This Basis of Preparation is to be read in conjunction with the financial statements available on this website.

The information contained herein is provided in accordance with the requirements of the Financial Reporting Guideline for Non-Scheme Pipelines of December 2017 as published by the Australian Energy Regulator (Guidelines). Specifically, this Basis of Preparation outlines the methods, principles and inputs used in preparing the

- Pipeline financial statements which consist of
  - Statement of Pipeline Assets
  - Statement of Pipeline Revenues and Expenses
- Asset Value using the recovered capital method
- Weighted Average Pricing.

The financial statements and Basis of Preparation are published in accordance with the requirements of the Guideline. They do not necessarily represent SEA Gas' view as to the appropriate approach to asset value methodology, pricing and charging methods in respect of its pipeline services.

Service Providers

South East Australia Gas Pty Ltd is the agent for and on behalf of the SEA Gas Partnership (SEA Gas). The ultimate owners (APA Group and Rest) have appointed SEA Gas to publish on behalf of all partners the information as required under Part 23.

Rest and APA Group have issued letters to the Australian Energy Regulator appointing SEA Gas to be the responsible service provider for this purpose.

SEA Gas' PCA & PCI Pipelines

The SEA Gas pipeline system provides gas retailers and industrial customers with gas transportation services between western Victoria and Adelaide. We do this by contracting with customers to receive their gas through our facilities at Iona and deliver to multiple points around the pipeline system.

Nonetheless, for the purposes of the Guidelines and associated Rules[1], the SEA Gas pipeline system has two (2) pipelines.

- The Port Campbell to Adelaide pipeline (PCA) of approximately 689km.
- The Port Campbell to Iona pipeline (PCI) of approximately 11km.

1. Pipeline Financial Statements

The pipeline financial statements presented

- are in Australian dollars and exclusive of GST (section 1.5.3)
- relate to the period 1 January 2018 to 30 June 2018 and
- have been prepared using the depreciated book value method.

The preparation of the pipeline financial statements conforms with Australian Accounting Standards (AASBs) and requires management to make judgements, estimates and assumptions that affect the application of

[1] Rules means Part 23 of the National Gas Rules as commencing on 1 August 2017.

policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities. Unless otherwise noted in this Basis of Preparation the source of information provided in these statements have been sourced from accounting records within the SEA Gas Partnership.

Any judgments made by management in the application of Australian Accounting Standards that have a significant effect on the Pipeline financial statements and estimates with a significant risk of material adjustment are disclosed in this Basis of Preparation.

a. Statement of Pipeline Assets

Capitalisation principles

The value of assets is the cost base of SEA Gas Assets. To avoid doubt, there has been no revaluation, no application of indexation and no impairment of SEA Gas assets for the period to and as at 30 June 2018.

Asset Life and depreciation principles

Assets are depreciated from the date of purchase or, in respect of internally constructed assets, from the time an asset is completed and held ready for use.

The PCA and PCI pipelines commenced operations from 1 January 2004. Depreciation of construction assets commenced from 1 January 2004.

The written down value of assets represents the allocated cost base adjusted for depreciation. The depreciation rates applied are those prescribed in the Guidelines. All assets are depreciated using the straight-line method over their estimated useful lives, considering estimated residual values (except for freehold land).

Pipeline and Shared Asset - Allocation principle

Where costs can be attributed directly to a pipeline, then that cost is allocated to that pipeline.

For Pipeline assets, costs have been apportioned across the 2 pipelines based on the original construction cost of the pipeline system. Where assets cannot be directly identified to either the PCA or PCI, an allocator was used to attribute that cost. Allocators where selected by SEA Gas on the basis that they best represent the spread of that cost over the two (2) pipelines. The following allocators were used in the allocation of assets:

Pipeline Asset	Allocator	PCA (%)	PCI (%)	Explanation
Pipeline - Construction cost	Allocated Pipeline cost per construction contract	98.83	1.17	Original Construction contract data were used to identify pipeline assets relating to PCA and PCI
Pipeline - General	Length of Pipeline (KM)	98.43	1.57	General assets are allocated over the length each pipeline length

Pipeline Asset	Allocator	PCA (%)	PCI (%)	Explanation
Compressors	PCA	100.00	-	Compressor assets are on the PCA only
City Gates, supply regulators and valve stations	Allocated Gates / Regulator cost per construction contract	100.00	-	Original Construction contract data were used to identify pipeline assets relating to PCA and PCI
Metering	Allocated Metering cost per construction contract	66.86	33.14	Original Construction contract data were used to identify pipeline assets relating to PCA and PCI
SCADA	Allocated SCADA cost per construction contract	86.63	13.37	Original Construction contract data were used to identify pipeline assets relating to PCA and PCI
Buildings	Allocated Pipeline cost per EPC contract	98.83	1.17	Original Construction contract data were used to identify pipeline assets relating to PCA and PCI
Land and Easements	Length of Pipeline (KM)	98.43	1.57	General assets are allocated over the length each pipeline length
Other Depreciable assets	Length of Pipeline (KM)	98.43	1.57	General assets are allocated over the length each pipeline length
Shared Supporting Assets	Length of Pipeline (KM)	98.43	1.57	General assets are allocated over the length each pipeline length

