



Managing Director & CEO, Andrew Harding
Australian Coal Supply: Performance & Investment

Coal Investment Seminar
Japan Oil, Gas and Metals National Corporation

Tokyo, Japan
26 April 2018



Good morning

On behalf of Aurizon, I am delighted to be in Tokyo this morning.

When visiting Japan over a number of years, I have always appreciated the warm welcome and your hospitality.

Australia and Japan share a deep and highly-valued relationship, nurtured over many decades of trade and cultural exchange.

High-quality Australian resources, especially coal and iron ore, have been at the heart of that trading relationship.

Today I welcome the opportunity to share information about Aurizon's critical role in Australia's coal industry.

I would like to thank the Queensland Government's Trade & Investment Commissioner Adachi-san and his officers for their support and helping to facilitate our attendance at your Coal Investment Promotion Seminar today.

With me today, I have Mr Edward McKeiver, Group Executive of our Coal business and Mr Michael Riches, Group Executive of our Network business. I will talk more about their businesses and responsibilities a little later on.



Aurizon's connection with Japan and Japanese companies extends more than 50 years - since the start of coal exports from Central Queensland in the late 1960s.

I was appointed as Aurizon's Managing Director & CEO in December 2016, and look forward to continuing and building on this strong relationship.

Prior to joining Aurizon, I led Rio Tinto's Iron Ore business, where I fostered strong and valued relationships with members of the Japanese steel industry.

I am very aware of how important Australia's high-quality coal is to your country and your continued economic growth.

I am proud to now lead Aurizon, a company that transports on our tracks and our trains approximately 65 % of Australia's coal exports.

Japan's economy has just seen its 8th straight quarter of growth - the longest run of growth since the late 1980s.

The latest figures show Japanese industrial production has risen by a healthy 4.2 per cent over the year. With the 2020 Tokyo Olympics on the horizon, steel production will ramp up for major infrastructure projects.

In this context, we know the importance of providing a secure, reliable supply of high-quality commodities to Japan. Aurizon is a very committed and long-term partner in that supply chain.



In our rail haulage operations, we have two businesses – Coal and Bulk.

Our Coal business led by Mr McKeiver services mines in Queensland and New South Wales, hauling more than 200 million tonnes of coal on average each year.

This includes both thermal coal for energy and metallurgical coal for steel making. The majority of coal is destined for export, with the balance of about 8% used in Australia's domestic energy market.

The Coal business has about AUD \$3 billion of working assets, including more than 300 locomotives and almost 8,500 coal wagons.

It has more than 1,700 employees including train crew, maintenance staff, and those responsible for customer relationships. Regardless of role, each and every employee is responsible for delivering safely and professionally for our customers.

Our Bulk business transports commodities such as iron ore, industrial products, fertilizers and agricultural goods. Many of these commodities are transported for export to countries across Asia, including Japan.

I will now talk about our rail infrastructure business, Aurizon Network, led by Mr Riches. Network's 1200 employees are responsible for providing, maintaining and managing access to the 2,670 kilometre Central Queensland Coal Network.

It consists of four major coal systems that connect to five major export ports.

Three rail operators use the Network, delivering coal for about 30 customers from 40 mines. A significant number of these mines are owned or partially owned by Japanese companies, reflecting the long-term partnership between Japan and Queensland's coal industry.

A regulatory process ensures there is open and equitable access to the network. It also regulates the revenue and investment returns that Aurizon can earn, which I will talk about a little more later.

Coal is not only big business for us and our customers, but for every Australian. The coal industry has helped sustain the longest period of economic growth in Australia's history and was valued at more than AUD \$50 billion last year and employed more than 30,000 Australians.

As a supply chain partner for the coal industry, we are committed to delivering sustainable and long-term benefits for the industry, our shareholders and in the communities where we operate.

