component of the amounts payable by them to Network. Network maintains its position that the notices issued by WIRP customers in relation to the WIRP fee are not valid. Aurizon issued proceedings in the Supreme Court of Queensland to assert its contractual rights under the Project Deeds. The proceedings have been admitted to the Commercial List of the Supreme Court of Queensland and have been set down for a 10-day hearing commencing in FY2019. The Court has made orders to prepare the matter for trial. The risk is that the entire amount of the WIRP fee is deemed not payable by the WIRP customers.

› Inability to Delivery Adjacencies

The strategy of leveraging expertise to adjacent assets and activities may be not be delivered as planned due to:

- The infrequency of investment opportunities – only a limited number of assets are adjacent to the existing Aurizon markets, and they may not be made available for sale
- Aurizon's potential inability to construct a deal – many factors such as access to capital markets, agreement with consortium or joint venture partners, or other legal restrictions may prohibit the execution of an acceptable transaction
- Competitor valuations – available adjacencies are infrastructure assets which are currently in demand from institutional funds. These funds or other competitors may pay a higher price than Aurizon, resulting in limited opportunities for growth

› Climate Change Risk

The long term implications of climate change may impact Aurizon on several fronts. For example:

- Demand for thermal coal is subject to energy policy and regulation of Green House Gas (GHG) emissions (including carbon pricing)
- Investor concern over climate related risks may impact the ability to access capital for Aurizon and its customers for funding coal mining, transport and coal fired power projects
- Carbon liability under the Safeguard Mechanism Rule and potential penalties for inappropriate carbon reporting under the National Greenhouse and Energy Reporting (NGER) Act
- Current and future disruption arising from increased severity and/or frequency of extreme weather events (higher temperatures, strong winds, flooding and associated erosion, bushfires and others)

Climate change risks and opportunities are disclosed annually in our submission to the CDP and in Aurizon's sustainability report

Sustainability

Aurizon's Sustainability Report details how Aurizon takes account of social, environmental and economic considerations related to its operations. In October 2017, Aurizon released its fourth Sustainability Report. This report contributed to Aurizon maintaining a Leading rating by the Australian Council of Superannuation Investors (ACSI) in June 2018. This was the fourth consecutive year of recognition and resulted in Aurizon being one of 35 ASX200 companies being considered a Leader by ACSI.

This year will be the second reporting period in which we have incorporated recommendations from the Financial Stability Board's (FSB) Final Report: Recommendation of the Task Force on Climate-related Financial Disclosures (TCFD), released in June 2017. Aurizon acknowledges that climate change is affecting a wide range of industries around the world, resulting in financial implications. Transition risks, related to energy policy, regulation, technology and market shifts (that are necessary to achieve the transition to a low-carbon economy) will affect the demand for the commodities that Aurizon hauls. Physical risks related to extreme weather events will also continue to affect Aurizon through supply chain disruptions.

Aurizon's 2018 Sustainability Report will be published in October 2018.

A brief summary of Aurizon's performance in connection with safety, environment and people is outlined below.

› Safety

As reported in 1HFY2018 results, Aurizon's commitment to safety is continuing with the company introducing a revised set of injury definitions on 1 July 2017. The key changes were the inclusion of contractors in all injury metrics and widening the scope of total recordable injuries to include all restricted work injuries. Previously, Aurizon had used a set of metrics and injury definitions benchmarked against the rail industry. These new definitions have been benchmarked against a broader set of global transport and resource organisations, including many of Aurizon's customers.

FY2018 saw a deterioration in performance in the early part of the financial year, which was disappointing but a focus on newly identified areas for improvement has seen positive changes towards the latter part of FY2018, resulting in a Total Recordable Injury Frequency Rate (TRIFR) for FY2018 of 10.02, a reduction of 3% against the 1HFY2018 result. However, the full year performance was still a deterioration against FY2017 which was 7.12.