Apart from operation of the pipelines, SEA Gas does not have any “other operations” which will require sharing of SEA Gas’ assets.

b. Statement of Revenue and Expenses

Revenue

Revenues that are identified as being directly attributable to a pipeline are allocated directly to that pipeline. The Gas Management Contract System (GCMS) was used to directly identify the amount of contracted revenue per pipeline. No re-allocation of GCMS data was required.

Any allocation of indirect revenues is based on the proportion of total identified revenue allocated over both the PCA and PCI.

Related Party Revenue: Revenue received directly from the SEA Gas (Mortlake) Partnership (for the management of that Partnership) is classified as a related party transaction.

Expenses

Where possible, expenses which can be identified as being directly attributed to each pipeline are allocated to that pipeline. The source of this identification is from invoices and SEA Gas' financial system.

All expenses from accounting records for the required period were reviewed. Expenses that were considered to be of a nature that have a direct impact on the pipeline assets, were categorised as a direct cost. Expenses that were considered to be general in nature, but are required in order to ensure operation of the pipeline, were categorised as indirect. All expenses have been allocated over the two (2) pipelines.

Each line item was further reviewed and an appropriate allocator was applied in order to allocate the cost over the two (2) pipelines. Allocators included Pipeline Revenue and Pipeline asset allocations as determined from previous sections. Where an allocator was needed, the following allocators were used;

Direct Expense	Allocator	PCA (%)	PCI (%)	Explanation
Wages	% of pipeline revenue to Total revenue	96.68	3.32	Pipeline revenue was used as a basis of allocating costs over the pipeline. A further split between direct and indirect cost was based on employee roles. Only operational and asset management roles are considered direct.
Repairs & Maintenance	% of pipeline Fixed asset register (FAR) equip to Total FAR equipment	96-98	2 -4	Depending on the line item, the appropriate total FAR item was used to allocate over the pipelines.
Depreciation	Length of Pipeline (KM)	98.43	1.57	General assets are allocated over the length each pipeline length.

Direct Expense	**Allocator**	**PCA (%)**	**PCI (%)**	**Explanation**
Insurance	% of pipeline revenue to Total revenue	96.68	3.32	Pipeline revenue was used as a basis of allocating costs over the pipeline.
Licence & Market compliance	% of pipeline Fixed asset register (FAR) plant and equipment to Total FAR plant and equipment	96-98	2-4	Depending on the line item, the appropriate total FAR item was used to allocate over the pipelines.
Other Direct costs	% of pipeline revenue to Total revenue	96.68	3.32	Pipeline revenue was used as a basis of allocating costs over the pipeline.

Shared Costs	**Allocator**	**PCA (%)**	**PCI (%)**	**Explanation**
Employee Costs	% of pipeline revenue to Total revenue	96.68	3.32	Pipeline revenue was used as a basis of allocating costs over the pipeline. A further split between direct and indirect cost was based on employee roles. Employees not included in direct wages above have been treated as indirect cost.
Information Technology & Communication	% of pipeline revenue to Total revenue	96.68	3.32	Pipeline revenue was used as a basis of allocating costs over the pipeline.

Indirect operating Expenses	% of pipeline revenue to Total revenue	96.68	3.32	Pipeline revenue was used as a basis of allocating costs over the pipeline.
Shared Asset Depreciation	Length of Pipeline (KM)	98.43	1.57	General assets are allocated over the length each pipeline length.
Rental & Leasing	% of pipeline revenue to Total revenue	96.68	3.32	Pipeline revenue was used as a basis of allocating costs over the pipeline.

Related party expense: The Statement of Expenses includes Related Party expenses. The SEA Gas Partnership contracts with APA Group (a 50% owner of the SEA Gas Partnership) for the provision of maintenance services and for the procurement of some insurance. All operational and other business activities are performed by SEA Gas personnel.

Interest and Tax expense: In accordance with the Guidelines, the Statement of Expenses

- excludes Interest. The values under 'Directly attributable finance charges' are sundry bank and agent fees incurred in SEA Gas' day to day operations. An allocation between the PCA and PCI was made based on Revenue earned by pipeline;
- excludes Tax. Structurally, SEA Gas is a General Partnership. Taxation is a pass through to Owner entities.

