United Energy Distribution Pty Limited
ABN 70 064 651 029

United Energy
6 Nexus Court
Mulgrave VIC 3170
PO Box 449
Mt Waverley VIC 3149
T 03 8846 9900
F 03 8846 9999

www.ue.com.au

19th October 2015

Our Reference: UE.SU.01

Mr Scott Sandles,
Director
Australian Energy Regulator
G.P.O. Box 520
MELBOURNE VICTORIA 3001

Dear Mr Sandles

RE: Chairmont Consulting report on debt, Appendix C, Harmonised spreadsheet information

This letter responds to a request from the AER for a confidentiality check in relation to cost of debt data and debt practices information. The letter will also explain a mistake that has been observed in the way in which Chairmont has interpreted the yield and pricing information from a bond issued by United Energy Distribution Pty. Ltd.

Business claim for confidentiality over debt data

United Energy asserts confidentiality over two of the charts presented in Appendix C of the Chairmont report. These charts are Graph 19, which shows the United Energy net fixed rate maturity profile, and Graph 25, which presents the United Energy issuance history. A separate confidentiality template has been prepared so as to give effect to the claim being made by the business.

Mistake in the characterisation of a five-year AUD medium-term note (MTN) issued by United Energy on 11/04/2012

In April 2012, United Energy issued an Australian dollar denominated, medium term note with a term to maturity of five years. The bond, with Bloomberg identifier EJ1181084, pays a coupon of 6.25 per cent on a semi-annual basis. The first settlement date for the bond was 11th April 2012. The issue spread is reported by Bloomberg to have been 220 basis points over "mid-swaps" which, in practice, would have meant 220 basis points over the five year swap rate at issuance. The first screen shot presented below, which is taken from the first DES page for the particular bond, shows that the issue price was 98.96800. The second screenshot, which is taken from the second DES page, indicates that the yield at issuance was 6.495 per cent. The bond was therefore issued into the market at slightly below par, which meant that the yield was also above the coupon rate.

An approximate check can be used to verify these figures. On 11th April 2012, the end-of-day Australian five-year swap rate was reported to have been 4.285 per cent (the end of day proxy can be obtained using the variable "ADSWAP5 Curncy"). If a spread of 220 basis points is added to this value, then the resultant yield is 6.505 per cent, which is close to the actual value recorded by Bloomberg as being the yield at issue for bond EJ1181084.


UELAU 6 ¼ 04/11/17 ↓3.232 +.000 3.288 / 3.176 104.215 / 104.379
At 16:39 --x-- Source BCMP
UELAU 6 ¼ 04/11/17 Corp Page 1/11 Description: Bond
94) Notes 95) Buy 96) Sell 97) Settings
21) Bond Description 22) Issuer Description
Pages
1) Bond Info
2) Addtl Info
3) Covenants
4) Guarantors
5) Bond Ratings
6) Identifiers
7) Exchanges
8) Inv Parties
9) Fees, Restrict
10) Schedules
11) Coupons
Quick Links
32) ALLQ Pricing
33) QRD Quote Reca
34) TDH Trade Hist
35) CAC Corp Action
36) CF Prospectus
37) CN Sec News
38) HDS Holders
39) VPR Underly Info
66) Send Bond
Issuer Information
Name UNITED ENERGY DISTRIBUTI
Industry Utilities
Security Information
Mkt Iss Australian
Country AU Currency AUD
Rank Sr Unsecured Series
Coupon 6.250000 Type Fixed
Cpn Freq S/A
Day Cnt ACT/ACT Iss Price 98.96800
Maturity 04/11/2017
BULLET
Iss Sprd +220bp vs Mid Swaps
Calc Type (23)AUSTRALIA:EX-DIV
Announcement Date 04/03/2012
Interest Accrual Date 04/11/2012
1st Settle Date 04/11/2012
1st Coupon Date 10/11/2012
MIN PC FOR AUS INVESTORS AU$500.000
Identifiers
ID Number EJ1181084
ISIN AU3CB0192599
FIGI BBG002VJ18Q2
Bond Ratings
Moody's Baa2
S&P BBB
Composite BBB
Issuance & Trading
Amt Issued/Outstanding
AUD 265,000.00 (M) /
AUD 265,000.00 (M)
Min Piece/Increment
10,000.00 / 10,000.00
Par Amount 10,000.00
Book Runner CBA,WESTPC
Exchange NOT LISTED
Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2015 Bloomberg Finance L.P.
SN 534909 AEDT GMT+11:00 H439-5431-1 19-Oct-2015 19:47:40