Delivery on focus areas informs future strategy	
Capital Management	<ul style="list-style-type: none">• Target dividend: 40%• Dividend reinvestment of 100% (excluding 100%)• \$100m buy-back announced
Innovation	<ul style="list-style-type: none">• Operational discipline implemented 1 July 2017• Reorganised front office
Transformation	<ul style="list-style-type: none">• Delivered value of all stages of the cycle, transition to continuous improvement• Technology and innovation and best practice• Retaining employee capability to deliver future value
Staff Actions (understanding 175)	<ul style="list-style-type: none">• Staff Decision-makers are encouraged to make better decisions available to them and able to make as a consequence of reduced operational flexibility• Need to ensure appropriate return given risk taken
Strategy	<ul style="list-style-type: none">• Addressing current value drivers• Evaluating and determining future value drivers

Since I started with Aurizon, I have implemented changes to improve our performance and our productivity.

I have re-shaped the structure to focus on our core strengths in coal and bulk haulage, and rail infrastructure.

It is a simpler structure where each Group Executive has full profit and loss accountability for their business, and all the levers to drive better operational performance and better customer service outcomes.

Aurizon has been running a transformation program across the company since privatisation eight years ago.

Across all metrics – operational, financial and safety – we have seen significant improvements.

For example, by June – the end of our fiscal year – the Company is on track to deliver approximately \$380 million of transformation benefits over the past three years.

Our leadership team is very committed to achieving continuous improvement year after year, across all dimensions of our business.

Having worked most of my career in the mining industry, I come from a unique position. I have seen the safety and productivity benefits technology and innovation have offered mining, and while much has been achieved at Aurizon already, I believe there are still so many opportunities.

I am committed to creating a strong business and a sustainable future that creates value for our employees, our customers, our communities, and our shareholders.

Without our shareholders, we would not have a company – it is that simple. They invest in Aurizon with the expectation of receiving a good return from their investment.

At Board level, we are committed to managing our capital and returning surplus capital to investors where possible. We have recently completed a \$300 million buy-back of shares.

Let me now turn to some major challenges with the regulatory process that governs our rail network in Central Queensland, and dictates what we can charge customers to use the track.

This is called an Access Undertaking and is what you might consider the rule book for the Network. It is complex and is updated every four years with input from stakeholders across the coal industry.

The current Draft Decision of the Access Undertaking is a major issue for us, our customers and the supply chain. Appointed by the Queensland Government, the regulator, the Queensland Competition Authority, has proposed we should receive \$1 billion less over the four-year regulatory period than set out in our submission.

It is a very significant reduction – about 25% of the total amount of revenue we had sought. Revenue that should reflect the commercial and regulatory risks of operating one of the world's most complex coal export supply chains.

The revenue proposed is also less than the previous regulatory period even though the asset base is 20% larger and is forecast by the regulator to rail an additional 130 million tonnes over the four years.

There are two key issues with the Draft Decision.

First is the regulator's proposed rate of return on the asset. Our investors have spoken loud and clear with more than \$2 billion of market capitalisation lost since the Draft Decision was announced in December.

We maintain the very strong view that the proposed rate of return of 5.41% does not promote the economically efficient operation of the asset nor incentivise investment in the network.

The rate of return proposed by the regulator makes our coal network one of the lowest rated regulated assets in Australia.

The second major issue is the \$100 million plus reduction in allowances to operate and maintain the network, despite the increase in forecast tonnages and the asset base.

The regulator advocates lowest-cost maintenance practices rather than the flexible work practices that Aurizon had used to maximise throughput for customers.

Now we are having to align our operating and maintenance practices to the regulator's position. It is not a decision we have taken lightly because we know the impact on all in the coal supply chain.

The reason is that we do not know when the Final Decision will be announced and when the time comes, it will be backdated to 1 July 2017. As a commercial business, we just cannot continue to incur costs that might not be recovered.

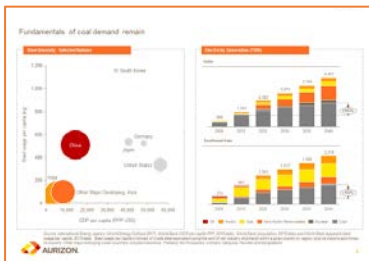
In February, we estimated that the impact would be a reduction in coal throughput of approximately 20 million tonnes per annum.

Aurizon does understand our rail network's critical role in the long-term success of Queensland's AUD \$30 billion coal industry and are proud of the work we have done to provide efficient, safe and reliable services for our customers.

We are seeking to engage directly with our customers and supply chain partners on the range of issues contained in the Draft Decision. We are working towards an outcome that is better aligned with the long-term interests of the Queensland coal industry and the economy more broadly.