2. *Asset Valuation using Recovered Capital Method (RCM)*

a. General approach

In respect of applying the Guidelines to determine an RCM value, SEA Gas has adopted a general principle to use actual observable information where it is available and reliable and use estimates or proxies where it is not available or cannot be relied upon.

Described below are the key elements used in generating the RCM asset value as required by the Guidelines (RCM Value).

Common inputs between this RCM Value and the data supporting the Pipeline Financial Statements includes Construction costs to 2003, Capital expenditure and value of assets disposed 2004 – 2018, actual revenue and operating expenditure (before interest) 2004 – 2018.

Other key inputs used in calculating the RCM Value include,

- A commercial rate of return has been applied to the asset base to produce a return on capital, which is configured using a 'vanilla' nominal Weighted Average Cost of Capital (WACC)
- An allowance has been made for the 'cost' of tax
- The actual revenue received has been applied against the asset base net of the above elements to produce an end-of-year estimate of the unrecovered capital.

b. Approach to key inputs

Rate of return

Under Rule 569 of the National Gas Rules, the rate of return to be applied to the closing value of the capital base from the immediately preceding year, should be determined for each year and is to be commensurate with the prevailing conditions in the market for funds and reflect the risks the service provider faces in providing pipeline services.

As not all necessary information is known, SEA Gas has used a mix of observable and proxy information to determine a Rate of Return for each year.

Return on debt

SEA Gas has used the observable market cost of debt from 2004 – 2018. SEA Gas has this information through its experience in managing debt and swap margins.

Return on equity

In applying the Guidelines, SEA Gas has used a post-tax Equity return equivalent to the allowed post-tax return on equity allowed in the current prevailing determinations at the beginning of each year (i.e. at 1 July) since commercial operations began (January 2004) plus a risk premium as applicable for the circumstances that SEA Gas faced. (i.e. a proxy)

- Where there were multiple determinations prevailing at the time, the return on equity from the more recent determination was assumed.
- With regards to the risk premium, a range of 1% - 2% premium on top of the determined return on equity has been applied. The lower end of the range has been used in the early years and the higher end for more recent years. SEA Gas notes that Foundation Shipping Contracts have existed for the entirety of the first 15 years of operation. During that time pipeline capacity has been fully contracted and credit support was based on the need for BBB+ ratings of counter parties. SEA Gas acknowledges the dynamic changes to East Coast Gas market and the risks and opportunities that represents for all participants.

Gearing

Gearing of 60% has been assumed for each year. Capital structure decisions entail the selection of an appropriate financing mix for specific underlying assets of the business. The 60% assumption is a long-standing benchmark for the Australian pipeline industry in Australia when businesses have a reliable and stable income stream. Noting the materiality of Foundation Shipping arrangements as described above, the proxy of 60% is considered the best estimate for each of the years in this review.

Treatment of Taxation

The SEA Gas Partnership is a tax flow through entity and so the actual taxation position of the investors is unknown and any estimates could not be relied upon. The Explanatory Statement to the Guidelines state that service providers will have the option to account for tax using a Pre-tax commercial rate of return or a Post-tax approach with net tax liabilities explicitly modelled.[2]

SEA Gas has adopted a Post-tax approach and estimated the net tax liabilities using a benchmark tax approach consistent with the approach used by the AER's determination for regulated utilities.

In the absence of using actual tax liabilities, SEA Gas considers that a Post-tax approach is the most reasonable approach and produces the best estimate of tax liabilities in the circumstances.

No Indexation applied

The calculation that complies with the Guidelines has no indexation. SEA Gas' conclusion is that the Guideline's approach to the calculation of the RCM Value is unique as the nominal value of money is a cost and its exclusion is inconsistent with the outcomes of a workably competitive market and the principles in Part 23. Applying normal practice to SEA Gas' numbers we estimate the impact on Indexation would be to significantly increase the RCM Value.

3. Weighted Average Price

For the 6 months ending 30 June 2018, Firm Forward Haul service represents nearly all of SEA Gas' shipper revenue on the PCA.

The methodology used is the capacity-based postage stamp revenue method.

Foundation shippers have a suite of services and allowances under the original contracts. These services and allowances are linked to the Firm Forward Haul charge and conditions of that service. With this in mind SEA Gas has included any sundry recoveries associated with these services in the determination of the Firm Forward Haul charge.

The PCI services 2 customers. In accordance with the Rules and as advised to the Australian Energy Regulator an exemption to not disclose WAP for the PCI service has been applied for. Hence, the weighted average price of PCI service is not disclosed.

[2] AER, Financial Reporting Guidelines for Non-Scheme Pipelines – Explanatory Statement, December 2017, Section 4.3