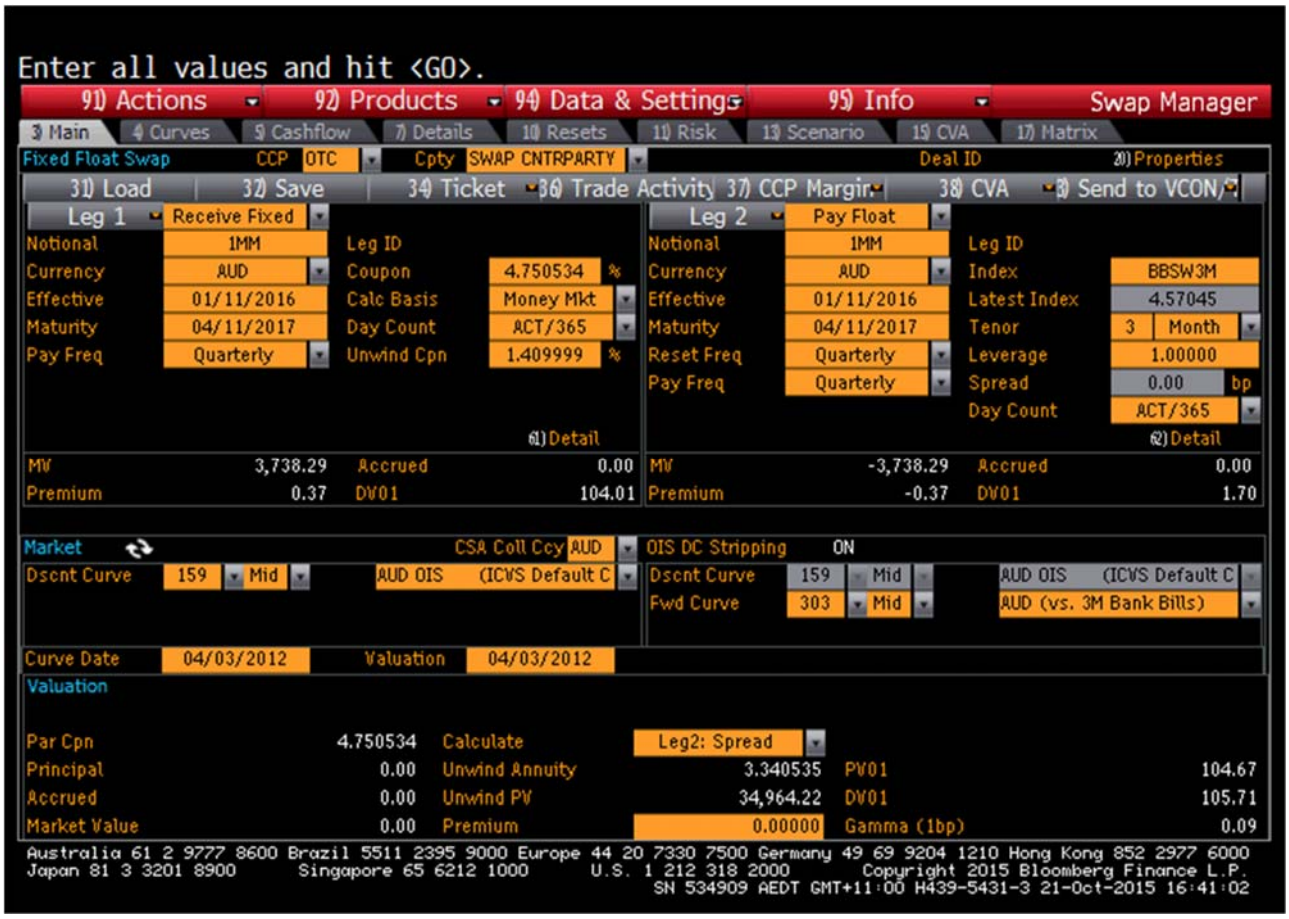

S rg
UELAU 6 ¼ 04/11/17 Corp Page 2/11 Description: Bond
94) Notes 95) Buy 96) Sell 97) Settings
21) Bond Description 22) Issuer Description
Pages
1) Bond Info
2) Addtl Info
3) Covenants
4) Guarantors
5) Bond Ratings
6) Identifiers
7) Exchanges
8) Inv Parties
9) Fees, Restrict
10) Schedules
11) Coupons
Quick Links
32) ALLQ Pricing
33) QRD Quote Reca
34) TDH Trade Hist
35) CAC Corp Action
36) CF Prospectus
37) CN Sec News
38) HDS Holders
39) VPR Underly Info
66) Send Bond
Additional Information
51) Details 53) Coupon 54) Dflt Info 56) Struct 57) ECB/EU 58) Reg/Tax
Issuer
Obligor United Energy Distribution Pty Ltd
Sector Utilities
Use of Proceeds
71) Use of Proceeds General Corporate Purpose
Other
Country of Risk AU
Registered Yes
Secondary Series UELM02
Yield at Issue 6.495000
Australia 61 2 9777 8600 Brazil 5511 2395 9000 Europe 44 20 7330 7500 Germany 49 69 9204 1210 Hong Kong 852 2977 6000
Japan 81 3 3201 8900 Singapore 65 6212 1000 U.S. 1 212 318 2000 Copyright 2015 Bloomberg Finance L.P.
SN 534909 AEDT GMT+11:00 H439-5431-1 19-Oct-2015 20:09:22

The yield and spread function (YAS) can also be used to derive retrospective estimates. The third screenshot in this letter, which is presented below, shows the spread against a comparable maturity Australian, Commonwealth Government Bond, if the settlement date was 11th April 2012. The trade date is represented as being 3rd April 2012 which corresponds with the announcement date for the bond. The issue price has been calculated to be less than 100, whilst the yield on the bond is shown as being higher than 6.25 per cent.

Information about the United Energy MTN with Bloomberg identifier EJ1181084 was also provided to the AER in the debt information request template which provided information that was current as at 30th June 2015. The face value of the bond was shown to be $265 million, although the actual amount raised was $264 million. The hedging arrangements that have been put in place are actually a pay floating, receive fixed swap, however the swap only takes effect on 11th January 2016, with a scheduled expiration date of 11th April 2017. The pay floating component will be comprised of a premium of 158 basis points over a forward starting swap with a commensurate term to maturity. Thus, the forward starting swap will commence three years and nine months after the bond has been issued, and will have a term to maturity of one year and three months.

The premium of 158 basis points, which is to apply from 11th January 2016, was determined at the time the bond was issued, in April 2012. In order to understand how the premium was obtained, the SWPM function in Bloomberg can be applied to derive a retrospective estimate of the underlying swap rate. The screenshot below shows the settings that have been used. In particular, the relevant curve date is 3rd April 2012. The coupon rate for the floating leg of the swap has been solved to be 4.751 per cent. This is not the same as the rate that would have been worked out in April 2012, but the estimate is relatively close. The sum of the swap rate for the forward starting swap, and the premium of 158 basis points,

