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APA Group

MD on ENV Offer

Open Briefing interview with Managing Director Mick McCormack

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In this Open Briefing®, Mick discusses:

- Rationale for proposed merger with ENV
- Consistency with APA strategy
- Benefits for both APA and ENV shareholders 3 Key points

Record of interview:

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APA Group (ASX: APA) recently announced that it had approached the Board of Envestra Limited (ASX: ENV) with an indicative and non-binding merger proposal. Why is APA Group seeking to move to full ownership of Envestra from a 33 percent shareholding currently? Why do you believe that combining the two businesses will add value for APA Group?

MD Mick McCormack
There are two key reasons. First, there are clear benefits in unifying the operation of the Envestra assets with full ownership. Envestra currently benefits from our skills and know-how, which we deliver through our long-term operating and maintenance (O&M) agreement. Through this agreement we have responsibility for operating and maintaining all of Envestra's assets, as well as responsibility for planning, designing and constructing network extensions, and promoting the use of gas within the networks. Over the next five years we'll be delivering around $2 billion in capital projects and operating services for Envestra and we'll be using all of our smarts to deliver the best results.

We believe that our capabilities have added enormous value to Envestra, and will continue to do so over the long term. Our share of the value we are creating is at present capped by our 33 percent equity interest. While we receive a fee for operating and managing the assets – 3 percent of regulated revenue – substantially all of the value we create is from careful cost control, the vast majority of which is retained by Envestra. Moving to full ownership of Envestra would ensure total alignment of our interests and would see APA investors, together with Envestra shareholders, properly rewarded for the value we create.

Secondly, the additional scale that a merger with Envestra would bring to APA should be attractive to investors in both companies. We've been saying for some time that we have an appetite for a range of value creating growth opportunities – not growth for growth's sake, but opportunities that can add value to our overall asset portfolio. For example, over the short to medium term we'll be looking at new and existing pipelines – everything from expanding our pipelines, additional pipelines supporting LNG projects in Queensland, connections to new gas developments, even a pipeline connecting our east coast gas grid to the Northern Territory. The new combined group will have enhanced access to capital and will be strongly positioned to undertake multi-billion dollar opportunities.

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To what extent do you expect the combination of the businesses will be as attractive to Envestra shareholders as it is to APA securityholders?

MD Mick McCormack
The benefits to APA securityholders of aligned interests, enhanced scale and strong future growth prospects, apply equally to Envestra shareholders. We also expect Envestra shareholders to see real attraction in the opportunity to have exposure to the combined group.

While Envestra shareholders are attracted to the steady cash flow of regulated assets we believe that the combined group really is the best of both worlds – a combined offering of continued cash flow stability but with a superior growth outlook.

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APA has recently stated that inadequate returns are being offered by regulated assets in the current low interest rate environment. In light of this, is the proposed acquisition of Envestra consistent with APA's strategy?

MD Mick McCormack
Our primary objective is to grow the business securely and sustainably within our core area of gas infrastructure. So irrespective of whether an asset is regulated or unregulated, we invest in assets and businesses where we're able to earn a fair, commercial return for the skill set we bring, and create further value for our investors.

Our proposal is completely aligned to that objective and strategy. What distinguishes this proposed transaction with Envestra in this present climate of lower returns on regulated assets, is that it brings a combination of revenue certainty for up to five years under the current access arrangements, $1.3 billion of approved capex that we can build at a cost equal to the resultant increase in regulated asset base (RAB), and the opportunity I've already referred to: the unique ability to better capture the value APA is already contributing.

The market is familiar with the trend of internalising management across a range of infrastructure and property entities. This creates value through better alignment of interests. The drivers here are very similar; we're looking to achieve the same result by bringing ownership and operation together within the one entity, effectively taking the management fees out of the structure by removing the corporate costs that exist within Envestra.

In these circumstances we've been able to frame a proposal that's attractive to shareholders in Envestra and APA alike.

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APA has been an investor in Envestra since 2007, why is this the right time to look to move to full ownership?

MD Mick McCormack
There's always a range of factors that drive the timing of a corporate transaction, and not all of them are within our control. One of the key factors for us with Envestra was having sufficient confidence around the revenue and capital outlook for the next three to five years. We became a lot more comfortable on this front when the Australian Energy Regulator (AER) issued its decision on Envestra's Victorian business in April this year.

With that situation settled we've been able to frame a proposal that fairly values Envestra while minimising uncertainty for APA.

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Corporate transactions are typically pitched at a premium to the trading price of the company being acquired. Why haven't you incorporated a more substantial premium in your proposal?

MD Mick McCormack
At the date of our approach, our proposal represented a 10.6 percent premium to Envestra's one month volume weighted average price (VWAP). For the reasons I've outlined earlier, we believe we are uniquely placed to offer Envestra shareholders full value for their shares. At a time when Envestra is trading near record highs due to the current strong investor interest in infrastructure assets and its highly predictable cash flows, our proposal implies a RAB multiple of around 1.4 times – which I'm sure those familiar with the industry will recognise as an attractive offer.

Indeed, the terms of the proposal appropriately reflect the quality of Envestra's cash flows, and the value that we're able to add through our ongoing focus on cost control and innovation.

In addition, the proposal is for an all-share merger, and we think there's a great opportunity for Envestra shareholders to derive real benefit from ongoing exposure to the Envestra assets, as well as enjoying the enhanced growth prospects of the enlarged group.

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Why haven't you provided more detailed financial information on the proposal?

MD Mick McCormack
We're in the very early stages of this proposal and there's no certainty that the transaction will proceed. At present we're working from publicly available information, and we think it will be more appropriate to provide more detailed information once we've completed our due diligence and if agreement to move forward is reached with the Envestra board. In addition, we're currently in a black-out period regarding our 2013 financial information, so it's best to wait until the key information is available.

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Thank you Mick.

For more information about APA Group, visit www.apa.com.au or call Chris Kotsaris (Investor Relations) on +61 2 9693 0049 or chris.kotsaris@apa.com.au

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