It is important that while we are addressing these challenges we do not lose sight of the opportunities to transform our business and improve productivity.

By sustaining a long-term transformation process we can enhance Australia’s global competitiveness through the supply chains serving our customers. In this way, we are then delivering broader and universal economic benefits, which I believe large companies like Aurizon should deliver.



Despite much noise from the anti-coal movement, the long-term demand for metallurgical coal and thermal coal remains.

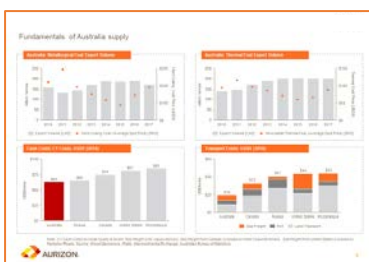
Over the past 30 years, more than three billion tonnes of metallurgical and thermal coal from Australia has been exported to Japan, driving energy generation and steel production

For thermal coal, it is energy generation that drives demand. According to the International Energy Agency World Energy Outlook 2016, an estimated 1.2 billion people or 16% of the global population, do not have access to electricity, including over 500 million people in developing Asia.

We remain confident about the outlook for Australian coal export volume. On the demand side, Australia’s largest metallurgical coal trading partner, India, reached annual crude steel production of over one hundred million tonnes for the first time in 2017. Investment in infrastructure and manufacturing in India will continue to drive demand for steel and therefore metallurgical coal.

Recalling that over 95% of Australian thermal coal exports are destined for Asia, it is this region (rather than global consumption) that continues to add energy generation capacity.

Although we of course recognise that renewable energy will increase in energy mix over the long-term, thermal coal capacity will remain (and expected to grow in absolute terms) in key export nations of Australia.



The strength of Australia’s coal supply has meant that in periods of lower commodity prices, export volume has been resilient, maintaining the vital link to steel mills and coal fired energy generation. This differs from a number of competing supply nations where export volume is dependent on prevailing coal prices.

This resilience is driven by the quality of Australian coal and cost competitiveness, and including access to reliable rail infrastructure. This is why it is important that we receive a regulatory decision that supports the long-term interests of all participants the Queensland coal industry.



We have continued to invest in capital expenditure programs to increase rail capacity for our customers across the Central Queensland Coal Network and support the future growth of Queensland's coal industry.

In our growing coal haulage business in the Hunter Valley we have invested more than half a billion dollars in facilities to support efficient and competitive delivery of coal for our customers.

As the chart on the right hand side shows, investment in new Australian coal supply has been limited over the past three years. However we are seeing early signs of investment returning with the latest quarterly capital expenditure figure indicating a 29% uplift compared to the previous year.

Before I close today, I would like to thank you again for inviting me and my colleagues here this morning.

We acknowledge it was Japanese investment that pioneered Australia's resources industry to global markets and started the strong and dynamic trade relationship our two countries now share.

As a long-term partner in the coal supply chain, we remain committed to the ongoing success and strength of the industry and the broader economies.

For Aurizon, this means continuous improvement across every dimension of our business, and continued investment in our assets, our infrastructure and our relationships with our supply chain partners.

Thank you.





AURIZON®

We deliver.



We are Australia's largest rail freight operator.



We transport more than 250 million tonnes of Australian commodities each year.



We are a top 100 ASX-listed company with a market capitalisation of more than \$8 billion



We are an integrated above and below rail supply chain operator and developer.



We employ more than 4,500 people at more than 160 operational sites across Australia.

Australia's largest integrated freight rail network.

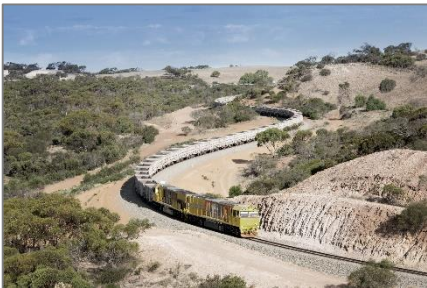
RAIL HAULAGE

Multiple commodities, customers and integrated supply chains.



COAL

- Services 40+ mines.
- Moves 200 million tonnes annually.
- Exports to markets including Japan, China, South Korea, India and Taiwan.