would have been equal to the issue yield of 6.495 per cent. Therefore, the issue yield (6.495%) and the spread-over-swap (158 basis points) imply an actual forward-starting swap rate that was closer to 4.915 per cent.



Chairmont Consulting does not appear to have provided a correct representation of the MTN with Bloomberg identifier EJ1181084. Graph 25 shows the issuance history for United Energy, however the customised nature of the forward swap does not seem to have been portrayed accurately. If hedging considerations are set aside, then, over the life of the bond, there should be fixed coupon payments of 6.25 per cent from April 2012 until April 2017. The spread over the five year swap rate was 220 basis points at issuance. There is no evidence, in Graph 25, of a line or a series of dots at 220 basis points.

An alternative way of considering the spreads on the bond is to separately examine the periods from 11th April 2012 to 10th January 2016, and from 11th January 2016 to 11th April 2017. For the first three years and nine months, the issue spread should be considered relative to a swap rate with a commensurate term to maturity. As at 11th April 2012, an end-of-day swap rate with a tenor of three years and nine months was approximately equal to 4.169 per cent. This value has been obtained by interpolating between the three year and the four year swap rates. Since the issue yield was 6.495 per cent, then the spread against the 3 year 9 month swap rate would have been about 233 basis points. From 11th January 2016, the spread of 158 basis points should be measured as an increment to the forward-starting swap rate of approximately 4.915 per cent.

At the time at which the swaps were undertaken, the present value of cash flows under a scenario of no hedging would have been approximately equal to the present value of expected cash flows under a scenario in which there was hedging using forward starting swaps.

The empirical exercise that has been reported in this letter demonstrates that there are risks inherent in the use of the information on debt instruments and financial instruments that has been provided by United Energy (and by other distribution network service providers). The AER and its consultants may misconstrue the data that has been supplied.

Further information

Should you have any questions in relation to this matter, then please contact Jeremy Rothfield, Economist, on 03 8846 9854.

Yours sincerely,

Jeremy Rothfield
Network Regulation and Compliance Manager