Changing injury definitions is the first step in a broader program that is underway to create a learning safety culture. This journey will require an underlying shift in beliefs from a control orientated environment towards interdependence and self-sustaining behaviours. To make this shift a program of work is being developed that will focus on:

- development of leadership behaviours and capabilities for our frontline leaders
- updating systems, processes, governance and tools to better support frontline operations
- clarification of accountabilities for operational and support roles

› Environment

Aurizon delivers environmental value through effective management of material environmental risks and improved enterprise environmental performance. In recognition of our efforts, in November 2017 Aurizon received the results for its 2017 CDP (formally carbon disclosure project) submission which confirmed that Aurizon had retained a Management B score. This reflects Aurizon's ongoing efforts to improve visibility and transparency on issues relating to climate change.

Aurizon has continued progress against its Board endorsed locomotive greenhouse gas (GHG) emissions intensity target, achieving in FY2018 a 7% emissions intensity reduction compared with FY2015. This represents a 1% improvement on performance when compared with FY2017 which was hampered by challenges associated with severe weather events and above average mean temperatures.

In November 2017, the Rail Safety and Standards Board approved and published a Code of Practice (COP) on the Management of Locomotive Exhaust Emissions. This COP was developed by Australian rail freight operators (including Aurizon) as an industry led approach to improving locomotive diesel emissions. This industry led approach prioritises both particulate matter and greenhouse gas emissions, while being careful not to decrease fuel efficiency in pursuit of nitrogen oxide reductions (which was highlighted as a potentially negative impact by a locomotive upgrade trial undertaken by the New South Wales Environmental Protection Authority in 2015). The COP will form part of Aurizon's continuing efforts to improving air quality which also includes reducing diesel consumption, using cleaner diesel, operating electric locomotives and promoting rail over road freight.

In June 2018, Aurizon had two notifiable environmental incidents involving the spillage of hydrocarbons. The remediation of the two incidents is underway and is expected to be completed, with no long term environmental impact, during 1QFY2019.

› People

At Aurizon our values (Safety, People, Integrity, Customer and Excellence) guide our people's work in delivering bulk commodities to the world. Our areas of focus to develop the capability of our people include:

- continuing to make Aurizon a more inclusive and diverse workplace, where everyone can work to their full potential
- improving our people, processes and systems (performance and succession) to achieve exceptional performance and build capability
- continuing to increase our employee presence through regional Australia

For further information relating to our people, please see the Sustainability page on our website.

Entities over which control was gained or lost during the period

None

Details of associate and joint venture entities

Entity	Country of incorporation	Ownership Interest	
		30 June 2018 %	30 June 2017 %
Investment in associates			
Aquila Resources Limited	Australia	15	15
Joint Ventures			
Chun Wo/CRGL	Hong Kong	17	17
ARG Risk Management Limited	Bermuda	50	50
Integrated Logistics Company Pty Ltd	Australia	14	14
ACN 169 052 288	Australia	15	15

The profit contribution from any one of these associate or joint venture entities is not material to the Group's profit.

APPENDIX

Intermodal – Discontinued Operations

($m)	FY2018	FY2017	Variance %
Total revenue	**225.4**	**309.8**	**(27%)**
Operating Costs	(247.1)	(340.7)	27%
EBITDA	**(21.7)**	**(30.9)**	**30%**
Depreciation and amortisation	(2.3)	(17.3)	87%
EBIT	**(24.0)**	**(48.2)**	**50%**
Significant Items	(74.7)	(167.2)	55%
Net Finance Cost	-	0.1	-
Income Tax Benefit	21.6	64.6	(67%)
NPAT (Discontinued operations)	**(77.1)**	**(150.7)**	**49%**
Total TEUs ('000s)	266.0	405.2	(34%)

Performance Overview

EBIT loss improved $24.2m mainly due to:

› $9.2m reduction in operating losses with the closure of Intermodal Interstate in December 2017
› $15.0m reduction in depreciation due to the Intermodal impairment in FY2017

Significant items for the discontinued operation of ($74.7m) were recognised in FY2018 relating to the closure of Intermodal Interstate and includes:

› Contract, lease and supplier exit costs
› Redundancy costs for 168 employees
› Asset impairments