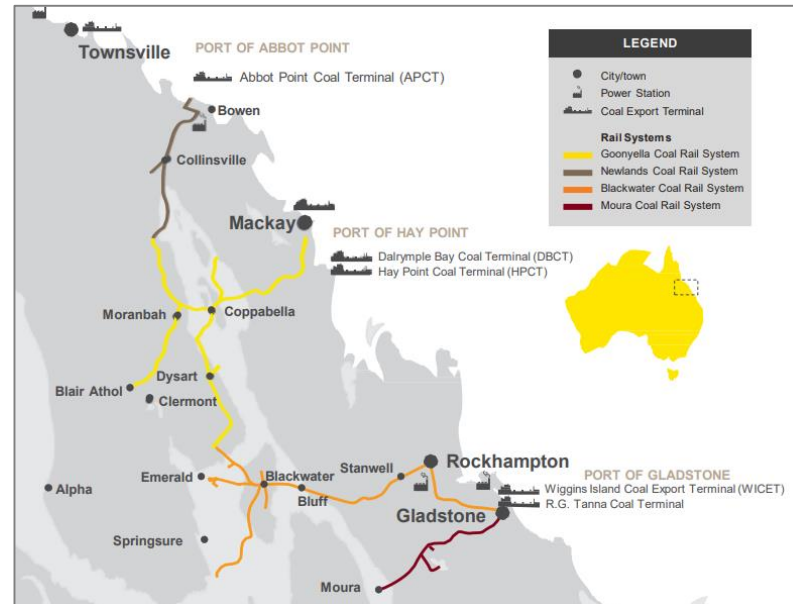


BULK

- Australia's leading bulk freight specialist.
- Transports Iron ore, minerals, other commodities and agricultural products.

RAIL NETWORK

Asset Maintenance, Network Management and Infrastructure Development.

