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Market Briefing

Australian Power & Gas MD on 2013 half year results and full year outlook

Interview with James Myatt (Managing Director & CEO)

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The 2013 half year result saw strong growth in revenue, up 42% to \$248.3 million. Can you explain what drove this?

James Myatt

The increase in revenue to \$248.3 million for the first half of the 2013 financial year was due mainly to two key drivers. Firstly, retail prices increased as distributor cost increases and the Federal Government's carbon tax were passed on to consumers. Secondly, we saw a change in the mix of our customer base towards New South Wales and Queensland, which have higher energy usage and therefore higher revenues.

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The 2013 half year result saw statutory net profit after tax more than double to \$3.1 million however underlying net profit was down. Can you explain the key reasons behind this?

James Myatt

The company's statutory net profit after tax of \$3.1 million benefited from a \$5.1 million gain from an increase in value of hedges that provide fixed priced electricity wholesale costs in the Victorian, New South Wales and Queensland markets.

Adjusting profit to remove the change in value of hedges more accurately reflects the operating performance of Australian Power & Gas. Excluding this gain, Australian Power & Gas' underlying performance was a loss of \$2 million compared to a profit after tax of \$1 million in the first half of 2012.

The key reason driver for the underlying loss was a \$6 million expense incurred to increase the company's provision for potential bad debts due to customer payment issues following an unexpected growth in the number of customers on hardship programs. This increase in potential bad debt has coincided with the increased costs faced by consumers that occurred in 2012 with the implementation of the carbon tax and strong rises in energy network costs. The increase also occurred at the end of the year and was compounded by Christmas and the January holiday period when many households have higher expenses.





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Can you explain the background to the increased bad debts provision given it is the first time that Australian Power & Gas has experienced this?

James Myatt

As I mentioned earlier, the cost of energy increased substantially over the last six months as distributor cost increases and the Federal Government's carbon tax were passed on to consumers. We have not historically had significant issues with collections, but it has come to light that over November and December 2012 there was a higher incidence of customers not paying their bills on time.

The Board has determined that it would be appropriate to incur a one-off \$6 million charge to the profit and loss account to provide for potential bad debts, even though we believe we will be able to collect the majority of outstanding amounts owed.

Our retail customer billing and collections is outsourced to a reputed provider. As well as what we believe appears to be industry challenges as other energy companies have reported increased provisioning, we are also looking into our outsourced provider's processes to investigate why there was such a large increase in overdue accounts.

This is the first time that this has happened with this provider since the establishment of Australian Power & Gas, so we are carefully reviewing the causes so the situation can be quickly and appropriately remedied, and we can minimise the chances of this re-occurring. We have appointed an Australian Power & Gas billing and collections specialist to work within the outsource provider to overview operations. We have also appointed Ernst & Young to undertake a full review of the back office processes of our outsource provider and the internal Australian Power & Gas controls. Immediate intervention into the current resource levels and processes within our billing and collections provider has already been started.

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Do you expect to recover these overdue debts, and if so by when?

James Myatt

We believe we will be able to recover before the end of this financial year, the majority of debts more than 90 days overdue. From what we currently understand, the issues that have arisen are short term in nature. Also these customers are open or current customers so collectability rates should be high.

Resolution of these short term issues will lead to an increase in future profits as the amount of the provision is reversed. It will also improve cashflows in the second half of this financial year.





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Customer account numbers were up slightly to just under 342,000. You have maintained your guidance for customer accounts for the year to be between 350,000 to 360,000; are you still on track for this?

James Myatt

The past six months saw a mixed performance in each State. Customer growth continued in New South Wales with 3,600 net new accounts. Customer numbers were maintained in Victoria. However, in Queensland customer numbers fell due to adverse pricing regulation imposed by the Queensland Government. Australian Power & Gas has not actively marketed in Queensland since July 2012.

Since the start of 2013, we have put in place a number of new campaigns that have been getting traction in New South Wales and Victoria. We have also continued to diversify marketing channels. As a result of these initiatives, we have seen further growth in customer numbers, with January and February being some of our strongest sales months over the last 18 months, and total customer account numbers now approaching 344,000.

In addition to our retail customers, we also now have commercial and industrial customers as part of the trial we are running for this new market. While the number of commercial customers so far is small, in terms of retail customer equivalents they now number around 20,000. This new business is still in its trial phase as we finalise our internal billing and collections processes and our marketing plan.

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Was cashflow affected by the collections issue?

James Myatt

Due to the billing and collections issues, cashflow for the first half of this financial year was lower than it otherwise would have been. However, cash flows were still up with underlying operating cashflows up 32% to \$10.3 million.

We continued investment in customer acquisition costs, which amounted to \$8.7 million, and systems development costs of \$1.0 million and one-off costs of \$6 million relating to the establishment of new funding facilities were also incurred during this half.

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Given the cash outflow and new funding facilities entered with Macquarie Bank during the half, how is the company's cash position and balance sheet looking?

James Myatt

Australian Power & Gas had cash at 31 December 2012 of \$25.6 million. This was up \$7.3 million from June 2012. Excluding the \$19 million security for guarantees to suppliers, wholesale facilities and bank covenant requirements, the company's net cash position increased by \$1.8 million to \$6.3 million.





Overall, the company's balance sheet improved. Gearing, as measured by underlying net debt to equity, was steady at 47%. Net assets were up \$2.6 million to \$52 million.

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Given the first half performance, do you still believe you will be able to achieve your previous earnings guidance of an underlying full year profit after tax of between \$8 million and \$11 million?

James Myatt

Australian Power & Gas' results for the full year depend partly on our ability to resolve the previous billing and collections problems and collect the outstanding debtors. While we believe we can collect the majority of outstanding debts, the Board has decided that it would be prudent to review the previous guidance and revise the 2013 full financial year expectations to \$6 million to \$9 million underlying profit after tax.

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Thank you, James.

For further information, please contact Australian Power & Gas on +61-(0)2 8908 2700, or visit www.australianpowerandgas.com.au

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