

**COMMENTS ON CIE REPORT FOR IPART  
'REVIEW OF CONSUMPTION FORECASTS'  
Murrumbidgee Irrigation  
28 March 2006**

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*OVERVIEW*

Murrumbidgee irrigation concurs with all major conclusions of this report, except the recommendation that SWC be approved to use a higher WACC to combat revenue instability.

The latter conclusion is not supported because of the very low probability that SWC would adhere to the complementary recommendation that adjusted WACCs be applied by valley according to relative risks arising from revenue instability. SWC has consistently, in the past, refused to adequately acknowledge relative costs as a driver of prices, and avoided a valley based approach to its business. In these circumstances, an increased WACC will likely result in cross subsidy and increased returns for SWC – that are already very high – in the Murrumbidgee Valley, without improvement in services.

Murrumbidgee Irrigation suggests that SWC do not need to have any price (or return) based risk management strategy for the Murrumbidgee Valley. This is supported by the data shown overleaf (appendix 3 from Murrumbidgee Irrigation's submission to IPART, 2006).

### Appendix 3: SWC's financial outcomes against the 'user' account in the Murrumbidgee Valley

The following table shows estimated financial outcomes for SWC for transactions with "users" only based on the SWC submission to IPART for the 2006-07. It shows that the proposed returns for SWC are quite high, and the business risks are very low.

The returns are high firstly because SWC project revenue requirements based on budgets. That is, SWC propose to charge for services that are not in place (because the capex has not yet occurred). If an RAB is to work, it should be based on real capital and services, and returns of and on capital should only be calculated for capital at the start of the relevant year. It is not appropriate to allow a price setter – such as SWC – to set those prices on budget estimates.

The second reason that returns are high is upside financial risks (risk of increased revenue and/or decreased costs) are reasonably high. If SWC continues its historical levels of opex in the Murrumbidgee, say \$3.5m, then the gross return on capital averages over 16%, and the net return would average over 15%. An assumption of little or no change in actual opex costs would not seem extraordinary.

The prices suggested by SWC are based on the one standard deviation below average use. In the Murrumbidgee this is 14% below average use. If diversions over the next few years are average the gross return for SWC increases to over 11% and the net return to over 10%. This is quite probable given that since 1999-2000 regulated diversions in the Murrumbidgee have averaged 1,838 GL or just 4% below average. This period has seen the worst drought sequence for the Valley since the Federation drought at the turn of the century.

Taken together the 'upside' financial risks would result in a gross return on capital of over 18% and a net return of over 17%.

#### SWC financial outcomes on the "user" account (SWC IPART submission 2006-07)

	2007	2008	2009	2010	2011
	\$m	\$m	\$m	\$m	\$m
"User" revenue	9.639	9.791	9.737	9.653	9.585
* fixed charges	3.856	3.916	3.895	3.861	3.834
* variable charges	5.783	5.875	5.842	5.792	5.751
"User" opex	6.522	6.522	6.326	6.136	5.952
Depreciation (return of capital)	0.284	0.31	0.334	0.352	0.372
Profit (return on capital)	2.833	2.959	3.077	3.165	3.261
Capex	2.399	1.813	2.206	0.973	2.492
RAB (end year)	36.115	37.618	39.49	40.111	42.231
Cash flow	0.718	1.456	1.205	2.544	1.141
Accumulated cash flow	0.718	2.174	3.379	5.923	7.064
<u>Returns (% of the start year RAB)</u>					
* gross (of plus on capital)	9.2%	9.1%	9.1%	8.9%	9.1%
* net (on capital only)	8.3%	8.2%	8.2%	8.0%	8.1%
* cash	2.1%	4.0%	3.2%	6.4%	2.8%
<u>Cash flow (% of variable charges)</u>	12.4%	24.8%	20.6%	43.9%	19.8%
Initial RAB (end 2005-06)	34	\$m			
Ave depreciation	0.3304	\$m			
Ave investment	1.9766	\$m			
Ave net capex	1.6462	\$m			
Ave depreciation (% of RAB)	0.9%				
Ave return on capital	8.2%				
Eventual capital	225	\$m			
Eventual net profit per year	18	\$m			