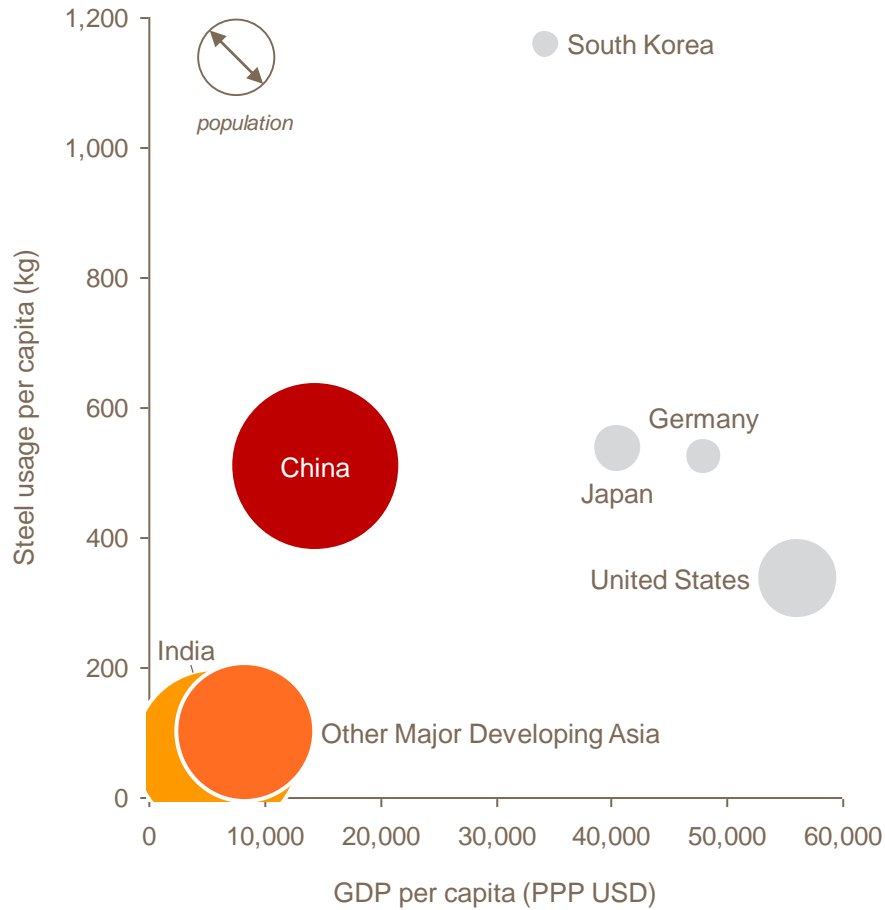


Delivery on focus areas informs future strategy

Structure	<ul style="list-style-type: none">• Business unit structure implemented 1 July 2017• Management team refresh
Transformation	<ul style="list-style-type: none">• Delivers value at all stages of the cycle, transition to continuous improvement• Technology and innovation will be key drivers• Improving employee capability to deliver future value
Capital Management	<ul style="list-style-type: none">• Target gearing ~40%• Dividends maintained at 100% underlying NPAT• \$300m buy-back completed
UT5 Access Undertaking Draft Decision	<ul style="list-style-type: none">• Draft Decision creates an environment in which operating practices are being modified to align to Draft Decision requirements, reducing operational flexibility• Draft Decision return necessitates revision of risk tolerance
Strategy	<ul style="list-style-type: none">• Addressing current value drivers• Enabling and determining future value drivers

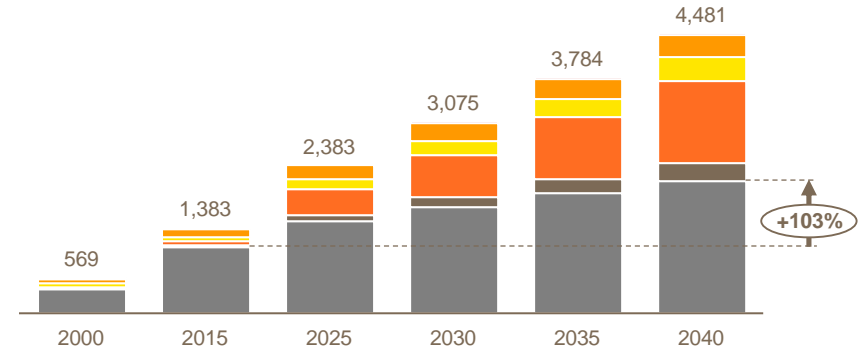
Fundamentals of coal demand remain

Steel Intensity: Selected Nations

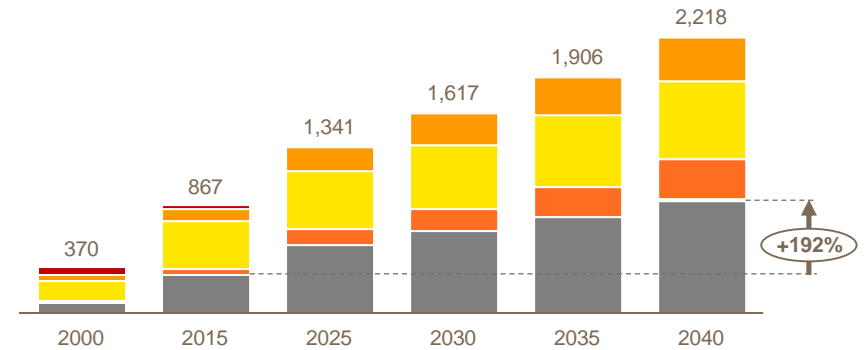


Electricity Generation (TWh)

India



Southeast Asia

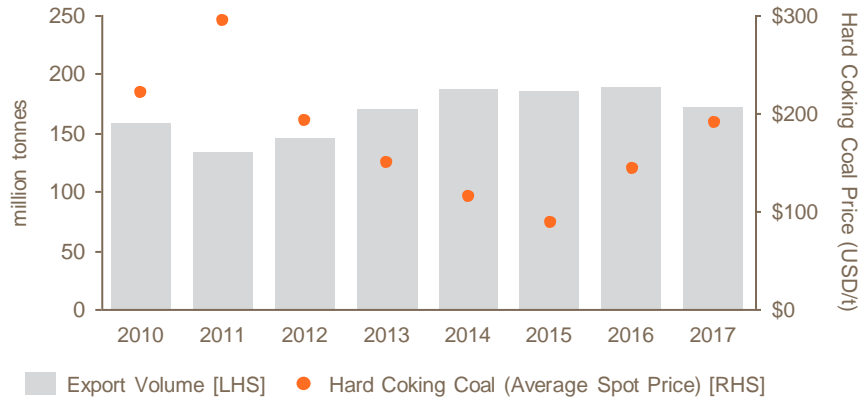


Oil Hydro Gas Non-Hydro Renewables Nuclear Coal

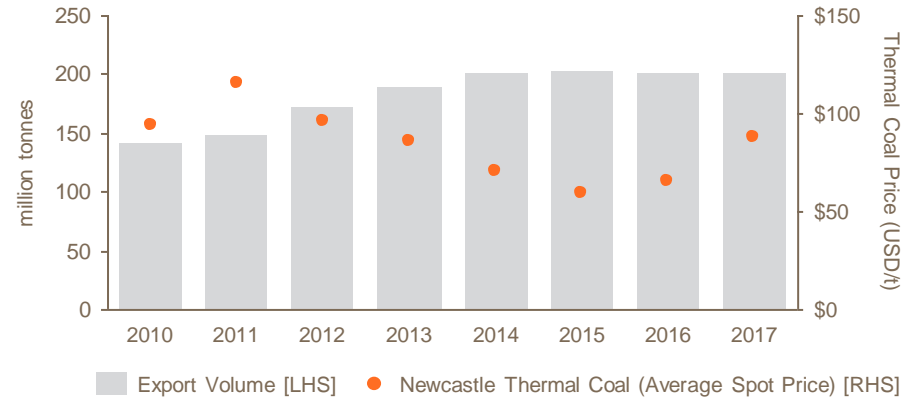
Source: International Energy Agency (World Energy Outlook 2017), World Bank (GDP per capita PPP, 2015 data), World Bank (population, 2015 data) and World Steel (apparent steel usage per capita, 2015 data). Other Major Developing Asia includes Indonesia, Thailand, Philippines, Vietnam, Malaysia, Pakistan and Bangladesh.

Fundamentals of Australia supply

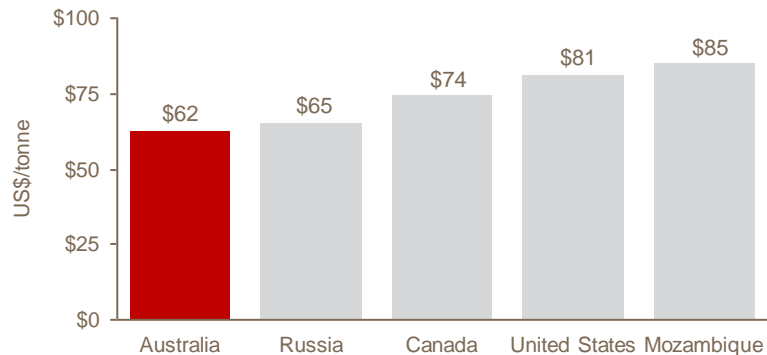
Australia: Metallurgical Coal Export Volume



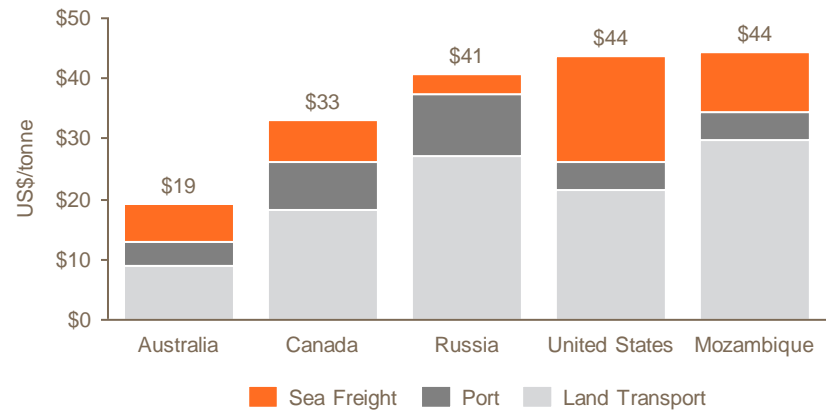
Australia: Thermal Coal Export Volume



Metallurgical Coal: C1 Cash Costs, USD/t (2018)



Transport Costs: USD/t (2018)



Note: C1 Cash Costs exclude royalty & levies. Sea freight is for Japan delivery. Sea freight from Canada is based on West Coast terminals. Sea freight from United States is based on Hampton Roads. Source: Wood Mackenzie, Platts, Intercontinental Exchange, Australian Bureau of Statistics.

Aurizon is continuing to invest to support future coal supply

Recent Aurizon Investment in Australia Coal Supply

Hexham Train Support Facility

The Hexham Train Support Facility services Aurizon's growing Hunter Valley coal freight business and alleviates capacity pressures in the coal supply chain.

Wiggins Island Rail Project

This project involved the staged development of new (and upgraded) rail infrastructure to service the Wiggins Island Coal Export Terminal (WICET) at the Port of Gladstone.

Bauhinia (Rolleston) Electrification

The Bauhinia rail line is a 107 kilometre rail spur from Rangal south to the Rolleston Mine on the Blackwater System in Central Queensland. This allows electric locomotives to operate on this part of the rail network.

Hay Point (Goonyella) Rail Expansion Project

The Hay Point Rail Expansion Project services 30 coal mines in the northern Bowen Basin as the final leg of the Goonyella Rail System. Coal is railed to the Port of Hay Point where it is exported through the Hay Point Coal Terminal and the Dalrymple Bay Coal Terminal.

Goonyella to Abbot Point Expansion Project

The Project included the 69-kilometre greenfield Northern Missing Link, which connects the Goonyella coal rail system to the Newlands rail system. In addition, the project included the expansion and upgrade of track along the Newlands rail system.

Australia: Coal Mining Capital Expenditure

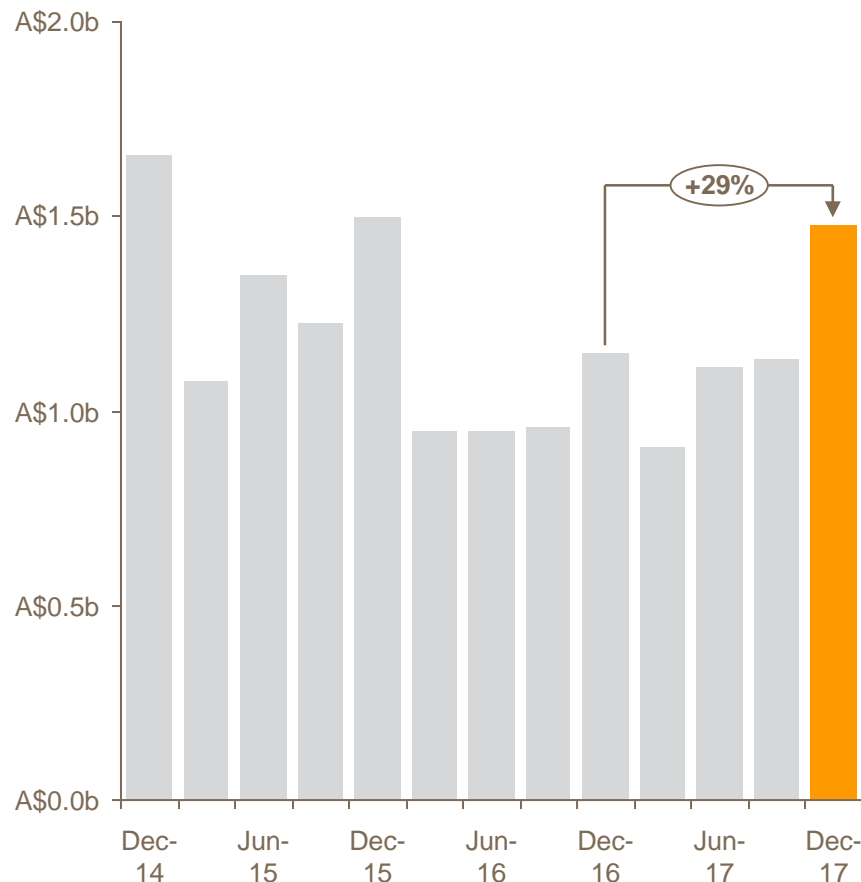


Chart source: Australian Bureau of Statistics



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